Item No. on Agenda

Report to the Police Fire and Crime Panel – 13 February 2023

TREASURY MANAGEMENT STRATEGY 2023/2024

Report of the Staffordshire Commissioner

1. Background

1.1 In addition to the existing role overseeing Staffordshire Police, the Staffordshire Commissioner became responsible for the governance of the Staffordshire Fire and Rescue Service from August 2018. However, both remain separate organisations, with separate budgets and governance processes.

1.2 This report will detail the Treasury Management Strategy for the Staffordshire Commissioner Fire and Rescue Authority only; a separate report has been completed and supported by the Board for the Staffordshire Police and Crime Commissioner. Therefore, reference is made only to **Staffordshire Commissioner Fire and Rescue Authority ('the Authority')** as part of this report.

2. Introduction

2.1 This report outlines the Authority's Treasury Management Strategy for the 2023/24 financial year.

2.2 Treasury management comprises the management of the Authority's cash flows, borrowings and investments, and their associated risks. The Authority is exposed to financial risks, including the effects on revenue from changing interest rates on borrowings and investments, and the risks of a potential loss of invested funds. Therefore, it is essential that the Authority successfully identifies, monitors, and controls financial risk as part of prudent financial management.

2.3 The Authority conducts its treasury risk management within the framework of the Chartered Institute of Public Finance and Accountancy's (CIPFA) *Treasury Management in the Public Services Code of Practice 2017 Edition* (the CIPFA Code). The CIPFA Code requires that the Authority approves a treasury management strategy before the start of each financial year. In addition, this report fulfils the legal obligation to have regard to the CIPFA Code under the Local Government Act 2003.

2.4 The Annual Investment Strategy (AIS) for 2023/24 meets the requirements of the statutory guidance issued by the Department for Levelling up, Communities and Local Government (DLUHC), previously the Ministry of Housing, Communities and Local Government in its *Guidance on Local Government Investments 2018 Edition.*

2.5 This strategy has been prepared in conjunction with the Treasury and Pensions team at Staffordshire County Council (SCC), and after consultation with the Director of Finance.

3. Recommendations

3.1 That the Police Fire and Crime Panel note the proposed borrowing strategy for the 2023/24 financial year. The main features are:

a) a borrowing strategy to operate within the prudential limits set out in **Appendix 2**;
b) a borrowing strategy, to use cash as far as is practical with the option to borrow up to £3m long-term where the Director of Finance considers this appropriate in 2023/24;
c) a strategy on borrowing in advance of need that will not be used in 2023/24; and
d) a loan restructuring strategy that is potentially unlimited where this rebalances risk.

3.2 The Strategic Governance Board (Fire) to note in accordance with the DLUHC's Guidance on Local Authority Investments, the adoption of the Annual Investment Strategy (AIS) 2023/24 as detailed in **Section 7** of this report and the risks summarised in **Appendix 5**. Also, to note the policies on:

- reviewing the strategy;
- use of external advisors; and
- training.

4. External Context

Economic background

4.1 Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies; UK interest rates were volatile for most of 2022.

4.2 2022/23 has seen large increases in the bank base rate by the Bank of England, the Federal Reserve in the US and European Central Bank (ECB). UK base rates rose from 0.75% in March 2021 to 3.50% in December 2022. It is expected that UK interest rates may peak around 4.5% in June 2023, as forecast by Link, the Council's independent treasury advisor, and reduce in 2024, after the Bank of England has brought inflation under control.

4.3 UK Consumer Price Inflation (CPI) for October 2022 registered +11.1%, this decreased to +10.5% by December 2022 and is forecast to reduce further in 2023, as the peak is considered to have passed. The Monetary Policy Committee (MPC) of the Bank of England saw this level of inflation as transitory, as it was principally driven by gas prices and demand and supply chain issues, although it has lasted longer than initially forecast.

4.4 The UK unemployment rate fell to a 48-year low of 3.6% during 2022, and this was despite a net migration increase of circa 500,000. With an increase in people

registered as long-term sick, the UK labour force shrunk by circa 500,000 in the year to June 2022, making it more difficult for the UK economy to grow.

4.5 Gross Domestic Product (GDP) - Q2 2022 saw UK GDP revised upwards to +0.2% quarter on quarter, but this was quickly reversed in Q3 2022, with some of the fall in GDP attributed to the extra Bank Holiday for the late Queen's funeral. In the Bank of England's November projection, which was based on the elevated path of market interest rates, GDP is projected to continue to fall throughout 2023 and the first half of 2024, as high energy prices and tighter financial conditions weigh on spending. GDP growth is then forecast increase by around 0.75% towards the end of 2024. Although there is judged to be a significant margin of excess demand currently, continued weakness in spending is forecast to lead to an increasing amount of economic slack emerging from the first half of next year.

4.6 Globally all the major economies are expected to struggle in the short term. The Purchasing Manager Indices for the US, Eurozone and China all point to at least one if not more quarters of GDP contraction.

4.7 GBP Sterling strengthened towards the end of 2022, recovering from a record low of $1.035 versus the US Dollar, following the Truss government's "fiscal event" in September 2022, to $1.22. Notwithstanding GBP's better performance in the latter part of the year, 2023 is likely to see a housing correction as some fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

Credit outlook

4.8 Although bank Credit Default Swap (CDS) prices, (market indicators of credit risk), spiked upwards during the days of the Truss/Kwarteng government, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

4.9 Significant levels of downgrades to short and long-term credit ratings have not materialised from Credit Agencies, since the on-set of the Covid-19 crisis in March 2020. In the main, where they have changed, alterations have been limited to outlooks. However, more recently the UK sovereign debt rating has been placed on negative outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. When setting minimum sovereign debt ratings, the Council does not set a minimum rating for the UK due to the unavoidable exposure.

4.10 Looking forward, potential for bank losses still remains a risk and a cautious approach to bank deposits in 2023/24 is advisable. The Council, as a local authority, is exposed to bail-in risk, as the Government will no longer support banks if they fail but rather it will be the investors who primarily bear the financial burden of rescuing the bank.

Interest rate forecast

4.11 The Council's treasury management advisor, Link, is forecasting the Bank of England Base Rate to rise to 4.50% by June 2023 and remain at that level until the

end of the year. It is then expected that rates will fall away incrementally from March 2024 and settle around 2.50% by December 2025. As with all projections there are major risks to this forecast, such as the performance of the economy versus expectations, labour and supply shortages, trade agreements and the geopolitical climate.

4.12 Gilt yields have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are currently in the range of 3.75% to 4.50% and the medium to longer part of the yield curve is inverted to a small degree (yields are lower at the longer end of the yield curve compared to the short to medium end). Link, the Council's treasury advisors, see the markets as having already built in nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook. Markets are, however, volatile, and further movement of gilt yields across the whole spectrum of the curve is possible.

4.13 Due to the ongoing risks outlined above, the treasury strategy retains the low-risk approach adopted in recent years, based on prioritising security, liquidity and then yield.

5. Local Context

5.1 On 14 December 2022, the Authority held £16.800m of external borrowing and had £17.335m temporarily invested. The Authority's future requirements for borrowing and investments can be considered by reviewing its balance sheet forecasts described in the following paragraphs.

Balance sheet

5.2 In terms of borrowing, the Authority discloses its Capital Financing Requirement (CFR) as part of its Statement of Accounts. This represents the underlying need to borrow for capital purposes i.e., the amounts that have been financed through external and internal borrowing rather than being permanently financed. As the CFR also includes capital expenditure that has been funded through Private finance Initiatives (PFI), these PFI liabilities are removed to calculate the Authority's Loans CFR.

5.3 If the Authority increases debt to fund additional capital expenditure, this will increase its Loans CFR; conversely repaying debt through the Minimum Revenue Provision (MRP) will reduce its Loans CFR. The table below shows forecasts for the Authority's Loans CFR and how this will be financed through external and internal borrowing:

	31.03.23 Estimate £m	31.03.24 Forecast £m	31.03.25 Forecast £m	31.03.26 Forecast £m
Loans CFR	25.1	28.5	28.9	29.3
Less: External borrowing	(16.8)	(16.7)	(16.1)	(16.1)
Less: Capital financing from reserves	(1.7)	(1.1)	(0.0)	(0.0)
Internal / (over) borrowing	**6.6**	**10.7**	**12.8**	**13.2**

5.4 The previous table shows that the Authority's Loans CFR is forecast to increase steadily over the period, because of the following - vehicle replacement capital

expenditure including the purchase of 2 Aerial Ladder Platforms and 2 Heavy Rescue Tenders; investment in ops equipment including the replacement of Breathing Apparatus kit; current PPE (firefighting gear) replacement and Improvements to ICT infrastructure. The Authority's internal borrowing requirements move in line with the Loans CFR projections.

5.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total external borrowing should be lower than its highest forecast CFR over the next three years; the information in the table at 5.3 shows the Authority will comply with this recommendation in this period.

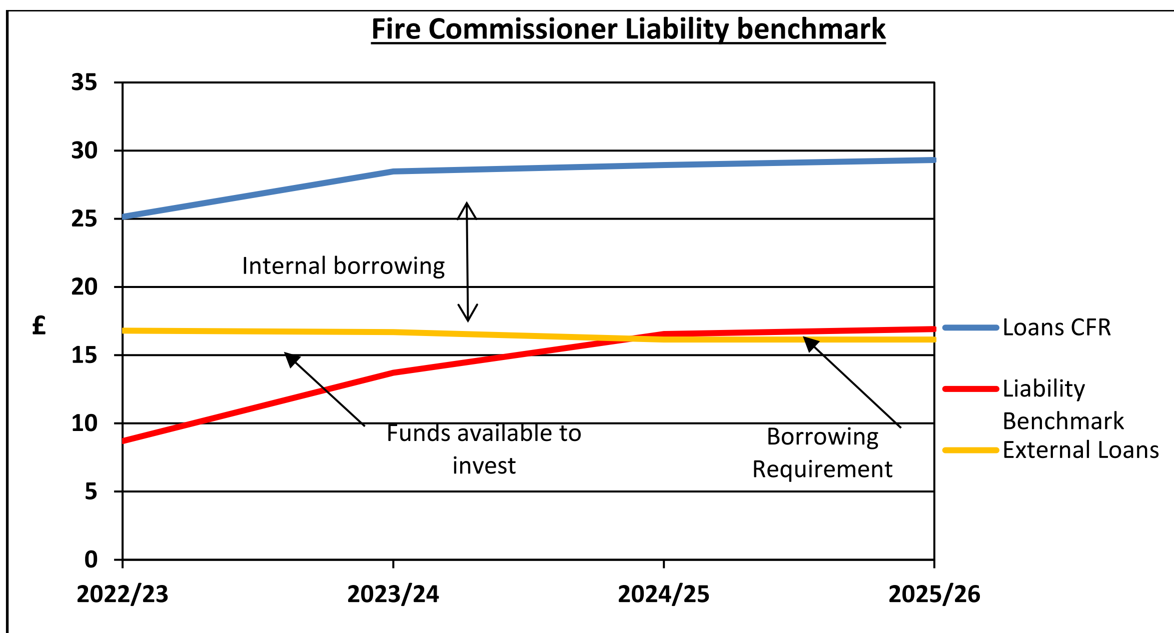
5.6 For investments, the Authority's total resources available are measured by its usable reserves and working capital less any amounts that have been internally borrowed. This is shown in the following table:

	31.03.23 Estimate £m	31.03.24 Forecast £m	31.03.25 Forecast £m	31.03.26 Forecast £m
Usable reserves	14.7	13.7	12.4	12.4
Working capital surplus	0.0	0.0	0.0	0.0
(Less Internal) / Add Over Borrowing	(6.6)	(10.7)	(12.8)	(13.2)
Investments/ (New borrowing)	**8.1**	**3.0**	**(0.4)**	**(0.8)**

5.7 The table above shows a continuation of the Authority's recent strategy in using internal borrowing to reduce the need for external borrowing and as a result, reduce temporary investment levels. Forecasts indicate that this strategy can continue until 2024/25 if reserves remain at current levels as projected when further borrowing may be required.

Liability benchmark

5.8 The CIPFA Prudential Code requires local authorities to develop their own liability benchmark to manage treasury management risk. The liability benchmark represents the minimum amount of loans required to maintain cash balances at nil i.e., when all usable reserves and working capital surpluses are used to offset the mount of loans borrowed.



5.9 The chart shows that the Authority's Loans CFR (blue line) has been financed through a combination of external borrowing (yellow line) and internal borrowing (the difference between the yellow line and the blue line).

5.10 The chart indicates that Authority will have reducing funds available to invest in 2023/24. This is because the Authority's Loans CFR, and hence its liability benchmark, has been steadily increasing whilst its level of external loans has been steadily decreasing with loans being repaid upon maturity.

6. Borrowing Strategy 2023/24

6.1 In 2023/24, the Authority will hold £16.8m in external loans as part of its strategy for funding previous years capital programmes. The Authority will need to ensure total amounts borrowed do not exceed the authorised limit of £30.4 million (when excluding other liabilities such as PFI), as disclosed in **Appendix 2**.

Objectives

6.2 The primary objective for the Authority when considering borrowing money is to strike an appropriate balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. Although relatively low interest costs may be secured for the short term, it is more difficult to predict interest costs over the long term. The risks associated with the borrowing Strategy are laid out in **Appendix 3**.

Strategy

6.3 Given the ongoing financial pressure on public services and local government funding, the Authority continues to address the key issue of affordability without compromising the long-term stability of its debt portfolio. As short-term interest rates have been lower than long term rates, it has been more cost effective to use its internal cash resources in lieu of borrowing in the short term.

6.4 The liability benchmark analysis at **paragraph 5.8** indicates that the Authority may need to take out additional borrowing during 2024/25 because of the increased

capital programme. In addition, the Authority requires a borrowing strategy to mitigate against changing circumstances or when external borrowing to replace internal debt becomes cheaper.

6.5 It is important to understand that not all of the borrowing requirement needs to be closed with loans; an important aspect of using some cash in the current financial climate is its risk reduction effects:

- Using cash reduces security risk as investment balances are lower. Regulations emphasise the importance of minimising this risk and is discussed later in this report. This action minimises bail-in risk, where certain investors, such as the Authority (as it is classed as a local authority under legislation) will suffer the financial burden of a failing bank rather than the Government, should there be issues in the future.
- There is less exposure to variable interest rate changes; this exposure arises when a fixed term loan is taken out with corresponding variable rate investments. This is avoided when cash is used.
- The current interest rate environment still allows a portion of the capital programme to be funded at lower cost through the use of cash and this opportunity should continue to be maximised.

6.6 The Authority will monitor the benefits of internal borrowing on a regular basis as this strategy must be balanced against the possibility that long-term borrowing costs may increase in future years, leading to additional costs incurred in deferring borrowing. With the Bank of England Base Rate possibly increasing during 2023/24, the Authority will need to determine whether it borrows additional sums at long term fixed rates in 2023/24 or continues to use internal borrowing with a view to only borrow for longer periods when interest rates have fallen. To this end, the Authority will consult with the Treasury team at Staffordshire County Council.

6.7 The strategy proposed is one that still aims to balance the liquidity needs of day-to-day cash management with the low-risk approach that is offered by using cash. As cash balances may not be sufficient in the future, the Authority will need to consider what loans should be raised to provide the liquidity necessary to allow it to continue to pay its bills.

Sources of borrowing

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

- the Public Works Loans Board (PWLB)
- the UK Municipal Bonds Agency Plc and any other special purpose companies created to enable local authority bond issues
- Other UK public sector bodies
- UK public pension funds
- Approved banks or building societies authorised to operate in the UK
- Any institutions approved for investments.

Short-term loans

6.9 Short-term loans raised from money markets are under 12 months duration. These are low cost, and the Authority can respond flexibly to liquidity pressures by raising these when needed. The disadvantage of short-term loans is one of availability and it can be difficult to raise quickly from banks and building societies.

6.10 The local authority lending market has progressed considerably in recent years and funds are generally available in the short to medium term. However, future availability cannot be predicted as loans raised depend upon other local authorities still having cash balances and being prepared to lend it to the Authority.

Long-term loans

6.11 Long-term loans are those for a duration of more than 12 months. The Authority has previously raised most of its long-term borrowing from the PWLB, a statutory body that issues loans to local authorities. Government consent is not required hence the PWLB continues to be seen as the 'lender of first resort' because of the flexibility and ease of access. However, local authorities are required by law to have regard to the Prudential Code and only borrow within relevant legislation and its borrowing powers.

6.12 The exact type of loan to be raised by the Authority and its duration would have to be considered at the time; but with current interest rates and the maturity profile of the existing loan portfolio, loans towards the shorter end of the yield curve offer better value for money.

6.13 The optimum timing for borrowing cannot be foreseen and decisions often need to be taken at short notice. Because of this, it is proposed to delegate the decision to borrow up to £3m in long-term loans to the Director of Finance at the Authority and reported retrospectively to the Strategic Governance Board (Fire). In addition, the treasury management outturn and half-year reports will update the position later in the year.

6.14 The overall strategy of maximising the use of cash in lieu of borrowing is still considered a relatively low risk strategy, although it is impossible to eliminate all treasury risk. The consequences of using cash are the possibility of increased costs in the future if interest rates rise; this must be balanced with the extra cost now if loans are raised (the cost of carry).

Loan restructuring

6.15 Movements in interest rates over time may provide opportunities to restructure the loan portfolio in one of two ways:

- Replace existing loans with new loans at a lower rate (known as loan rescheduling).
- Repay loans early without replacing the loans. However, this would increase the use of cash which may not be possible if reserve levels are not adequate.

6.16 Currently loan restructuring would be very expensive and unattractive for the Authority. This is because gilt yields are below the average rate on the Authority's existing loan portfolio. This would lead to large penalties to compensate the PWLB or its successor body if loans were repaid early.

6.17 The loans position includes a £1m LOBO (Lender Option Borrower Option) loan held with Dexia Bank where the maturity date is uncertain. The bank has an option to amend (i.e., increase) the loan interest rate on pre-determined dates in 2023/24; if this option is exercised then the Authority as a matter of policy will repay the loan.

6.18 In recent years, some banks owning LOBO loans have been actively removing these non-core assets from their balance sheet and were willing to significantly reduce the repayment penalty. Dexia Bank are not currently offering such favourable repayment terms for their LOBO loans, although it is possible, they may do so in future years.

6.19 Aside from a potential restructure, it is judged unlikely in the current interest rate environment that LOBO loans options will be exercised. A repayment of the LOBO loan would further increase the "gap" funded from cash; alternatively, the Authority could take up an alternative loan, say with the Public Works Loan Board (PWLB), or its successor body. Although the Authority understands that the lender is still unlikely to exercise its option in the current interest rate environment, there does remain an element of refinancing risk.

6.20 Market conditions and regulations can change, and the outcome cannot be foreseen. It is therefore proposed to allow unlimited loan restructuring with the decision being delegated to the Director of Finance at the Authority and reported retrospectively to the Strategic Governance Board (Fire).

Policy on Borrowing in Advance of Need

6.21 As the borrowing strategy proposed for 2023/24 involves maximising the use of cash until borrowing is required, the policy is not to borrow in advance this year. This will be revisited annually as part of the overall borrowing strategy.

7. Annual Investment Strategy (AIS) 2023/24

7.1 It is the Authority's borrowing strategy that determines its investment strategy and with the Authority's policy to continue with the use of cash instead of borrowing, balances available for temporary investments are lower.

7.2 The Authority still may have significant level of funds to invest at different points of the year; this usually represents income received in advance of expenditure plus balances and reserves held. In the first 3 quarters of 2022/23, the Authority's investment balance averaged at around £18.4m.

MiFID II

7.3 Following the introduction of the second Markets in Financial Instruments Directive (MiFID II) regulations from January 2018, local authorities will automatically be treated as retail clients by financial services firms, unless they meet the criteria and 'opt up' to be professional clients. As a retail client, the Authority would receive enhanced protections, but this would also mean it may face increased costs and restricted access to certain products including money market funds, pooled funds, treasury bills and treasury advice.

7.4 The Authority meets the criteria set out under MiFID II and will continue to be treated as a professional client by regulated financial services firms in 2023/24.

Objectives

7.5 The CIPFA Code requires the local authorities to invest their funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield.

7.6 The Authority's objective when investing its cash is to strike an appropriate balance between risk and return, thereby minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Strategy

7.7 The main characteristics which should determine an investment strategy are:
- the credit risk of the counterparties invested with;
- the length of the investment; and
- the type of financial instrument that is used.

7.8 The Authority has taken a low-risk approach to investment and the AIS for 2023/24 will continue to do so. Short term unsecured bank investments have generally provided very low returns with additional risk from bail-in regulations. The Authority will continue to concentrate its short-term investments in more secure MMFs and government investments.

7.9 DLUHC Guidance on Local Government Investments specifies the types of financial instruments that local authorities can invest with, and the Authority has divided its approved treasury investments into Standard Investments and Non-Standard Investments.

Standard investments

7.10 The Authority considers Standard Investments to be those made with approved counterparties that do not require further approval from the Director of Finance at the Authority. These investments are for a period of less than a year and are those most frequently used by the Authority. Standard Investments can be invested with:
- UK Government – central government or local authority, parish council or community council
- short term MMFs
- bank and building society investments

i) Government

7.11 The Authority invests with central government by using its Debt Management Account Deposit Facility (DMADF) account. Funds held in the DMADF account are backed by the UK Government so they are very secure; however returns tend to be lower than those received elsewhere.

7.12 The Authority invests in term deposits with local authorities which can provide a higher return depending on the availability of, or the need for cash in the local authority lending market. Like central government investments, local government investments are not subject to bail in risk.

7.13 Although investments in the local authority lending market have a low risk of insolvency, they are not completely without risk. The financial risks of a few local

authorities have been documented in the press; the Authority will continue to monitor such developments and seek information from the County Council's Treasury team where necessary.

ii) Money Market Funds (MMFs)

7.14 Money Market Funds have high credit quality and are pooled investment vehicles consisting of money market deposits and similar instruments. Short-term MMFs that offer same day liquidity can be used as an alternative to instant access bank accounts. The Authority has used same day notice MMFs for some time as they have tended to provide greater security and a higher yield than bank accounts.

7.15 EU regulation introduced in January 2019 have meant most same day notice MMFs have converted from a Constant Net Asset Value (CNAV) to a Low Volatility Net Asset Value (LVNAV) structure. The assets of LVNAV MMFs are marked to market, meaning the dealing NAV (unit price) may fluctuate in extreme circumstances. However, LVNAV MMFs are allowed to maintain a constant dealing NAV provided they meet strict criteria and minimum liquidity requirements. Public debt CNAV MMFs are still available where 99.5% of assets are invested in government debt instruments.

7.16 The Authority will continue to use same day notice MMFs that meet the criteria listed below. These are considered to have sufficient high credit quality to be included on the Authority's Approved Lending List:

- Diversified – MMFs invest across many different investments meaning they achieve more diversification than the Authority could achieve on its own account.
- Short liquidity – cash can be accessed daily.
- Ring-fenced assets – the investments are owned by investors and not the fund management company.
- Custodian – the investments are managed by an independent bank known as a custodian, who operates at arms-length from the fund management company.

7.17 Like all treasury instruments, MMFs do carry an element of risk:

- The failure of one or more of an MMF's investments could lead to a run on MMFs, especially during a financial crisis; however, the new MMF regulations do limit this risk to some extent.
- If the UK enters a recession, there is a possibility that the Bank Rate could be set at or below zero. This could mean interest earned from MMFs could become negative after the deduction of their fee. In this instance, the Authority could move funds to an alternative category of investment.

iii) Bank and building society accounts

7.18 The Authority can make investments with banks and building societies that meet the minimum threshold **(see paragraph 7.32**) by using call accounts or term deposits, but these investments will run the risk of credit loss via a bail in, if the regulator determines that the bank is failing or likely to fail. Due to this issue and a general cautious approach to bank and building society investments, currently the only bank or building society in use by the Authority is its banking provider, Lloyds Bank (see section below). Use of any further banks or building societies is

delegated to the Director of Finance with the outcome reported in the regular treasury management reports to the Strategic Governance Board (Fire).

iv) Operational bank account

7.19 The Authority's banking provider is Lloyds Bank. Cash is retained with Lloyds Bank each night earning interest at below market rate; the amount retained will be set in line with the diversification policy set out at **paragraph 7.23**.

7.20 In respect of the Bank ring-fencing legislation Lloyds Bank has a relatively small investment banking operation meaning that 97% of the bank's assets remain within the 'retail bank' ring-fence. The Authority's business with Lloyds Bank will take place within the 'retail bank' ring-fence (Lloyds Bank Plc) and not form part of their investment banking operations (Lloyds Bank Corporate Markets).

7.21 Should the Lloyds credit rating fall below the Authority's minimum threshold, then minimum balances will be retained for operational efficiency. The Authority will continue to seek support from the County Council's Treasury team on bank credit risk and any changes will be determined by the Director of Finance at the Authority.

Standard Investment diversification

7.22 Risks to investments, such as those discussed for MMFs in **paragraph 7.17**, point towards the fundamental need for diversification across counterparties and investment categories, where possible. Diversification can help to protect the security of investments by limiting the Authority's loss in the event of a counterparty default. Diversification will not protect the Authority from a systemic failure of the banking sector even if the risk of this has diminished following the bail-in banking regulations.

7.23 Diversification can be achieved by setting a maximum amount to be invested with each counterparty, to limit risk and to ensure a spread of investments.

- No limits are proposed for government investments as these may be utilised for all the Authority's investments in certain circumstances.
- For MMF's a standard limit of £2.5m per MMF is in place to meet liquidity requirements.

7.24 For Lloyds Bank a limit is set of the lower of 10% of total balances or £1.0m (subject to a minimum upper level of £500k); this amount will minimise processing costs and provide additional liquidity for the Authority. The Treasury team at Staffordshire County Council will review and reset this limit once a month.

7.25 Where cash balances are low then this may mean that all investments are placed with the MMFs and Lloyds Bank. However, balances will be within the limits stated above.

7.26 It is proposed that both the application and amendment of this policy are delegated to the Director of Finance at the Authority with the outcome reported in the regular treasury management reports to the Strategic Governance Board (Fire).

Non-Standard Investments

7.27 The Authority considers Non-Standard Investments to be all other types of approved investment counterparties that are not included as part of Standard Investments i.e., those investments that are used less frequently and may require further approval from the Director of Finance at the Authority.

7.28 Collective Investment Schemes are Non-Standard Investments that range from enhanced MMF's to property and equity funds. These all have varying risk and return profiles. The Authority approved a decision to use this category of investment in 2016/17 by committing to the Royal London Fund, a AAA rated enhanced Cash Plus MMF with a 3-day liquidity notice period.

7.29 The Royal London Cash Plus Fund allows the Authority to earn an increased yield in a low interest rate environment, and where the Authority has high cash balances. Security is maintained as it invests in highly sought after covered (secured) bonds, which are exempt from bail-in. These enhanced duration MMF's have the same characteristics as same day liquidity MMF's but typically have a 3–5-day notice period. They also have a recommended investment duration of at least 6 months, due to their longer investment horizon.

7.30 The financial limit for the Royal London Cash Plus MMF was recently increased to £2.5m to be in line with the same day liquidity MMF's. It also allows for additional flexibility at times when there are surplus funds available to invest.

Credit Management Strategy for 2023/24

7.31 Investments made by the Authority should be of 'high credit quality'. Although this can be difficult to define, credit ratings can be used as published by external credit rating agencies (the three main agencies are Moody's, Standard & Poors and Fitch). Credit ratings can be obtained from the County Council's Treasury team, where available.

7.32 For 2023/24, the minimum credit-rating thresholds are set at a long-term rating of 'A-' where applicable. Counterparties that are rated below this level are excluded. However, credit ratings are not the only aspect of how creditworthiness is assessed.

7.33 The following elements are also factored in when evaluating creditworthiness:
- Potential government support.
- Credit Default Swap prices (CDS) (i.e., the cost of insuring against counterparty default).
- Share prices and bond yields.
- Balance sheet structure.
- Macro-economic factors.
- A subjective overlay, i.e., a judgement being made about whether the counterparty should be recommended or not.

7.34 The Authority remains responsible for all its investment decisions. The County Council's Treasury team will continue to have treasury management meetings with the Authority on a quarterly basis where a review of the Lending List will take place.

7.35 Under stressed market conditions, additional meetings with County Council's Treasury team may take place at very short notice. A decision may be made to

adjust the Authority's investment risk profile; the end result may involve moving investments to lower risk counterparties or instruments.

Non-treasury investments

7.36 Under the CIPFA Codes and DLUHC Guidance, local authorities may invest in other financial assets and property for financial return, and also make loans and investments for service purposes.

7.37 Such non-treasury investments should be assessed as part of a separate investment strategy. They should set out the specific policies and arrangements for non-treasury investments and ensure the same robust procedures for the consideration of risk and return are applied to these, as for treasury investments.

7.38 In the absence of any legal powers to do so the Authority does not currently hold any non-treasury investments and, therefore, no additional commercial strategy is required.

Risk

7.39 Although guidance sets out security and liquidity as being the main treasury risks, they are not the only investment risks faced by the Authority. **Appendix 5** sets out a high-level risk assessment for six of the key risks which are summarised in the following table:

Risk	Assessment
Security	Low
Liquidity	Low to Medium
Interest rate	Low to Medium
Market	Low
Refinancing	Low to Medium
Regulatory and legal	Low

7.40 Within the Authority's AIS there is a balance to be struck between the security of investments and liquidity; the safest investments are not necessarily the most liquid and so a pragmatic approach must be taken.

7.41 The proposed AIS has been evaluated against these risks and the judgement is that the most significant risks have been reduced as far as possible. This is not to say that all risk has been eliminated which is not possible in treasury terms.

8. Review of strategy

8.1 The Authority will prepare a revised strategy when there are significant changes to the following factors:

- the economic environment.
- the financial risk environment.
- the budgetary position.
- the regulatory environment.

8.2 The responsibility for assessing these circumstances and proposing changes to the strategy is allocated to the Director of Finance at the Authority.

9. Policy on the use of external service providers

9.1 Currently the Authority has no contracted external treasury adviser and this is considered appropriate with the simple arrangements set out.

9.2 The treasury service for the Authority is provided by the County Council's Treasury team, who use Link as their external treasury management adviser. The County Council's contract with Link started in 2021 following a tender process. The Authority could use Link to provide consultancy advice on an ad-hoc basis should this be considered necessary.

10. Investment management training

10.1 Treasury management is a specialised area requiring high quality and well-trained staff with an up-to-date knowledge of current issues, legislation and treasury risk management techniques.

10.2 The County Council's Treasury team who provide the treasury service, are experienced and attend regular CIPFA and treasury consultant training seminars throughout the year as well as speaking to brokers and fund managers to further understand the market.

10.3 Training needs for Authority's staff who attend quarterly meetings with the County Council's Treasury team are assessed on an ongoing basis by local managers.

11. Service Level Agreement

11.1 Staffordshire County Council provides treasury management and banking services as part of a Service Level Agreement (SLA) with the Authority. The SLA does not constitute a contract but is a document of good practice; it outlines the range of services offered by the County Council and the degree of co-operation required from the Authority in order for the County Council to fulfil its role.

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Background Documents:

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2017)
2. The Prudential Code for Capital Finance in Local Authorities (CIPFA) (2017)
3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)
5. Statutory Guidance on Minimum Revenue Provision – Issued under section 21 (1A) of the Local Government Act 2003 (2018)

Appendix 1

Financial Implications

All financial implications are covered in the body of this report.

Legal Implications

Approval of Prudential Indicators and an Annual Investment Strategy are necessary to meet the requirements of the Local Government Act 2003.

Equality & Diversity Implications

There are no equality and diversity implications.

Risk Implications

Risk is inherent in treasury management operations and is dealt with throughout this report. **Appendices 3 and 5** show a risk assessment for borrowing and investment activities.

Consultation and Engagement Undertaken

Staffordshire County Council's Treasury and Pension Fund Team have provided the economic background and forecasts for this report.

Procurement and Social Value Implications

The daily treasury management function is carried out on behalf of the Authority by Staffordshire County Council, under a Service Level Agreement (SLA).

Protective Security Considerations

Data protection and protective security policies are implemented within Staffordshire County Council and all departments within the County Council. Treasury management activities are undertaken in line with these policies and the agreed SLA.

Appendix 2

Police Fire and Crime Panel
13 February 2023

Treasury Management Indicators

Indicator	Estimate 2023/24	Estimate 2024/25	Estimate 2025/26
1. External Debt	**£m**	**£m**	**£m**
Authorised Limit	30.4	31.9	32.3
Authorised Limit for other liabilities	66.4	63.7	60.8
TOTAL	**96.8**	**95.6**	**93.1**
Operational Boundary	17.7	18.7	19.0
Operational Boundary for other liabilities	66.4	63.7	60.8
TOTAL	**84.1**	**82.4**	**79.8**
External Loans	**23.5**	**20.3**	**19.0**
The Authorised Limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the Capital Programme. *The Operational Boundary represents the Director's estimate of the day-to-day limit for Treasury Management activity based on the most likely i.e., prudent but not worst-case scenario* *Other liabilities relate to PFI schemes on the balance sheet.*			
2. Interest Rate Exposures	£m	£m	£m
a. Upper Limit (Fixed)	28.5	28.9	29.3
b. Upper Limit (Variable)	(25)	(25)	(25)
Upper limits of fixed and variable borrowing and investments are required to be set. This limits the Authority's exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for treasury management activities. Negative figures are shown in brackets; these relate to investments at a variable rate which are not offset by variable borrowings.			
3. Maturity Structure of Borrowing	Upper Limit	Lower Limit	
Under 12 months	10%	0%	0.60%
12 months and with 24 months	10%	0%	1.49%
24 months and within 5 years	30%	0%	5.65%
5 years and with 10 years	50%	0%	1.49%
10 years and above	100%	25%	90.77%
This indicator identifies the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. *The Authority currently applies the prudent practice of ensuring that no more than 10% of its total gross fixed rate loans mature in any one financial year.*			
4. Total principal sums invested for periods longer than a year	£	£	£
Any investments made for longer than a year will be in accordance with the limits on non-specified investments.	nil	nil	nil

Appendix 3

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Risk assessment – Borrowing strategy

Risk heading	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Security	A third party fails to meet its contractual obligations (i.e., counterparty risk).	Unlikely that there is a failure between the agreement to borrow and sums being received a few days later. However, if we borrow in advance we must invest until this is needed, and this increases exposure to investment risk.	Usually borrow from the Government (PWLB or its successor body) with funds received within 3 working days from the date of agreement to borrow.	**LOW**	Use of cash to fund borrowing reduces this risk further i.e., less money is held with banks and third parties as a result.
Liquidity	Cash is not readily available when it is needed.	Only borrow for capital – usually borrow from Government (PWLB or its successor body) with a maximum limit of £3m for long-term borrowing set in 2023/24.	Prudential rules on borrowing and consideration of whether Government is secure.	**LOW**	Use of cash to fund borrowing increases this risk as liquidity is reduced when borrowing is avoided. However, the Authority is able to borrow money temporarily using the money markets should it need to, so the overall risk remains low.
Interest rate	Unexpected reduction in short term Interest rates.	Depends on the mix between fixed rate borrowing and variable rate borrowing. Higher exposure to variable rate borrowing helps the budget.	The control is set out below.	**LOW to MEDIUM**	Pursuing a strategy of using cash reduces the overall net exposure to sudden interest rate falls.
Interest rate	Unexpected increase in short term interest rates.	Mix of variable and fixed rates – Lower exposure to variable rate borrowing helps the budget.	Limit variable rate borrowing to a relatively small proportion (e.g., 20%).	**LOW to MEDIUM**	20% limit provides a suitable risk control.

Risk heading	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Market	The market value of loans changes substantially (i.e., how much is the borrowing strategy exposed to long term interest rate change).	How much risk is built into the maturity profile of the loans structure. LOBO's (5% of all loans) are the only 'market' instrument in borrowing terms currently used.	This is inversely linked to refinancing risk below.	**MEDIUM**	Use of cash will shorten the duration of the loan portfolio and reduces this risk. Without the use of cash this risk assessment would probably be high.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	Need to avoid a high level of borrowing over a short period where you are exposed to high interest rates.	The Authority has a policy of limiting maturing loans to 10% of the loans portfolio.	**MEDIUM**	Using cash to fund borrowing potentially increases the refinancing risk. Without the use of cash this risk assessment would probably be low.
Regulatory and legal risk	Rules governing local government borrowing are changed or amended without notice, which has happened in the recent past.	Local government is heavily reliant upon PWLB (or its successor body); cost and ability to reschedule / manage loans are determined by the Government The Government could close the PWLB (or its successor body) and force local authorities to use market loans for all new borrowing.	Market loans will be evaluated and taken if these are good overall value and dilute reliance on the PWLB (or its successor body). The UK Municipal Bonds Agency may provide an alternative in the future. .	**MEDIUM**	One LOBO loan is held. Use of cash means that PWLB (or its successor body) loans are not being taken. If the PWLB (or its successor body) was closed to new business, then market loans would be the only option.

Appendix 4

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Lending List – January 2023	
	Time Limit
Regulation Investments	
UK Government DMADF account	6 months
UK Local Authority	12 months
Banks	
Lloyds Group (£1.0m max)	overnight
MMF	
Federated (£2.5m max)	call only
Morgan Stanley (£2.5m max)	call only
Aberdeen Standard (£2.5m max)	call only
Enhanced MMF	
Royal London Cash Plus (£2.5m max)	3-day notice

Appendix 5

Police Fire and Crime Panel
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Risk assessment - Investments

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Security	A third party fails to meet its contractual obligations (i.e., counterparty risk).	Crucial that money invested is returned (principal and interest).	Relies on credit management policy including credit risk, diversification, duration and amount of investment, and an ongoing review of the credit environment. Prudential limit on investment over 1 year.	**LOW**	Use of the counterparties identified within the AIS reduces this risk to a low level. The borrowing strategy identified will reduce cash balances and the resulting security risk. With the exception of regulation investments, counterparties have a financial limit to ensure funds are spread amongst them. Overall, this remains a low-risk strategy.
Liquidity	Cash is not readily available when it is needed.	Need to plan investment to match cash requirements.	Managed through detailed cash flow forecast and investment in highly liquid funds – can also borrow temporarily (Local Authorities are a good credit risk if lent money).	**LOW**	Same day access accounts are currently held with: • Federated MMF • Morgan Stanley MMF • Aberdeen Standard MMF • Lloyds Banking Group (as banker) Cash flow plans are completed annually and regularly updated. Overall, the risk is low.

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Interest rate	Unexpected reduction in Interest rate.	Reduces the return on investment and reduces the level of reserves.	Can reduce risk by; A) netting off investment against borrowing to reduce net exposure B) investing for longer periods.	**LOW**	Investments will be short term; this does not protect against an interest rate reduction. The current interest rate environment has interest rates at historically low levels.
Interest rate	Unexpected increase in interest rates.	In order to take advantage of the unexpected return, would need to keep investment short term and increase the amount of cash invested (e.g., by not using cash in lieu of borrowing).	Controlled through the overall strategy.	**MEDIUM**	Current policy allows upturns to be taken advantage of as investments are not fixed for long periods. Using cash to fund borrowing (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.
Market	Unexpected need to liquidate market instrument quickly and accept ‘price on the day’.	Only relevant if invest in market instruments (e.g., CD’s, Gilts).	Limit investment in market instruments or alternatively have capacity to borrow to avoid need to liquidate. Controlled by limits on Non-Standard Investments.	**LOW**	Market instruments are not in use by the Authority.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	Reflected in the term (duration) of investments. If everything invested shorter term, there is a higher refinancing risk.	Proportion of investments maturing in the short term.	**LOW/ MEDIUM**	The current policy is to invest in the relatively short term. There is an increased risk with this strategy due to frequent ‘refinancing’ but this is expected to be advantageous in a rising interest rate environment. Using cash to fund borrowing (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.

Appendix 5 (continued)

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Regulatory and legal risk	Rules governing local government investment powers are changed or amended without notice.	Investment powers are granted through statute and guidance.	None.	**LOW**	The current policy of using cash in lieu of borrowing reduces the Authority's dependency on interest receipts. The AIS is low risk and uses liquid and conservative investment instruments.