

# Appendix F4: Treasury Management Strategy Statement 2024/25

## 1. Introduction

- 1.1. Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risks are therefore central to the Authority's prudent financial management.
- 1.2. Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
- 1.3. The Council is required to operate a balanced budget, which broadly means that monies received during the year will meet payments expenditure. The function of treasury management is to ensure that the Council's capital programme and corporate investment plans are adequately funded, and the cashflow is adequately planned, with cash being available when it is needed to discharge the Council's legal obligations and deliver Council services. Surplus monies are invested to obtain an optimal return, while ensuring security of capital and liquidity.
- 1.4. Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy, which can be found at Appendix F3.

## 2. Economic Outlook

- 2.1. The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be major influences on the Authority's treasury management strategy for 2024/25.
- 2.2. A more detailed economic outlook provided by Arlingclose is in Appendix A of this document.

## 3. Interest rate forecast

- 3.1. Although UK inflation and wage growth remain elevated, the Authority's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25%, and The Bank of England's Monetary Policy Committee will start reducing rates in 2024 to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose forecast rate cuts from Q3 2024 to a low of around 3% by early mid-2026.

- 3.2. Arlingclose expects long-term gilt yields to be broadly stable at current levels (amid continued volatility), following the decline in yields towards the end of 2023, which reflects the expected lower medium-term path for Bank Rate. Yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.
- 3.3. A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix B of this document.
- 3.4. For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate/yield of 4.0%, and that new long-term loans will be borrowed at an average rate of 5.72%.

## 4. Local Context

- 4.1. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.
- 4.2. On 31st December 2023, the Authority held £307.544m of borrowing and £86.7m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in **table 1** below.

**Table 1: Balance sheet summary and forecast**

	<b>31.3.23 Actual £m</b>	<b>31.3.24 Estimate £m</b>	<b>31.3.25 Forecast £m</b>	<b>31.3.26 Forecast £m</b>	<b>31.3.27 Forecast £m</b>
General Fund CFR	190.702	216.568	259.376	274.566	295.645
HRA CFR	463.593	541.280	669.918	700.734	740.321
PFI CFR	80.552	76.098	71.226	65.954	60.367
<b>Capital financing requirement</b>	<b>734.847</b>	<b>833.946</b>	<b>1000.520</b>	<b>1041.254</b>	<b>1096.333</b>
Less: Other debt liabilities *	(80.552)	(76.098)	(71.226)	(65.954)	(60.367)
<b>Loans CFR</b>	<b>654.295</b>	<b>757.848</b>	<b>929.294</b>	<b>975.300</b>	<b>1035.966</b>
Less: External borrowing **	(285.606)	(302.544)	(273.876)	(255.208)	(249.873)
<b>Internal (over) borrowing</b>	<b>368.689</b>	<b>455.304</b>	<b>655.418</b>	<b>720.092</b>	<b>786.093</b>
Less: Balance sheet resources	(422.389)	(393.170)	(370.176)	(361.520)	(356.970)
<b>(Treasury investments) or New borrowing</b>	<b>(53.700)</b>	<b>62.134</b>	<b>285.242</b>	<b>358.572</b>	<b>429.123</b>

\* leases and PFI liabilities that form part of the Authority's total debt

\*\* shows only loans to which the Authority is committed and excludes optional refinancing.

- 4.3. The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £1,093.333m over the forecast period.
- 4.4. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2024/25.

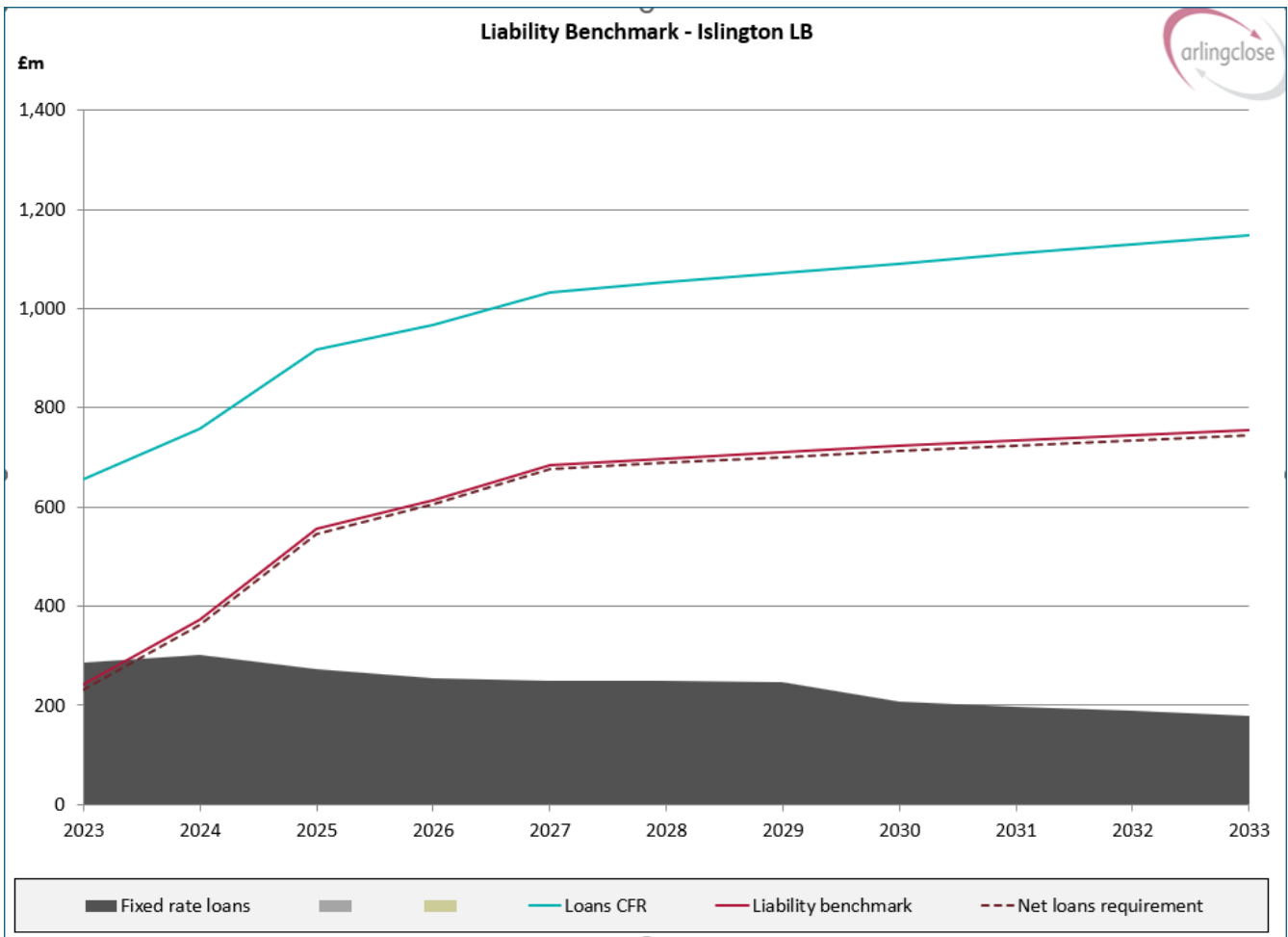
## 5. Liability benchmark

- 5.1. To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.
- 5.2. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

**Table 2: Prudential Indicator: Liability benchmark**

	<b>31.3.23 Actual £m</b>	<b>31.3.24 Estimate £m</b>	<b>31.3.25 Forecast £m</b>	<b>31.3.26 Forecast £m</b>	<b>31.3.27 Forecast £m</b>
Loans CFR	654.295	757.848	929.294	975.300	1035.966
Less: Balance sheet resources	(422.389)	(393.170)	(370.176)	(361.520)	(356.970)
<b>Net loans requirement</b>	<b>231.906</b>	<b>364.678</b>	<b>559.118</b>	<b>613.780</b>	<b>678.996</b>
Plus: Liquidity allowance	10.000	10.000	10.000	10.000	10.000
<b>Liability benchmark</b>	<b>241.906</b>	<b>374.678</b>	<b>569.118</b>	<b>623.780</b>	<b>688.996</b>

- 5.3. Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing, minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



- 5.4. The chart above shows how the optimum position determined by the benchmarks compares to the current portfolio commitments. Positive balances show the loans position compared to the Liability Benchmark and negative balances show Investments compared to the Investment Benchmark. Any areas of the chart where the current loan commitments are below the Liability Benchmark show the need for external borrowing. The Council must borrow up to that level to avoid the determined liquidity allowance from being insufficient. Anywhere on the chart that shows the existing commitments above the level of the Liability Benchmark shows an excess level of borrowing over the required position and is reflected in over benchmark investment positions.
- 5.5. As the net position has been derived, and the level of external borrowing determined (the maximum of existing commitments or Liability Benchmark), the consequential level of investments can be solved. Where there is excess borrowing, there is excess investments, over the level of liquidity required. Where borrowing is required, it will be determined as such a level to ensure the liquid investments do not fall below the specified level required.

## 6. Borrowing Strategy

- 6.1. The Authority currently holds £307.544 million of loans, an increase of £21.938 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority expects

to borrow up to £272.4m in 2024/25. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £661.2million.

- 6.2. Objectives: The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.
- 6.3. Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of 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 and it is therefore likely to be more cost effective over the medium-term to either use internal resources, or to borrow short-term loans instead.
- 6.4. By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority 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.
- 6.5. The Authority has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.
- 6.6. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.
- 6.7. Alternatively, the Authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.
- 6.8. In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

### **Sources of borrowing:**

- 6.9. The approved sources of long-term and short-term borrowing are:
  - HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
  - UK Infrastructure Bank Ltd
  - any institution approved for investments (see below)
  - any other bank or building society authorised to operate in the UK
  - any other UK public sector body
  - UK public and private sector pension funds (except our local Local Government Pension Scheme)

- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

#### **Other sources of debt finance:**

6.10. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback
- similar asset based finance

#### **Municipal Bonds Agency:**

6.11. UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons:

- Borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and
- There will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

#### **LOBOs:**

6.12. Islington Council holds no LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the council has the option either to accept the new rate or to repay the loan at no additional cost.

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

6.13. These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

#### **Debt rescheduling:**

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

## 7. Treasury Investment Strategy

- 7.1. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's treasury investment balance has ranged between £80 million and £112 million, and similar levels are expected to be maintained in the forthcoming year.
- 7.2. The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 7.3. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

### Strategy

- 7.4. As demonstrated by the liability benchmark above, the Authority expects to be a long-term borrower and treasury investments will therefore predominantly be short-term low risk instruments to manage day-to-day cash flows. Limited longer-term instruments, where limited additional risk is accepted in return for higher investment income to support local public services, will be made where cash flows allow.
- 7.5. The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Authority 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 for 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.

### ESG policy

- 7.6. Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority 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.

### Business models

- 7.7. Under the IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore,

where other criteria are also met, these investments will continue to be accounted for at amortised cost.

### Approved counterparties

7.8. The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the limits shown.

**Table 3: Treasury investment counterparties and limits**

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£15m	Unlimited
Secured investments *	25 years	£15m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£5m	£10m
Registered providers (unsecured) *	5 years	£5m	£25m
Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£10m	£50m
Real estate investment trusts	n/a	£10m	£25m
Other investments *	5 years	£5m	£10m

### Minimum credit rating\*:

7.9. The Council has reviewed the way it formulates its counterparty criteria. The lending list criteria is devised from the use of rating agencies which will include) as well as other factors. The main sovereign states whose banks are to be included are Australia, Canada, Finland, France, Denmark, Germany, Netherlands, Switzerland and the US. These countries and the Banks within them have been selected after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+ minimum short term F1).
- Credit Default Swaps.
- GDP; Net Debt as a Percentage of GDP.
- Sovereign Support Mechanisms / potential support from a well-resourced parent institution.
- Share Price.
- The Council has restricted its investment activity to the following institutions while conditions in the financial sector are monitored for stability and cashflow positions are averaging around £100m.
- The Debt Management Agency Deposit Facility (The rates of interest from the DMADF are below equivalent money market rates. However, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure).
- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV) and Variable Net Asset Value (VNAV).



- Deposits with other local authorities.
- Business reserve accounts and term deposits. These have been primarily restricted to UK institutions that are rated at least A+ long term.

**Government:**

7.10. 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.

**Secured investments:**

7.11. 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.

7.12. 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.

**Banks and building societies (unsecured):**

7.13. 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.

**Registered providers (unsecured):**

7.14. Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (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.

**Money market funds:**

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

**Strategic pooled funds:**

7.16. Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority 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 Authority's investment objectives will be monitored regularly.

**Real estate investment trusts:**

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

**Other investments:**

7.18. 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 Authority's investment at risk.

**Operational bank accounts:**

7.19. The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £30m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

**Risk assessment and credit ratings:**

7.20. Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. 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.

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

**Other information on the security of investments:**

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

**Reputational aspects:**

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

7.24. 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 Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security.

7.25. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

**Investment limits:**

7.26. The Authority's revenue reserves available to cover investment losses are forecast to be £229.6 million on 31<sup>st</sup> March 2024 and £206.6 million on 31<sup>st</sup> March 2025. To limit risk in the case of a single default, the maximum that will be lent to any one organisation will be £15m million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

7.27. Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

**Liquidity management:**

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

## 8. Treasury Management Prudential Indicators

8.1. The Authority measures and manages its exposures to treasury management risks using the following indicators.

### Security:

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

Credit risk indicator	Target
Portfolio average credit	A+

### Liquidity:

8.3. The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one-month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 1 months	£25m

### Interest rate exposures:

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

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£8.850m
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£6.200m

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

### Maturity structure of borrowing:

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

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	30%	0%
12 months and within 24 months	35%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and within 20 years	50%	0%

20 years and above	100%	40%
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8.7. 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.

**Long-term treasury management investments:**

8.8. The purpose of this indicator is to control the Authority’s exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments will be:

Price risk indicator	2024/25	2025/26	2026/27	No fixed date
Limit on principal invested beyond year end	£30m	£20m	£20m	£50m

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

**Authorised Limit**

8.10. The authorised borrowing limit for the Authority is £987.69m.

## 9. Related Matters

9.1. The CIPFA Code requires the Authority to include the following in its treasury management strategy.

**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). 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).

9.3. The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority 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.

9.4. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

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

### Housing Revenue Account:

- 9.6. On 1<sup>st</sup> April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account.
- 9.7. 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.

### Markets in Financial Instruments Directive

- 9.8. The Council has opted up to professional client status with its providers of financial services, including [advisers, banks, brokers and fund managers], allowing it access to a greater range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of The Council's treasury management activities, the Corporate Director of Resources believes this to be the most appropriate status.

### Financial Implications

- 9.9. The budget for investment income in 2024/25 is £1.75 million. The budget for debt interest paid in 2024/25 is £13 million. If actual levels of investments and borrowing, or actual interest rates, differ from those forecasts, performance against budget will be correspondingly different.

## 10. Other Options Considered

- 10.1. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Corporate Director of Resources having consulted the Executive Member for Finance and Performance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

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

Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

## Appendix A – Arlingclose Economic External Context

The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level for the rest of 2023. In December 2023, members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25%. The three dissenters wanted to increase rates by another 0.25%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with upside risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

Office for National Statistics (ONS) figures showed CPI inflation was 3.9% in November 2023, down from a 4.6% rate in the previous month and, in line with the recent trend, lower than expected. The core CPI inflation rate declined to 5.1% from the previous month's 5.7%, again lower than predictions. Looking ahead, using the interest rate path implied by financial markets the BoE expects CPI inflation to continue falling slowly, but taking until early 2025 to reach the 2% target before dropping below target during the second half 2025 and into 2026.

ONS figures showed the UK economy contracted by 0.1% between July and September 2023. The BoE forecasts GDP will likely stagnate through 2024. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.

The labour market appears to be loosening, but only very slowly. The unemployment rate rose slightly to 4.2% between June and August 2023, from 4.0% in the previous 3-month period, but the lack of consistency in the data between the two periods made comparisons difficult. Earnings growth has remained strong, but has showed some signs of easing; regular pay (excluding bonuses) was up 7.3% over the period and total pay (including bonuses) up 7.2%. Adjusted for inflation, regular pay was 1.4% and total pay 1.3%. Looking forward, the MPR showed the unemployment rate is expected to be around 4.25% in the second half of calendar 2023, but then rising steadily over the forecast horizon to around 5% in late 2025/early 2026.

Having increased its key interest rate to a target range of 5.25-5.50% in August 2023, the US Federal Reserve appears now to have concluded the hiking cycle. It is likely this level represents the peak in US rates following a more dovish meeting outcome in December 2023. US GDP grew at an annualised rate of 4.9% between July and September 2023, ahead of expectations for a 4.3% expansion and the 2.1% reading for Q2. But the impact from higher rates has started to feed into economic activity and growth will weaken in 2024. Annual CPI inflation was 3.1% in November.

Eurozone inflation has declined steadily since the start of 2023, falling to an annual rate of 2.4% in November 2023. Economic growth has been weak and GDP contracted by 0.1% in the three months to September 2023. In line with other central banks, the European Central Bank has increased rates,



taking its deposit facility, fixed rate tender, and marginal lending rates to 3.75%, 4.25% and 4.50% respectively.

### **Credit outlook:**

Credit Default Swap (CDS) prices were volatile during 2023, spiking in March on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in Q2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.

On an annual basis, CDS price volatility has so far been lower in 2023 compared to 2022, but this year has seen more of a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget. Moody's also affirmed the Aa3 rating in recognition of the UK's economic resilience and strong institutional framework.

Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.

There remain competing tensions in the banking sector, on one side from higher interest rates boosting net income and profitability against another of a weakening economic outlook and likely recessions that increase the possibility of a deterioration in the quality of banks' assets.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

## **Appendix B – Arlingclose Economic & Interest Rate Forecast – December 2023**

### **Underlying assumptions:**

- UK inflation and wage growth remain elevated but have eased over the past two months fuelling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.
- The MPC's message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.
- Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the more timely PMI figures

suggest that the services sector is recovering from a weak Q3. Tighter policy will however bear down on domestic and external activity as interest rates bite.

- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.
- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.
- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant loosening in the future to boost activity.
- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium-term level for Bank Rate.
- There is a heightened risk of fiscal policy and/or geo-political events causing substantial volatility in yields.

#### **Forecast:**

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

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

PWLB Standard Rate	= Gilt yield + 1.00%
PWLB Certainty Rate	= Gilt yield + 0.80%
PWLB HRA Rate	= Gilt yield + 0.40%
UK Infrastructure Bank Rate	= Gilt yield + 0.40

## Appendix C – Counterparty List

Minimum criteria	A+	F1	A1	P-1	A+	A-1						
	Fitch L/T	Fitch S/T	Moody s L/T	Moody s S/T	S & P L/T	S & P S/T	Sovereign Rating - F/M/S&P	Max Limit - £m	Max Term	LBI	Arlingclose Current Advice	Lending at 31/12/2023
<b>UK Banks</b>												
Barclays	A+	F1	A1	P-1	A	A-1	AA-/Aa3/AAu	£15m	100 days	<b>Council Bankers from Mar 2015 - overnight liquidity only</b>	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Handelsbanken plc	AA	F1+	NR	NR	AA-	A-1+	AA+/+Aa2/AA-	£15m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
HSBC	AA-	F1+	A1	P-1	A+	A-1	AA-/Aa3/AAu	£15m	6 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Lloyds Bank PLC / Bank of Scotland	A+	F1	A1	P-1	A+	A-1	AA-/Aa3/AAu	£15m	6 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
RBS	A+	F1	A1	(P)P-1	A	A-1	AA-/Aa3/AAu	£15m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
NATWEST PLC	A+	F1	A1	P-1	A	A-1	AA-/Aa3/AAu	£15m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Santander UK	A+	F1	A1	P-1	A	A-1	AA-/Aa3/AAu	£15m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Standard Chartered	A+	F1	A1	P-1	A+	A-1	AA-/Aa3/AAu	£15m	6 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
<b>UK Building Societies (except for those marked * below)</b>												
Coventry*	A	F1	A2	P-1			AA-/Aa3/AAu	NONE			Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Leeds*	A	F1	A3	P-2			AA-/Aa3/AAu	NONE			Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Nationwide	A+	F1	A1	P-1	A-1	A+	AA-/Aa3/AAu	£15m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Yorkshire*	A	F1	A3	P-2	NR	NR	AA-/Aa3/AAu	NONE			Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
<b>Non UK Banks</b>												
<b>Australia</b>												
Australia & NZ Banking Group	A+	F1	Aa3	P-1	AA-	A-1+	AAA/Aaa/AAAu	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Commonwealth Bank of Australia	A+	F1	Aa3	P-1	AA-	A-1+	AAA/Aaa/AAAu	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
National Australia Bank	A+	F1	Aa3	P-1	AA-	A-1+	AAA/Aaa/AAAu	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0

## Appendix C – Counterparty List

Westpac Banking Corporation	A+	F1	Aa3	P-1	AA-	A-1+	AAA/Aaa/AAAu	£10m	100 days	Limit to 3 Months		
<b>Canada</b>												
Bank of Montreal	AA	F1+	Aa2	P-1	A+	A-1+	AA+/Aa1/AA+	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Bank of Nova Scotia	AA	F1+	Aa2	P-1	A+	A-1	AA+/Aa1/AA+	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Canadian Imperial Bank of Commerce	AA	F1+	Aa2	P-1	A+	A-1	AA+/Aa1/AA+	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Royal Bank of Canada	AA+	F1+	Aa2	P-1	AA-	A-1+	AA+/Aa1/AA+	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
Toronto-Dominion Bank	AA	F1+u	Aaf1	P-1	AA-	A-1+	AA+/Aa1/AA+	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
<b>Finland</b>												
Nordea Bank ABP	AA	F1+	Aa3	P-1	AA-	A-1+	AA+/Aa1/AA+	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
<b>Germany</b>												
DZ BANK AG DEUTSCHE ZENTRAL-	AA	F1+	Aa2	P-1	A+	A-1	AAA/Aaau/AAAu	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
LANDESBANK BADEN-WUERTEMBERG	A	F1	Aa3	P-1	NR	NR	AAA/Aaau/AAAu	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	0
<b>Netherlands</b>												
Cooperative Rabobank	AA-	F1+	Aa2	P-1	AA-	A-1	AAA/Aaa/AAA	£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
<b>Local Authorities</b>												
<b>UK Local Authorities (except for those below)</b>							AA-/Aa3/AAu	£15m(per authority)	24 Months +		Limit to 24 Months - WEF 11/12/2018	<b>40,200,000</b>
Birmingham City Council London Borough of Croydon Slough Borough Council Thurrock Borough Council Warrington Borough Council Woking Borough Council Nottingham Borough Council												
<b>Other</b>												
Supra-National Bonds ( EIB )	AA+	F1+	Aa1	P-1	AAA	A-1+	N/A	Unlimited	25 years		Limit to 25 years 10% of portfolio -	
Transport For London (Suspended)	A+	F1+	A=	P-2	Baaa 1	A-1	AA-/Aa3/AAu	NONE			Up to 24 months - Limit 10% of portfolio	
UK DMADF	NR	NR	NR	NR	NR	NR	AA-/Aa3/AAu	Unlimited	50 years		Unlimited	<b>16,500,000</b>

## Appendix C – Counterparty List

MMFs ( except JP MORGAN ASSET MANAGEMENT GOV)		AAA mmf		Aaa-mf		AAA m		£10m	100 days	Limit to 3 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	<b>30,000,000</b>
LCR Finance PLC	AA-	NR	Aa3	NR	AA	NR	AA-/Aa3/AAu	£15m	10 years		10 years - Limit to 10% of Fund Size	
Network Rail Infrastructure Finance PLC	AA-	NR	Aa3	P-1	AA	NR	AA-/Aa3/AAu	£15m	10 years		10 years - Limit to 10% of Fund Size	
UK Government	AA-	NR	Aa3	NR	Aau	A-1+u	AA-/Aa3/AAu	Unlimited	50 years		Unlimited	
Wellcome Trust Finance PLC	NR	NR	Aaa	NR	AAA	NR	AA-/Aa3/AAu	£10m	20 years		15 years - Limit to 10% of Fund Size	
<b>TOTAL FUNDS INVESTED</b>												<b>86,700,000</b>