

**COUNCIL MEETING – 22ND FEBRUARY 2024**

**AGENDA ITEM NO. 6 (2)**

**ANNUAL TREASURY MANAGEMENT STRATEGY AND ANNUAL NON-TREASURY INVESTMENT STRATEGY 2024/25**

A report from the meeting of Corporate Governance, Audit and Standards Committee held on 31st January 2024.

**1 INTRODUCTION**

- 1.1 This report sets out the proposed Treasury Management Strategy and Non-Treasury Investment Strategy for the year 2024-25, including the borrowing and investment strategies and treasury management indicators for capital finance for 2024-25 and the Minimum Revenue Provision Statement.
- 1.2 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 approval of 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.
- 1.3 The CIPFA Treasury Management Code of Practice 2021 Edition, requires the Authority to have a separate Non-Treasury Investment Strategy (Appendix 2) which must be approved before April 2024.
- 1.4 Local authorities are also required by regulation to 'have regard to' the provisions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) 2021.

**2 PURPOSE**

- 2.1 The primary purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

- 2.2 The secondary function of the treasury management operation is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure the Council can meet its capital spending obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).
- 2.3 Accordingly, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: *"The management of the Council's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks"*.
- 2.4 The primary purpose of non-treasury investment management operations is to ensure that all investments made primarily for service reasons or primarily to generate a profit have a suitable level of security and liquidity. This strategy also ensures that the risks and rewards of these investments are monitored regularly.
- 2.5 The secondary function of investment management is to generate returns. These returns are monitored on a regular basis.
- 2.6 The purpose of the indicators is to set a framework for affordable, prudent and sustainable capital investment.
- 2.7 The appendices (1 to 3) set out the Treasury Management Strategy, Investment Strategy and Minimal Revenue Provision Statement for 2024-25 and fulfil key legislative requirements as follows:

#### Appendix 1

- The **Treasury Management Strategy** which sets out how the Council's treasury operation will support capital decisions taken during the period, the day-to-day treasury management and the limitations on activity through treasury prudential indicators, in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Annual Borrowing Strategy** which sets out the Council's objectives for borrowing together with the approved sources of long and short-term borrowing and;
- **Annual Treasury Management Investment Strategy** which sets

out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss, in accordance with CIPFA's Code of Practice on Treasury Management.

#### Appendix 2

- The **Non-Treasury Investment Strategy** sets out the Council's investment decisions taken during the period and monitors performance and security, in accordance with DLUHC (Department for Levelling Up, Housing and Communities) Investment Guidance.

#### Appendix 3

- The Council's **Minimum Revenue Provision (MRP) Statement**, which sets out how the Council will pay for capital assets through revenue each year, as required by the Local Government Act 2003 (Regulations 27 and 28 in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003).

2.8 These policies and parameters provide an approved framework within which officers undertake the day-to-day capital, treasury and non-treasury investment activities.

### **3 SCOPE**

3.1 This report covers the Council's treasury management and investment activities as set out in paragraphs 2.1 to 2.8 above. The funds invested consist of short-term cash available due to timing of income and expenditure, prudential borrowing and the Council's capital receipts.

3.2 The Council's treasury management advisors Arlingclose continue to advise diversification in investments (spreading small amounts over a few counterparties) wherever possible.

3.3 Prudential borrowing of £120.0m was incurred by 31<sup>st</sup> March 2023 in relation to capital expenditure. As this was all borrowed on a short-term basis a proportion of it will need to be refinanced on an ongoing basis as it matures. The Council also plan to reduce this borrowing need by generating approximately £40m in asset sales over the next three years.

3.4 Careful observation of the "gross debt v capital financing requirement" indicator will need to be undertaken progressively throughout the financial year.

- 3.5 Where a material change to the attached strategies occurs during the year a revised strategy will be presented to Full Council before the change is implemented.

#### **4 RECOMMENDATIONS**

4.1 The Council is recommended to approve:

- (i) Treasury Management Strategy 2024/25, Annual Borrowing Strategy 2024/25 attached at Appendix 1;
- (ii) Annual Non-Treasury Investment Strategy attached 2024/25 at Appendix 2; and
- (iii) Minimum Revenue Provision (MRP) Statement set out in Appendix 3.

P.J. CULLUM  
CHAIRMAN OF CORPORATE GOVERNANCE,  
AUDIT AND STANDARDS COMMITTEE

## TREASURY MANAGEMENT STRATEGY 2024-25

### 1 INTRODUCTION

- 1.1 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.
- 1.2 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. The Corporate Governance Audit and Strategy Committee is the nominated Committee responsible for the effective scrutiny of the Treasury Management Strategy and policies.
- 1.3 Investments held for service purposes or for commercial profit are considered in a separate part of this report, the Investment Strategy at Appendix 2.
- 1.4 This Strategy covers:
- External Context
  - Local Context
  - Annual Borrowing Strategy
  - Annual Investment Strategy
  - Treasury Management Prudential Indicators
  - Related Matters

### 2 EXTERNAL CONTEXT

#### **Economic background (January 2024):**

- 2.1 Economic background: The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in

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Ukraine and the Middle East, will be major influences on the Authority's treasury management strategy for 2024/25.

- 2.2 The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level for the rest of 2023. In December 2023, members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25%. The three dissenters wanted to increase rates by another 0.25%.
- 2.3 The November quarterly Monetary Policy Report (MPR) forecast a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with upside risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.
- 2.4 Office for National Statistics (ONS) figures showed CPI inflation was 3.9% in November 2023, down from a 4.6% rate in the previous month and, in line with the recent trend, lower than expected. The core CPI inflation rate declined to 5.1% from the previous month's 5.7%, again lower than predictions. Looking ahead, using the interest rate path implied by financial markets the BoE expects CPI inflation to continue falling slowly, but taking until early 2025 to reach the 2% target before dropping below target during the second half 2025 and into 2026.
- 2.5 ONS figures showed the UK economy contracted by 0.1% between July and September 2023. The BoE forecasts GDP will likely stagnate through 2024. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.
- 2.6 The labour market appears to be loosening, but only very slowly. The unemployment rate rose slightly to 4.2% between June and August 2023, from 4.0% in the previous 3-month period, but the lack of consistency in the data between the two periods made comparisons difficult. Earnings growth has remained strong but has showed some signs of easing; regular pay (excluding bonuses) was up 7.3% over the period and total pay (including bonuses) up 7.2%. Adjusted for inflation, regular pay was 1.4% and total pay 1.3%. Looking forward, the MPR showed the unemployment rate is expected to be around 4.25% in the second half of calendar 2023, but then rising steadily over the forecast horizon to around 5% in late 2025/early 2026.
- 2.7 Having increased its key interest rate to a target range of 5.25-5.50%

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in August 2023, the US Federal Reserve appears now to have concluded the hiking cycle. It is likely this level represents the peak in US rates following a more dovish meeting outcome in December 2023. US GDP grew at an annualised rate of 4.9% between July and September 2023, ahead of expectations for a 4.3% expansion and the 2.1% reading for Q2. But the impact from higher rates has started to feed into economic activity and growth will weaken in 2024. Annual CPI inflation was 3.1% in November.

- 2.8 Eurozone inflation has declined steadily since the start of 2023, falling to an annual rate of 2.4% in November 2023. Economic growth has been weak, and GDP contracted by 0.1% in the three months to September 2023. In line with other central banks, the European Central Bank has increased rates, taking its deposit facility, fixed rate tender, and marginal lending rates to 3.75%, 4.25% and 4.50% respectively.

### **Credit Outlook:**

- 2.9 Credit Default Swap (CDS) prices were volatile during 2023, spiking in March on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in Q2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.
- 2.10 On an annual basis, CDS price volatility has so far been lower in 2023 compared to 2022, but this year has seen more of a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again. CDS prices are an indicator of the market's perception of how likely a counterparty is to default, they are monitored as part of treasury risk management.
- 2.11 Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget. Moody's also affirmed the Aa3 rating in recognition of the UK's economic resilience and strong institutional framework.
- 2.12 Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.

- 2.13 There remain competing tensions in the banking sector, on one side from higher interest rates boosting net income and profitability against another of a weakening economic outlook and likely recessions that increase the possibility of a deterioration in the quality of banks' assets.
- 2.14 However, the institutions on our adviser (Arlingclose's) counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

### **Interest Rate Forecast (December 2023):**

- 2.15 Although UK inflation and wage growth remain elevated, the Council's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25%. The Bank of England's Monetary Policy Committee will start reducing rates in 2024 to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.
- 2.16 Arlingclose expects long-term gilt yields to be broadly stable at current levels (amid continued volatility), following the decline in yields towards the end of 2023, which reflects the expected lower medium-term path for Bank Rate. Yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.
- 2.17 A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix A.

## **3 LOCAL CONTEXT**

- 3.1 On 31 December 2023, the Council held £162.0m of short-term borrowing and £39.7m of investments. This is set out in further detail in Appendix B. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below. To date the Council has relied upon its own cashflow (internal borrowing) to fund capital expenditure, supplemented by short-term external borrowing to provide liquidity. A significant element of the external borrowing will be replaced during the



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year with renewed short-term borrowing based upon the Councils projected cashflow requirements. The objective is to minimise the need for external borrowing and enable the CFR to be reduced by replacing capital receipts from asset sales as these are achieved.

**Table 1: Balance Sheet Summary and Forecast in £ millions.**

	<b>2022-23 Actual</b>	<b>2023-24 Forecast</b>	<b>2024-25 Estimate</b>	<b>2025-26 Estimate</b>	<b>2026-27 Estimate</b>
Capital Financing Requirement	139.7	166.3	167.9	141.4	129.1
Less: Other Debt Liabilities	1.4	1.1	0.8	0.4	0.1
<b>Loans CFR</b>	<b>139.7</b>	<b>166.3</b>	<b>167.1</b>	<b>141.0</b>	<b>129.0</b>
Less: External Borrowing	120.0	164.0	5.0	-	-
<b>Internal Borrowing</b>	<b>18.2</b>	<b>1.2</b>	<b>162.1</b>	<b>141.0</b>	<b>129.0</b>
Less: Balance Sheet Resources	38.6	32.0	26.7	22.1	17.3
<b>Treasury Investments / (New Borrowing)</b>	<b>20.4</b>	<b>30.9</b>	<b>(135.4)</b>	<b>(118.9)</b>	<b>(111.7)</b>

- 3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. The Council will not have sufficient working capital to fund the required level of borrowing and will borrow funds from other local authorities' short term to provide liquidity and manage cash requirement during year.
- 3.3 The Council's CFR is projected to increase to £167.1m in 2024/25 before reducing. The majority of currently held loans are due to mature within the next year and will need to be replaced, meaning the Council can expect to have an ongoing borrowing need in future. Over the forecast period above it is expected that £111.7m of borrowing will be needed by 2026/27, this is lower than the £162.0m of loans held at 31<sup>st</sup> December 2023.

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- 3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The table above shows that the Council expects to comply with this recommendation during 2024-25 and following two financial years.
- 3.5 **Liability benchmark:** 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 in the table above, but that cash and investment balances are kept to a minimum level of £25m at each year-end. This incorporates £20m invested in strategic pooled funds that cannot be sold at short notice and an additional £5m liquidity buffer to manage short-term cashflow requirements.
- 3.6 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 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.

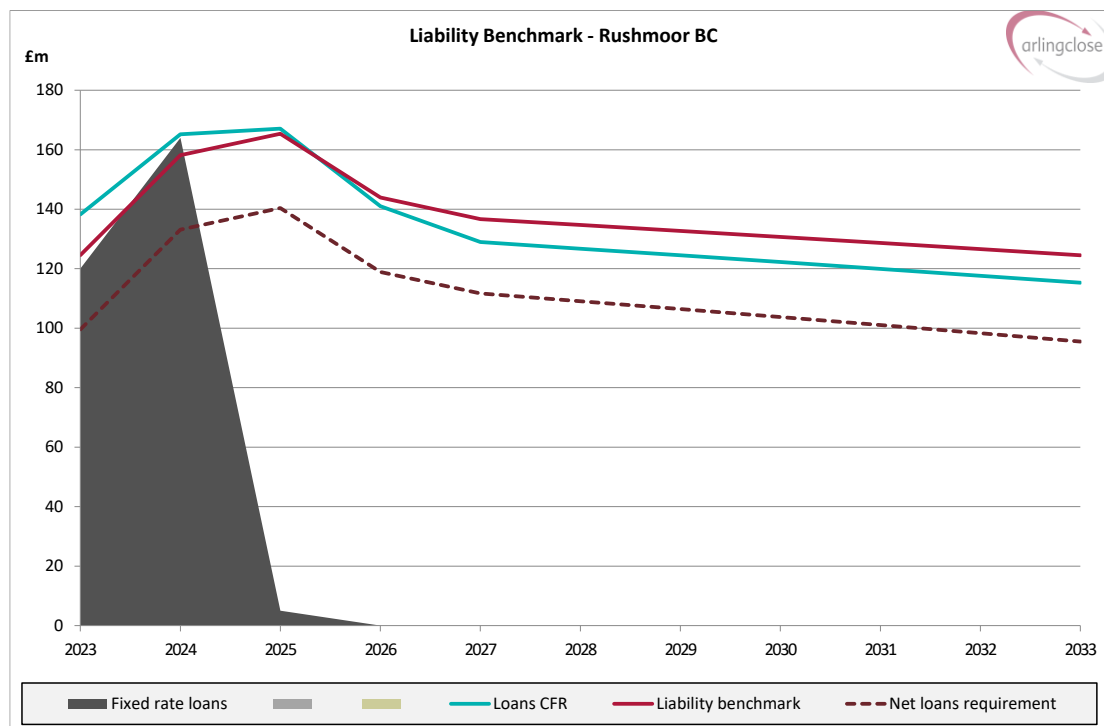
**Table 2: Prudential Indicator: Liability Benchmark in £ millions**

	<b>2022-23 Actual</b>	<b>2023-24 Forecast</b>	<b>2024-25 Estimate</b>	<b>2025-26 Estimate</b>	<b>2026-27 Estimate</b>
Loans CFR	139.7	166.3	167.1	141.0	129.0
Less: Balance Sheet Resources	38.6	32.0	26.7	22.1	17.3
<b>Net Loans Requirement</b>	<b>99.6</b>	<b>133.1</b>	<b>140.4</b>	<b>118.9</b>	<b>111.7</b>
Plus: Liquidity Allowance	25.0	25.0	25.0	25.0	25.0
<b>Liability Benchmark</b>	<b>124.6</b>	<b>158.1</b>	<b>165.4</b>	<b>143.9</b>	<b>136.7</b>

- 3.7 Following on from the medium-term forecast in table 2 above, the 10-year liability benchmark assumes no capital expenditure funded by borrowing

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after 2025/26 and that reserves increase with inflation of 2.5%. This is shown below together with the maturity profile of the Council's existing borrowing:



- 3.8 This shows that the Council has a significant borrowing need for a number of years into the future as the CFR and liability benchmark remain high. The majority of the need to borrow is to replace existing short-term loans that will mature.

## 4 ANNUAL BORROWING STRATEGY 2024-25

- 4.1 The Council held 162.0m in loans at 31<sup>st</sup> December 2023 as part of its previous strategy for funding prior years' capital programmes. This presents an increase in borrowing from the previous year. The majority of current debt is due to mature with in next 12 months.
- 4.2 The balance sheet forecast in table 1 (above) shows that the Council expects to need to borrow £135.4m by the end of 2024/25. This is to replace existing short-term loans as they mature.
- 4.4 **Objectives:** The Council's chief objective when borrowing money will be to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty 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.
- 4.5 **Strategy:** The Council has to date adopted an approach of borrowing on a short-term basis to take advantage of historically low short-term

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interest rates. Since late 2021 however interest rates, and correspondingly the Council's cost of borrowing, have risen dramatically. Bank of England Base Rate was 0.1% in December 2021 and is now 5.25%.

- 4.6 In the medium term the Council aims to have a higher proportion of debt in longer-term loans, enabling greater long-term certainty in costs. As current interest rates are expected to fall the intention is to wait until rates are lower before beginning this process. The situation is kept under constant review.
- 4.7 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.
- 4.8 PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity to retain its access to PWLB loans.
- 4.9 In addition, the Council may borrow further short-term loans to cover unplanned cash flow shortages.
- 4.10 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are summarised below:
- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
  - UK Infrastructure Bank Ltd
  - Any institution approved for investments
  - Money market loans (long term & temporary)
  - Any other bank or building society authorised to operate in the UK
  - UK Local Authorities
  - UK public and private sector pension funds (except the Local Government Pension Scheme administered by Hampshire County Council)
  - Capital market bond investors
  - UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues.
  - Lottery monies
- 4.11 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Private Finance Initiative
- Sale and leaseback
- Similar asset based finance

4.12 The Council has previously raised all of its borrowing on a short-term basis from Local Authorities. In future the Council expects to continue to utilise this source and is also likely to utilise the PWLB for longer-term loans as appropriate. The Council continues to investigate other sources of finance, that may be available at more favourable rates.

4.13 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment if the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.

## 5 **ANNUAL TREASURY MANAGEMENT INVESTMENT STRATEGY 2024-25**

5.1 The Guidance on Local Government Investments in England gives priority to security and liquidity, and the Council's aim has been to achieve a yield commensurate with these principles.

5.2 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. As at 31 December 2023 the Council's investment balance stood at £39.7m. In future years the Council expects to hold a minimum of £25m in investments. Further detail on current investments is given in Appendix 2.

5.3 During 2023 the Council has generated returns from existing long-term pooled fund investments together with diversification within the Council's investment portfolio. The Council held the following investments on 31 December 2023:

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- £19.3m in pooled funds (providing a balance across a range of 6 different types of funds).
- £24.7m deposited with other local authorities
- £15.0m held in money market funds with next day access

- 5.4 **Objectives:** The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. 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, 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) issues when investing.
- 5.5 **Strategy:** The Council's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.
- 5.6 The CIPFA Code does not permit local authorities to borrow to invest purely of financial gain. Borrowing and investing for day-to-day treasury management is permitted.
- 5.7 Long-term investments are also permitted for treasury management purposes. Investments in strategic pooled funds which invest in products such as bonds, property and equity will in the longer term produce higher returns than cash investments. In the long term they are much more likely to protect the value of investments by gaining a return greater than inflation. This is the reason for the Council's current portfolio of strategic pooled funds.
- 5.8 The Council will give due consideration to the potential sale of strategic pooled funds in future as part of an ongoing review of their risk and return to the Council. A sale at the present time is not a suitable option as due to the current economic climate this would be realising a loss in these

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investments. The funds are considered long-term products that are unsuitable for sale at short notice.

- 5.9 **ESG policy:** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, 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.
- 5.10 **Business models:** Under the IFRS 9 standard on financial instruments, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed 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.
- 5.11 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown. The schedule of approved counterparties is underpinned by a detailed list of named counterparties. This list is maintained within Financial Services for treasury management operational purposes.

**Table 3: Treasury Management Investment Counterparties and Limits**

Sector	Time Limit	Counterparty Limit (£m)	Sector Limit (£m)
The UK Government	50 years	Unlimited	N/A
Local authorities and other government agencies	25 years	6	Unlimited
Money market funds*	N/A	6	Unlimited
Secured investments*	25 years	6	Unlimited
Banks (unsecured) *	13 months	3	30
Building societies (unsecured) *	13 months	3	6
Strategic pooled funds	N/A	6	30

\* **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 considered.

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



cash limit for secured investments.

- 5.14 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. 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.
- 5.15 **Banks and building societies (unsecured):** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
- 5.16 **Strategic pooled funds:** Bond, equity 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.
- 5.17 **Operational bank accounts:** The may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £2m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.
- 5.18 Investments may be made with banks or any public or private sector organisations that meet the above credit rating criteria. The Council may also invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management adviser.
- 5.19 **Credit rating:** Investment limits are set by reference to the lowest

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published long-term credit rating from a selection of external rating agencies. 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 considered.

**5.20 Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify the Council of 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 with that entity
- 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.

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

**5.22 Other Information on the Security of Investments:** 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 organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

**5.23 Reputational aspects:** The Authority is aware that investment with certain counterparties, while considered secure from a purely financial perspective, may leave it open to criticism, valid or otherwise, that may affect its public reputation, and this risk will therefore be considered when making investment decisions.

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5.24 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not reflected in general credit-ratings. In these circumstances, where the Council feels the whole market has been affected, it 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. 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 will cause investment returns to fall but will protect the principal sum invested.

5.25 **Investment limits:** The Council's revenue reserves available to cover investment losses are forecast to be £12.5 million on 31 March 2024. In order that no more than half of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £6 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries, and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country since the risk is diversified over many countries. Detail of investment limits are given in table 4 below.

**Table 4: Prudential Indicator: Liability Benchmark in £ millions**

	<b>Cash Limit</b>
Any group of pooled fund under the same management	15
Negotiable instruments held in a broker's nominee account	15
Foreign countries	6

5.26 **Liquidity management:** The Council reviews cash flow daily to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet

its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast. The Council will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

### 6 TREASURY MANAGEMENT PRUDENTIAL INDICATORS

6.1 The Treasury Management Code requires that local authorities set several indicators for treasury management performance, which have been set as below. A voluntary measure for credit risk as set out in paragraph 7.2.

6.2 **Credit Risk (Credit Score Analysis):** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its 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.

The advice from Arlingclose is to aim for an average A+, or higher, average credit rating, with an average score of 5 or lower. The scores are weighted according to the size of our deposits (value-weighted average) and the maturity of the deposits (time-weighted average).

Credit risk indicator	Target
Portfolio average credit rating	A+
Portfolio average credit score	5.0

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

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Liquidity risk indicator	Target
Total cash available within 3 months	£5m

- 6.4 **Interest Rate Exposures:** This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£2.0m
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£2.0m

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

- 6.5 **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:

Maturity Structure	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

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

The Council has set these limits at a broad level to avoid overly onerous restrictions on future borrowing decisions. At the present time 91% of the

## APPENDIX 1

Councils loans mature in under 12 months. The Council plans to further diversify the maturity of its debt as interest rates are expected to fall further reducing the cost of long-term debt. The Council wishes to have the full flexibility as to when this debt will mature. This indicator will continue to be reviewed in future.

- 6.6 **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 limits on the long-term principal sum invested to final maturities beyond the period end will be:

<b>Principal Sums Invested</b>	<b>2023-24</b>	<b>2024-25</b>	<b>2025-26</b>
Limit on principal invested beyond year end at any one time	£40m	£40m	£30m

## 7 RELATED MATTERS

- 7.1 The CIPFA Code requires the Council to include the following in its treasury management strategy.
- 7.2 **Policy on Use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk, and to reduce costs or increase income at the expense of greater risk. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e., those that are not embedded into a loan or investment).

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, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the

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appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

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.

**7.3 Markets in Financial Instruments Directive:** The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers, and fund managers, allowing it access to a greater range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Executive Head of Finance believes this to be the most appropriate status.

**7.4 Investment Training:** The investment training needs of the Council's treasury management staff are assessed on a continuous basis, discussed as part of the staff development reviews, and reviewed as the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

**7.5 Financial Implications - Investments:** The budget for investment income in 2024-25 is £2.35m, based on an average investment portfolio of £30m at an average interest rate of 4.8%. Performance of investments against budget will be reviewed on an ongoing basis and as part of our quarterly budget monitoring process.

**7.6 Financial Implications - Borrowing:** The budget for interest costs in relation to borrowing in 2024-25 is £8.68m (not including IFRIC 4 lease accounting interest). This is determined by taking the expected borrowing for the year multiplied by the expected interest rate for short-term borrowing for the same period.

**7.7 Other Options Considered:** The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Executive Head of Finance continues to believe 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.

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Alternative	2023-24	2024-25
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	Invest in a wider range of counterparties and/or for longer times	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 may not be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain



### **Appendix A: Arlingclose Economic and Interest Rate Forecast – November 2023**

#### **Underlying assumptions:**

- UK inflation and wage growth remain elevated but have eased over the past two months fuelling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.
- The MPC's message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.
- Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the timelier PMI figures suggest that the services sector is recovering from a weak Q3. Tighter policy will however bear down on domestic and external activity as interest rates bite.
- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.
- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects have diminished.
- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant loosening in the future to boost activity.
- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium-term level for Bank Rate.
- There is a heightened risk of fiscal policy and/or geo-political events causing substantial volatility in yields.

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### Forecast:

- The MPC held Bank Rate at 5.25% in November. We believe this is the peak for Bank Rate.
- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. We see rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.
- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.
- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
<b>Official Bank Rate</b>													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
<b>3-month money market rate</b>													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.40	5.40	5.40	5.30	5.15	4.80	4.30	4.10	3.80	3.50	3.25	3.05	3.05
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
<b>5yr gilt yield</b>													
Upside risk	0.00	0.25	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.77	3.75	3.75	3.75	3.70	3.60	3.50	3.50	3.40	3.30	3.30	3.30	3.35
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
<b>10yr gilt yield</b>													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.72	3.75	3.80	3.80	3.80	3.80	3.80	3.80	3.75	3.65	3.60	3.65	3.70
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
<b>20yr gilt yield</b>													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.16	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.25
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
<b>50yr gilt yield</b>													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.76	3.80	3.85	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.95	3.95	3.95
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

PWLB Standard Rate = Gilt yield + 1.00%

PWLB Certainty Rate = Gilt yield + 0.80%

PWLB HRA Rate = Gilt yield + 0.40%

UK Infrastructure Bank Rate = Gilt yield + 0.40%

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### Appendix B: Existing Investment and Debt Position – December 2023

	31/12/2023 Actual Portfolio £m	31/12/2023 Average Rate
<b>External borrowing:</b>		
Local authorities	162.0	4.7%
<b>Other long-term liabilities:</b>	1.4	1.0%
<b>Total gross external debt:</b>	163.4	4.7%
<b>Treasury investments:</b>		
Local authorities	24.7	5.30%
Money market funds	15.0	5.75%
Strategic pooled funds	19.3	7.13%
<b>Total treasury investments</b>	<b>39.7</b>	<b>6.02%</b>
<b>Net debt</b>	<b>123.7</b>	4.3%

### ANNUAL NON-TREASURY INVESTMENT STRATEGY 2024-25

#### 1 INTRODUCTION

- 1.1 The Council invests its money for three broad purposes:
- because it has surplus cash because 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).
- 1.2 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.
- 1.3 The statutory guidance defines investments as “all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios.” The Council interprets this to exclude (a) trade receivables which meet the accounting definition of financial assets but are not investments in the everyday sense of the word and (b) property held partially to generate a profit but primarily for the provision of local public services. This aligns the Council’s definition of an investment with that in the 2021 edition of the CIPFA Prudential Code, a more recent piece of statutory guidance.

#### 2 TREASURY MANAGEMENT INVESTMENTS

- 2.1 The Council typically receives its income in cash (e.g., from taxes and grants) before it pays for its expenditure in cash (e.g., through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. 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 fluctuate between £20m and £60m during the 2024/25 financial year.
- 2.2 **Contribution:** The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

### 3 SERVICE IMPROVEMENTS: LOANS

- 3.1 **Contribution:** The Council lends money to its subsidiary (Rushmoor Homes Limited), local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enabled the development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business. The Council established a Wholly Owned Company (WOC) subsidiary, Rushmoor Homes Limited (RHL), in April 2020. The Council will lend to RHL at a commercial rate to enable procurement of property.
- 3.2 **Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. To limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

#### Loans for service purposes

Category of Borrower	2022-23 Actual £m	2023-24 Forecast £m	2024-25 Estimate £m
Local businesses	6.7	6.7	6.7
Subsidiaries & partnerships	0.7	1.2	3.0
Employees	0.1	0.1	0.1
Total	7.5	8.0	9.8

- 3.3 Accounting standards require the Council to set aside 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.
- 3.4 **Risk assessment:** The Council assesses the risk of loss before entering into lending agreements and whilst holding service loans by assessing the counterparty's resilience, the service users' needs that the loan is designed to help meet and how these will evolve over-time. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Executive Head of Finance. All loans will be subject to contract agreed by the Corporate Manager – Legal

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Services. All loans must be approved by Full Council and will be monitored by the Executive Head of Finance.

- 3.5 **FIL loan interest deferral:** The Council has two loan agreements with FIL. As reported to members in the Revenue Budget Monitoring Report for P1 (FIN2115) the Council and the other funding consortium funding partners as part of the original FIL loan agreed to defer interest payments to provide cashflow support to Farnborough International Limited (FIL) following the cancellation of the 2020 Airshow. A revised Intercreditor Agreement was signed during 2021 that includes the capitalisation of interest and deferral of repayments to the public sector funding partners by 2 years. The first loan repayments will now be due in June 2026 with a further payment in June 2028. Therefore, the Council will not receive the full payment of interest covering the period from March 2020 to March 2022 until March 2024 subject to the covenant agreements within the agreement being met.

### 4 **COMERCIAL INVESTMENTS: PROPERTY**

- 4.1 **Contribution:** The Council has investments in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services.
- 4.2 In November 2020 the Public Works and Loan Board (PWLB) issued new lending terms (subsequently clarified in August 2021) making it conditional that Local Authorities have no intention to buy investment assets primarily for yield in the current and follow two financial years. To access this facility the Council revised its capital programme and will not be acquiring any further investment assets primarily for yield.

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### Property held for investment purposes.

Property by Type	31-Mar-23 Actual		
	Purchase Cost £m	Gains / (Losses) £m	Value in Accounts £m
Industrial units	51.8	9.3	61.1
Offices	36.6	(3.9)	32.7
Retail	31.6	(4.4)	27.2
Caravan Park	0.3	3.1	3.5
Petrol Stations	2.3	0.3	2.5
Waste Recycling	1.0	0.2	1.1
Mixed Use	0.2	0.1	0.3
Other	0.2	(0.0)	0.2
<b>Total</b>	<b>123.9</b>	<b>4.8</b>	<b>128.7</b>

Property by Type	31-Mar-24 Expected		
	Purchase Cost £m	Gains / (Losses) £m	Value in Accounts £m
Industrial units	51.8	-	59.3
Offices	36.6	-	32.7
Retail	31.6	-	27.2
Caravan Park	0.3	-	3.5
Petrol Stations	2.3	-	2.5
Waste Recycling	1.0	-	1.1
Mixed Use	0.2	-	0.3
Other	0.2	-	0.2
<b>Total</b>	<b>123.9</b>	<b>-</b>	<b>128.7</b>

- 4.3 **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.
- 4.4 Where value in accounts is at or above purchase cost: 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.

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- 4.5 Should the 2023/24 and 2024/25 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.
- 4.6 Where value in accounts is below purchase cost: The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss, and the Council will therefore take mitigating actions to protect the capital invested. These actions include:
- Quarterly review of the portfolio
  - Consideration of advice from the Council's commercial property advisers by the Council's Property Investment Advisory Group (PIAG). Currently is agreed that the best course of action is to hold the majority of the assets as values will increase over the long term and most assets within the portfolio are considered sound with strong covenants/dependable income streams. Assets identified for disposal will be taken forward to market.
- 4.7 **Risk assessment:** The Council assesses the risk of loss before entering and whilst holding property investments by:
- Assessment of the relevant market sector(s) including the level of competition, barriers to entry/exit, future market prospects
  - Assessment of exposure to particular market segments to ensure adequate diversification
  - Use of external advisors if considered appropriate by the Executive Head of Finance
  - Continual monitoring of risk across the whole portfolio and specific assets
- 4.8 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert into liquid asset at short notice and will be subject to market conditions in terms of timescales involved. However, to ensure that invested sums could be accessed when they are needed the portfolio will be regularly reviewed and prioritised to ensure that commercial property could be sold as a going concern as soon as possible.

## 5 LOAN COMMITMENTS AND FINANCIAL GUARANTEES

- 5.1 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.
- 5.2 The Council has contractually committed £0.167m of loans to RHL for



2023-24 and £0m for 2024/25.

5.3 The Council has no financial guarantees.

**6 PROPORTIONALITY**

6.1 The Council has become increasingly dependent on profit generating investment activity to achieve a balanced revenue budget. Table below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Strategy. The Head of Service responsible for the Council’s property and estates functions would review the cause of any shortfall and identify any actions needed to ensure the income shortfall is mitigated or remedied.

6.2 With the introduction the revised PWLB lending terms, the Council has no intention to purchase investment assets primarily for yield in the current and following two financial years. With no further expenditure planned on investment assets primarily for yield the proportion of investment to Gross service expenditure will fluctuate because of changes in investment income from existing holdings and changes in Gross service expenditure.

**Proportionality of Investments**

	<b>2023-24</b>	<b>2023-24</b>	<b>2024-2025</b>	<b>2025-2026</b>	<b>2026-2027</b>
	<b>Budget</b>	<b>Forecast</b>	<b>Budget</b>	<b>Budget</b>	<b>Budget</b>
Investment income	8.3	7.9	8.7	9.5	9.5
Gross service expenditure	30.9	31.3	32.7	33.5	34.6
Proportion	26.7%	25.1%	26.6%	28.4%	27.5%

**7 BORROWING IN ADVANCE OF NEED**

7.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

7.2 The Council may, in supporting the delivery of the Council’s Capital Programme, borrow in advance of need where it is expected to demonstrate the best longer-term value for money position. 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 (ie: the cost of holding does not outweigh the benefits of early borrowing) and that the Council can ensure the security of such funds.

- 7.3 The Council is aware that it will be exposed to the risk of loss of the borrowed sums, and potential interest rate changes. These risks will be managed as part of the Council's overall management of its treasury risks and will be reported through the standard reporting method.

### 8 CAPACITY, SKILLS AND CULTURE

- 8.1 **Elected members and statutory officers:** The Council recognises that those elected Members and statutory officers involved in the investment decision making process must have appropriate capacity, skills and information to enable them to:

- take informed decisions as to whether to enter into a specific investment;
- to assess individual investments in the context of the strategic objectives and risk profile of the Council; and
- to enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Cabinet have appropriate skills, providing training and advisor support where there is a skills gap.

- 8.2 **Agents:** Lambert Smith Hampton Investment Management (LSHIM) were appointed as the Council's external investment advisor during 2019/20. LSHIM manage property investment portfolios for institutions, local authorities, and private family offices. The LSHIM investment team are all RICS qualified and have significant combined commercial experience. The assigned investment team can call on the wider expertise and resource of the parent company (Lambert Smith Hampton-LSH) that have offices throughout the UK.
- 8.3 **Commercial deals:** The Council will ensure that the Cabinet, officers and agents negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.
- 8.4 **Corporate governance:** Any non-treasury management (i.e. property, service loans etc) investment decisions will be scrutinised by Executive Leadership Team, Property Investment Activity Group (PIAG) and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event the Committee can make any recommendations to the Council if it sees fit.

### 9 INVESTMENT INDICATORS

## APPENDIX 2

- 9.1 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.
- 9.2 **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.

<b>Total Investment Exposure £m</b>	<b>31-Mar-23 Actual</b>	<b>31-Mar-24 Forecast</b>	<b>31-Mar-25 Forecast</b>
Treasury Management Investments	20.4	30.9	25.0
Service Improvement: Loans	7.5	8.0	9.8
Commercial Investments: Property	128.7	123.9	123.9
<b>Total</b>	<b>152.1</b>	<b>159.7</b>	<b>159.7</b>
Commitments to lend	-	0.167	-
Guarantees issued on loans	-	-	-
<b>Total exposure</b>	<b>152.1</b>	<b>159.7</b>	<b>159.7</b>

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

<b>Investments funded by borrowing £m</b>	<b>31-Mar-23 Actual</b>	<b>31-Mar-24 Forecast</b>	<b>31-Mar-25 Forecast</b>
Treasury Management Investments	-	-	-
Service Improvement: Loans	7.8	27.8	27.8
Service Improvement: Shares	-	-	-
Commercial Investments: Property	92.2	92.2	92.2
<b>Total</b>	<b>100.0</b>	<b>120.0</b>	<b>120.0</b>

## APPENDIX 2

- 9.4 **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.

<b>Investments net rate of return</b>	<b>31-Mar-23 Actual</b>	<b>31-Mar-24 Forecast</b>	<b>31-Mar-25 Forecast</b>
Treasury Management Investments	-6.69%	4.35%	4.35%
Service Improvement: Loans	0%	0%	0%
Commercial Investments: Property	5.2%	5.2%	5.2%
<b>All Investments</b>	4.63%	5.1%	5.1%

- 9.5 Treasury management returns are forecast to recover in 2024-25 predominantly due to an improved performance of the capital value of shares owned in strategic pooled funds. Interest rates for cash investments have also been higher this year. Service investment loan returns are forecast to remain low during 2023-24 due to the interest deferral on Farnborough International Limited loan, which the Council entered into as part of a funding consortium.

### MINIMUM REVENUE PROVISION STATEMENT 2024-25

1. Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the former Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.
2. The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits.
3. The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year for calculating a prudent amount of MRP. The guidance recommends charging MRP over the expected useful life of the assets created by the capital expenditure and gives two calculation options. The Council currently uses the straight-line method, where equal annual charges for MRP are made over the asset life.
4. The alternative in the guidance is to use the annuity method, where MRP is calculated as the principal repayment on an annuity loan, like a repayment mortgage. This sees the MRP charge increase each year over the asset life but remains a prudent option since the interest cost associated with the outstanding CFR reduces as the balance reduces, leading to a flat total cost of MRP plus interest, as with a fixed-rate repayment mortgage.
5. The Council will now use the annuity basis and an annuity rate equal to the average PWLB certainty rate for annuity loans in the year of expenditure, for a loan term equal to the asset life, and forecast rates for future years, starting in the year after the asset becomes operational or in the year following expenditure was incurred up to a maximum of 50 years.
7. For assets acquired by finance lease or private finance initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.
8. Where former operating leases have been brought onto the balance sheet on 1st April 2022 due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.
9. Where loans are made to other bodies and designated as capital expenditure, no MRP will be charged. However, the capital receipts

## **APPENDIX 3**

generated by the repayments on those loans will be set aside to repay debt instead.