Appendix M

Treasury Management Strategy

Introduction

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

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

3. Investments held for service purposes or for commercial profit are considered in the separate Appendix N - Investment Strategy.

External Context

Economic background

4. The following economic commentary is provided by the Council's treasury advisors, Link Group.

5. *"The first half of 2023/24 saw:*

    - *Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.*
    - *Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.*
    - *CPI inflation falling from 8.7% in April to 6.7% in September, its lowest rate since February 2022, but still the highest in the G7.*
    - *Core CPI inflation declining to 6.1% in September from 7.1% in April and May, a then 31 years high.*
    - *A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose by 7.8% for the period June to August, excluding bonuses).*

6. *The registering of 0% GDP for Q3 suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.*

7. *The fall in the composite Purchasing Managers Index from 48.6 in August to 46.7 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0% q/q rise in real GDP in the period July to September, being followed by a contraction in the next couple of quarters.*

8. *The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.*

9. *As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.*

10. *The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.*

11. *But the cooling in labour market conditions still has not fed through to an easing in wage growth. The headline 3myy rate rose 7.8% for the period June to August, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular annual average total pay growth for the private sector was 7.1% in June to August 2023, for the public sector this was 12.5% and is the highest total pay annual growth rate since comparable records began in 2001. However, this is affected by the NHS and civil service one-off non-consolidated payments made in June, July and August 2023. The Bank of England's prediction was for private sector wage growth to fall to 6.9% in September.*

12. *CPI inflation declined from 6.8% in July to 6.7% in August and September, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.1%. That reverses all the rise since March.*

13. *In its latest monetary policy meeting on 02 November, the Bank of England left interest rates unchanged at 5.25%. The vote to keep rates on hold was a split vote, 6-3. It is clear that some members of the MPC are still concerned about the stickiness of inflation.*

14. *Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. In terms of messaging, the Bank once again said that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures", citing the rise in global bond yields and the upside risks to inflation from "energy prices given events in the Middle East". So, like the Fed, the Bank is keeping the door open to the possibility of further rate hikes. However, it also repeated the phrase that policy will be "sufficiently restrictive for sufficiently long" and that the "MPC's projections indicate that monetary policy is likely to need to be restrictive for an extended period of time". Indeed, Governor Bailey was at pains in his press conference to drum home to markets that the Bank means business in squeezing inflation out of the economy.*

15. *This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates in the future.*

16. *Currently, the Fed has pushed up US rates to a range of 5.25% to 5.5%, whilst the MPC followed by raising Bank Rate to 5.25%. EZ rates have also increased to 4% with further tightening a possibility.*

17. *Ultimately, however, from a UK perspective it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also)".*

Interest rate forecast

18. The Council has appointed Link Group as its treasury advisor and part of their service is to assist the formulation of a view on interest rates. Link provided the following forecasts on 07 November 2023. These are forecasts for Bank Rate and PWLB certainty rates (gilt yields plus 80 bps).

Link Group Interest Rate View 07.11.23	Dec -23	Mar -24	Jun -24	Sep -24	Dec -24	Mar -25	Jun -25	Sep -25	Dec -25	Mar -26	Jun -26	Sep -26	Dec -26
Bank Rate	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.25	3.00	3.00	3.00	3.00	3.00
5yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

19. Link forecast that the MPC will keep Bank Rate at 5.25% for the remainder of 2023 and the first half of 2024 to combat on-going inflationary and wage pressures. Link

Group do not think that the MPC will increase Bank Rate above 5.25%, but it is possible.

20. The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of Link Group forecasts, as inflation starts to fall through the remainder of 2023 and into 2024.

21. These interest rate forecasts are a central estimate, not a prediction, and there are upside and downside risks, which could alter the eventual path of interest rates.

Local Context

22. The following table summarises the Council's balance sheet for the current (2023/24) and previous financial year and provides a forecast for the medium term.

Balance sheet summary and forecast

	31.3.23	**31.3.24**	**31.3.25**	**31.3.26**	**31.3.27**
	Actual	**Estimate**	**Forecast**	**Forecast**	**Forecast**
	£m	**£m**	**£m**	**£m**	**£m**
Total CFR	1,292.4	1,271.6	1,300.8	1,300.8	1,268.4
Other long-term liabilities and adjustments	-187.5	-178.3	-168.0	-156.8	-145.9
Adjustment for Transferred Debt[1]	28.9	27.7	26.6	25.6	24.5
Loans CFR	**1,133.8**	**1,121.0**	**1,159.4**	**1,169.6**	**1,147.0**
External borrowing	-802.4	-771.9	-742.6	-710.3	-685.1
Internal borrowing	**331.4**	**349.2**	**416.9**	**459.2**	**461.9**
Less balance sheet resources	-827.6	-742.0	-751.0	-767.2	-799.5
Treasury investments	**496.2**	**392.9**	**334.1**	**307.9**	**337.6**

23. The Council's capital expenditure plans are the key driver of treasury management activity and the starting point for the treasury management strategy is the Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure, which has not immediately been paid for through a

[1] The Council manages debt on behalf of Medway Council that was transferred to it following the reorganisation that created Medway Council. The value of this debt is included within the total sum of external borrowing shown in the balance sheet summary and forecast table and therefore it is also included in the calculation of the loans CFR within the table. This is in accordance with the requirements of the Prudential Code and ensures that resultant comparison between the loans CFR, external borrowing and internal borrowing is presented on a consistent basis.

revenue or capital resource, will increase the CFR. The Council's current capital expenditure and financing plans are set out in the Capital Strategy at appendix O.

24. The CFR does not increase indefinitely, due the requirement to make a minimum revenue provision, a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used. The MRP charge is not shown separately here but is factored into the CFR.

25. The Total CFR includes any other long-term liabilities (e.g., PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of schemes include a borrowing facility by the PFI, PPP lease provider and so the Authority is not required to separately borrow for these schemes. For the purposes of determining the treasury management strategy, other long-term liabilities are removed to arrive at the Loans CFR.

26. The Council has externally borrowed £802.4m (as at 31 March 2023) to meet most of the borrowing requirement implied by the Loans CFR, and this figure will decline gradually over the medium term as external loans mature and are repaid (assuming no additional external borrowing is undertaken).

27. The balance of the Loans CFR borrowing requirement is met through internal borrowing, namely the temporary use of the Council's balance sheet resources on lieu of investment. The Council's internal borrowing is forecast to rise over the medium term, compensating for the change in external borrowing noted above.

28. Balance sheet resources represent the Council's underlying capacity for investment (mostly reserves, provisions and working capital). Balance sheet resources exceed internal borrowing and therefore the Council is forecast to continue to have positive external investment balances for the foreseeable future.

29. The current borrowing and investment balances, as at 30 November 2023, when the Council held £776.0m of external borrowing and £508.5m of treasury investments, are set out in further detail in Annex A.

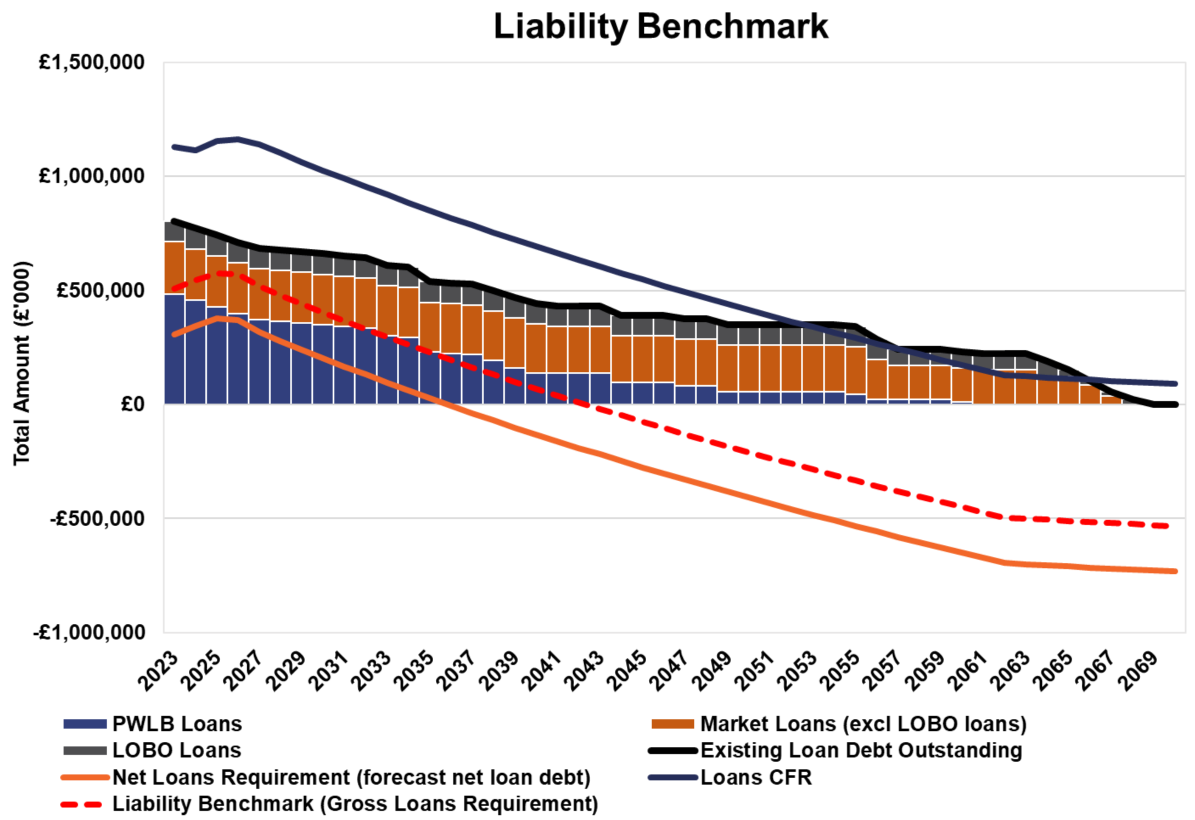
Liability benchmark

30. To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £200m at each year-end to maintain sufficient liquidity but minimise credit risk.

31. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the minimum cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

32. The liability benchmark is shown in the below chart. The chart illustrates the maturity profile of the Council's existing borrowing and assumes no new capital expenditure funded by borrowing beyond 2026/27.

<u>Figure 1: Liability Benchmark Chart</u>



33. The chart shows the overall borrowing requirement (the Loans CFR), which is projected to increase moderately over the medium term in line with the authority's plans, before declining over the long term as the annual minimum revenue provision (MRP) charge gradually reduces the Council's borrowing requirement. The borrowing requirement is currently met by a combination of fixed rate loans, LOBO loans and internal borrowing.

34. The Council could theoretically reduce its investment balances to zero and maximise the use of internal borrowing before acquiring any external borrowing. The net loans requirement (orange solid line) represents the minimum amount of external borrowing required under this strategy. However, such an approach would naturally involve an intolerable level of liquidity risk, and therefore a minimum liquidity requirement (assessed at £200m) is added to the net loans requirement to arrive at the liability benchmark itself. In effect, the liability benchmark represents the minimum amount of debt that the Council requires to meet its borrowing requirement and to provide sufficient liquidity for day-to-day cash flow.

35. The chart demonstrates that the Council's existing stock of external debt, exceeds the minimum amount required based on current financial plans, and therefore the authority does not have a need to enter into new external borrowing. The liability benchmark is forecast to rise over the medium term due to a combined increase in capital expenditure and reduction in available balance sheet resources (usable reserves, mainly) before declining over the long term. At the same time external debt is forecast to decline as individual loans expire.

36. Although not shown in figure 1, both the Loans CFR and the liability benchmark are likely to increase in later years as new capital expenditure cycles are approved.

Borrowing Strategy

37. On 30 November 2023, the Council had £776.0m external debt, including £28.1m attributable to Medway Council, as part of its strategy for funding previous years' capital programmes. This represents a decrease of £26.5m on 31 March 2023 and reflects the Council's strategy of maintaining borrowing below the underlying levels.

38. The balance sheet forecast in table 1 shows that the Council does not expect to need to undertake additional borrowing in 2024-25. The Council may borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing set out in the Capital Strategy (Appendix O).

Objective

39. The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy

40. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

41. The Council is currently maintaining an under-borrowed position. This means that the underlying borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate remains elevated through to the second half of 2024.

42. By doing so, the Council is able to reduce net borrowing costs and reduce investment counterparty exposure. Internal borrowing is not cost free as it is at the expense of investment returns foregone and neither does it remove the need for Minimum Revenue Provision (MRP) to be made.

43. Given borrowing rates are forecast to decline over the medium term, consideration will also be given to short term rather than long term external borrowing should liquidity considerations necessitate any additional external borrowing (although it is not the Council's central expectation that borrowing will be required for liquidity reasons).

44. Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years. The Corporate Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

    - *if it was felt that there was a significant risk of a sharp FALL in borrowing rates,* then borrowing will be postponed.

    - *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

45. The Council also retains the option to arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

46. Any decisions will be reported to the Treasury Management Group and the Governance and Audit Committee at the next available opportunity.

Sources of borrowing

47. The Council has previously raised the majority of its long-term borrowing from the PWLB and is likely to continue with this practice but will consider long-term loans from other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

48. The approved sources of long-term and short-term borrowing are:
    - HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
    - any institution approved for investments (see below)
    - any other bank or building society authorised to operate in the UK
    - any other UK public sector body
    - UK public and private sector pension funds (except the Kent Pension Fund)
    - capital market bond investors
    - UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
    - UK Infrastructure Bank

49. PWLB lending arrangements have changed, and loans are no longer available to local authorities planning to buy investment assets primarily for yield. The Council does not intend to borrow to invest primarily for financial return and will retain its access to PWLB loans.

Other sources of debt finance

50. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
    - leasing
    - hire-purchase
    - Private Finance Initiative
    - sale and leaseback

LOBO (Lender's Option Borrower's Option) loans

51. The Council holds £90m of LOBO loans (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. LOBOs totalling £40m have option dates during 2024/25, and with interest rates having risen recently, there is a reasonable chance that lenders will exercise their options. If they do, the Council will likely take the option to repay LOBO loans to reduce refinancing risk in later years.

Debt rescheduling

52. The PWLB allows councils to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

53. Any decisions involving the repayment of LOBO loans or debt rescheduling will be reported to the Treasury Management Group and the Governance and Audit Committee at the next available opportunity.

Policy on Borrowing in Advance of Need

54. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Treasury Investment Strategy

55. The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Since the beginning of April 2023, the Council's cash balance has ranged between £470.5m and £640.5m; investment balances are forecast to be around £392.9m at the end of 2023/24 and approximately £334.1m at the end of 2024/25.

56. **Objectives:** The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults, the liquidity of investments and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) risks when investing.

57. **Strategy:** As demonstrated by the liability benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and to mitigate the negative impact of inflation on the value of the Council's long-term resources.

58. **ESG policy:** The Council is committed to responsible treasury management and to being a good steward of the assets in which it invests. As stated in paragraph 1 above, the successful identification, monitoring and control of financial risk are central to the Council's prudent financial management, and this includes the identification and management of environment, social and governance (ESG) risks that arise in the course of carrying out treasury management activities. Therefore, the Council integrates ESG considerations into its treasury management decision-making process.

59. The framework for evaluating investment opportunities is still developing. When investing in banks and funds, and after satisfying security, liquidity and yield considerations, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code

60. Assets within the strategic pooled funds portfolio are managed by third-party investment managers responsible for the day-to-day investment decisions, including undertaking voting and engagement activities on behalf of the Council. The Council incorporates analysis of ESG integration and active ownership capabilities when selecting and monitoring investment managers.

61. The Council requires its investment managers to engage with companies to monitor and develop their management of ESG issues in order to enhance the value of the Council's investments. The Council also requires feedback from the investment managers on the activities they undertake and regularly reviews this feedback through meetings and reporting.

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

Approved counterparties

63. The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the limits shown.

	Time limit	**Counterparty limit**	**Sector limit**
The UK Government	50 years	unlimited	
UK Local Authorities	10 years	£25m	
Kent local authorities for cashflow purposes only	1 year		£70m
Other Government entities	25 years	£20m	£30m
UK banks and building societies (unsecured) *	13 months	£20m	Unlimited
Council's banking services provider *	Overnight	£20m	
Overseas banks (unsecured) *	13 months	£20m	£30m country limit
Money Market Funds *	n/a	£20m per fund or 0.5% of the fund size if lower	
Cash plus / short term bond funds		£20m per fund	
Secured investments *	25 years	£20m	£150m
Corporates (non-financials)	5 years	£2m per issuer	£20m
Registered Providers (unsecured) *	5 years	£10m	£50m
Loans incl. to developers in the No Use Empty programme			£40m
Strategic pooled funds and real estate investment trusts	n/a		£250m
- Absolute Return funds		£25m per fund	
- Multi Asset Income funds		£25m per fund	
- Property funds		£75m or 5% of total fund value if greater	

- Bond funds		£25m per fund	
- Equity Income Funds		£25m per fund	
- Real Estate Investment Trusts		£25m per fund	

64. This table should be read in conjunction with the notes below.

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

65. **Government:** Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

66. **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used.

67. **Banks and building societies (unsecured):** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investments with banks rated below the agreed minimum rating of A- are restricted to overnight deposits with the Council's current banking services provider.

68. **Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing. As providers of public services, they retain the likelihood of receiving government support if needed.

69. **Money Market Funds:** Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to Money Market Funds, the Council will

take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

70. **Pooled investment funds:** Bond, equity, multi-asset and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

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

72. **Other investment:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Council's investment at risk.

73. **Operational bank accounts:** The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk assessment and credit ratings

74. Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

75. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that entity until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments

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

77. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government or with other local authorities. This may cause investment returns to fall but will protect the principal sum invested.

Investment limits

78. The Council may invest its surplus funds with any of the counterparty types listed above subject to the cash limits per counterparty and the durations shown in the table at paragraph 63.

Liquidity management

79. The Council forecasts its cash flow requirements 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.

80. The Council will spread its liquid cash over several bank accounts and money market funds to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Prudential Indicators

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

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

Credit risk indicator	Minimum Level
Portfolio average credit rating	AA-

83. **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Liquidity risk indicator	Minimum Level
Total cash available within 3 months	£75m

84. **Interest rate exposure**: The 2021 CIPFA Prudential Code removes the requirement to set treasury indicators for fixed and variable interest rate exposure. Instead, the Council is required to set out how it intends to manage interest rate exposure.

    This organisation will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements and management information arrangements.

    It will achieve this by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates.

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

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	50%	0%
20 years and within 40 years	50%	0%
40 years and longer	50%	0%

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

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

Price risk indicator	**2024-25**	**2025-26**	**2026-27**	**No fixed date**
Limit on principal invested beyond year end	£150m	£100m	£50m	£250m

Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

87. **Liability indicator:** see paragraph 32 above.

Related Matters

88. The CIPFA Code requires the Council to include the following in its Treasury Management Strategy.

89. **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over councils' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

90. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be considered when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

91. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

92. In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

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

94. **IFRS 9 Statutory Override:** Under the accounting standard IFRS 9, entities are required to recognise the revenue impact arising from the movement in value of investments held at fair value. The MHCLG (DLUHC) initially enacted a statutory over-ride from 1 April 2018 for a five-year period until 31 March 2023 following the introduction of IFRS 9 in respect of the requirement for any unrealised capital gains or losses on marketable pooled funds to be chargeable in year. This was subsequently extended to 31 March 2025 and has the effect of allowing any unrealised capital gains or losses arising from qualifying investments to be held on the balance sheet until 31 March 2025. The Council currently holds investment assets which fall under the statutory override (the strategic pooled funds) and it manages the risk arising from expiry of the statutory override on a corporate basis.

Financial Implications

95. The budget for net investment income in 2024-25 is £13.0m, based on an average investment portfolio of £426m at an average interest rate of 4.88%.[2] The budget for debt interest payable in 2024-25 is £32.5m, based on an average debt portfolio of £748.3m at an average interest rate of 4.35%. If actual levels of investments and borrowing, or actual interest rates, differ from forecast, performance against budget will be correspondingly different.

Other Options Considered

96. The CIPFA Code does not prescribe any particular Treasury Management Strategy for councils to adopt. The Corporate Director of Finance, having consulted the Treasury Management Group, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income in the long term	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain

[2] Gross investment income for 2024-25 is estimated to be £20.8m including £7.8m attributable to other bodies.

Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income in the long term though potentially not in the short term	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Training

The CIPFA Treasury Management Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management.

Training was most recently undertaken by members on 23 November 2023 and further training will be arranged as required.

Annex A – Existing Investment & Debt Portfolio Position

	30-Nov-23	30-Nov-23
	Actual Portfolio	**Average Rate**
	£m	**%**
External borrowing		
Public Works Loan Board	460.12	4.40
LOBO loans from banks	90.00	4.15
Banks and other lenders (Fixed term)	216.10	4.54
Streetlighting Project	9.79	2.55
Total external borrowing	**776.01**	**4.39**
Treasury investments		
Bank Call Accounts	1.00	1.92
Covered bonds (secured)	97.25	4.80
Government (incl. local authorities)	88.80	5.25
Money Market Funds	134.76	5.33
Equity	1.30	
No Use Empty Loans	16.55	4.50
Total internally managed investments	**339.66**	**5.14**
Pooled investments funds		
- Property	55.19	5.05
- Multi Asset	53.52	5.00
- Absolute Return	5.19	2.26
- Equity UK	30.21	6.24
- Equity Global	24.74	4.17
Total pooled investments	**168.85**	**5.09**
Total treasury investments	**508.51**	**5.12**
Net debt	**267.50**	

Appendix M

GLOSSARY

Local Authority Treasury Management Terms

Bond	A certificate of long-term debt issued by a company, government, or other institution, which is tradable on financial markets
Borrowing	Usually refers to the stock of outstanding loans owed and bonds issued.
CFR	Capital Financing Requirement. A council’s underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with capital expenditure and decreases with capital finance and MRP.
Capital gain or loss	An increase or decrease in the capital value of an investment, for example through movements in its market price.
Collective investment scheme	Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as ‘pooled funds’).
Cost of carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim.
Counterparty	The other party to a loan, investment or other contract.
Counterparty limit	The maximum amount an investor is willing to lend to a counterparty, in order to manage credit risk.
Covered bond	Bond issued by a financial institution that is secured on that institution’s assets, usually residential mortgages, and is therefore lower risk than unsecured bonds. Covered bonds are exempt from bail-in.
CPI	Consumer Price Index - the measure of inflation targeted by the Monetary Policy Committee.
Deposit	A regulated placing of cash with a financial institution. Deposits are not tradable on financial markets.
Diversified income fund	A collective investment scheme that invests in a range of bonds, equity and property in order to minimise price risk, and also focuses on investments that pay income.
Dividend	Income paid to investors in shares and collective investment schemes. Dividends are not contractual, and the amount is therefore not known in advance.
DMADF	Debt Management Account Deposit Facility – a facility offered by the DMO enabling councils to deposit cash at very low credit risk. Not available in Northern Ireland.
DMO	Debt Management Office – an executive agency of HM Treasury that deals with central government’s debt and investments.
Equity	An investment which usually confers ownership and voting rights
Floating rate note (FRN)	Bond where the interest rate changes at set intervals linked to a market variable, most commonly 3-month LIBOR or SONIA

FTSE	Financial Times stock exchange – a series of indices on the London Stock Exchange. The FTSE 100 is the index of the largest 100 companies on the exchange, the FTSE 250 is the next largest 250 and the FTSE 350 combines the two
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
GILT	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
Income return	Return on investment from dividends, interest and rent but excluding capital gains and losses.
IFRS	International Financial Reporting Standards, the set of accounting rules in use by UK local authorities since 2010
IMF	International Monetary Fund
LIBID	London interbank bid rate - the benchmark interest rate at which banks bid to borrow cash from other banks, traditionally 0.125% lower than LIBOR.
LIBOR	London interbank offer rate - the benchmark interest rate at which banks offer to lend cash to other banks. Published every London working day at 11am for various currencies and terms. Due to be phased out by 2022.
LOBO	Lender's Option Borrower's option
MMF	Money Market Funds. A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to Constant Net Asset Value (CNAV) and Low Volatility Net Asset Value (LVNAV) funds with a Weighted Average Maturity (WAM) under 60 days which offer instant access, but the European Union definition extends to include cash plus funds
Monetary Policy	Measures taken by central banks to boost or slow the economy, usually via changes in interest rates. Monetary easing refers to cuts in interest rates, making it cheaper for households and businesses to borrow and hence spend more, boosting the economy, while monetary tightening refers to the opposite. See also fiscal policy and quantitative easing.
MPC	Monetary Policy Committee. Committee of the Bank of England responsible for implementing monetary policy in the UK by changing Bank Rate and quantitative easing with the aim of keeping CPI inflation at around 2%.
MRP	Minimum Revenue Provision – an annual amount that local authorities are required to set aside and charge to revenue for the repayment of debt associated with capital expenditure. Local authorities are required by law to have regard to government guidance on MRP. Not applicable in Scotland, but see Loans Fund
Pooled Fund	Scheme in which multiple investors hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Prudential Code	Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice. Local authorities are required by law to have regard to the Prudential Code. The Code was update din December 2021

PWLB	Public Works Loan Board – a statutory body operating within the Debt Management Office (DMO) that lends money from the National Loans Fund to councils and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
Quantitative easing (QE)	Process by which central banks directly increase the quantity of money in the economy in order to promote GDP growth and prevent deflation. Normally achieved by the central bank buying government bonds in exchange for newly created money.
REIT	Real estate investment trust – a company whose main activity is owning investment property and is therefore similar to a property fund in many ways
Share	An equity investment, which usually also confers ownership and voting rights
Short-term	Usually means less than one year
SONIA	Based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors
Total return	The overall return on an investment, including interest, dividends, rent, fees and capital gains and losses.
Weighted average life (WAL)	The weighted average time for principal repayment, that is, the average time it takes for every dollar of principal to be repaid. The time weights are based on the principal payments,
Weighted average maturity (WAM)	The weighted average maturity or WAM is the weighted average amount of time until the securities in a portfolio mature.