

Report to	North Wales Fire and Rescue Authority
Date	16 January 2023
Lead Officer	Helen MacArthur – Assistant Chief Fire Officer
Contact Officer	Helen Howard – Head of Finance
Subject	Capital and Treasury Management Update



PURPOSE OF REPORT

- 1 The purpose of this report is to:
 - i. Provide Members with an update on the treasury management activity for 2022/23; and
 - ii. present to members the proposed Capital Strategy and Treasury Management Strategy (the Strategies) incorporating the Minimum Revenue Statement for the period April 2023 – March 2024.

EXECUTIVE SUMMARY

- 2 The development of capital and treasury management strategies is the best practice approach to the longer-term planning of capital expenditure and funding. These Strategies provide an overview of the planned future capital expenditure, capital financing and treasury management activity necessary to achieve the objectives of the North Wales Fire and Rescue Authority (the Authority).
- 3 The Authority should also ensure that the revenue implications are fully considered and capital expenditure and financing decisions are financially sustainable. The Minimum Revenue Provision (MRP) Statement sets out the revenue consequences of the current capital planning assessments.
- 4 The Strategies also provide assurances on how associated risks are managed and the implications for future financial sustainability. They provide a summary of the overall processes and procedures that govern the purchase and financing of assets in order to enhance members' understanding of these, sometimes technical, areas.
- 5 These Strategies have been developed in conjunction with the draft revenue and capital budgets for 2023/24 and the Medium-Term Financial Plan.

OBSERVATIONS FROM THE AUDIT COMMITTEE

- 6 The Audit Committee considered the appendices contained within this report at its meeting of the 12 December 2022. The Audit Committee noted the content of the report but was unable to endorse the Capital and Treasury Management Strategies or Minimum Revenue Provision (MRP) Statement as the capital budget for 2023/24 remained in draft form at that time.

RECOMMENDATIONS

- 7 Members are asked to:
 - i. note the mid-year position for the treasury management activities for 2022/23;
 - ii. approve the Capital and Treasury Management Strategies and the Minimum Revenue Provision Statement for 2023/24, subject to any amendments necessary, following approval of the final revenue and capital budgets for 2023/24; and
 - iii. in the event of amendments to the draft revenue and capital budgets for 2023/24 delegate approval of these Strategies and MRP Statement to the Executive Panel at its meeting of 20 March 2023.

BACKGROUND

- 5 The Authority is required to approve the Treasury Management and Capital Strategies and the Minimum Revenue Provision Statement prior to the commencement of the financial year.

INFORMATION

- 6 Appendix 1 to this report confirms the capital and treasury management activity for the period 1 April 2022 – 30 September 2022. A full year update will be provided to the Authority at its meeting in July 2023.
- 7 The Capital and Treasury Management Strategies and the Minimum Revenue Provision Statement are contained within Appendices 2 – 4. The capital expenditure and subsequent borrowing requirements contained within the appendices include the proposed capital expenditure set out in the draft capital and revenue budgets for 2023/24. In the event that the revenue and capital budgets for 2023/24 require further revision, it will be necessary to amend the strategies and MRP Statement.

- 8 The Capital Strategy sets out the future plans for the Authority's capital expenditure and funding requirements and is laid out in Appendix 2 of this report. It is noted that future plans include major investment in a new training centre for the provision of essential training to our staff. This scheme will be developed over the forthcoming year and will be presented to Members at a future Authority meeting. The business case will include the financial implications, including the governance and long-term affordability of the proposals
- 9 The Treasury Management Strategy (the Strategy) is contained within Appendix 3 and provides an overview of the Authority's approach to borrowing to fund the capital expenditure plans. The Strategy also incorporates the approach to the management of investments, although Members should note that this incorporates the management of short-term surplus cash only.
- 10 The Minimum Revenue Provision Statement provides further commentary on the revenue implications of capital expenditure and funding plans and is set out within Appendix 4.
- 11 These documents are technical in nature and follow the recommended practice set out by the Chartered Institute of Public Finance (Cipfa). Although they are presented as separate documents they provide the governance arrangements covering capital expenditure, financing and the associated treasury management activity.
- 12 The Authority is supported through the use of professional advisors, Arlingclose, who provide advice and guidance in relation to treasury management activities.

IMPLICATIONS

Wellbeing Objectives	This report links to the Authority's long-term well-being objectives by ensuring that the purchase of assets to support front line service delivery is prudent, affordable and sustainable. The Capital Strategy is designed to ensure that there is sufficient investment in infrastructure to enable the service to provide emergency responses and prevention work well in to the future.
Budget	The strategies link to the revenue and capital budget setting which considers longer term affordability
Legal	The regulatory framework is set out in the appendices to the report.
Staffing	None
Equalities/Human Rights/Welsh Language	None
Risks	The reports set out the financial risks associated with borrowing and investment activities.

Treasury Management Outturn Report 2022/23 (Appendix 1)

Introduction

In December 2003 the North Wales Fire and Rescue Authority (the Authority) adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports. This quarterly report provides an additional update.

The Authority's treasury management strategy for 2022/23 was approved at a meeting on 16 January 2022. As the Authority has borrowed substantial sums of money to fund its capital expenditure, it is 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 risk remains central to the Authority's treasury management strategy.

CIPFA published its revised Treasury Management Code of Practice [the TM Code] and Prudential Code for Capital Finance in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the two Codes took immediate effect, although local authorities could defer introducing the revised reporting requirements within the revised Codes until the 2023/24 financial year if they wish, which the Authority has elected to do.

Treasury risk management at the Authority is conducted within the framework of the TM Code. This Code now also includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

External Context

Economic background: The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

Central Bank rhetoric and action remained robust. The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were in all likelihood recessions in those regions.

UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. RPI registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate 3m/year for April fell to 3.8% and declined further to 3.6% in July. Although now back below pre-pandemic levels, the recent decline was driven by an increase in inactivity rather than demand for labour. Pay growth in July was 5.5% for total pay (including bonuses) and 5.2% for regular pay. Once adjusted for inflation, however, growth in total pay was -2.6% and -2.8% for regular pay.

With disposable income squeezed and higher energy bills still to come, consumer confidence fell to a record low of -44 in August, down -41 in the previous month. Quarterly GDP fell -0.1% in the April-June quarter driven by a decline in services output, but slightly better than the 0.3% fall expected by the Bank of England.

The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. The September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so, given ongoing strong rhetoric around tackling inflation, further Bank Rate rises should be expected.

On 23 September the UK government, following a change of leadership, announced a raft of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts. The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

Bank of England policymakers noted that any resulting inflationary impact of increased demand would be met with monetary tightening, raising the prospect of much higher Bank Rate and consequential negative impacts on the housing market.

After hitting 9.1% in June, annual US inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

Eurozone CPI inflation reached 9.1% y/y in August, with energy prices the main contributor, but also strong upward pressure from food prices. Inflation has increased steadily since April from 7.4%. In July the European Central Bank increased interest rates for the first time since 2011, pushing its deposit rate from – 0.5% to 0% and its main refinancing rate from 0.0% to 0.5%. This was followed in September by further hikes of 0.75% to both policy rates, taking the deposit rate to 0.75% and refinancing rate to 1.25%.

Financial markets: Uncertainty remained in control of financial market sentiment and bond yields remained volatile, continuing their general upward trend as concern over higher inflation and higher interest rates continued to dominate. Towards the end of September, volatility in financial markets was significantly exacerbated by the UK government's fiscal plans, leading to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling.

Due to pressure on pension funds, the Bank of England announced a direct intervention in the gilt market to increase liquidity and reduce yields.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to 4.40%, the 10-year gilt yield rose from 1.61% to 4.15%, the 20-year yield from 1.82% to 4.13% and the 50-year yield from 1.56% to 3.25%. The Sterling Overnight Rate (SONIA) averaged 1.22% over the period.

Credit review:

Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks, in May Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. These recommendations were unchanged at the end of the period.

Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. Nevertheless, increased market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

Local Context

On 31st March 2022, the Authority had net borrowing of £24.5m arising from its revenue and capital income and expenditure. 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. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.22 Actual £m
General Fund CFR	28.4
External borrowing	24.5
Internal borrowing	3.9
Less: Balance Sheet Resources	-6.4
Less: New Investments	2.5
New borrowing	0

* finance leases form part of the Authority's total debt

The treasury management position on 30 September 2022 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.22 Balance £m	Movement £m	30.9.22 Balance £m	30.9.22 Rate %
Long-term borrowing	10.76	3.00	13.76	1.87 – 4.90
Short-term borrowing	13.67	(4.05)	9.62	1.30 – 2.00
Total borrowing	24.43	(1.05)	23.38	
Long-term investments	0	0	0	
Short-term investments	0	0	0	
Cash and cash equivalents	(2.53)	(2.20)	(4.73)	*1.75%
Total investments	(2.53)	(2.20)	(4.73)	
Net borrowing	21.90	(3.25)	18.65	

*Only relates to balances held in the call account

Borrowing

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return, and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority.

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

Over the April-September period short term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget', included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies. Exceptional volatility threatened financial stability, requiring Bank of England intervention in the gilt market. Over a twenty-four-hour period, some PWLB rates increased to 6%, before the intervention had the desired effect, bringing rates back down by over 1% for certain maturities. A truly wild and unprecedented period in fixed income markets, with a direct impact on PWLB rates.

Interest rates rose by over 2% during the period in both the long and short term. As an indication the 5-year maturity certainty rate rose from 2.30% on 1st April to 5.09% on 30th September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%

This has meant that the cost of borrowing has rose significantly. Interest costs were expected to be £0.325m for 2022/23, however latest indications suggest costs will increase to £0.825m by the end of this financial year.

At 30 September the Authority held £23.38m of loans, a decrease of £1.05m to 31 March 2022, as part of its strategy for funding previous years' capital programmes. Outstanding loans on 30 September are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.3.22 Balance £m	Net Movement £m	30.9.22 Balance £m	30.9.22 Weighted Average Rate %	30.9.22 Weighted Average Maturity (years)
Public Works Loan Board	15.43	1.95	17.38	2.23	5.88
Local authorities (short-term)	9.00	(3.00)	6.00	1.30	1.00
Total borrowing	24.43	(1.05)	23.38		

Table 3B: Long-dated Loans borrowed

	Amount £m	Rate %	Period (Years)
PWLB Maturity Loan	2.3	4.80	29
PWLB EIP Loan	0.2	3.09	14
Total borrowing	2.5		

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long-term borrowing was maintained.

Treasury Investment Activity

The CIPFA revised Treasury Management Code defines treasury management investments as those which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £0 and £3m million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.22 Balance £m	Net Movement £m	30.9.22 Balance £m	30.9.22 Income Return %	30.9.22 Weighted Average Maturity days
Banks & building societies	2.53	2.20	4.73	1.75	on call
Total investments	2.53	2.20	4.73		

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum 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 increases in Bank Rate over the period under review, and with the prospect of more increases to come, short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose by around 1.5% for overnight/7-day maturities and by nearly 3.5% for 9-12-month maturities.

The authority uses bank call accounts to deposit cash, for short periods, until it is required.

Treasury Performance

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget in table 5 below.

Table 5: Performance

	Actual £m	Forecast £m	Budget £m	Over/ under
Minimum Revenue Position	1.93	1.93	1.93	0
Financing Costs	0.29	0.82	0.32	0.50
Total borrowing	2.22	2.75	2.25	0.50
Call Account	0.01	0.02	0	0.02
Total treasury investments	0.01	0.02	0	0.02

Compliance

The Assistant Chief Fire Officer (Finance and Resources) reports that all treasury management activities undertaken during the six months complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 6: Debt Limits

	30.9.22 Actual £m	2022/23 Operational Boundary £m	2022/23 Authorised Limit	Complied?
Borrowing	23.38	28.99	30.99	Yes
Total debt	23.38	28.99	30.99	

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Table 7: Investment Limits

Institution	Description	Limit	30.09.22 Actual	Complied
Banks	All UK banks and their subsidiaries that have good ratings (Fitch or equivalent). This is currently defined as long term (BBB)	£5m	£4.73m	Yes
Central Government	Debt management Office	Unlimited	0	Yes
Money Market Funds (MMF)	Only in conjunction with advice from Arlingclose.	£1m per fund	0	Yes
Local Authorities	All except those subject to limitation of council tax and precepts under Part 1 of the Local Government Finance Act 1992.	£2m	0	Yes
Building Societies	Building societies with a rating (as for the banking sector).	£2m	0	Yes
Building Societies (Assets £1bn)	Building societies without a rating but with assets of £1billion or more.	£2m/ 9 months	0	Yes

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. [This indicator covers the risk of replacement loans being unavailable, not interest rate risk.] The upper and lower limits on the maturity structure of all borrowing were:

	30.9.22 Actual	Actual Limit	Upper Limit	Lower Limit	Complied?
Under 12 months	5.11	29%	60%	0%	Y
12 months and within 24 months	1.42	9%	45%	0%	Y
24 months and within 5 years	8.12	47%	45%	0%	N
5 years and within 10 years	0.23	1%	75%	0%	Y
10 years and above	2.30	14%	100%	0%	Y

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 26 September 2022 interest rate forecast)

Arlingclose expects Bank Rate to continue at current levels, 5%, until the end of the year.

The MPC is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 200bps of increases this calendar year.

This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the BoE. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

Background:

Monetary policymakers are behind the curve having only raised rates by 50bps in September. This was before the "Mini-Budget", poorly received by the markets, triggered a rout in gilts with a huge spike in yields and a further fall in sterling. In a shift from recent trends, the focus now is perceived to be on supporting sterling whilst also focusing on subduing high inflation.

There is now an increased possibility of a special Bank of England MPC meeting to raise rates to support the currency. Followed by a more forceful stance over concerns on the looser fiscal outlook. The MPC is therefore likely to raise Bank Rate higher than would otherwise have been necessary given already declining demand. A prolonged economic downturn could ensue.

Uncertainty on the path of interest rates has increased dramatically due to the possible risk from unknowns which could include for instance another Conservative leadership contest, a general election, or further tax changes including implementing windfall taxes.

The government's blank cheque approach to energy price caps, combined with international energy markets priced in dollars, presents a fiscal mismatch that has contributed to significant decline in sterling and sharp rises in gilt yields which will feed through to consumers' loans and mortgages and business funding costs.

UK government policy has mitigated some of the expected rise in energy inflation for households and businesses flattening the peak for CPI, whilst extending the duration of elevated CPI. Continued currency weakness could add inflationary pressure.

The UK economy already appears to be in recession, with business activity and household spending falling. The short to medium-term outlook for the UK economy is relatively bleak.

Global bond yields have jumped as investors focus on higher and stickier US policy rates. The rise in UK government bond yields has been sharper, due to both an apparent decline in investor confidence and a rise in interest rate expectations, following the UK government's shift to borrow to loosen fiscal policy. Gilt yields will remain higher unless the government's plans are perceived to be fiscally responsible.

The housing market impact of increases in the Base Rate could act as a "circuit breaker" which stops rates rising much beyond 5.0%, but this remains an uncertainty.

Capital Strategy Report 2023/24 (Appendix 2)

Introduction

This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services, along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these, sometimes technical, areas.

Decisions made this year on capital and treasury management will have financial consequences for the North Wales Fire and Rescue Authority (the Authority) for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

Capital Expenditure and Financing

Capital expenditure is where the Authority spends money on assets, such as land, property, equipment or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

In 2023/24, the Authority is planning capital expenditure of £3.832m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
General Fund services	1.175	2.516	3.832	5.834	5.658
New Training Centre			3.000	25.000	20.000
Total	1.175	2.516	6.832	30.834	25.658

IFRS16 accounting for Leases will be introduced in 2024/25. Work is ongoing to determine the impact of this and therefore leases have not been included in the above figures.

The main General Fund capital projects include minor building works, specialist vehicles, equipment and information technology. Included separately is the potential new training centre. The training centre requires significant investment over the next 3 years, which accounts for the increase in capital expenditure from 2023/24 onwards. The Authority does not incur capital expenditure on investments.

Governance: In September each year, managers submit bids to include projects in the Authority’s capital programme. Bids are collated by the Head of Finance who calculates the financing requirement and cost. The Service Leadership Team appraises all bids based on a comparison of strategic priorities against financing costs and makes recommendations for schemes to be included in the capital plan. The final capital programme is then presented to the Executive Panel in December and to the Authority in January each year.

- Full details of the Authority’s capital programme are within the MTFP Report

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority’s own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget *	2024/25 budget	2025/26 budget
Capital receipts	0.015	0.015	0	0	0
Revenue resources	0.148	0.165	0	0	0
Debt	1.012	2.336	6.832	30.834	25.658
TOTAL	1.175	2.516	6.832	30.834	25.658

The above debt includes the new training centre, as detailed in Table 1.

Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of prior years’ debt finance in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Minimum revenue provision (MRP)	2.000	1.937	1.999	2.077	3.049
Capital receipts	0.015	0.015	0	0	0
TOTAL	2.015	1.952	1.999	2.077	3.049

- The Authority’s full minimum revenue provision statement is available as part of the Treasury Management Strategy

The Authority’s cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £4.833m during 2023/24. Based on the above figures for expenditure and financing, the Authority’s estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget*	31.3.2025 budget *	31.3.2026 budget*
General Fund services	28.396	28.999	33.832	62.589	85.198

The above debt includes the new training centre, as detailed in Table 1. It is assumed that this will be fully funded by the Authority.

Asset management: To ensure that capital assets continue to be of long-term use, the Authority is developing an updated asset management strategy.

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Authority is not planning to receive any capital receipts in the coming financial year.

Treasury Management

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Authority’s spending needs, while managing the risks involved. This includes the management of borrowing to fund capital expenditure as well as the day to day management of revenue cash. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Authority is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

Due to decisions taken in the past, the Authority currently has £20.46m borrowing at an average interest rate of 2.23%.

Borrowing strategy: The Authority’s main objective when borrowing is to achieve a low but certain cost of finance, while retaining flexibility should plans change in the future. These objectives are often conflicting, and the Authority therefore seeks to strike a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher.

The Authority does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

Projected levels of the Authority's total outstanding debt (which comprises borrowing, PFI liabilities, leases and transferred debt) are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2022 actual	31.3.2023 forecast	*31.3.2024 budget	*31.3.2025 budget	*31.3.2026 budget
Debt (incl. Finance leases)	24.435	21.960	27.626	55.895	77.285
Capital Financing Requirement	28.396	28.999	33.832	62.589	85.198

*The above debt includes the new training centre, as detailed in Table 1. It is assumed that this will be fully funded by the Authority.

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Authority expects to comply with this in the medium term.

Liability benchmark: To compare the Authority'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 £2m at each year-end. This benchmark is currently £24m and is forecast to rise to £33.3m over the next three years.

The liability benchmark does not include the cost of the potential new training centre. This indicator will be updated if the scheme is approved.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
Outstanding borrowing	24.5	24.1	21.7	18.3	15.0
Liability benchmark	24.0	24.6	27.1	30.2	33.3

The table shows that the Authority expects to remain borrowed below its liability benchmark.

Affordable borrowing limit: 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 as a warning level should debt approach the limit.

Table 8: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2022/23 limit	2023/24 limit	2024/25 limit	2025/26 limit
Authorised limit – borrowing	31.396	30.999	35.832	64.589
Operational boundary – borrowing	28.396	28.999	33.832	62.589

- Further details on borrowing are in the treasury management strategy

Treasury investment strategy: Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

The Authority’s policy on treasury investments is to place short term cash surpluses into bank call accounts until required. The Authority does not have long term investments. Cash that is likely to be spent in the near term is invested securely, with selected high-quality banks, to minimise the risk of loss.

Risk management: The effective management and control of risk are prime objectives of the Authority’s treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

- The treasury management prudential indicators are included in the treasury management strategy

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Assistant Chief Fire Officer (Finance and Resources) and staff, who must act in line with the treasury management strategy approved by the Authority. Reports on treasury management activity are presented to committee. The audit committee is responsible for scrutinising treasury management decisions.

Liabilities

In addition to debt of £24.5m detailed above, the Authority is committed to making future payments to cover its pension fund deficit (valued at £328m). It has also set aside £0.737m for provisions to cover specific risks. The Authority is also at risk of having to pay for changes in the regulations relating to firefighter pensions, but has not put aside any money because the remedy is still ongoing.

Governance: Decisions on incurring new discretionary liabilities are taken by the Head of Finance in consultation with the Assistant Chief Fire Officer (Finance and Resources). The risk of liabilities crystallising and requiring payment is monitored by the Head of Finance and reported annually to the Authority. New liabilities exceeding £1m are reported to the Authority for notification as appropriate.

- Further details on liabilities are on pages 37 and 60 of the 2021/22 statement of accounts [consolidated-nwfra-soa-2021_2022-signed-as-at-17_10_22.pdf \(gov.wales\)](#)

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from the levy and general government grants.

Table 11: Prudential Indicator: Proportion of financing costs to net revenue stream

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Financing costs (£m)	2.29	2.75	3.1	4.7	6.9
Proportion of net revenue stream	6.3%	7.0%	7.0%	9.8%	13.5%

- Further details on the revenue implications of capital expenditure are detailed within the 2023/24 revenue budget

Sustainability: Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The inclusion of the new training centre will be financially challenging due to the scale and cost of the project, which will mean that the Authority will need to borrow significant additional funds over the next 3 years. This will have an impact on the revenue position, which is funded via the levy, over the longer term. Although the high-level financial implications have been calculated and included within the capital and treasury management strategies, for awareness the business case has not yet been considered or approved by the Authority. This will be finalised during 2023/24 and presented to Members for full consideration, including long term affordability.

Knowledge and Skills

The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Treasurer, Assistant Chief Fire Officer (Finance and Resources), and Head of Finance and Procurement are qualified accountants with many years' experience. In addition, there is consultation with facilities staff via a Service level Agreement, and the Environment and Climate Change Manager.

Use is also made of external advisers and consultants that are specialists in their field. The Authority currently employs Arlingclose Limited as treasury management advisers. This approach is more cost effective than employing such staff directly, and ensures that the Authority has access to knowledge and skills commensurate with its risk appetite.

Treasury Management Strategy Statement 2023/24 (Appendix 3)

Introduction

Treasury management is the management of the North Wales Fire and Rescue Authority's (the Authority's) cash flows, borrowing and investments, and the associated risks. The Authority has borrowed 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 Authority's prudent financial management.

Treasury risk management at the Authority 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. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Authority to approve an investment 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 both the CIPFA Code and the WG Guidance.

Revised strategy: In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

External Context

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 (BoE) increased Bank Rate by 0.75% to 3.0% in November 2022, the largest single rate hike since 1989 and the eighth successive rise since December 2021. The decision was voted for by a 7-2 majority of the Monetary Policy Committee (MPC), with one of the two dissenters voting for a 0.50% rise and the other for just a 0.25% rise.

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 grew by 0.2% between April and June 2022, but 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 peak 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 with a peak of 5.25%. However, the BoE has stated it considers this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate fell to 3.5%, driven mostly by a shrinking labour force. Earnings were up strongly in nominal terms by 6% for total pay and 5.4% for regular pay but factoring in inflation means real total pay was -2.4% and regular pay -2.9%. Looking forward, the 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 0.75% in November 2022 to 3.75%-4.0%. This was the fourth successive 0.75% rise 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 8%. GDP grew at an annualised rate of 2.6% between July and September 2022, a better-than-expected rise, 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 has been rising consistently in the Euro Zone since the start of the year, hitting an annual rate of 10.7% in October 2022. Economic growth has been weakening with an expansion of just 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 0.75% in October, the third major increase in a row, taking its main refinancing rate to 2% and deposit facility rate to 1.5%.

Credit outlook:

Credit default swap (CDS) prices have followed an upward trend throughout the year, 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 has been higher in 2022 compared to 2021 and this year has seen a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

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

The Authority's treasury management adviser, Arlingclose, forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside, should inflation not evolve as the Bank forecasts and remains persistently higher.

Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.6%, 3.7%, and 3.9% respectively over the 3-year period to September 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

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

For the purpose of setting the budget, it has been assumed that new long-term loans will be borrowed at an average rate of 5%.

Local Context

On 30 November 2022, the Authority held £19.46m of borrowing and £1.0m of treasury investments (cash in bank). This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Capital Financing Requirement (CFR) is set out in the table below:

	2021/22 Actual £m	2022/23 Revised £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Opening CFR	29.4	28.4	29.0	33.9	62.6
Closing CFR	28.4	29.0	33.9	62.6	85.2
Movement in CFR	(1.0)	0.6	4.9	28.7	22.6

Movement in CFR represented by

Net financing need for the year (Capital expenditure)	1.0	2.5	6.9	30.8	25.6
Less MRP/VRP	(2.0)	(1.9)	(2.0)	(2.1)	(3.0)
Movement in CFR	(1.0)	0.6	4.9	28.7	22.6

*These figures include the potential borrowing requirement for a new training centre (expected costs: 2023/24: £3m, 2024/25: £25m, 2025/26: £20m), which is subject to a separate business case.

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 Authority's current strategy 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, but minimal investments and will therefore be required to borrow up to £85m over the forecast period, which includes £48m for the potential training centre.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2023/24.

Liability benchmark: To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This does not include the potential costs of the new training centre as detailed in table 1 above, but that cash and investment balances are kept to a minimum level of £2.0m at each year-end to maintain sufficient liquidity but minimise credit risk.

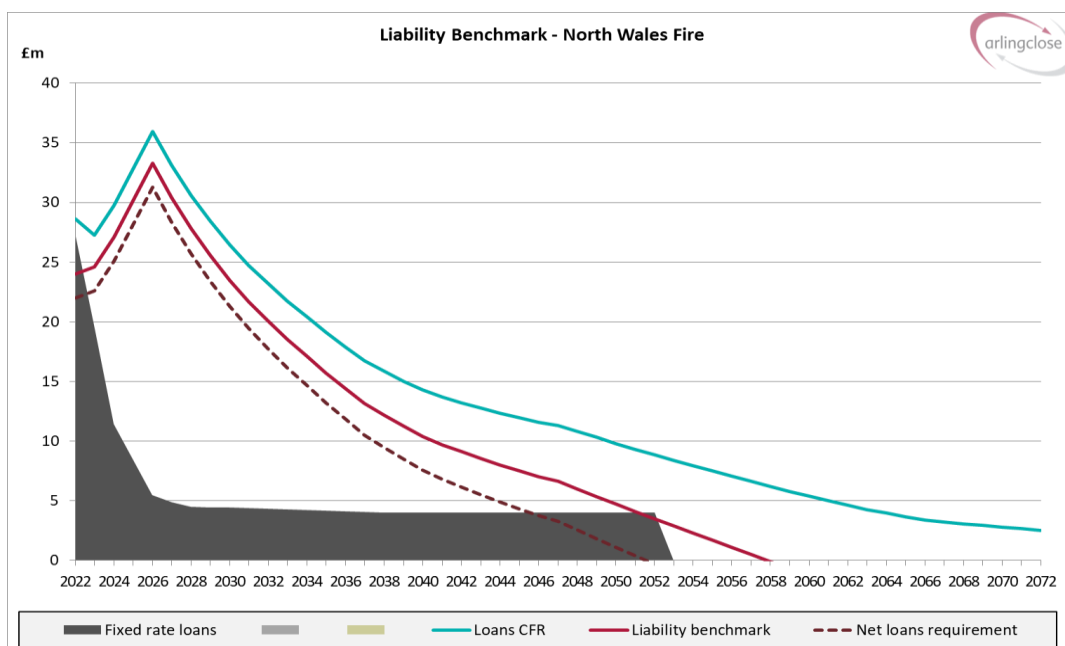
The liability benchmark is an important tool to help establish whether the Authority is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Authority 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.

This is the first year the liability benchmark has been calculated and has been devised in association with the treasury advisors. However, it will be developed further throughout the year, to take account of developments that have not been included below. It does not include the cost of borrowing to fund the potential new training centre. This indicator will be updated on an ongoing basis.

Table 2: Prudential Indicator: Liability benchmark

	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
Loans CFR	28.4	27.0	29.5	32.6	35.7
Less: Balance sheet resources	-6.4	-4.4	-4.4	-4.4	-4.4
Net loans requirement	22.0	22.6	25.1	28.2	31.3
Plus: Liquidity allowance	2.0	2.0	2.0	2.0	2.0
Liability benchmark	24.0	24.6	27.1	30.2	33.3

Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes estimated capital expenditure, not including the cost of the proposed new training centre funded by borrowing, and minimum revenue provision on new capital expenditure based on various asset lives, as per the accounting policies, and is dependent on the asset and income, expenditure and reserves all increasing by inflation of 3% a year. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



The blue line represents the need to fund capital expenditure through borrowing (the Capital Financing Requirement or CFR). The red lines represent the need to fund capital expenditure through borrowing once reserves and working capital surplus' (or deficits) have been taken into account – this is actually the real need to borrow which CIPFA have defined as being the Liability Benchmark. The dashed red line represents the position at year end and the solid line represents the average mid-year position. The grey shaded areas show actual loans. When the grey area falls below the red lines this infers a borrowing need. The graph shows the authority is expecting to need to borrow in future years. The Authority will always have a borrowing requirement as it does not hold significant cash or reserves and only has limited access to capital grant funding.

Borrowing Strategy

The Authority currently holds, £19.46m of loans, a reduction of £4.97m on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £28.99m in 2023/24. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £30.99m.

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, should the Authority'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 without compromising the longer-term stability of the debt portfolio. 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 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. The benefits of 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. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority 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.

The Authority has previously raised all of its long-term borrowing from the PWLB (formerly the Public Works Loan Board) but will consider long-term loans from other sources including banks, pensions and local authorities, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

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.

In addition, the Authority may borrow further short-term loans to cover unplanned cash flow shortages.

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 your local 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 other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

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 the Authority.

Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

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

Treasury Investment Strategy

The Authority does not hold invested funds. Cash is placed temporarily in a call account until it is required.

Objectives: Both the CIPFA Code and the WG Guidance require 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.

Strategy: As demonstrated by the liability benchmark above, the Authority does not expect to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

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. 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.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the limits shown.

Table 3: Treasury investment counterparties and limits

Sector	Description	Counterparty limit	Sector limit
The UK Government	Debt Management Office	Unlimited	n/a
Local authorities & other government entities	All except those subject to limitation of council tax and precepts under Part 1 of the Local Government Finance Act 1992.	£2m	Unlimited
Banks (unsecured)*	All UK banks and their subsidiaries that have good ratings (Fitch or equivalent).	£5m	Unlimited
Building societies (unsecured)*	Building societies with a rating	£2m	Unlimited
Money Market Funds (MMF)	Only in conjunction with advice from Arlingclose.	£1m	Unlimited

This table must be read in conjunction with the notes below

*** Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £1m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

Government: Loans to, and 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, although they are not zero risk. 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.

Banks and building societies (unsecured): Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Operational bank accounts: The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £5m per bank. 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 Authority maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority'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.

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

Other information on the security of investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority 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, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Liquidity management: The Authority monitors the cash flow on a daily basis and forecasts known income and expenditure in order 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments.

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:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	60%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	45%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Related Matters

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

Financial derivatives: In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Government Guidance: Further matters required by the WG Guidance are included in Appendix C.

Financial Implications

The budget for investment income in 2023/24 is nil. The budget for debt interest paid in 2023/24 is £1.2m million, based on an average debt portfolio of £25 million at an average interest rate of 4.6%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Treasurer 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 A – Arlingclose Economic & Interest Rate Forecast – November 2022

Underlying assumptions:

- UK interest rate expectations have eased following the mini-budget, with a growing expectation that UK fiscal policy will now be tightened to restore investor confidence, adding to the pressure on household finances. The peak for UK interest rates will therefore be lower, although the path for interest rates and gilt yields remain highly uncertain.
- Globally, economic growth is slowing as inflation and tighter monetary policy depress activity. Inflation, however, continues to run hot, raising expectations that policymakers, particularly in the US, will err on the side of caution, continue to increase rates and tighten economies into recession.
- The new Chancellor dismantled the mini-budget, calming bond markets and broadly removing the premium evident since the first Tory leadership election. Support for retail energy bills will be less generous, causing a lower but more prolonged peak in inflation. This will have ramifications for both growth and inflation expectations.
- The UK economy is already experiencing recessionary conditions, with business activity and household spending falling. Tighter monetary and fiscal policy, alongside high inflation will bear down on household disposable income. The short- to medium-term outlook for the UK economy is bleak, with the BoE projecting a protracted recession.
- Demand for labour remains strong, although there are some signs of easing. The decline in the active workforce has fed through into higher wage growth, which could prolong higher inflation. The development of the UK labour market will be a key influence on MPC decisions. It is difficult to see labour market strength remaining given the current economic outlook.
- Global bond yields have steadied somewhat as attention turns towards a possible turning point in US monetary policy. Stubborn US inflation and strong labour markets mean that the Federal Reserve remains hawkish, creating inflationary risks for other central banks breaking ranks.
- However, in a departure from Fed and ECB policy, in November the BoE attempted to explicitly talk down interest rate expectations, underlining the damage current market expectations will do to the UK economy, and the probable resulting inflation undershoot in the medium term. This did not stop the Governor affirming that there will be further rises in Bank Rate.

Forecast:

- The MPC remains concerned about inflation but sees the path for Bank Rate to be below that priced into markets.
- Following the exceptional 75bp rise in November, Arlingclose believes the MPC will slow the rate of increase at the next few meetings. Arlingclose now expects Bank Rate to peak at 4.25%, with a further 50bp rise in December and smaller rises in 2023.
- The UK economy likely entered into recession in Q3, which will continue for some time. Once inflation has fallen from the peak, the MPC will cut Bank Rate.
- Arlingclose expects gilt yields to remain broadly steady despite the MPC's attempt to push down on interest rate expectations. Without a weakening in the inflation outlook, investors will price in higher inflation expectations given signs of a softer monetary policy stance.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales will maintain yields at a higher level than would otherwise be the case.

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.50	3.50	3.50
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.90	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.75	3.75	3.75
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.36	3.65	3.90	3.90	3.90	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.70	3.75	3.75	3.75	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.88	4.00	4.00	4.00	4.00	4.00	3.90	3.90	3.90	3.90	3.90	3.90	3.90
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.24	3.40	3.40	3.40	3.40	3.40	3.30	3.30	3.30	3.30	3.30	3.30	3.30
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

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

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

UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B – Existing Investment & Debt Portfolio Position

	30 Nov 2022 Actual portfolio £m	30 Nov 2022 Average rate %
External borrowing:		
Public Works Loan Board	13.46	2.37
Local authorities	6.00	1.30
Total external borrowing	19.46	
Total gross external debt	19.46	
Treasury investments:		
Banks (unsecured)	1.0	2.25
Net debt	18.46	

Annual Minimum Revenue Provision Statement 2023/24 (Appendix 4)

Annual Minimum Revenue Provision Statement 2023/24

Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The *Local Government Act 2003* requires the Authority to have regard to Welsh Government's *Guidance on Minimum Revenue Provision* (the WG Guidance) most recently issued in 2018.

The broad aim of the WG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The WG Guidance requires the Authority to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance.

- For capital expenditure incurred after 31 March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.
- Capital expenditure incurred during 2023/24 will not be subject to a MRP charge until 2024/25 or later.

Based on the Authority's latest estimate of its capital financing requirement (CFR) on 31 March 2023, the budget for MRP has been set as follows:

	31.03.2023 Estimated CFR £m	2023/24 Estimated MRP £m
Total General Fund	29.0	2.0