Kirklees COUNCIL

Name and date of meeting: **Corporate Governance and Audit Committee**
21 January 2022

Cabinet
1 February 2022

Council
16 February 2022

Title of report: Treasury Management Strategy and Investment Strategy 2022/23

Purpose of report

Under the CIPFA Code of Practice on Treasury Management (2017) and accompanying Prudential Code 2017 the Council must present a Treasury Management Strategy at the start of each financial year. Alongside the Treasury Management Strategy, the Annual Investment Strategy must also be approved by Council.

Key Decision - Is it likely to result in spending or saving £250k or more, or to have a significant effect on two or more electoral wards?	**Yes (for Cabinet)**
Key Decision - Is it in the [Council's Forward Plan (key decisions and private reports?)]	**Key Decision: Yes** **Private Report/Private Appendix: N/A**
The Decision - Is it eligible for call in by Scrutiny?	**No**
Date signed off by Strategic Director and name **Is it also signed off by Service Director** **Is it also signed off by the Service Director Legal, Governance and Commissioning**	**N/A** **Eamonn Croston – 13 January 2022** **Julie Muscroft – 13 January 2022**
Cabinet member [portfolio]	**Corporate** **Paul Davies**

Electoral wards affected: **All**
Ward councillors consulted: **N/A**
Public or Private: **Public**
GDPR: This report contains no information that falls within the scope of General Data Protection Regulations.

1 Summary

1.1 The Council has adopted CIPFA's Code of Practice on Treasury Management (2017 Edition), and accompanying Prudential Code 2017, and is thereby required to approve a treasury management strategy before the start of each financial year. In addition, the Ministry for Housing, Communities and Local Government (MHCLG) issued guidance on local authority investments in February 2018, which requires the Council to approve an annual Investment Strategy before the start of each financial year.

1.2 This report meets the requirements of the aforementioned CIPFA Codes and MHCLG Guidance.

1.3 Cabinet is responsible for the implementation and monitoring of the treasury management policies. The Corporate Governance and Audit Committee undertake a scrutiny role with regard to treasury management. The last training for members of this Committee was provided in November 2021 by the Council's treasury management advisors/consultants, Arlingclose.

1.4 This report will:

(i) outline the outlook for interest rates and credit risk, and in light of this, recommend an investment strategy (Treasury Management Investments) for the Council to follow in 2022/23;

(ii) outline the current and estimated future levels of Council borrowing (internal and external) and recommend a borrowing strategy for 2022/23;

(iii) review the methodologies adopted for providing for the repayment of debt and recommend a policy for calculating the Minimum Revenue Provision (MRP);

(iv) review other treasury management matters including the policy on the use of financial derivatives, prudential indicators, the use of consultants, and the policy on charging interest to the Housing Revenue Account;

(v) recommend an annual Investment Strategy (Non-Treasury Investments) for the Council in 2022/23 in line with MHCLG (2017) guidance.

2 Information required to take a decision

The following paragraphs 2.1 to 2.5 have been provided by our Treasury Management external advisors, Arlingclose:

Economic Background

2.1 The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Council's treasury management strategy for 2022/23.

2.2 The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates and unanimously to maintain the asset purchase programme. Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously but notes that Omicron could weaken the demand for labour.

2.3 UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%. In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

2.4 Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

Interest Rate Forecast

2.5 The Authority’s treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates. Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose’s central case are to the upside while over the medium-term the risks become more balanced. Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

Borrowing and Investment – General Strategy for 2022/23

2.6 The Capital Financing Requirement (CFR) represents the Council's underlying need to finance capital expenditure by borrowing or other long-term liability arrangements. A Council can choose to borrow externally to fund its CFR. If it does this, it is likely that it would be investing externally an amount equivalent to its total reserves, balances and net creditors. Alternatively, a Council can choose not to invest externally but instead use these balances to effectively "borrow internally" and minimise external borrowing. In between these two extremes, a Council may have a mixture of external and internal investments / external and internal borrowing.

Table 1 below sets out the forecast CFR position for the Council as at 31 March 2022 and forecast CFR and borrowing requirements over the following 5 years. CIPFA's Prudential Code recommends that the Council's total debt should be lower than its highest forecast CFR. Table 1 shows that the Authority expects to comply with this recommendation.

<u>Table 1: Balance Sheet Forecast</u>

	2021/22 £m	**2022/23 £m**	**2023/24 £m**	**2024/25 £m**	**2025/26 £m**	**2026/27 £m**
General Fund CFR						
- Non PFI	539.9	610.7	689.8	770.9	826.5	820.7
- PFI	39.4	35.5	33.6	31.3	28.8	26.4
HRA CFR - Non PFI	170.5	177.3	190.3	205.6	209.2	213.1
- PFI	45.2	42.7	40.6	38.0	35.3	32.4
Total CFR	**795.0**	**866.2**	**954.3**	**1,045.8**	**1,099.8**	**1,092.6**
Less: PFI debt liabilities*	84.6	78.2	74.2	69.3	64.1	58.8
Borrowing CFR	**710.4**	**788.0**	**880.1**	**976.5**	**1,035.7**	**1,033.8**
Financed by:						
Deferred Liabilities *	3.7	3.6	3.6	3.5	3.5	3.5
Internal Borrowing	222.9	197.8	178.3	173.7	170.6	169.2
External Borrowing	483.8	586.6	698.2	799.3	861.6	861.1
Total	**710.4**	**788.0**	**880.1**	**976.5**	**1,035.7**	**1,033.8**
Treasury investments	30.0	30.0	30.0	30.0	30.0	30.0

** £84.6m other debt liabilities, incl leases and PFI (£6.4m falling due in 2022/23)*

2.7 Prior to 2009/10 the Council's policy had been to borrow up to its CFR, investing externally the majority of its balances. With the onset of instabilities in the financial markets and the economic downturn, the policy changed to one of ensuring the security of the Council's balances. This coincided with significant falls in investment returns, making the budgetary benefit of maximising external borrowing more marginal. Thus, the Council has chosen to steadily reduce monies invested externally and instead has used internal balances to offset new borrowing requirements.

2.8 There is a marked increase in the CFR compared with previous years due to increases in the capital programme, in particular the proposed Cultural Heart regeneration programme as part of the Huddersfield Blueprint, which has added a further £166m of borrowing requirement (on top of the £44m in the existing plan) compared to last year's 5 year capital plan. The external borrowing necessary to fund the projected rise in CFR will be a mixture of long and short-term borrowing.

2.9 Table 1 above shows the level of internal borrowing forecast over the next 5 years. As Council usable reserves are forecast to reduce over the 5 years in line with planned commitments, the internal borrowing will also reduce resulting in further external borrowing that will need to be required to fund the CFR.

2.10 The relative mix of future internal and external borrowing will be considered in conjunction with advice from the Council's external treasury management advisor, noting that provision has been made in the updated Council budget plan revenue resource assumptions to accommodate a continued future mix of internal and external borrowing.

2.11 The Service Director - Finance, supports the approach that the borrowing and investment strategy for 2022/23 continues to place emphasis on the security of the Council's balances. The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Although credit conditions generally on banks and building societies have tended to be relatively benign despite the impact of the pandemic, the global economy is fragile. Looking forward credit will remain a risk suggesting the Council needs to take a cautious approach to bank deposits in 2022/23.

2.12 It is recommended that balances should continue to be invested to a level which is perceived to be reasonably secure and which is needed to meet the day-to-day cash flow requirements of the Council (around £20 million). The remainder of the balances will be effectively invested internally, that is used to offset borrowing requirements.

2.13 In order to increase investment returns, the Council has invested £10 million in the Local Authorities Pooled Investment Fund (LAPF) as per the approved Council 2019/20 Treasury Management Strategy. The Council will not make any further investment in the property fund or similar investments.

2.14 Average current Council cashflow balances remain consistent at about £30 million (including the LAPF), with the investment in the LAPF leaving about £20 million for day-to-day cashflow requirement as noted above.

Borrowing Strategy

2.15 The Council is forecast to hold around £554.4 million of external borrowing and other long-term liabilities as at 31 March 2022. This is analysed at Table 3 below:

Table 3 – year end estimate – 31 March 2022

	£m	%
PWLB loans (fixed rate)	301.3	54
LOBOs	60.0	11
Loan stock (fixed rate)	7.0	1
Other long term loans (fixed rate)	43.4	8
Temporary borrowing	58.1	11
Total external borrowing	**469.8**	
Other Long Term Liabilities (mainly PFI)	84.6	15
Total external debt liabilities	**554.4**	

2.16 The approved sources of borrowing are:

- HM Treasury's PWLB lending facility
- Any bank or building society authorised to operate in the UK
- Other local authorities
- Capital market bond investors
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues
- UK public and private sector pension funds
- Salix Finance Limited

2.17 The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, in order to lower interest payments. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield. The Council intends to avoid this activity in order to retain its access to PWLB loans.

2.18 The Council also has LOBO (Lender's Option, Borrower's Option) loans, where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The Council will take the option to repay at no cost, if it has the opportunity to do so. The Council's current limit on LOBO borrowing is set at 11% of long term debt.

2.19 The Council's approach over a number of years has been to borrow short term and take advantage of historically low interest rates, however the recent shift in approach is to increase long term borrowing gradually to ensure a more balanced risk approach. Over the past year, the Council has taken on £40m long term PWLB borrowing. This emerging strategy is intended to provide more certainty and hedge against future interest rate volatility if the Council otherwise continued to rely heavily on short term borrowing over the medium term.

2.20 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 Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term. This will be subject to ongoing review, in consultation with Arlingclose, as to when it will be appropriate to borrow longer term with the PWLB or via an alternative source

2.21 One example of an alternative source of funding is the Local Capital Finance Company established in 2014 by the Local Government Association. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantees over the very small risk that other local authority borrowers default on their loans; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

2.22 Alternatively, the Council may arrange forward starting loans, with alternative lenders as these are not available through the PWLB, 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.

2.23 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. At the present time, the Council is not in a position to undertake early repayments due to the current prohibitive early repayment rates.

2.24 Salix Finance Limited provides interest free Government funding to the public sector to improve their energy efficiency, reduce carbon emissions and lower energy bills. The Council to date has taken the opportunity to secure £6.8 million interest free loans to part fund the £12.0 million approved street lighting replacement scheme in the Council's approved capital plan.

2.25 Borrowing policy and performance are monitored throughout the year and are reported to Members via a Half Yearly Report and also an Outturn Report in line with approved guidance.

Treasury Investment Strategy

2.26 Investment guidance issued by MHCLG requires that an investment strategy, outlining the Council's policies for managing investments in terms of risk, liquidity and yield, should be approved by full Council or equivalent level, before the start of the financial year. This strategy can then only be varied during the year by full Council.

2.27 The Council will not place direct investments in companies as defined by the Carbon Underground 200 on 1 February each year.

2.28 A new regulatory update came into force from 3rd January 2018; the second Markets in Financial Instruments Directive (MiFID II), which meant that the Council had to formally apply to renew its status as a 'professional client' (also referred to as the 'opt up' option), but subject to certain criteria being met.

2.29 Following full Council approval on 13th December 2017, officers have now successfully 'opted up' the Council to professional client status, effective from 3rd January 2018. Given the size and range of the Council's treasury management activities, the Service Director Finance believes this to continue to be the most appropriate status.

2.30 The Council's investment criteria are detailed in Appendix A. The Council will continue to maintain a relatively low risk strategy giving priority to security and liquidity, and as such invest an average of around £20 million externally in relatively short-term, liquid investments through the money markets, for the purpose of managing day-to-day cash flow requirements. Any remaining balances, net of investment in the local authority property fund, will be used internally, offsetting borrowing requirements.

2.31 The Council uses credit ratings from the three main rating agencies - Fitch, Moody's and Standard & Poor's to assess the risk of investment defaults (Appendix B). The lowest credit rating of an organisation will be used to help determine credit quality. Long term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade.

2.32 Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria:

- No new investments will be made;
- Any existing investments that can be recalled at no cost will be recalled;
- 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 rating is on review for possible downgrade ("negative watch") so that it is likely to fall below the required criteria, then no further investments will be made in that organisation until the outcome is announced. This policy will not apply to negative outlooks.

2.33 Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, financial statements and rating agency reports. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the approved criteria.

2.34 Annual cash flow forecasts are prepared which are continuously updated. Investment policy and performance will be monitored continuously and will be reported to Members during the year and as part of the annual report on Treasury Management.

Statement of Policy on the Minimum Revenue Provision (MRP)

2.35 MRP is the statutory requirement for local authorities to set aside some of their revenue resources as provision for reducing the underlying need to borrow (Capital Financing Requirement – CFR), ie the borrowing taken out in order to finance capital expenditure.

2.36 Prior to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2008, which came into force on 31 March 2008, the set aside was specified as a percentage of a Council's CFR (2% for HRA debt, 4% for General Fund). The current Regulations are less prescriptive with a requirement to ensure the amount set aside is deemed to be **prudent**, although there is accompanying current DLUHC guidance which sets out possible methods a Council might wish to follow.

2.37 Current MHCLG guidance recommends that Council's prepare a statement of policy on making MRP in respect of the forthcoming year, with approval by full Council before the start of the financial year. If these proposals subsequently need to be varied, a revised statement should be put to full Council. Appendix C details the Council's policy for the provision of MRP.

2.38 Appendix C details a change in accounting policy for the calculation of MRP to be implemented from 1 April 2022, which now stipulates that the Council will only charge MRP once an asset is operational (previously MRP was chargeable based on the date of the associated borrowing). This ensures that there is a clear link between the charge for MRP and the life of the asset created.

2.39 Existing budget plans approved the MRP unwind in later years be brought forward and increased to the maximum allowable level of £13.7m in 2022/23, and £13.6m in 2023/24 at which point the unwind will be fully utilised. Updated budget plans for 2022/23 and future years maintain this approach.

Policy on the Use of Financial Derivatives

2.40 Local authorities (including this Council) have in the past made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans). The Localism Act 2011 includes a general power of competence that appears to remove the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

2.41 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where it is confident it has the powers to enter into such transactions. They will only be used for the prudent management of its financial affairs and never for speculative purposes and where it can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to.

2.42 Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Non-Treasury Investments

2.43 The Council may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, loans to local businesses and landlords, or as equity investments and loans to the Council's subsidiaries. Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. They are however covered by the Council's Investment Strategy (see Appendix E).

Treasury Management Indicators

2.44 The Council is asked to approve certain treasury management indicators, the purpose of which is to contain the activity of the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decision impacting negatively on the Council's overall financial position. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs. The proposed indicators are set out in Appendix D.

Other Matters

2.45 After a long consultation, an updated CIPFA Prudential Code has been published in December 2021, with a soft launch of the Code to be adopted for strategies in 2022/23 and full implementation in 2023/24.

2.46 The new Code stipulates restrictions on borrowing primarily for financial return, including commercial property. The Council's current and proposed capital plans do not include any capital investment funded by borrowing primarily for commercial return, that may otherwise have restricted access to PWLB borrowing going forward. The new Code does not introduce restrictions on councils borrowing for purposes essential to their core aims, such as for housing and regeneration projects, or for treasury management purposes.

2.47 The CIPFA Code also requires the Council to note the following matters each year as part of the treasury management strategy:

(i) *Investment Consultants*

The Council's adviser is Arlingclose Limited. The services received include:

- Advice and guidance on relevant policies, strategies and reports;
- Advice on investment and debt management;
- Notification of credit ratings and other information on credit quality;
- Reports on treasury performance;
- Forecasts of interest rates and economic activity; and
- Training courses.

The quality of the service is monitored on a continuous basis by the Council's treasury management team.

(ii) *Investment Training*

As part of the MiFID II requirements, the needs of the Council's treasury management staff for training in investment management are assessed on a continuous basis, and formally on a 6-monthly basis as part of the staff appraisal process. Additionally training requirements are assessed when the responsibilities of individual members of staff change. Staff attend training courses and seminars as appropriate.

(iii) *Investment of money borrowed in advance of need*

The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. However, as this would involve externally investing such sums until required and thus increasing exposures to both interest rate and principal risks, it is not believed appropriate to undertake such a policy at this time.

(iv) Policy on charging interest to the Housing Revenue Account (HRA)

Following the reform of housing finance, the Council is free to adopt its own policy on sharing interest costs and income between General Fund and the HRA. The CIPFA code recommends that authorities state their policy each year in the strategy report.

On 1 April 2012, the Council notionally split each of its existing long term loans into General Fund and HRA pools. New long term loans borrowed will be assigned in their entirety to one pool or the other. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. Interest will be applied to this balance using the Council's average investment rate.

3 Implications for the Council

3.1 Working with People
N/A

3.2 Working with Partners
N/A

3.3 Placed based working
N/A

3.4 Climate Change and Air Quality
N/A

3.5 Improving Outcomes for Children
N/A

3.6 Other (e.g. Legal/Financial or Human Resources)
The revenue implications of the strategies outlined have been reflected in the Council's annual budget report 2022-27.
The Council must have regard to the CIPFA Code of Practice on Treasury Management; the Prudential Code for Capital Finance in Local Authorities (the Prudential Code) 2017 and the DLUHC statutory guidance on Local Government Investments when performing its duties under Part 1 of the Local

Government Act 2003 and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended).
The council has the power to borrow under section 1 of the Local Government Act 2003 and the Council has powers to invest under section 12 of the Local Government Act 2003.

4 Consultees and their opinions

Arlingclose, the treasury management advisors to the Council, have provided the economic context commentary contained in this report.

5 Next steps

Treasury management performance will be monitored and reported to members during the year.

Following consideration at Corporate Governance & Audit Committee, this report will be presented to Cabinet on 1 February 2022 and then full Council on 16 February 2022 for approval.

6 Officer recommendations and reasons

That Corporate Governance & Audit Committee recommend the following for consideration by Cabinet and then approval by full Council:

(i) the treasury management strategy incorporating: the borrowing strategy outlined in paragraphs 2.15 to 2.25;
(ii) the investment strategy (treasury management investments) outlined in paragraphs 2.26 to 2.34 and Appendices A and B;
(iii) the policy for provision of repayment of debt (Minimum Revenue Provision) outlined in paragraphs 2.35 to 2.39 and at Appendix C;
(iv) the treasury management indicators in Appendix D and
(v) the Investment Strategy (Non-Treasury Investments) at Appendix E.

Reasons:

1. Section 151 of the Local Government Act 1972 requires the Council to make arrangements for the proper administration of its financial affairs .

2. The Council must have regard to the CIPFA Treasury Management Code of Practice on Treasury Management and the Prudential Code for Capital Finance in Local Authorities (the Prudential Code) 2017 and the DLUHC Statutory guidance on Local government Investments (2018) when performing its duties under Part 1 of the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended).

7 Cabinet Portfolio Holder recommendation

The report and recommendations be submitted to Cabinet on 1 February 2022 and Council on 16 February 2022.

8 **Contact officer**

James Anderson	Head of Accountancy	01484 221000
Rachel Firth	Finance Manager	01484 221000

9 **Background Papers and History of Decisions**

CIPFA's Code of Practice on Treasury Management in the Public Services; CIPFA's Prudential Code for Capital Finance in Local Authorities; Guidance on Local Government Investments (MHCLG 2018); The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (Amended 2008); Localism Act 2011. CIPFA Treasury Management Code and Prudential Code 2017.

10 **Service Director responsible**

Eamonn Croston 01484 221000

APPENDIX A

<u>Investment Policy for 2022/23</u>

Investment Limits:

- The Council is able to invest an unlimited amount with the UK Government for up to 6 months.
- The Council is able to invest up to £10 million and up to three months with UK banks and building societies with a “high to upper medium grade” credit rating.
- The Council is able to invest up to £10 million and up to two months with foreign banks with a “high to upper medium grade” credit rating.
- The Council is able to invest up to £10 million and up to three months with individual local authorities.
- The Council is able to invest up to £10 million in individual MMFs (instant access or up to 2 day notice). There will be an overall limit of £40 million for MMFs (non-government funds), plus up to £10 million invested in a fund backed by government securities.
- The Council is able to invest up to £10 million in Local Authority Pooled Investment Funds.

The maximum limits apply to any one counter-party and to a banking group rather than each individual bank within a group.

Note:

The limits set out above exclude any amounts held on the Council’s behalf by the Yorkshire Purchasing Organisation (YPO). The YPO (a consortium in which the Council has an interest) invest funds as part of their treasury management processes. For the avoidance of doubt, this element does not form part of the limits set above. For context, the Council’s proportion of YPO’s maximum investment with any given counterparty is approximately £155k.

The Council will not place direct investments in companies as defined by the Carbon Underground 200 on 1 February each year.

Liquidity management:

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

	Short-term Credit Ratings / Long-term Credit Ratings			Investment Limits per Counterparty		Counterparties falling into category as at Nov 2021
	Fitch	**Moody's**	**S & P**	**£m**	**Period (2)**	
UK Banks / Building Societies (Deposit accounts, fixed term deposits and REPOs)	F1	P-1	A-1	10	<3mth	HSBC Lloyds Group Santander UK Barclays Coventry BS Bank of Scotland Handelsbanken Nationwide BS
	AAA,AA+,AA, AA-,A+,A, A-	Aaa,Aa1,Aa2, Aa3,A1,A2,A3	AAA,AA+,AA, AA-,A+,A,A-			
Foreign Banks (Deposit accounts, fixed term deposits and REPOs)	F1	P-1	A-1	10	<2mth	Various
	AAA,AA+,AA, AA-,A+,A,A-	Aaa,Aa1,Aa2, Aa3,A1,A2,A3	AAA,AA+,AA, AA-,A+,A,A-			
MMF (1)	-	-	-	10	Instant access/ up to 2 day notice	Aberdeen Deutsche Bank Aviva Goldman Sachs
UK Government (Fixed term deposits)	-	-	-	Unlimited	<6mth	
UK local authorities (Fixed term deposits)	-	-	-	10	<3mth	
Local Authority Pooled Investment Funds	-	-	-	10	>6mth	

(1) Overall limit for investments in MMFs of £50 million – the assets the funds invest in are securities and structures secured on government securities
(2) The investment period begins from the commitment to invest, rather than the date on which funds are paid over.

Credit ratings

<table>
<tr><th colspan="2">Moody's</th><th colspan="2">S&P</th><th colspan="2">Fitch</th><th></th></tr>
<tr><th>Long-term</th><th>Short-term</th><th>Long-term</th><th>Short-term</th><th>Long-term</th><th>Short-term</th><th></th></tr>
<tr><td>Aaa</td><td rowspan="6">P-1</td><td>AAA</td><td rowspan="4">A-1+</td><td>AAA</td><td rowspan="4">F1+</td><td>Prime</td></tr>
<tr><td>Aa1</td><td>AA+</td><td>AA+</td><td rowspan="3">High grade</td></tr>
<tr><td>Aa2</td><td>AA</td><td>AA</td></tr>
<tr><td>Aa3</td><td>AA-</td><td>AA-</td></tr>
<tr><td>A1</td><td>A+</td><td rowspan="2">A-1</td><td>A+</td><td rowspan="2">F1</td><td rowspan="3">Upper medium grade</td></tr>
<tr><td>A2</td><td>A</td><td>A</td></tr>
<tr><td>A3</td><td rowspan="2">P-2</td><td>A-</td><td rowspan="2">A-2</td><td>A-</td><td rowspan="2">F2</td></tr>
<tr><td>Baa1</td><td>BBB+</td><td>BBB+</td><td rowspan="3">Lower medium grade</td></tr>
<tr><td>Baa2</td><td rowspan="2">P-3</td><td>BBB</td><td rowspan="2">A-3</td><td>BBB</td><td rowspan="2">F3</td></tr>
<tr><td>Baa3</td><td>BBB-</td><td>BBB-</td></tr>
<tr><td>Ba1</td><td rowspan="14">Not prime</td><td>BB+</td><td rowspan="6">B</td><td>BB+</td><td rowspan="6">B</td><td rowspan="3">Non-investment grade speculative</td></tr>
<tr><td>Ba2</td><td>BB</td><td>BB</td></tr>
<tr><td>Ba3</td><td>BB-</td><td>BB-</td></tr>
<tr><td>B1</td><td>B+</td><td>B+</td><td rowspan="3">Highly speculative</td></tr>
<tr><td>B2</td><td>B</td><td>B</td></tr>
<tr><td>B3</td><td>B-</td><td>B-</td></tr>
<tr><td>Caa1</td><td>CCC+</td><td rowspan="5">C</td><td rowspan="5">CCC</td><td rowspan="5">C</td><td>Substantial risks</td></tr>
<tr><td>Caa2</td><td>CCC</td><td>Extremely speculative</td></tr>
<tr><td>Caa3</td><td>CCC-</td><td rowspan="3">In default with little prospect for recovery</td></tr>
<tr><td rowspan="2">Ca</td><td>CC</td></tr>
<tr><td>C</td></tr>
<tr><td>C</td><td rowspan="3">D</td><td rowspan="3">/</td><td>DDD</td><td rowspan="3">/</td><td rowspan="3">In default</td></tr>
<tr><td>/</td><td>DD</td></tr>
<tr><td>/</td><td></td></tr>
</table>

APPENDIX C

CURRENT MINIMUM REVENUE PROVISION POLICY

1. Background

1.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2008 requires authorities to <u>make an amount of MRP which the authority considers "prudent"</u>.

1.2 The regulation does not itself define "prudent provision". However, guidance issued alongside the regulations makes recommendations on the interpretation of that term.

2 Policy for 2022/23 onwards

2.1 The Service Director Finance recommends the following policy for making prudent provision for MRP:

(i) General Fund Borrowing (pre 1st April 2008) - Provision to be made over the estimated average life of the asset (as at 1 April 2008) for which borrowing was taken - deemed to be 50 years (annuity calculation).

(ii) Calculations to compare this to the previous MRP charge indicated that between 2007/08 and 2015/16 the Council provided an additional £91.2 million with which it will "un-wind" over 7 years from 2017/18.

(iii) General Fund Prudential Borrowing – Provision to be made over the estimated life of the asset for which borrowing is undertaken. Provision to commence in the year following when the asset is operational. Where large loans are made to other bodies for their capital expenditure, no MRP will be charged. However, the capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead.

(iv) HRA Borrowing - Provision to be made for debt repayments equal to its share of any scheduled external debt repayments.

(v) PFI schemes - Provision to equal the part of the unitary payment that writes down the balance sheet liability, together with amounts relating to lifecycle costs incurred in the year.

TREASURY MANAGEMENT INDICATORS

Gross Debt and the Capital Financing Requirement (CFR)
The Code requires that where gross debt is greater than the CFR, the reasons for this should be clearly stated in the annual strategy. This does not apply to this Council as its gross debt will not exceed the CFR over the forecast period (see the ‘Gross Debt and the Capital Financing Requirement table within the Capital Strategy).

Interest Rate Exposures
While fixed rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance justifies retaining a degree of flexibility through the use of variable interest rates on at least part of the treasury management portfolio.

It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2022/23, 2023/24 and 2024/25 of £891 million, £979 million, £1,071 million of its net principal. It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 2021/22, 2022/23 and 2023/24 of £200 million of its net principal.

Maturity Structure of Borrowing
This indicator is designed to prevent the Council having large concentrations of fixed rate debt* needing to be replaced at times of uncertainty over interest rates. It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period as percentage of total projected borrowing that is fixed rate		
	Upper Limit (%)	**Lower Limit (%)**
Under 12 months	20	0
Between 1 and 2 years	20	0
Between 2 and 5 years	60	0
Between 5 and 10 years	80	0
More than 10 years	100	20

*LOBOs are classed as fixed rate debt unless it is considered probable that the loan option will be exercised.

Total principal sums invested for periods longer than 364 days
The Council is not intending to invest sums for periods longer than 364 days.

Appendix E

Investment Strategy 2022/23

Introduction

The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- to support local public services by lending to or buying shares in other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This investment strategy meets the requirements of statutory guidance issued by the government in January 2018 and focuses on the second and third of these categories.

Treasury Management Investments

The Council typically receives its income in cash (eg. from taxes and grants) before it pays for its expenditure in cash (eg. through payroll and invoices). It also holds reserves for future expenditure. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to average £30 million with fluctuations between £20 million and £50 million during the 2022/23 financial year.

Contribution: The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

Further details: Full details of the Council’s policies and its plan for 2022/23 for treasury management investments are covered in the treasury management strategy report 2022/23 to which this Investment Strategy is appended.

Service Investments: Loans

Contribution: The Council makes investments to assist local public services, including making loans to a variety of organisations, mainly local businesses, the local education college and local residents to support local public services and stimulate local economic growth.

The Council provided a significant loan to Kirklees College to help facilitate a new campus in Huddersfield and the delivery of a successful further education provision for post 16 students and adults across the district.

Smaller loans have also been provided to local residents to be able to provide energy efficient heating within their own homes. The Council is part of the Leeds City Region Investment Fund where all local authorities contribute to the fund which provides individual loans to support infrastructure and construction projects which help deliver economic growth and job creation.

Existing capital plans provide for development finance loans to support major town centre regeneration and economic growth, up to a Council approved £31 million (per the 5 year Capital Plan 2022/23 to 2026/27) through the Property Investment Fund. Amounts have been set aside in the capital plan for this type of investment.

The Council will continue to roll forward from last year's Investment Strategy, the earmarking (up to £1 million) to provide financial loans to support 3rd sector partners and anchor organisations. A further element (up to £1 million) will be provided for loans and/or match funding in support of community asset transfers. The Council is underwriting this provision from within the existing earmarked property and other loan reserve.

Security: The main risk when making loans is that the borrower will be unable to repay the principal lent and/or the interest due. Investment Strategy guidance states that in order to limit this risk and ensure that total Council exposure to loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have to be set and approved annually by Council. The proposed upper limits for Council loans are set out at Table 1 below:

Table 1: Loans for service purposes in £ millions

Category of borrower	31.03.2021 actual			2022/23
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Further education college	14.5	-0.8	13.7	**13.7**
Leeds City Region revolving investment fund	3.0	0.0	3.0	**4.3**
Local businesses and charities	5.7*	-0.1	5.6*	**23.6**
Local residents	2.3	0.0	2.3	**2.3**
TOTAL	**25.5**	**-0.9**	**24.6**	**43.9**

* This is made up of numerous small investments, the largest of which is £5.2 million towards 103 New Street.

Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk assessment:

The Council assesses the risk of loss before entering into and whilst holding service loans. This will include the nature of the market/sector to which the loan relates, and loan security against business/sector assets. The single largest current loan relates to Kirklees College which is a public sector entity and considered to be a viable going concern. The strength of the Council's partnership with key anchor organisations in the district like the College, and ability to influence, support and monitor the College's ongoing financial position, are also key factors, including Council senior finance representation on the College's finance committee.

Development finance loans such as Property Investment Fund (PIF) and HD-One will allow the Council to offer loans to development projects which offer significant economic benefits to the Council and the wider Kirklees district.

Any funding offers made will be on the basis that the loan repayments made by the recipient will cover the Council's financing costs and allow for an appropriate margin on cost of funds reflecting the level of risk involved and consistent with State Aid principles. All funding offers made will be subject to appropriate due diligence, including external specialist advice where appropriate, availability of credit ratings in respect of any potential loanee where appropriate, and loan security arrangements. Each individual loan offer will be the subject of a further Cabinet report.

It would not be the intention for the Council to directly compete with existing providers of investment funding. The Council would only look to invest, at its discretion, when there was a clear and demonstrable added value case to be made in terms of local economic benefits for development finance involvement. In many instances the Council investment would be short term to cover the construction phase of development which is the most critical period for schemes to locate finance that is timely and on reasonable terms.

Once out of the development phase there is sufficient liquidity at an appropriate risk margin in the existing investment markets for schemes to be refinanced at which point the Council investment would be repaid. Any investment from the PIF would be on terms that allowed the Council to fully cover its costs, including the costs of borrowing to fund any advance, and creation of an appropriate risk contingency.

Service Investments: Shares

Contribution: The Council invests in the shares of local businesses to support local public services and stimulate local economic growth. The main share investment (£1.0 million) is a 9.9% holding in Kirklees School Services Ltd which operates 20 schools on our behalf on a 32 year contract under PFI. The Council also has a 40% shareholding in Kirklees Stadium Development Ltd, a 14% holding in QED KMC Holdings Ltd (£0.2 million) and a 50% shareholding in Kirklees Henry Boot Partnership Ltd (£0.1 million).
Security: One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 2: Shares held for service purposes in £ millions

Category of company	31.03.2021 actual			2022/23
	Amounts invested	Gains or losses (-)	Value in accounts	Approved Limit
Local businesses	1.3	0.1	1.4	3.8

Risk assessment: The Council entered into these shareholdings for the purposes of participating in the governance and control of organisations that it considered to be important for the purposes of securing economic benefits to the borough. The Council is also the sole client in respect of one of these investments. The Council assessed the risk of participation taking account of the financial and public benefits, including the opportunity to make a potential gain in the event of the business being successful, although this was not the core purpose for initial participation. The Council assesses the risk of loss before entering into and whilst holding shares by continued oversight and involvement in the strategic and operational aspects of the business, and participation in decision making, although the financial risk of the investment is perhaps lower than the operational and or reputational impacts of any failure by the companies in which the Council holds share based investments.

Liquidity: The Council has entered into these shareholdings for the purposes of delivery of its public service and community leadership obligations and the investments are considered to be long term. Viability of the investments in the long term is an important part of the strategy, but as the Councils share ownership and participation is strategic rather than financial the daily or periodic value is of less concern than the overall long-term health of the organisation in which the investment is held.

Non-specified Investments: Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

<u>Commercial Investments: Property</u>

Contribution: The Council invests in local commercial property such as retail town centre shops and buildings with the intention of making a profit that will be spent on local public services.

These assets fall under the definition of Investment Properties in the CIPFA Accounting Code and are valued at fair value in the accounts in accordance with IFRS13. Fair value is when an asset is valued at its highest and best use.

Table 3: Property held for investment purposes in £ millions

Property type	Actual	31.03.2021 actual		31.03.2022 expected	
	Purchase cost	Gains or losses (-)	Value in accounts	Gains or losses (-)	Value in accounts
Commercial Property	*See below	0.4	19.8	0.0	19.8

*The purchase cost cannot be ascertained as the majority of these assets have been owned by Kirklees for many years and purchased by Huddersfield Corporation during the 1920's from Ramsdens Estate. There is a signed legal document and a 'book of acquisition' which is a hard-backed ledger held in legal services.

Security: In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2021/22 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full

Council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

Risk assessment: The Council's current commercial asset portfolio held for investment purposes is largely a historical portfolio. It is monitored and reviewed annually as part of the Council's wider asset strategy including potential future appreciation and potential receipt value.

It is not the Council's intention to invest in any new commercial portfolio investments at this time. If any new investments are identified a risk assessment would be performed.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to which are necessary for the achievement of its business/service objectives. Cash flow projections are prepared on a regular and timely basis.

Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. The Council does not have any loan commitments, however there are some guarantees that the Council holds including a guarantee on outstanding contributions to the Pension Fund in the event of a default by certain bodies and a guarantee to the Homes & Communities Agency (HCA) in the event of a default by Kirklees Community Association (KCA) on the redevelopment of the Fieldhead Estate. The Council also act as a guarantor to a loan of £0.9 million that KSDL hold in the event of default.

Capacity, Skills and Culture

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Service Director Finance is a qualified accountant with extensive local government experience, the Strategic Director – Growth and Regeneration has extensive experience of major Council regeneration schemes and partnerships with major business and third-party partners, as do key Service Directors. The Council pays for staff to study towards relevant professional qualifications including CIPFA and AAT.

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. This approach is more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Cabinet is responsible for the implementation and monitoring of any Investment policy. The Corporate Governance and Audit Committee undertake a scrutiny role with regard to investment. Regular training for members of the Committee is provided by our treasury advisors to enable them to make decisions to ensure accountability and responsibility on investment decisions within the context of the Council's corporate values. Any new investment decisions are also approved at full Council.

Investment Indicators

The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans.

Table 4: Total investment exposure in £ millions

Total investment exposure	**31.03.2021 Actual**	**31.03.2022 Forecast**	**31.03.2023 Forecast**
Treasury management investments	27.2	30.0	30.0
Service investments: Loans	24.6	35.1	43.9
Service investments: Shares	1.4	1.4	1.4
Commercial investments: Property	19.8	19.8	19.8
TOTAL INVESTMENTS	**73.0**	**86.3**	**95.2**
Commitments to lend	0.0	0.0	0.0
Guarantees issued on loans	0.9	0.9	0.9
TOTAL EXPOSURE	**73.9**	**87.2**	**96.1**

How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Table 5: Investments funded by borrowing in £ millions

Investments funded by borrowing	**31.03.2021 Actual**	**31.03.2022 Forecast**	**31.03.2023 Forecast**
Service investments: Loans	**17.3**	**27.0**	**24.5**

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 6: Investment rate of return (net of all costs)

Investments net rate of return	2020/21 Actual	2021/22 Forecast	2022/23 Forecast
Treasury management investments	0.7%	0.9%	1.2%
Service investments: Loans	1.4%	1.4%	1.4%
Service investments: Shares	None	None	None
Commercial investments: Property	5.6%	5.0%	5.0%
ALL INVESTMENTS	**7.7%**	**7.3%**	**7.6%**