

## Capital, Treasury and Investment Strategy - detail

### 1. Introduction

1.1 A capital strategy is the foundation of proper long-term planning of capital investment in assets and how it is to be delivered. It needs to link into the Council's overall corporate objectives and strategic priorities.

1.2 Council's need to invest in their assets, as they are the most valuable resource (termed as non-financial assets throughout the report).

1.3 Capital expenditure is defined as:

*"Money spent on acquiring or upgrading fixed assets, to increase the life of the asset or improve its productivity or efficiency to the organisation"*

1.4 Capital planning is about investment in assets and is, therefore, linked to asset planning. Council assets have been acquired using public money, so we have an obligation to protect the value of those assets. Failure to do this means assets will gradually deteriorate and in the long-term this puts the Council's ability to fulfil its basic responsibilities at risk.

1.5 An integral part of a capital strategy is how the programme is financed. This is inexplicitly linked to treasury management and informs the resources available for treasury investments.

1.6 Treasury management is an important part of the overall management of the Council's finances. Council's may borrow or invest for any purpose related to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs.

1.7 The CIPFA definition of treasury management is:

*"the management of the organisations 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"*

1.8 The Local Government Act 2003 requires Local Authorities to have regard to the Prudential Code. The Prudential Code, last revised in 2021, requires Local Authorities to determine a capital strategy. The strategy is to have regard to:

#### Capital expenditure

- an overview of the governance process for the approval and monitoring of capital expenditure
- a long-term view of capital expenditure plans
- an overview of asset management planning
- any restrictions around borrowing or funding of ongoing capital finance

#### Debt and borrowing and treasury management

- a projection of external debt and use of internal borrowing to support capital expenditure

- provision for the repayment of debt over the life of the underlying asset
- authorised limit and operational boundary for the following year
- the approach to treasury management including processes, due diligence and defining the risk appetite

#### Commercial activity

- the Council's approach to commercial activities, including processes, ensuring effective due diligence and defining the risk appetite including proportionality in respect of overall resources

#### Other long-term liabilities

- an overview of the governance process for approval and monitoring and ongoing risk management of any other financial guarantees and other long-term liabilities.

#### Knowledge and skills

- a summary of the knowledge and skills available to the Council and confirmation that these are commensurate with the risk appetite.

- 1.9 Included in these regulations and codes of practice, we are required to set Prudential and Treasury Indicators for assessing the prudence, affordability and sustainability of capital expenditure and treasury management decisions. The MHCLG investment guidance also suggest some local indicators.
- 1.10 The following sections of the strategy outline the Council's balance sheet and treasury position, capital expenditure and treasury management strategy.
- 1.11 In order to understand the context of the capital and investment strategy (where we are going and how we will get there), it is important to understand where we are now.

## **2. External Context**

### **Economic Background**

- 2.1 The Bank of England (BoE) increased Bank Rate by 0.75% to 3.0% in November 2022, the largest single rate hike since 1989 and the eighth successive rise since December 2021
- 2.2 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. Inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.
- 2.3 Growth is then expected to continue to fall throughout 2023 and the first half of 2024.
- 2.4 CPI inflation is expected to peak at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets with a peak of 5.25%.
- 2.5 the MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

**Credit outlook**

- 2.6 The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.
- 2.7 There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability

**Interest rate forecast**

- 2.8 Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.
- 2.9 While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.
- 2.10 Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.6%, 3.7%, and 3.9% respectively over the 3-year period to September 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

**3. Balance sheet and treasury position****Balance Sheet**

- 3.1 The Council has a strong asset backed balance sheet

	Balance at 31 March 2021		Balance at 31 March 2022		
	£'000	£'000	£'000	£'000	£'000
Long term assets	966,521			1,052,236	
Short term assets	92,938			65,185	
		1,059,459	89%	1,117,421	90%
Long term investments	27,022			39,174	
Short term investments	100,969			90,873	
		127,991	11%	130,047	10%
<b>Total assets</b>		<b>1,187,450</b>		<b>1,247,468</b>	
Current liabilities	(62,544)			(57,992)	
Long term liabilities	(143,258)			(116,284)	
		(205,802)	40%	(174,276)	36%
Short term borrowing	(163,772)			(134,294)	
Long term borrowing	(147,435)			(169,599)	
		(311,207)	60%	(303,893)	64%
<b>Total liabilities</b>		<b>(517,009)</b>		<b>(478,169)</b>	
<b>Net assets</b>		<b>670,441</b>		<b>769,299</b>	

- 3.2 The summary balance sheet shows that cash investments make up only 10% of the Councils assets. Investment property makes up 17% of the long-term assets (being £174 million). The largest proportion of our liabilities is long-term borrowing, of which 87% is HRA debt, and the remaining 13% is for the WUV project.

#### *Financial Stability/Sustainability*

- 3.3 Gearing is a measure of financial leverage, demonstrating the degree to which activities are funded by our own money or by debt. The higher the leverage, the riskier the organisation is considered to be because of the financial risk and that they must continue to service its debt regardless of the level of income or surplus. Gearing can be calculated by using the debt ratio (total debt / total assets) and is the proportion of our assets that are financed by debt.

	2021-22 Actual ('000)	2022-23 Outturn ('£000)	2023-24 Estimate ('£000)	2024-25 Estimate ('£000)	2025-26 Estimate ('£000)	2026-27 Estimate ('£000)
Total debts	303,893	240,235	388,277	454,290	476,892	479,417
Total assets	1,247,468	1,326,505	1,503,680	1,575,442	1,620,925	1,652,128
Debt Ratio %	24%	18%	26%	29%	29%	29%

- 3.4 This shows that our gearing is low, but increasing and remaining steady, which is because of our strong asset base, and projecting forwards capital spend will continue to grow our asset base.
- 3.5 Future years' estimates are based on adding the budgeted cost of capital investment onto the assets, and adding the assumed debt funded expenditure (not external debt as shown in the liability benchmark) to the debt figure to give an idea how the financial stability of the Council will be evolving.

*Local indicators*

3.6 The Local Government Association (LGA) use a number of different financial indicators to assess the financial sustainability of Councils as part of their financial diagnostic tool. We have chosen to use the following as local indicators:

- Total debt as a % of long-term assets
- Ratio of equity by net revenue expenditure
- Un-ringfenced reserves as a % of net revenue expenditure
- Working capital as a % of net revenue expenditure
- Short term liability pressure (short term liabilities as a % of total liabilities)
- Total investments as a % of net revenue expenditure
- Investment property as a % of net revenue expenditure

3.7 Suggested MHCLG local indicators are:

<b>Indicator</b>	<b>Description</b>
Debt to net service expenditure (NSE) ratio	Gross debt as a percentage of net service expenditure
Commercial income to NSE ratio	Dependence on non-fees and charges income to deliver core services. Fees and Charges are to be netted off gross service expenditure to calculate the NSE
Investment cover ratio	The total net income from property investments, compared to the interest expense
Loan to value ratio	The amount of debt compared to the total asset value
Target income returns	Net revenue income compared to equity. This is a measure of achievement of the portfolio of properties
Benchmarking of returns	As a measure against other investments and against other Council's property portfolios
Gross and net income	The income received from the investment portfolio at a gross level and net level (less costs) over time
Operating costs	The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-investments expands
Vacancy levels and tenant exposures for non-financial investments	Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is as productive as possible

3.8 These indicators will be calculated on an actual basis and will form part of the outturn report.

**Treasury position**

3.9 The following table shows the Council's current treasury position, which is the next step to moving forward from the balance sheet.

	March 22 Actual £'000	Dec 22 position £'000
<b>Investments</b>		
<u>Managed in-house</u>		
Call Accounts	330	2,810
Notice Accounts - UK	3,000	3,000
Money Market Funds	39,220	11,516
Temporary Fixed Deposits	57,500	53,000
Long term Fixed Deposits	18,500	20,000
Cash plus	5,000	0
Short term bonds	2,000	2,500
Gilts	0	5,000
Covered Bonds	16,100	11,400
CD	0	2,000
<b>Total investments managed in-house</b>	<b>141,650</b>	<b>111,226</b>
<u>Pooled Funds</u>		
CCLA	6,490	6,717
M&G	3,530	0
Schroders	700	730
UBS	2,220	1,797
Royal London	2,330	2,134
Fundamentum	1,980	2,066
Aegon	0	2,438
Funding Circle	500	98
<b>Total pooled funds investments</b>	<b>17,750</b>	<b>15,980</b>
<b>Total Investments</b>	<b>159,400</b>	<b>127,206</b>
<b>Borrowing</b>		
Temporary borrowing	163,772	87,000
Long-term borrowing (PWLb)	147,435	175,000
<b>Total borrowing</b>	<b>311,207</b>	<b>262,000</b>
<b>Net investments / (borrowing)</b>	<b>(151,807)</b>	<b>(134,794)</b>

3.10 The table shows the position at the start of the financial year (included in the balance sheet), and the position at the end of December 2022 (the latest position).

3.11 Investment balances have reduced, due to repaying temporary borrowing. The net borrowing position has decreased since due to a higher reduction in borrowing than reduction in investments.

#### 4. Capital expenditure

4.1 To understand the movement in our balance sheet over the medium term, it is important to understand the anticipated capital expenditure and capital receipts over that time.

4.2 The Council has an ambitious Corporate Plan and medium to long-term aspirations within the Borough. There is, therefore, a number of processes in place to ensure the capital programme is approved and monitored for good governance.

4.3 The Council has the following parts to its capital programme:

- Capital vision (radar stage)

- Approved programme (outline & final business case stage)
- Provisional programme (strategic outline case stage)
- Reserves and s106 funded programmes

- 4.4 The Council splits the schemes into three types to enable us to review the amount of spend on statutory items against those which we are expecting a financial return from as part of our regeneration plans:
- a) development for financial reasons - those schemes that are for economic growth, regeneration and redevelopment (including housing schemes) which have a neutral or positive direct financial benefit to the council. It is envisaged that this is achieved by the revenue income generated by the completed scheme/project being greater than the capital financing costs on the GF revenue account or by the capital receipts generated from the scheme being sufficient to repay any debt used to finance the scheme such that there are no borrowing costs on the revenue account.
  - b) development for non-financial reasons - those schemes that are for economic growth, regeneration, redevelopment, including housing schemes and infrastructure which have no direct financial benefit to the Council and
  - c) non-development essential schemes (i.e., those that must be done to keep our fixed assets in an acceptable condition) - those schemes that need to be undertaken for statutory/compliance reasons, are required to maintain service provision at existing levels (or prevent cost escalation). They often do not have cashable savings or efficiencies associated with them, but often prevent further cost escalation of services. Essential schemes often have revenue costs associated with them, particularly if funded from borrowing.
- 4.5 The capital programme covers a 5 to 10-year period, with more emphasis on the first five years.
- 4.6 Any projects that are expected to be delivered after the first five years of the programme, or those where the scheme has not yet been fully identified are placed on the Council's Capital Vision. The vision enables us to model the potential financial impact of these schemes and be aware of the potential schemes to be brought forward onto the GF capital programme in future.
- 4.7 Many of the bids in the capital programme are development projects, and their expenditure and income profile can span beyond the five-year timeframe. The Council's capital programme, is therefore, a prudent one. Any income arising as a result of a development project that is outside the five years or is currently only estimated is shown in the capital vision. Any development projects will be subject to a thorough business case, which will assess the delivery model, and officers will ensure that they are financially viable before they can proceed.
- 4.8 The Council maintains a provisional programme to be able to produce a realistic five-year programme and include the financial implications in the outline budget. It also gives Councillors an indication as to what schemes are being investigated, and an indication as to when these schemes may be progressed.
- 4.9 Under the financial regulations, schemes that are fully funded by s106 receipts or grants and contributions can be added to the capital programme under delegation.
- 4.10 During the year, the Capital Monitoring Group (CMG) meets on a quarterly basis to review the scheduling of the capital programme. The group consists of officer

representatives across the Council from different departments to give a joined-up approach.

- 4.11 The capital programme is also reviewed by CMT and Corporate Governance and Standards Committee (CGSC) as part of the regular quarterly financial monitoring and then as part of the final accounts report. Under the PPM Governance framework, the Major Project Portfolio Board, and its subgroups, meet regularly, and they receive highlight reports on the progress of all the major projects in the capital programme.
- 4.12 The proposed financing of the capital programme assume available resources will be used in the following order:
- a) capital receipts from the sale of assets (after applying the flexible use of capital receipts policy if applicable)
  - b) capital grants and contributions
  - c) earmarked reserves
  - d) the general fund capital schemes reserve
  - e) revenue contributions
  - f) internal borrowing
  - g) external borrowing
- 4.13 The actual financing of each years' capital programme is determined in the year in question.
- 4.14 Capital expenditure is split between the GF (incorporating non-HRA housing) and HRA housing.
- 4.15 Our current approved capital programme, revised in year for updates in the programme and for the new bids to be submitted for approval by the Executive is as follows:

CAPITAL EXPENDITURE SUMMARY	2022-23	2022-23	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
	Approved £000	Outturn £000	Variance £000	Estimate £000	Estimate £000	Estimate £000	Estimate £000	Estimate £000
<b>General Fund Capital Expenditure</b>								
- Main Programme	107,404	58,822	(48,582)	74,886	2,833	2,000	2,000	2,000
- Provisional schemes	44,510	725	(43,785)	118,833	67,989	43,483	27,642	29,203
- Schemes funded by reserves	1,618	1,530	(88)	1,031	940	0	0	0
- S106 Projects	58	263	205	122	0	0	0	0
- New Bids (net cost)	0	0	0	1,948	4,052	2,430	1,250	750
<b>Total Expenditure</b>	<b>153,590</b>	<b>61,340</b>	<b>(92,250)</b>	<b>196,820</b>	<b>75,814</b>	<b>47,913</b>	<b>30,892</b>	<b>31,953</b>
<b>Financed by :</b>								
Capital Receipts	0	(0)	(0)	0	0	(21,641)	(27,117)	(22,593)
Capital Grants/Contributions	(47,472)	(19,758)	27,714	(46,336)	(4,589)	(1,020)	0	0
Capital Reserves/Revenue	(1,838)	(2,979)	(1,141)	(1,131)	(1,160)	(220)	0	0
Borrowing	(104,280)	(38,603)	65,677	(149,353)	(70,065)	(25,032)	(3,775)	(9,360)
<b>Financing - Totals</b>	<b>(153,590)</b>	<b>(61,340)</b>	<b>92,250</b>	<b>(196,820)</b>	<b>(75,814)</b>	<b>(47,913)</b>	<b>(30,892)</b>	<b>(31,953)</b>
<b>Housing Revenue Account Capital Expenditure</b>								
- Main Programme	52,909	32,869	(20,040)	27,266	7,847	400	0	0
- Provisional schemes	7,281	75	(7,206)	15,928	26,324	34,373	49,575	5,575
- New bids	0	0	0	20,600	0	0	0	0
<b>Total Expenditure</b>	<b>60,190</b>	<b>32,944</b>	<b>(27,246)</b>	<b>63,794</b>	<b>34,171</b>	<b>34,773</b>	<b>49,575</b>	<b>5,575</b>
<b>Financed by :</b>								
- Capital Receipts	(8,540)	(3,208)	5,332	(8,494)	(3,430)	(3,521)	0	0
- Capital Reserves/Revenue	(40,103)	(18,188)	21,915	(55,300)	(30,741)	(31,252)	(49,575)	(5,575)
- Borrowing	0	0	0	0	0	0	0	0
<b>Financing - Totals</b>	<b>(48,643)</b>	<b>(21,396)</b>	<b>27,247</b>	<b>(63,794)</b>	<b>(34,171)</b>	<b>(34,773)</b>	<b>(49,575)</b>	<b>(5,575)</b>

- 4.16 The programme has slipped in 2022-23 – estimated expenditure on the GF of £154 million, has been reduced to £61 million. The majority of this relates to expenditure on regeneration schemes and has been moved into later years.
- 4.17 We split expenditure on housing services between the HRA and GF housing. Any expenditure that relates to the Council’s own stock, or its role as a landlord, is accounted for in the HRA capital programme. All other housing related expenditure is accounted for in the GF capital programme. Where there are mixed use schemes, we will split the expenditure based on the proposed percentage of social/affordable housing to be developed.

#### **New capital schemes**

- 4.18 To ensure good governance, the Council has the following process for the capital programme.
- 4.19 Each year, as part of the budget cycle, officers are asked to submit bids for capital funding covering at least a five-year period, and also radar projects for the capital vision. Requests also come through via the PPM mandate process the Council has adopted.
- 4.20 Any projects that are expected to be delivered after the five-year period, of those where a scheme has not yet been fully identified are placed on the Council’s Capital Vision <sup>1</sup>(see Appendix 9). This allows us to model the potential financial impact of these schemes and be aware of schemes that are likely to be brought forward onto the GF capital programme in future and start planning potential funding streams for those schemes.
- 4.21 Many of the bids in the programme are development projects, and their expenditure and income profile could span beyond the five-year timeframe in this report. This report, therefore, shows a prudent capital programme and any income arising as a result of a development project (either revenue or capital) that is outside of the five years or is currently only estimates, is shown on the capital vision.
- 4.22 Some capital receipts or revenue streams may arise as a result of investment in particular schemes, but in most cases are currently uncertain and it is too early to make assumptions. Some information has been included in the capital vision highlighting the potential income. It is likely there are cash-flow implications of the development schemes, where income will come in after the five-year time horizon and the expenditure will be incurred earlier in the programme.
- 4.23 Each project will require a business case, in line with guidance set out in the HM Treasury Green Book (‘Green book’). The following applies:
- Simple non-complex projects (e.g., BAU R&M) – a simple business justification case will be required to justify the spending proposal
  - All other projects will require a 3-stage business case consisting of:
    - a strategic outline case (i.e., the capital bid)
    - a detailed outline business case evaluating the strategic case, economic case (including options appraisal), commercial viability, financial affordability and management case for change – this will be

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<sup>1</sup> Long-term schemes identified in documents such as the Corporate Plan, SCC Local Transport Plan, the Councils’ Regeneration Strategy, Local Plan and the emerging Infrastructure Delivery Plan.

- reported to the Executive at the point a project is asking for approval to be moved from the provisional to the approved capital programme
- a final business case – setting out the procurement process and evaluation of tenders prior to the contractual commitment of expenditure

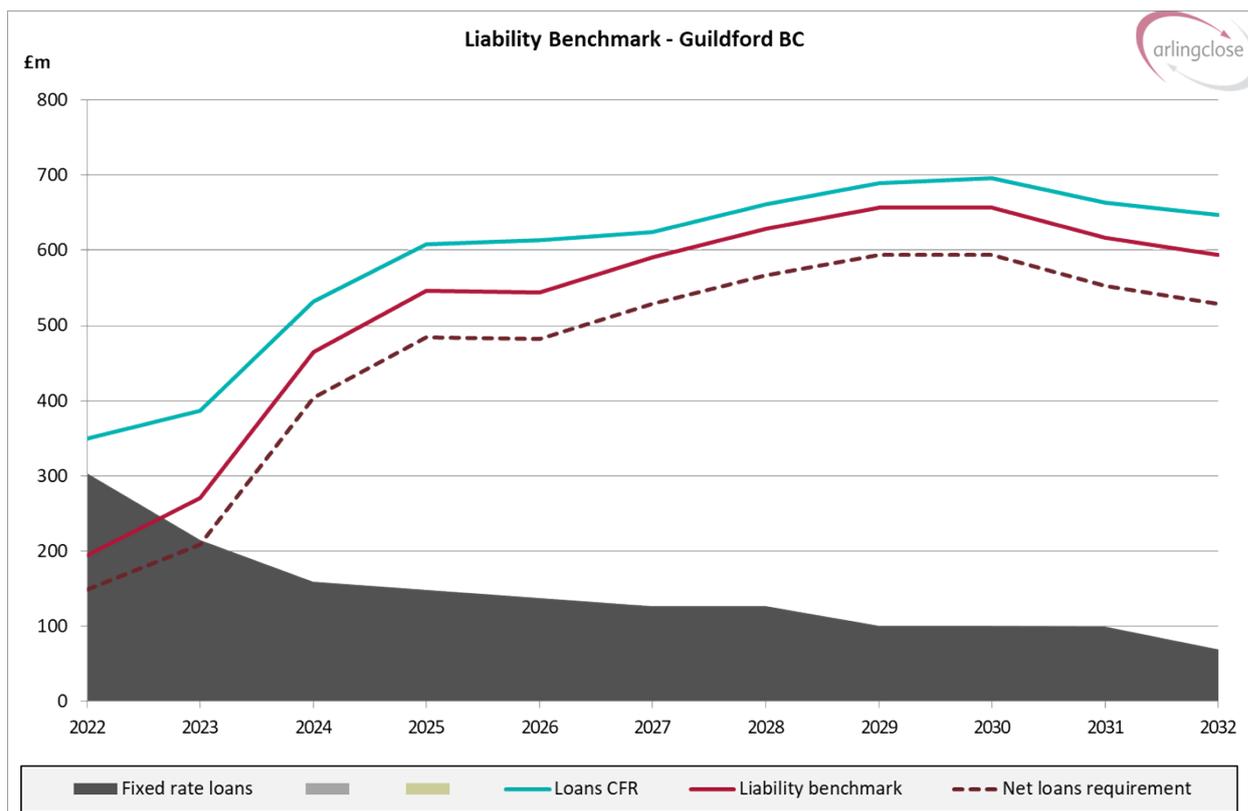
- 4.24 The Council has a limited amount of resources and needs to have regard to the overall affordability of the capital programme in future years. Each scheme, therefore, needs to be evaluated to ensure it meets the Council's objectives. The criteria is:
- a) Each project must meet one of the five spending objectives:
    - a. Economy (invest to save, i.e., to reduce cost of services)
    - b. Efficiency (i.e., to improve throughput and unit costs)
    - c. Effectiveness (improving outcomes for the community)
    - d. Retendering to replace elements of the existing service
    - e. Statutory or regulatory compliance (i.e., H&S)
  - b) Each scheme must be assessed against the fundamental themes within the Council's Corporate Plan to show how well it contributes towards achieving the strategic objectives of the Council
  - c) Each scheme must have some or all of a cost benefit analysis, including but not limited to detailing the Net Present Value calculation (NPV) of both cash-flows and quantifiable economic benefits, payback period, Internal Rate of Return (IRR), Peak Debt and the assessment of its Revenue impact.
  - d) NPV is to be the most important criteria and must remain positive over a range of sensitivities for the Council to invest
  - e) NPV calculation must use the recommended treasury discount rate in the Green Book, currently at 3.5%
  - f) The revenue impact must be neutral or positive on the GF for all development schemes for financial reasons
  - g) All projects should assess the qualitative benefits
- 4.25 Once Councillors have approved the new bids, they will be added to the provisional capital programme, unless the business case specifically recommends the scheme be implemented immediately, explaining in detail why.
- 4.26 Most projects over £200,000 require a further outline business case to be approved by the Executive before a project can be moved from the provisional to the approved programme, and authority is provided for officers to start implementing the project. Any project under £200,000 can be moved under delegation.
- 4.27 The net addition of the new bids for the GF is assumed to be funded by borrowing. The HRA new bids are assumed to be funded 1/3 capital receipts (RTB receipts), 1/3 borrowing and 1/3 capital reserves.

## **5. Treasury management, borrowing and investment strategy**

- 5.1 Treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The Council both borrows and invests substantial amounts 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.
- 5.2 Treasury risk management at the Council is conducted within the framework of the CIPFA Treasury Management in the Public Services: Code of Practice 2021 ('TM 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 TM Code.

### **Capital Financing Requirement (CFR)**

- 5.3 With the current treasury position, and future capital expenditure plans known, we can prepare a table showing the extent of our need to borrow for capital purposes (the CFR), and what we have borrowed, compared to our level (and projected level) of reserves. We split this between the HRA and the GF.
- 5.4 The CFR is derived from unfinanced capital expenditure, which arises when there are no capital receipts or reserves available to fund the capital programme.
- 5.5 The Council's investments consist of usable reserves and working capital and are the underlying resources available for investment.
- 5.6 The updated Codes require a new Prudential Indicator called the Liability Benchmark which Guildford had already been reporting for some years. This 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.



- 5.7 The liability benchmark shows the lowest risk level of borrowing – i.e., using the Council’s overall cash to fund the capital programme, and only externalising the borrowing when our minimum liquidity requirement is reached. If the liability benchmark line rises above the amount of loans we have (shaded area), we need to borrow externally and no longer have any internal borrowing capacity
- 5.8 The differential between the CFR and the net loans requirement is the Council’s overall external borrowing need. Where the external borrowing amount is lower than the CFR, it means we have internally borrowed and used non-capital receipts and reserves to initially finance capital expenditure (i.e., the Council’s overall cash). Items on the capital vision are currently excluded, mainly because the cost and/or timings of the schemes are unknown.
- 5.9 The Prudential Code recommends that the Council’s total debt (external borrowing) should be lower than its forecast CFR over the next three years – in other words, not over borrowing. The above shows that we are expecting to comply with this recommendation.
- 5.10 The table below shows our gross debt position against our CFR. This is one of the Prudential Indicators, and is a key indicator of prudence. This indicator aims to ensure that, over the medium-term, debt will only be for a capital purpose. We monitor this position and demonstrate prudence by ensuring that medium to long-term debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years (2022-23 to 2024-25).

Position at 31 March	Actual	Forecasts		£m			
	2022	2023	2024	2025	2026	2027	2028
Loans CFR	350.1	386.3	532.5	608.5	613.5	624.2	660.9
External borrowing	-303.7	-214.6	-159.0	-148.3	-137.7	-127.1	-126.4
Internal (over) borrowing	46.3	171.7	373.6	460.1	475.8	497.1	534.5
Balance sheet resources	-201.0	-177.6	-128.9	-123.7	-130.9	-95.3	-93.8
Investments (new borrowing)	154.6	5.9	-244.6	-336.4	-344.9	-401.8	-440.8

- 5.11 The Council has an increasing CFR due to the increasing need to borrow for the GF capital programme. The increase in estimated capital spend is more than the annual MRP. We are projecting the cash balance of the Council to reduce, whilst maintaining a good level of (core) reserves over the period shown in the table.
- 5.12 HRA reserves are decreasing over the early part of the period because of the HRA plans to build new social housing. Our priority is to build new homes rather than reduce debt.
- 5.13 GF reserves are projected to remain stable (our core cash). The CFR is increasing sharply due to the proposed capital programme. We are projecting a small need to borrow for the Council 2023-24, based on the current profile of the capital programme. We have taken out short-term loans in the year to cover cash flow.

#### **Borrowing strategy**

- 5.14 The Council's primary 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.
- 5.15 Given the significant cuts to public expenditure and in particular local government funding, our borrowing strategy continues to focus on affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources or to borrow short-term instead.
- 5.16 We will not automatically externally borrow for the GF when the cash balance is negative, although we will review the position in line with our borrowing strategy and the cash position for the Council as a whole.
- 5.17 When making decisions about longer-term borrowing, we will review the liability benchmark, as opposed to just the CFR, to assess the length of time we need to borrow for, according to our projections on the level of reserves we may have, as well as other factors detailed in our borrowing strategy. This helps to limit a number of treasury risks of holding large amounts of debt and investments. We will also assess borrowing based on individual projects.
- 5.18 By doing this, we are able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk.
- 5.19 We will undertake some modelling taking into account the projects listed in the Corporate Plan and capital vision, for example, which will tell us the potential impact on our borrowing requirement.
- 5.20 We will continue to monitor our internal borrowing position against the potential of incurring additional interest costs if we defer externalising borrowing into the future

when long-term borrowing costs are forecast to rise modestly. Arlingclose will assist us with this 'cost of carry' and breakdown analysis in line with our capital spending plans. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2023-24 with a view to keeping future interest costs low, even if this causes additional cost in the short term.

- 5.21 PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council needs to avoid this activity in order to retain access to PWLB funding.
- 5.22 The Council may decide to externalise our current internal borrowing, or to pre-fund future years' requirement, providing this does not exceed the authorised borrowing limit and the highest level of the CFR in the next three years (to ensure we do not over borrow).
- 5.23 Its output may determine whether we arrange forward starting loans where the interest 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.
- 5.24 We may continue to borrow short-term for cash flow shortages.
- 5.25 We have an agreement with Homes England on the WUV project, whereby we have been successful in being granted a loan at the local infrastructure rate. Borrowing will be taken out from the PWLB in line with the agreed timetable.

#### *Sources of borrowing*

- 5.26 We have previously borrowed our long-term borrowing from the PWLB. We will consider all borrowing sources moving forwards and may explore 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 TM Code.
- 5.27 PWLB loans are no longer available to local authorities planning to buy investment assets primary for yield, we made the decision several years ago to only buy properties for strategic reasons, and not those purely for yield.
- 5.28 We will consider, but are not limited to, the following long- and short-term borrowing sources:
- HM Treasury's PWLB lending facility
  - any institution approved for investments
  - 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 local pension fund)
  - capital market bond investors
  - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- 5.29 We may also raise capital finance by the following methods that are not borrowing, but may be classed as other debt liabilities:
- leasing
  - hire purchase

- sale and leaseback

#### *Municipal Bond Agency (MBA)*

- 5.30 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 because:
- a) borrowing authorities will be required to provide bonds investors with a guarantee to refund their investment in the event that the agency is unable to for any reason and
  - b) there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

#### *Short-term and variable rate loans*

- 5.31 These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the following interest rate exposure limits indicator, which is set to control the Council's exposure to interest rate risk. Financial derivatives may be used to manage this interest rate risk (see below).
- 5.32 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.
- 5.33 We are also required to present the maturity structure of borrowing. This indicator is set to control the Council's exposure to refinancing risk, in terms of loans being unavailable. The upper and lower limits of on the maturity structure of borrowing will be:

<b>Maturity Structure of borrowing</b>		
	<b>2023-24</b>	
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	50.00%
1 year to 2 years	0%	50.00%
3 years to 5 years	0%	60.00%
6 years to 10 years	0%	75.00%
11 years and above	0%	100.00%

- 5.34 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.

#### *Debt Rescheduling*

- 5.35 The PWLB allows local authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The 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 and where we have enough money in reserves to fund the repayment. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

**Investment strategy**

- 5.36 The TM code requires the Council to invest its treasury funds prudently, and to have regard to the security (protecting capital sums from loss) and liquidity (keeping money readily available for expenditure when needed or having access to cash) of 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.
- 5.37 Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 5.38 The TM Code does not permit Councils to both borrow and invest long-term for cash flow management, but they may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme up to three years, to manage inflation risk by investing usable reserves in instruments whose value rises with inflation and to manage price risk by adding diversification to the strategic pooled fund portfolio.
- 5.39 Diversification is key. All investments can earn extra interest, but not all investments will default. Also, to highlight the need for security and diversification it takes a long time of earning an extra 1% of interest cover to cover the 20% to 50% loss from a default. It is unlikely we will be able to move away from unsecured deposits entirely, but the less in this category and the more diversified the portfolio is the better the spread of risk.
- 5.40 Under the IRFS 9 accounting standard the accounting of 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.
- 5.41 The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.
- 5.42 ESG considerations are increasingly a factor in global investors decision making, but the framework for evaluating investment opportunities is still developing and therefore the Councils 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.

*Counterparty limits*

- 5.43 Limits per counterparty on investments are shown in the table below:

Sector	Time limit	Counterparty limit	Sector limit
UK Government	50 yrs	unlimited	n/a
Local authorities and other Government entities	25 yrs	£10 million	unlimited
Secured investments	25 yrs	£10 million	unlimited
Banks (unsecured)	13 mths	£6 million	unlimited
Building Societies (unsecured)	13 mths	£6 million	£15 million
Registered providers (unsecured)	5 yrs	£6 million	£20 million
Money Market Funds	n/a	£20 million	unlimited
Strategic pooled funds	n/a	£10 million	£50 million
Real estate investment trusts	n/a	£10 million	£20 million
Other investments	5 yrs	£10 million	£20 million

- 5.44 The time limits shown are the maximum from the start of an investment, and operationally we could have a shorter duration.
- 5.45 We have set limits to try and avoid default on our investments, although this may not always be successful. By setting realistic, but prudent limits we are forcing diversification which aims to help reduce the value of a default if we are exposed to one.
- 5.46 Credit rating: investment limits are set by reference to the lowest 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 taken into account.
- 5.47 For entities without published credit ratings, investments will only be made following external advice.
- 5.48 Government: loans, 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. Local Authorities are statutory bodies and have access to the PWLB for borrowing, and any of these loans would be transferred to a successor body. There has not been a Local authority default, despite some s114 notices being put in place, instead Government has stepped in so the risk of a local authority defaulting is very low.
- 5.49 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.

- 5.50 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.
- 5.51 Registered providers (unsecured): loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formally known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
- 5.52 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.
- 5.53 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.
- 5.54 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 the 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. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.
- 5.55 Other investments: 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.
- 5.56 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. These are not classed as investments, but are still subject to the risk of a bank bail-in. 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.

- 5.57 HSBC are our bankers. We may place investments with them, and on occasions we may be in a position where we have received some unexpected cash, and we may, therefore, breach the unsecured limit. We would aim for this to be for as short a duration as possible.
- 5.58 In addition, we may make an investment that is defined as capital expenditure by legislation, such as company shares.
- 5.59 We may invest in investments that are termed 'alternative' investments. These include, by way of example, but are not limited to, things such as renewable energy bonds (solar farms) and regeneration bonds. These are asset backed bonds, offering good returns, and will enable the Council to enter new markets, thus furthering the diversification of our investment portfolio with secured investments and enhancing yield. Any investments entered into of this type will be subject to a full due diligence review.

*Risk and credit ratings*

- 5.60 Arlingclose obtain and monitor credit ratings and they notify us with any changed 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
- 5.61 Where credit rating agencies announce that a credit rating is on review for possible downgrade ("rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, we will limit new investments with that organisation to overnight 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.
- 5.62 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 institutions in which we invest, 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 and investment advisors.
- 5.63 We will not make investments with any organisation if there are substantive doubts about its credit quality, even if it meets the above criteria.
- 5.64 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 our 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 meet the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or

invested in government treasury bills for example or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

5.65 We will measure and manage our exposure to treasury management risk by using the following indicators:

- **Security:** we have adopted a voluntary measure of our exposure to credit risk by monitoring the value-weighted average credit rating of our investment portfolio. This is calculated by applying a score to each investment based on credit ratings (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 average portfolio credit rating target is set for A for 2023-24.
- **Liquidity:** we monitor our liquidity for a given financial year using an online cash-flow system. We project forward for the financial year and enter all known cash transactions at the beginning of the financial year and then update the position on a daily basis. This forms the basis of our investment decisions in terms of duration and value of investments made. We have set £45 million as our minimum liquidity requirement. We also have a high-level cash flow projection over four years.

#### Interest rate risk

5.66 Interest rate risk is defined as “the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation’s finances, against which the organisation has failed to protect itself adequately”. In local authorities this risk is therefore commonly considered in the context of the impact of changes in interest rates on the revenue account

5.67 Long term treasury management investments: 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 treasury management investments will be:

	2022-23 Approved	2023-24 Estimate	2024-25 Estimate	2025-26 Estimate
Upper limit for total principal sums invested for longer than a year	£50m	£50m	£50m	£50m

5.68 Long-term investments with no fixed maturity date include strategic pooled funds, and REITS but exclude money market funds and bank accounts with no fixed maturity date as these are considered long-term.

5.69 Where we invest longer-term, we strike a balance between tradeable and fixed term investments. Whilst we do not enter into the tradeable deposits with the intention of selling, we are helping mitigate the risk exposure by using these types of investments so if we have a liquidity problem, we can liquidate these investments prior to maturity at nil or minimal cost.

## **6. Other items**

6.1 There are a number of additional items the Council is obliged by CIPFA and/or MHCLG to include in our strategy.

**Policy on the use of Financial Derivatives**

- 6.2 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).
- 6.3 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).
- 6.4 The Council will only use standalone 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 taken into account 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.
- 6.5 We may arrange financial derivative transactions with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
- 6.6 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.

**Markets in Financial Instruments Derivative**

- 6.7 The Council has opted up to professional client status with its providers of financial services, allowing it to access a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of our treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

**Policy on apportioning interest to the HRA**

- 6.8 The Council operates a two-pooled approach to its loan's portfolio, which means we separate long-term HRA and GF loans.
- 6.9 Interest payable and other costs or income arising from long-term loans (for example premiums and discounts on early redemption) will be charged or credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRAs underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance, which may be positive or negative.
- 6.10 We will charge long-term loan interest on an actual basis, as incurred.
- 6.11 For notional cash balances we will apply the average DMO rate for the year. This rate is the lowest credit risk investment. We apply this because if there are any investment defaults it will be a charge to the GF, regardless of whether it was HRA cash that was lost.