

Guildford Borough Council

Report to: Council

Date: 3 December 2024

Ward(s) affected: All

Report of Director: Strategic Director of Finance and Resources

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Report Status: Open

Capital, Treasury and Investment Strategy – October Refresh

1. Executive Summary

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

1.3 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 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.

1.5 Treasury management is an important part of the overall management of the Council's finances. A council 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.

1.6 The CIPFA definition of treasury management is:

“the management of the organisation’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.”

1.7 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.

1.8 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, then, MHCLG investment guidance also suggest some local indicators.

1.9 The following sections of the strategy outline the Council's balance sheet and treasury position, capital expenditure and treasury management strategy.

1.10 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. Recommendation to Council

That the capital and investment strategy specifically the investment strategy and Prudential Indicators contained in this report be approved.

3. Reasons for Recommendation:

3.1 To enable Council to approve the updated capital and investment strategy for the period up to 2028-29.

4. Status of Report

4.1 The report is 'open'

5. Strategic Priorities

- 5.1 The report underpins the Council's strategic framework through supporting the strategy of being a resilient and well managed council.

6. External Context

Economic Background

- 6.1 Economic background: UK headline consumer price inflation remained around the Bank of England (BoE) target later in the period, falling from an annual rate of 3.2% in March to 2.0% in May and then rebounding marginally to June to 2.2% in July and August, as was expected, due to base effects from energy prices. Core and services price inflation remained higher at 3.6% and 5.6% respectively in August.
- 6.2 The UK economy continued to expand over the period, albeit slowing from the 0.7% gain in the first calendar quarter to 0.5% (downwardly revised from 0.6%) in the second. Of the monthly figures, the economy was estimated to have registered no growth in July.
- 6.3 Labour market data was slightly better from a policymaker perspective, showing an easing in the tightness of the job market, with inactivity rates and vacancies declining. However, a degree of uncertainty remains given ongoing issues around the data collected for the labour force survey by the Office for National Statistics. Figures for the three months to July showed the unemployment rate fell to 4.1% (3mth/year) from 4.4% in the previous three-month period while the employment rate rose to 74.8% from 74.3%.
- 6.4 With headline inflation lower, the BoE cut Bank Rate from 5.25% to 5.00% at the August Monetary Policy Committee (MPC) meeting. The decision was finely balanced, voted by a 5-4 majority with four members preferring to hold at 5.25%. At the September MPC meeting, committee members voted 8-1 for no change at 5.00%, with the lone dissenter preferring Bank Rate to be cut again to 4.75%. The meeting minutes and vote suggested a reasonably hawkish tilt to rates, with sticky inflation remaining a concern among policymakers.

- 6.5 The latest BoE Monetary Policy Report, published in August, showed policymakers expected GDP growth to continue expanding during 2024 before falling back and moderating from 2025 to 2027. Unemployment was forecast to stay around 4.5% while inflation was shown picking up in the latter part of 2024 as the previous years' energy price declines fell out of the figures before slipping below the 2% target in 2025 and remaining there until early 2027.
- 6.6 Arlingclose, the authority's treasury adviser, maintained its central view that the Bank Rate would steadily fall from the 5.25% peak, with the first cut in August being followed by a series of further cuts, with November 2024 the likely next one, taking Bank Rate down to around 3% by the end of 2025.

Credit outlook

- 6.7 Having had its outlook increased by Fitch and ratings by S&P earlier in the period, Moody's upgraded Transport for London's rating to A2 from A3 in July.
- 6.8 Moody's also placed National Bank of Canada on Rating Watch for a possible upgrade, revising the outlook on Standard Chartered to Positive, the outlook to Negative on Toronto Dominion Bank, and downgrading the rating on Close Brothers to A1 from Aa3.
- 6.9 S&P upgraded the rating on National Bank of Canada to A+ from A, and together with Fitch, the two rating agencies assigned Lancashire County Council with a rating of AA- and A+ respectively.
- 6.10 Credit default swap prices were generally lower at the end of the period compared to the beginning for the vast majority of the names on UK and non-UK lists. Price volatility over the period was also generally more muted compared to previous periods.
- 6.11 Financial market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the

Authority's counterparty list recommended by Arlingclose remain under constant review.

Interest rate forecast

- 6.12 After substantial rises in interest rates since 2021 many central banks have now begun to reduce rates, albeit slowly. Gilt yields were volatile over the 6-month period and have reduced slightly between April and September 2024. Much of the downward pressure from lower inflation figures was counteracted by upward pressure from positive economic data. Data from the US continues to impact global bond markets including UK gilt yields.
- 6.13 The Public Works Loan Board (PWLB) certainty rate for 10-year maturity loans was 4.80% at the beginning of the half year and 4.79% at the end. The lowest available 10-year maturity rate was 4.52% and the highest was 5.18%. Rates for 20-year maturity loans ranged from 5.01% to 5.57% during the half year, and 50-year maturity loans from 4.88% to 5.40%.
- 6.14 Whilst the cost of short-term borrowing from other local authorities spiked to around 7% in late March 2024, primarily due a dearth of LA-LA lending/borrowing activity during the month, as expected shorter-term rates reverted to a more normal range and were generally around 5.00% - 5.25%.

Balance sheet and treasury position

Balance Sheet

- 6.15 The Council has a strong asset backed balance sheet.
- 6.16 The summary balance sheet shows that cash investments make up approximately 10% of the Councils assets. Investment property makes up 15% of the long-term assets (being £183 million).

	Balance at 31/3/23 (restated)			Balance at 31/3/24		
	£'000	£'000	%	£'000	£'000	%
Long term assets	1,115,654			1,116,654		

Short term assets	30,260			14,682		
		1,145,914	92%		1,131,336	94%
Long term investments	20,768			29,626		
Short term investments	78,904			43,716		
		99,672	8%		73,342	6%
Total Assets		1,245,586			1,204,678	
Current liabilities	-50,631			-59,005		
Long term liabilities	-20,535			1,290		
		-71,166	19%		-57,715	22%
Short term borrowing	-127,232			-74,040		
Long term borrowing	-168,053			-201,508		
		-295,285	81%		-275,548	78%
Total Liabilities		-366,451			-333,263	
Net Assets		879,135			871,415	

6.17 The largest proportion of our liabilities is from long-term borrowing, of which 61% is HRA debt, and the remaining 39% for the GF.

Financial Stability/Sustainability

6.18 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.

	2022/23 Actual ('000)	2023/24 Actual ('£000)	2024/25 Estimate ('£000)	2025/26 Estimate ('£000)	2026/27 Estimate ('£000)	2027/28 Estimate ('£000)
Total debts	295,285	275,548	374,722	434,598	437,798	448,494
Total assets	1,245,586	1,204,678	1,340,299	1,415,062	1,489,825	1,575,998
Debt Ratio %	24%	23%	28%	31%	29%	28%

6.19 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.

6.20 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

6.21 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

6.22 Suggested Government local indicators are:

Indicator	Description
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

Indicator	Description
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

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

Treasury position

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

	March 24 position £'000	Sep-24
Investments		
<u>Managed in-house</u>		
Notice Accounts - UK	3,270	3,000
Money Market Funds	12,550	21,698
Temporary Fixed Deposits	10,358	5,000
Long term Fixed Deposits	10,535	10,000
Short term bonds	3,800	3,750
Covered Bonds	8,470	8,300
Investments in subsidiaries	9,134	9,134
Total investments managed in-house	58,117	60,882
<u>Pooled Funds</u>		

CCLA	6,101	6,102
Schroders	736	736
UBS	1,768	0
Royal London	2,182	2,182
Fundamentum	1,906	1,906
Aegon	2,521	2,521
Funding Circle	11	11
Total pooled funds investments	15,225	13,458
Total Investments	73,342	74,340
Borrowing		
Temporary borrowing	74,040	67,857
Long-term borrowing (PWLB)	201,508	201,175
Total borrowing	275,548	269,032

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Net investments / (borrowing)	-202,206	-194,692

- 6.25 The table shows the position at the start of the financial year (included in the balance sheet), and the position at the end of September 2024 (the latest position).
- 6.26 Investment balances have increased as a result of cash flow timings. Long term borrowing has increased in favour of short-term borrowing as a result of borrowing for the capital programme. The net borrowing position has decreased since due to a higher level of investments than reduction in borrowing.

7. Capital expenditure

- 7.1 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.
- 7.2 The Council has a Corporate Strategy and medium to long-term aspirations within the Borough. There are processes and procedures in place to ensure the capital programme is approved and monitored for good governance.
- 7.3 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.
- 7.4 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.

- 7.5 The capital programme covers a rolling 5 to 10-year period, with more emphasis on the first five years.
- 7.6 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.
- 7.7 Many of the schemes in the capital programme are development projects, and their expenditure and income profiles 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.
- 7.8 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.

- 7.9 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.
- 7.10 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.
- 7.11 During the year, the Strategic Capital Board (SCB) meets monthly 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.
- 7.12 The capital programme is also reviewed by CLT 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 Enterprise Portfolio Board (EPB), and its subgroups, meet regularly, and they receive highlight reports on the progress of all the major projects in the capital programme.
- 7.13 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

7.14 The actual financing of each year's capital programme is determined in the year in question.

7.15 Capital expenditure is split between the GF (incorporating non-HRA housing) and HRA housing.

7.16 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	2024/25 Approved £000	2024/25 Forecast Outturn £000	2024/25 Variance £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000	2028/29 Estimate £000	2029/30 Estimate £000
General Fund Capital Expenditure								
- Main Programme	194,335	129,102	(65,233)	111,937	34,076	37,769	44,023	30,533
- S106 Projects			0	0	0	0	0	0
Total Expenditure	194,335	129,102	(65,233)	111,937	34,076	37,769	44,023	30,533
Financed by :								
Capital Receipts	(4,636)	(6,259)	(1,623)	(45,854)	(26,946)	(25,406)	(42,801)	(29,211)
Capital Grants/Contributions	(32,262)	(21,623)	10,639	(6,320)	(600)	0	0	0
Capital Reserves/Revenue	(2,895)	(2,274)	621	0	0	0	0	0
Borrowing	(154,542)	(98,946)	55,596	(59,763)	(6,530)	(11,361)	0	0
Financing - Totals	(194,335)	(129,102)	65,233	(111,937)	(34,076)	(36,767)	(42,801)	(29,211)
Housing Revenue Account Capital Expenditure								
- Main Programme	13,998	6,520	(7,479)	23,191	40,687	48,404	18,483	147
	0	0	0	0	0	0	0	0
Total Expenditure	13,998	6,520	(7,479)	23,191	40,687	48,404	18,483	147
Financed by :								
- Capital Receipts	(1,682)	(1,682)	0	(5,406)	0	(7,098)	(5,066)	(5,066)
- Capital Reserves/Revenue	(12,316)	(4,838)	7,479	(17,785)	(40,687)	(41,306)	(13,418)	4,919
- Borrowing	0	0	0	0	0	0	0	0
Financing - Totals	(13,998)	(6,520)	7,479	(23,191)	(40,687)	(48,404)	(18,483)	(147)

7.17 The programme has slipped in 2024/25 – estimated expenditure on the GF of £194 million, has been reduced to £129 million. The majority of this relates to expenditure on investment properties and regeneration schemes and have now either been removed from the programme in September 2024 or moved into later years.

7.18 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

- 7.19 To ensure good governance, the Council has the following process for the capital programme.
- 7.20 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 that the Council has adopted.
- 7.21 Any projects that are expected to be delivered after the five-year period, or those where a scheme has not yet been fully identified are placed on the Council's Capital Vision ¹. 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.
- 7.22 Each major 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 reported to the Executive at the point a project is asking for approval to be

¹ 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.

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.

7.23 The Council has a limited resources and must have regard to the overall affordability of the capital programme in future years. Each scheme, therefore, is evaluated to ensure it meets the Council's objectives. The criteria are:

- 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 (e.g., Health & Safety)
- b) Each scheme must be assessed against the fundamental themes within the Council's Corporate Strategy to show how well it contributes towards achieving the Council's strategic objectives.
- 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 criterion 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.

- 7.24 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.
- 7.25 Most projects over £50,000 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 £50,000 can be moved under delegation.
- 7.26 The net addition of the new bids for the GF is assumed to be funded by borrowing. Any HRA new bids are assumed to be funded 1/3 capital receipts (RTB receipts), 1/3 borrowing and 1/3 capital reserves.

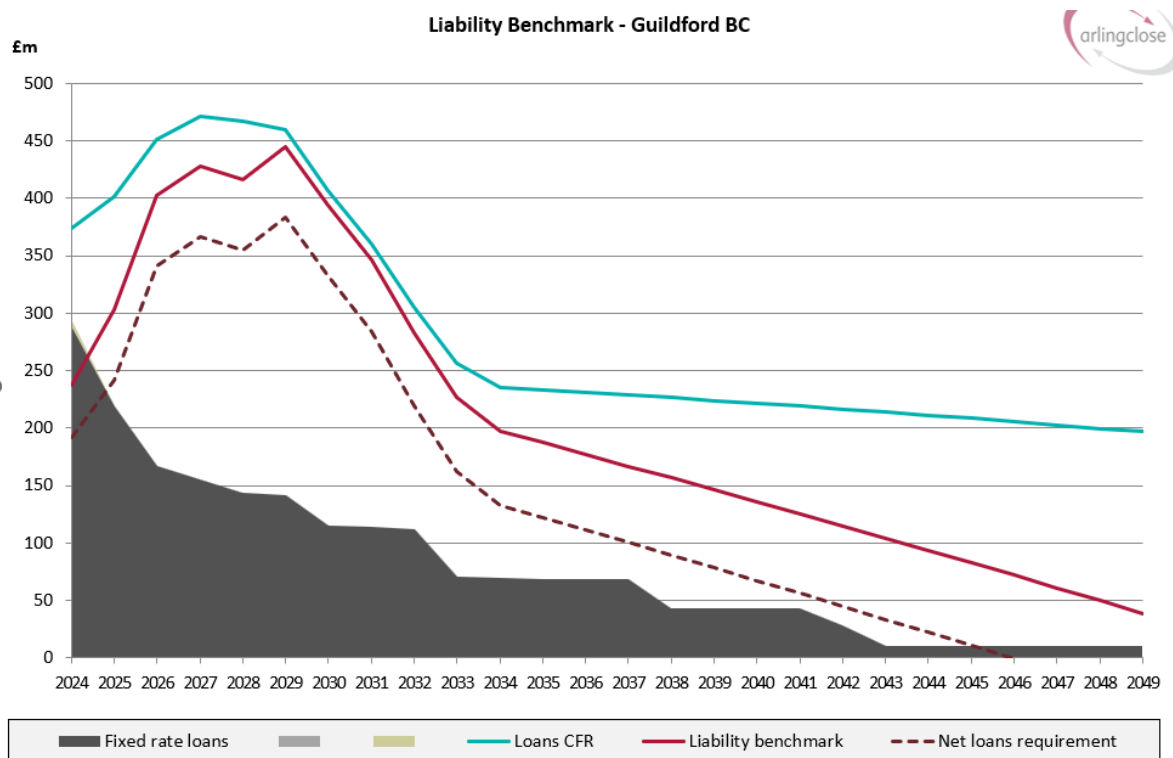
8. Treasury management, borrowing and investment strategy

- 8.1 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.
- 8.2 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)

- 8.3 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.

- 8.4 The CFR is derived from unfinanced capital expenditure, which arises when there are no capital receipts or reserves available to fund the capital programme.
- 8.5 The Council's investments consist of usable reserves and working capital and are the underlying resources available for investment.
- 8.6 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.



NOTE - The impact of the asset disposal programme is not shown as timing is unpredictable at present. This will reduce the peak CFR to below £472 million.

- 8.7 The liability benchmark shows the lowest risk level of required 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.

- 8.8 Items on the capital vision are currently excluded, mainly because the cost and/or timings of the schemes are unknown.
- 8.9 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.
- 8.10 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 (2024/25 to 2026/27).

Position at 31 March	2024	2025	2026	2027	2028	2029	2030
Loans CFR	399.6	496.9	555.0	556.3	565.2	551.2	529.5
External borrowing	-274.1	-236.5	-210.0	-188.4	-176.9	-150.3	-148.8
Internal (over) borrowing	125.5	260.4	345.0	367.9	388.3	400.8	380.7
Balance sheet resources	-188.4	-163.2	-145.6	-124.1	-119.4	-128.7	-138.6
Investments (new borrowing)	62.9	-97.2	-199.4	-243.8	-268.9	-272.1	-242.1
Treasury investments	62.9	20.0	20.0	20.0	20.0	20.0	20.2
New borrowing	0.0	117.2	219.4	263.8	288.9	292.1	262.3
Net loans requirement	211.1	333.8	409.3	432.2	445.8	422.4	390.9
Liquidity allowance	20.0	20.0	20.0	20.0	20.0	20.0	20.2
Liability benchmark	231.1	353.8	429.3	452.2	465.8	442.4	411.1

- 8.11 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 Minimum Revenue Provision. 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.
- 8.12 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.

- 8.13 GF reserves are projected to remain relatively stable (our core cash). The CFR is increasing sharply due to the proposed capital programme. We are projecting a large need to borrow for the Council from 2024/25, 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

- 8.14 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.
- 8.15 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. Short-term interest rates are currently at a 15-year high but are expected to fall in the coming years; therefore, it is likely to be more cost effective over the medium-term to either use internal resources or to borrow short-term loans instead.
- 8.16 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.
- 8.17 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.
- 8.18 By doing this, we are able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk.
- 8.19 We will undertake some modelling taking into account the projects listed in the Corporate Strategy and capital vision, for example, which will tell us the potential impact on our borrowing requirement.

- 8.20 We will continue to monitor our internal borrowing position against the borrowing rates in the market. 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 2024/25 with a view to keeping future interest costs low, even if this causes additional cost in the short term.
- 8.21 The Council may decide to externalise our current internal borrowing, or to pre-fund future years' requirement, provided that 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).
- 8.22 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.
- 8.23 We may continue to borrow short-term for cash flow shortages.
- 8.24 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.
- 8.25 The Government has also announced a HRA borrowing rate which is gilts less 60bp. The Council has previously repaid £45 million of HRA borrowing and may choose to re-borrow this to take advantage of the preferential rates.

Sources of borrowing

- 8.26 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.
- 8.27 PWLB loans are no longer available to local authorities planning to buy investment assets primary for yield. The Council decided several years ago to only buy properties for strategic reasons, and not those purely for yield.

8.28 We will consider, but are not limited to, the following long and short-term borrowing sources:

- HM Treasury's PWLB lending facility
- UK Infrastructure Bank
- 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
- Other private institutional investors

8.29 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
- similar asset-based finance

Municipal Bond Agency (MBA)

8.30 UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association (LGA) 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

- 8.31 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).
- 8.32 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.
- 8.33 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:

Maturity Structure of borrowing		
	2024/25	
	Lower	Upper
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%

- 8.34 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

- 8.35 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 sufficient 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

- 8.36 The TM code (and CIPFA 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.
- 8.37 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.
- 8.38 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.
- 8.39 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.
- 8.40 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.

- 8.41 The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.
- 8.42 ESG considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's 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

- 8.43 Limits per counterparty type 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

- 8.44 The time limits shown are the maximum from the start of an investment, and operationally we could have a shorter duration.
- 8.45 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.

- 8.46 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.
- 8.47 For entities without published credit ratings, investments will only be made following external advice.
- 8.48 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. 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.
- 8.49 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.

- 8.50 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.
- 8.51 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.
- 8.52 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.
- 8.53 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.
- 8.54 Real estate investment trusts (REITs): 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.

- 8.55 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.
- 8.56 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.
- 8.57 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.
- 8.58 In addition, we may make an investment that is defined as capital expenditure by legislation, such as company shares.
- 8.59 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 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

- 8.60 Arlingclose obtain and monitor credit ratings and they notify us with any changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

8.61 Where credit rating agencies announce that a credit rating is on review for possible downgrade (“negative watch”) 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.

8.62 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.

8.63 We will not make investments with any organisation if there are substantive doubts about its credit quality, even if it meets the above criteria.

8.64 The Council is aware that investments 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 taken into account when making investment decisions.

8.65 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, 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.

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

- Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average 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.
- 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

8.67 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

8.68 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 upper limit on the long-term treasury management investments is £30 million.

- 8.69 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.
- 8.70 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.
- 8.71 Whilst we are a long-term borrower, where we do invest cash for longer than three years it is generally in tradeable instruments (e.g. covered bonds) so we have access to liquidity if we need it, and are therefore comfortable we are not investing primarily for financial return.

9. Other items

- 9.1 There are a number of additional items the Council is obliged to follow under the TM CIPFA code.

Policy on the use of Financial Derivatives

- 9.2 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).
- 9.3 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).
- 9.4 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 to which the Council is exposed. 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.

- 9.5 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.
- 9.6 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

- 9.7 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

- 9.8 The Council operates a two-pooled approach to its loan's portfolio, which means we separate long-term HRA and GF loans.
- 9.9 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 HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance, which may be positive or negative. Annual interest will be calculated on the closing balance at our average interest rate on treasury investments excluding strategic pooled funds, adjusted for credit risk if a net investment balance, and at the Council's average rate of borrowing if a net borrowing balance.
- 9.10 We will charge long-term loan interest on an actual basis, as incurred.

10. Options

10.1 The Council could choose not to adopt the strategy.

11. Consultation

11.1 There has been early consultation on the budget and MTFP of which this report forms part of the budget.

11.2 This report has been discussed at Overview and Scrutiny Committee - Resources and feedback has been taken into consideration.

12. Key Risks

12.1 This strategy supports the setting of a balanced budget which is a legal duty. The strategy support good financial management which not only ensures the setting of a balanced budget for this year but a longer term achievable MTFP.

13. Legal and Governance Implications

13.1 The Council has a legal duty to set a balanced budget as set out in section 31 of the Local Government Finance Act 1992.

14. Financial Implications

14.1 There are no direct financial implications from adoption of this strategy.

15. Human Resources Implications

15.1 There are no human resource implications from this report

16. Equality and Diversity Implications

16.1 There are no direct equality, diversity or inclusion implications from adopting this strategy.

17. Climate Change and Sustainability Implications

17.1 There are no climate change implications from adopting this strategy.

18. Background Papers

None

19. Appendices

None.