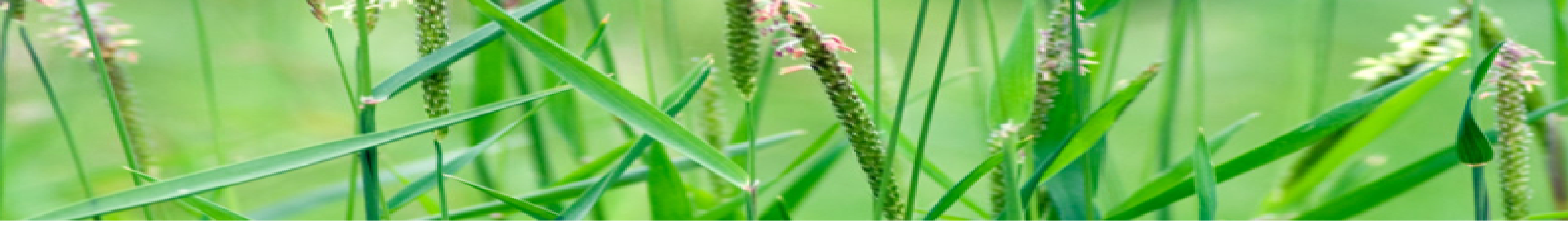


Appendix D

Uttlesford District Council

Treasury Management Strategy 2024/25

February 2024

Introduction

1. Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.
2. Treasury risk management at the Council is conducted within the framework of CIPFA's Treasury Management in the Public Services: Code of Practice (the 'TM Code'), which was last updated in 2021. This 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.
3. Investments held for service purposes or for commercial profit are considered in a different report, the Commercial Strategy (Appendix B).
4. As set out in the Medium Term Financial Strategy (Appendix C), the Council is currently investigating opportunities to divest of a proportion of its commercial investment portfolio. However, no decisions have yet been taken around which (if any) investments to sell. As such, this Treasury Management Strategy has been prepared on the basis of the Council's existing commercial investment portfolio. Should one or more asset sales be realised, this will result in a reduction in the Council's long term need to borrow, along with a requirement to invest any excess cash received in the short term (while the Council waits for fixed term borrowing to mature). Any such change will be reported to Cabinet in the quarterly treasury management outturn reports throughout the year.
5. This Treasury Management Strategy has been prepared with the support and advice of the Council's external treasury management advisers, Arlingclose.

External Context

Economic Background

6. 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 Council's treasury management strategy for 2024/25.
7. The Bank of England (BoE) increased the official Bank Rate of interest to 5.25% in August 2023, before maintaining this level for the rest of 2023. In February 2024, members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25%. Of the three dissenters, two wanted to increase rates by another 0.25%, while one wanted to reduce rates by 0.25%.
8. The UK economy contracted by 0.1% between July and September 2023. The February 2024 quarterly BoE Monetary Policy Report (MPR) forecasts a period of weak growth, with Gross Domestic Product (GDP) projected to increase by 0.1% in the first quarter of 2024, and at a similar pace over the following few quarters.
9. Office for National Statistics (ONS) figures showed CPI inflation was 4.0% in December 2023, up slightly from 3.9% in the previous month. The core CPI inflation rate remained at 5.1%. Looking forward, the BoE expects CPI inflation to fall temporarily to the 2% target in the second quarter of 2024, before increasing again in the last two quarters as the negative impact of falling energy prices lessens. It is then projected to remain above the 2% target for nearly all of the three year forecast period, reflecting some persistence of domestic inflationary pressures.
10. 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 up 1.4% and total pay 1.3%.

11. 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.
12. 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

13. 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 the second quarter of 2023, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily in the second half of the year.
14. On an annual basis, CDS price volatility has been lower in 2023 compared to 2022, but with more of a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.
15. 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.
16. 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.
17. 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.
18. However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest Rate Forecast

19. Although UK inflation and wage growth remain elevated, the Council's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25%. The Bank of England's Monetary Policy Committee will start reducing rates in 2024 to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.
20. 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.

21. A more detailed economic and interest rate forecast provided by Arlingclose is at Annexe D1.

22. For the purpose of setting the budget, it has been assumed that new fixed term treasury investments will be made at an average rate of 5.19%, and that new short term loans will be borrowed at an average rate of 5.36%.

Local Context

23. On 31 December 2023, the Council held £293.5 million of borrowing and £11.0 million of treasury investments. These are set out in further detail at Annexe D2. Forecast changes in these sums are shown in the balance sheet analysis in the table below:

Balance Sheet Summary and Forecast	31 March 2023 Actual £m	31 March 2024 Forecast £m	31 March 2025 Forecast £m	31 March 2026 Forecast £m	31 March 2027 Forecast £m
Capital financing requirement (CFR)					
General Fund	16.7	18.4	18.8	18.3	19.4
Commercial investments	238.5	253.1	263.8	260.5	257.1
Housing Revenue Account	80.9	81.9	80.9	83.9	81.9
Total - Capital financing requirement (CFR)	**336.1**	**353.4**	**363.5**	**362.7**	**358.4**
Less: Other debt liabilities*	(4.0)	(3.9)	(3.6)	(3.5)	(3.2)
Loans CFR	**332.1**	**349.5**	**359.9**	**359.2**	**355.2**
Less: External borrowing**	(299.4)	(282.1)	(184.8)	(180.9)	(177.0)
Internal borrowing	**32.7**	**67.4**	**175.1**	**178.3**	**178.2**
Less: Usable reserves	(34.0)	(31.9)	(30.6)	(35.2)	(32.9)
Less: Working capital	(11.3)	(11.3)	(11.3)	(11.3)	(11.3)
New borrowing / (investments)	**(12.6)**	**24.2**	**133.2**	**131.8**	**134.0**

* PFI liabilities that form part of the Council's total debt

** Includes only loans to which the Council is committed and excludes refinancing

24. 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 Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

25. The Council has an increasing CFR due to its capital programme, including the decision made by Full Council in August 2023 to loan an additional £21.1 million to Aspire (CRP) Ltd to finance further investment at Chesterford Research Park. The Council will be required to hold net borrowing of up to £318.0 million over the forecast period.

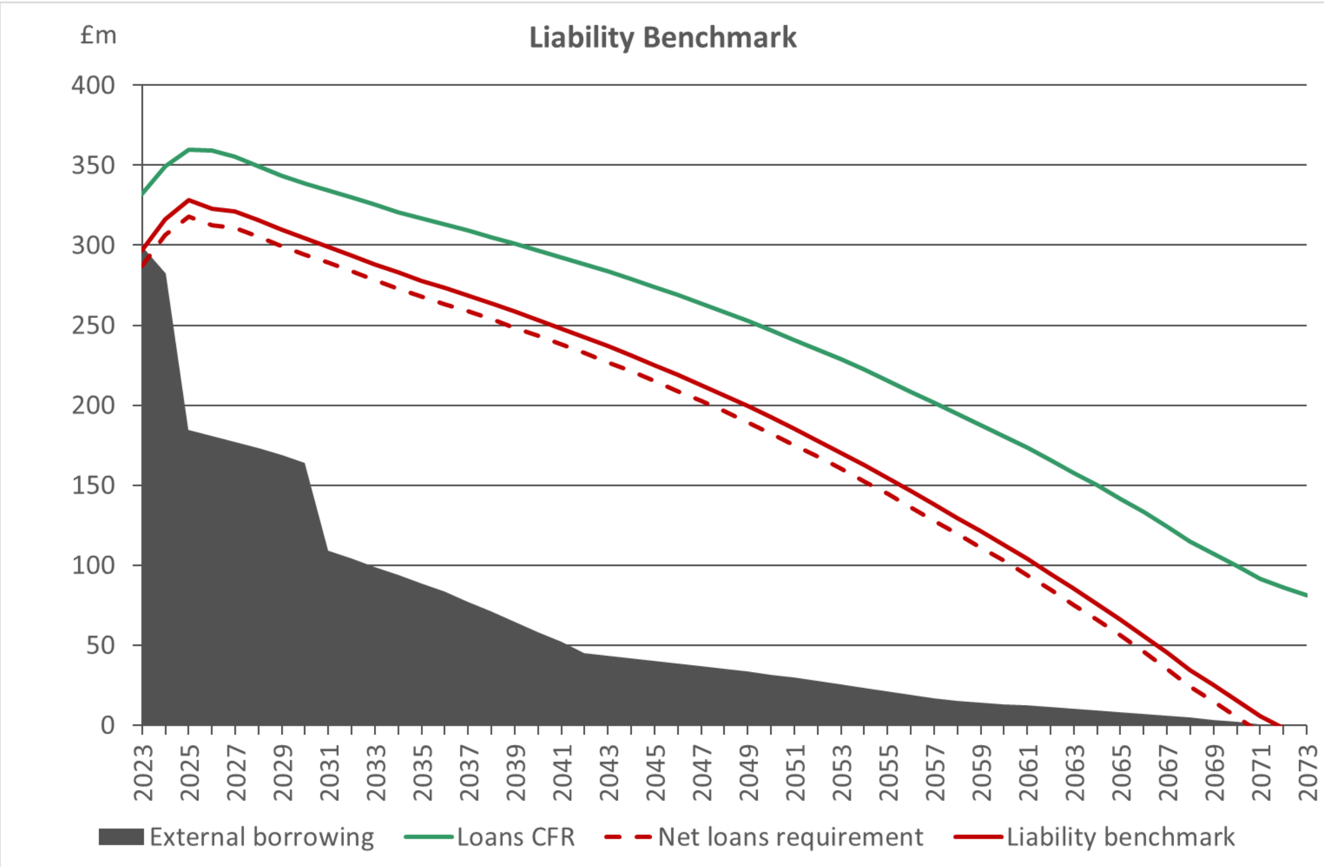
26. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The table above shows that the Council expects to comply with this recommendation during 2024/25.

Liability Benchmark

27. 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 the table at paragraph 23 above, but that cash and investment balances are kept to a minimum level of £10 million at each year end to maintain sufficient liquidity but minimise credit risk.

28. 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.

29. The chart below shows the Council's long term liability benchmark, together with the maturity profile of the Council's existing borrowing:



30. In the chart above, the loans CFR (green line) represents the need to finance capital expenditure through borrowing. The net loans requirement (dotted line) represents the minimum level of borrowing required once reserves and working capital have been taken into account. The liability benchmark (solid red line) represents the minimum level of borrowing required once reserves and working capital have been taken into account, but allowing for investment balances being maintained at a minimum level of £10 million. Where the liability benchmark exceeds the Council's current borrowing levels (dark grey area), this indicates a future borrowing need.

31. The forecast liability benchmark over the next three years is as follows:-

Liability Benchmark	31 March 2023 Actual £m	31 March 2024 Forecast £m	31 March 2025 Forecast £m	31 March 2026 Forecast £m	31 March 2027 Forecast £m
Loans CFR	**332.1**	**349.5**	**359.9**	**359.2**	**355.2**
Less: Usable reserves	(34.0)	(31.9)	(30.6)	(35.2)	(32.9)
Less: Working capital	(11.3)	(11.3)	(11.3)	(11.3)	(11.3)
Add: Minimum investments	10.0	10.0	10.0	10.0	10.0
Liability benchmark	**296.8**	**316.3**	**328.0**	**322.7**	**321.0**

Borrowing Strategy

32. As at 31 December 2023, the Council held £293.5 million of loans as part of its strategy for funding previous years' capital programmes. The liability benchmark forecast at paragraph 31 shows that the Council expects to hold borrowing of up to £328.0 million in 2024/25. The Council may also borrow additional sums to pre-fund future years' requirements, or to meet short term operational cashflow needs, providing this does not exceed the authorised limit for borrowing of £415 million (as set out in the Capital Strategy at Appendix E).

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

34. Given the significant cuts to public expenditure and in particular to local government funding in recent years, the Council'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 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.

35. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. 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.

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

<u>Sources of Finance</u>

37. The approved sources of long and short term borrowing are as follows:
    - HM Treasury's Public Works Loan Board (PWLB) lending facility;
    - UK Infrastructure Bank Ltd;
    - any institution approved for investments (see paragraph 49);
    - 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 Essex Pension Fund);
- capital market bond investors;
- retail investors via a regulated peer to peer platform; and
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

38. The Council 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 TM Code.
39. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield. Since the Council's Commercial Strategy (Appendix B) includes planned further development at Chesterford Research Park, the Council is currently unable to access the PWLB for new borrowing – however it is permitted to use PWLB loans to refinance existing borrowing as and when it falls due for repayment.
40. 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 for approval. In addition to the above sources of borrowing, 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 (PFI); and
    - sale and leaseback.

<u>Short term and Variable Rate Loans</u>

41. Short term and variable rate loans leave the Council exposed to the risk of short term interest rate rises and are therefore subject to the interest rate exposure limits set out at paragraph 66. Financial derivatives may be used to manage this interest rate risk (see paragraphs 73-76).

<u>Debt Rescheduling</u>

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

Treasury Investment Strategy

43. The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the financial year to date, the Council's treasury

investment balance has ranged between £8.0 and £22.5 million, and similar levels are expected to be maintained in the forthcoming year.

44. The TM Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

45. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

46. As demonstrated by the liability benchmark above, the Council expects to be a long term borrower and new treasury investments will therefore be made primarily to manage day to day cash flows using short term low risk instruments.

Environmental, Social and Governance (ESG) Policy

47. Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

Business Model and Accounting for Investments

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

Approved Counterparties

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

Counterparty	Time Limit	Counterparty Limit	Sector Limit
UK central government	50 years	Unlimited	N/A
UK local authorities including police and fire (irrespective of credit rating) - per authority	25 years	£5 million	Unlimited
Secured investments*	25 years	£5 million	Unlimited
Banks (unsecured)*	13 months	£3 million	Unlimited
UK building societies (unsecured)*	13 months	£3 million	£4 million
Saffron Building Society	100 days	£0.5 million	£4 million
Registered providers (unsecured)*	5 years	£3 million	£5 million
Money market funds*	N/A	£5 million	Unlimited
Strategic pooled funds	N/A	£3 million	£10 million
Real estate investment trusts	N/A	£3 million	£5 million
Other investments	5 years	£3 million	£3 million
* Investments will only be made with entities whose lowest published long term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.			

50. The above limits are unchanged from the previous year, with the exception of the sector limit for other investments, which has been increased from £2 million to £3 million to correct a previous inconsistency with the individual counterparty limit.

51. The limits above should be read in conjunction with the following notes:-

Counterparty Type	Notes
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.

Counterparty Type	Notes
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.
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 paragraph 52 below for arrangements relating to operational bank accounts.
Registered providers (unsecured)	Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (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	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.
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.
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 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	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.

52. In addition to the above investment limits, the Council may incur operational exposures (for example though 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 £3 million per bank. The BoE has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk Assessment and Credit Ratings

53. Credit ratings are obtained and monitored by Arlingclose, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Council's 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.

54. 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.

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

56. The Council 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.

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

Investment Limits

58. The Council's revenue reserves (both General Fund and Housing Revenue Account) available to cover investment losses are forecast to be £23.7 million at 31 March 2024, and £21.9 million at 31 March 2025. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government, local authorities and money market funds) will be £3 million. A group of non-government entities under the same ownership will be treated as a single organisation for limit purposes.

59. Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £3 million in operational bank accounts count against the relevant investment limits.

60. In addition, an investment limit of £5 million is placed on any group of pooled funds under the same management.

Liquidity Management

61. The Council uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long term investments are set by reference to the Council's Medium Term Financial Strategy (Appendix C) and cash flow forecast.

62. The Council will spread its liquid cash over at least three providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Prudential Indicators

63. The Council measures and manages its exposures to treasury management risks using a number of prudential indicators as set out below.

Security

64. The Council 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 rating	A

Liquidity

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

Liquidity Risk Indicator	Target
Total cash available within 3 months	£2 million

Interest Rate Exposure

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

Interest Rate Risk Indicator	Limit
Upper limit on one year revenue impact of a 1% rise in interest rates	£1.5 million
Upper limit on one year revenue impact of a 1% fall in interest rates	£1.5 million

67. 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

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

Refinancing Rate Risk Indicator	Upper Limit
Proportion of borrowing maturing in:	
Under 1 year	50%
At least 1 year and under 2 years	50%
At least 2 years and under 5 years	50%
At least 5 years and under 10 years	80%
At least 10 years and under 20 years	80%
At least 20 years	100%

69. 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

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

Price Risk Indicator	Limit
Limit on principal invested beyond year end	£10 million

71. 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.

Other Matters

72. The TM Code requires the Council to include the following other matters in this Treasury Management Strategy.

Financial Derivatives

73. 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).

74. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be 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.

75. 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 Council's Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

76. In line with the TM 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.

Housing Revenue Account

77. On 1 April 2012, the Council notionally split each of its existing long term loans into General Fund and Housing Revenue Account (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 and income arising from long term loans (e.g. 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. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

Markets in Financial Instruments Directive

78. 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 without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Strategic Director of Finance, Commercialisation and Corporate Services (Section 151 Officer) believes this to be the most appropriate status.

Financial Implications

79. The implications of this Treasury Management Strategy for the General Fund and HRA budgets for 2024/25 are set out below. These are based upon a number of assumptions, such as the level and type of investments and borrowing held, and future interest rate movements. Should actual events differ from the assumptions made, performance against the budget may vary.

80. The full 2024/25 General Fund budget is set out at Appendix H, while the full 2024/25 HRA budget is at Appendix G. The key risks and assumptions as they relate to these budgets are included in the Medium Term Financial Strategy (Appendix C).

General Fund

81. The budget for interest payable on long term borrowing in 2024/25 is £4.352 million, based upon an average long term debt portfolio of £114.8 million at an average interest rate of 3.79%.

82. The budget for interest payable on short term borrowing in 2024/25 is £6.665 million, based upon an average short term debt portfolio of £124.6 million at an average interest rate of 5.35%.

83. The budget for treasury investment income in 2024/25 is £446,000, based upon the General Fund share of the average investment balance of £10.8 million at an average interest rate of 5.30%.

Housing Revenue Account

84. The budget for interest payable on long term borrowing in 2024/25 is £2.639 million, based upon an average long term debt portfolio of £78.4 million at an average interest rate of 3.37%. There is no short term borrowing in the HRA.

85. The budget for treasury investment income in 2024/25 is £126,000, based upon the HRA share of the average investment portfolio of £10.8 million at an average interest rate of 5.30%.

Other Options Considered

86. The TM Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Strategic Director of Finance, Commercialisation and Corporate Services (Section 151 Officer), having consulted the Portfolio Holder for Finance and the Economy, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness.

87. Some alternative strategies, with their financial and risk management implications, are listed below:

Alternative Strategy	Impact on Income and Expenditure	Impact on Risk Management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower.	Lower chance of losses from credit related defaults, but any such losses may be greater.
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher.	Increased risk of losses from credit related defaults, but any such losses may be smaller.
Borrow additional sums at long term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income.	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 at 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.

List of Annexes

- Annexe D1 – Arlingclose Economic and Interest Rate Forecast – December 2023
- Annexe D2 – Existing Investment and Debt Portfolio Position – December 2023

Arlingclose Economic and Interest Rate Forecast – December 2023 Annexe D1

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 Monetary Policy Committee (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 of England'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 Purchasing Manager Index (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 geopolitical 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.

	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
Official Bank Rate													
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
3-month money market rate													
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
5yr gilt yield													
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
10yr gilt yield													
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
20yr gilt yield													
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
50yr gilt yield													
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%

Existing Investment and Debt Portfolio Position – December 2023 Annexe D2

Investment and Debt Portfolio	31 December 2023 Actual £m	31 December 2023 Average Rate %
External borrowing		
PWLB - General Fund	79.8	4.20
PWLB - Housing Revenue Account	78.4	3.32
Phoenix Life Ltd	35.8	2.86
Other local authorities	99.5	5.35
Subtotal - External borrowing	**293.5**	**4.19**
Other long-term liabilities		
Private Finance Initiative	4.0	8.29
Subtotal - Other long-term liabilities	**4.0**	**8.29**
Subtotal - Gross external debt	**297.5**	**4.25**
Treasury investments		
Government (including other local authorities)	11.0	5.60
Subtotal - Treasury investments	**11.0**	**5.60**
Net debt	**286.5**	**4.19**