Appendix 1

TREASURY MANAGEMENT STRATEGY 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 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 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 Investments held for service purposes or for commercial profit are considered in a different report, the Capital Strategy.

1.4 Should the assumptions on which this report is based change significantly, it may be necessary to seek approval to a revised Treasury Management Strategy. Such circumstances could include, for example, a large, unexpected change in interest rates, or in the Authority's capital programme or in the level of investments made or borrowing required.

2 External Context

Economic Background:

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

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

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

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

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

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

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

Credit Outlook:

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

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

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

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

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

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

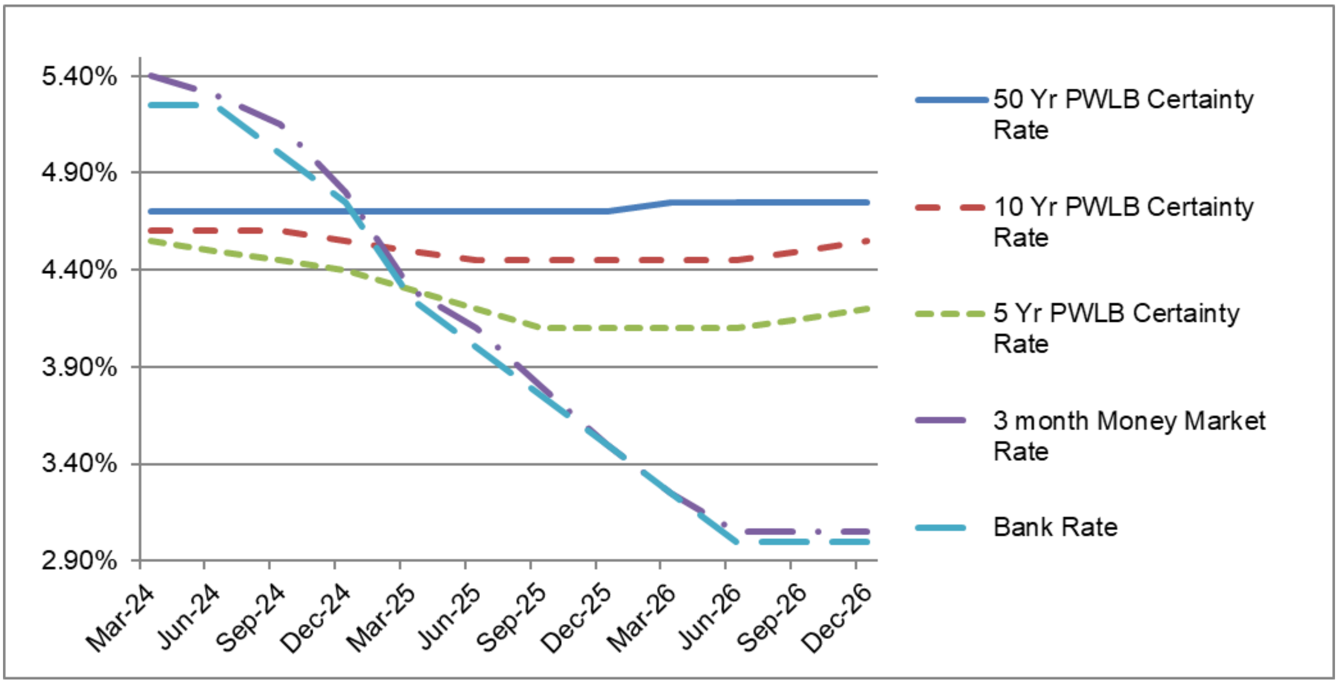
Interest Rate Forecast (December 2023):

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

2.16 Arlingclose expects long-term gilt yields to be broadly stable at current levels (amid continued volatility), following the decline in yields towards the end of 2023, which reflects the expected lower medium-term path for Bank Rate. Yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

2.17 The Council's latest interest rate forecast, reflecting advice from Arlingclose, is shown below.

The Public Works Loan Board (PWLB) rates relate to potential long-term borrowing, and the Money Market rate to short-term borrowing and investment.



For the purpose of setting the budget for 2024/25, it was assumed that:

- any new investments would be at an average rate of 4.60%, and
- new borrowing would be available, if required, at rates around 5.25%.

3 Local Context

At the end of January 2024 the Council held around £199.1 million of borrowing and £86.7 million of treasury investments:

Table 1: Existing Debt and Investment Portfolio Position

	£m
Short-Term Debt	0.0
Long-Term Debt	131.2
Lancashire County Council (LCC) Debt	12.1
Debt re PFI Arrangements	55.8
Gross Borrowings	**199.1**
This was offset by investments of:	86.7
Net Borrowing (gross borrowing less investments)	112.4
Net Borrowing (if LCC and PFI debt are excluded)	**44.5**

3.1 The Council's Capital Financing requirement (CFR) is the key measure of the Council's borrowing **need** in the long term. It is:

the accumulated need to borrow **to finance capital spend** (not funded from grants, etc.)

LESS the accumulated Minimum Revenue Provision (MRP) charges already made - councils must make a prudent MRP charge in their accounts, to finance their debt

LESS any capital receipts applied to finance outstanding debt.

The CFR tends to increase if capital spend financed from borrowing exceeds MRP.

3.2 Forecast changes in CFR and borrowing needs are shown in the table below:

Table 2: Balance Sheet Summary and Forecast

	31.3.23 Actual £m	31.3.24 Estimate £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m
General Fund CFR	281.2	283.6	341.9	352.5	357.3
Less: CFR re Other debt liabilities *1	-83.7	-83.2	-127.8	-127.3	-126.8
Loans CFR	**197.5**	**200.4**	**214.1**	**225.2**	**230.5**
Less: External borrowing *2	-138.0	-129.6	-119.5	-111.3	-105.1
Internal Borrowing	**59.5**	**70.8**	**94.6**	**113.9**	**125.4**
Less: Usable reserves *3	-104.00	-101.00	-91.0	-91.0	-91.0
Plus/Minus: Working capital	-6.3	-34.6	-16.6	-17.7	-18.8
Remaining Net Borrowing Need	**-50.8**	**-64.8**	**-13.0**	**5.2**	**15.6**

Net Borrowing Need addressed by		
Short Term Borrowing	**0.0**	**0.0**
Treasury Investments	**-50.8**	**-64.8**

*1 CFR regarding PFI liabilities, leases and transferred debt that form part of the Council's total debt. From 2024/25 this figure includes an estimate of £45.0 million arising from a change in accounting for leases.

*2 Only loans to which the Council is committed over the longer term

*3 Includes schools balances and grants received in advance of need

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 below their underlying levels, sometimes known as internal borrowing.

The Council's "Loans CFR" is forecast to increase in the medium-term because, based on current Capital Programme plans, the level of MRP being made is exceeded by the increase in the CFR resulting from additional spend financed from borrowing.

3.3 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that total debt should be lower than the highest forecast CFR over the next three years. Table 2 shows that the Council expects to comply with this recommendation during 2024/25.

4 Liability Benchmark

4.1 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 2 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.

4.2 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.

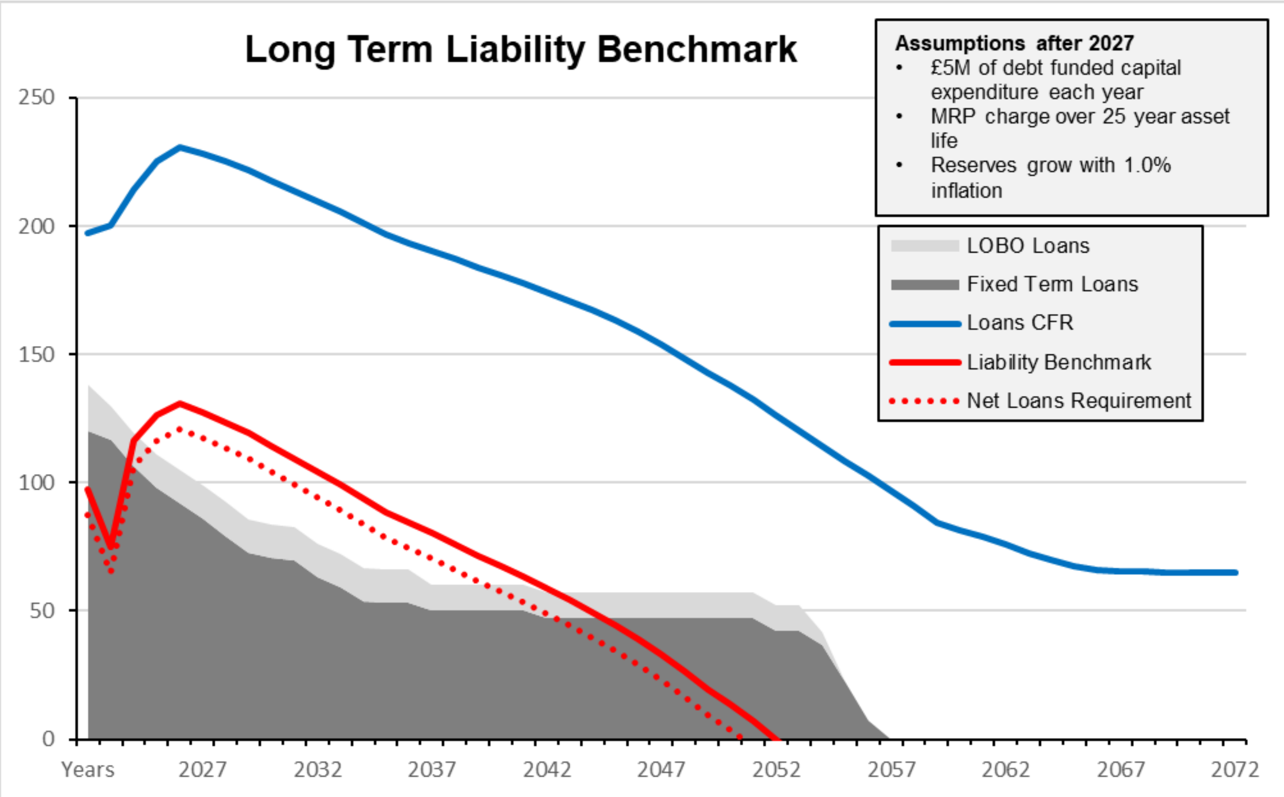
Table 3: Liability Benchmark

	31.3.23 Actual £m	31.3.24 Estimate £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m
Loans CFR	197.5	200.4	214.1	225.2	230.5
Less: Balance sheet resources	-104.00	-101.00	-91.0	-91.0	-91.0
Net loans requirement	**93.5**	**99.4**	**123.1**	**134.2**	**139.5**
Plus: Liquidity allowance	3.7	-24.6	-6.6	-7.7	-8.8
Liability Benchmark	**97.2**	**74.8**	**116.5**	**126.5**	**130.7**
Actual Borrowing	**138.0**	**129.6**	**119.5**	**111.3**	**105.1**

4.3 The above table shows that the borrowings the Council has already committed to are forecast to be below the liability benchmark in the future, and therefore the Council would be expecting to enter into new borrowings over the next 3 years. The majority of this would be replacing maturing short-term loans.

4.4 Current borrowing levels are above the liability benchmark for the following reasons:
- low levels of capital expenditure during 2022/23 and 2023/24 offset by high value capital receipts, reducing the borrowing requirement
- high cash balances at the end of 2023/24, partly as a result of grant funding received but not spent during the

4.5 Following on from the medium-term forecasts shown in Table 3 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £5 million a year, minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 1.0% a year. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



5 Borrowing Strategy

5.1 The authority currently holds £131.2 million of loans (excluding PFI and transferred debt), a decrease of £8.6 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 2 shows the authority's borrowing expectations for the next three years. The authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £361.9 million. However, given the current high level of interest rates, this is unlikely to be a strategy adopted in 2024/25.

5.2 **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.

5.3 **Strategy:** Given the significant cuts to public expenditure and the particular pressures on 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. With both short and long-term interest rates currently at high levels, it is likely to be more cost effective in the short-term to maximise the use of internal resources. By doing so, the Council can reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.4 Long-term borrowing rates are forecast to remain the same in the early part of 2024/25 before dropping in the latter part of the year and beyond. The benefits of deferring long-term borrowing for as long as possible will be monitored regularly against the costs of internal and short-term borrowing. Arlingclose will assist the Authority with this analysis.

5.5 The Authority has previously raised much 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. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; if the Council was to undertake such activities, alternative long term funding options would need to be explored. It is likely that this would take longer to arrange, and the process would require additional resources to complete. The interest rates at which such borrowing could be obtained are uncertain but may be at rates higher than those currently available from the PWLB.

5.6 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.

5.7 In addition, the Council may take further short-term loans to cover cash flow requirements.

5.8 The authority will continue to maintain a flexible approach to borrowing.

5.9 **Sources of Borrowing:** The approved sources of long-term and short-term borrowing will be:

- 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 (apart from the Lancashire County Council Pension Fund)
- 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 Financing: 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

5.10 **Municipal Bonds Agency:** The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. Blackburn with Darwen BC was one of a number of local authorities investing in the Agency to help to establish it. 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:

(a) 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
(b) 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 Municipal Bonds Agency will be subject to a separate report to the Executive Board.

5.11 **LOBOs:** The Council currently holds £8 million of 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 to either accept the new rate or to repay the loan at no additional cost. During December 2023, Dexia Credit Local exercised the option to increase the interest rate on a £5 million LOBO from 4.35% to 4.96%. Following a review of the financial implications, and supported by advice from Arlingclose, the Council subsequently exercised the option to repay the loan. Both of the remaining LOBO loans have options which may be exercised during 2024/25 and, with interest rates remaining relatively high, there is a good chance that lenders will exercise their options. If they do, the Authority may take the option to repay LOBO loans to reduce refinancing risk in later years. It is not currently expected that the Council will take any further LOBO loans - however in order to allow for some flexibility, the Council will limit its total exposure to LOBO loans to £25 million.

5.12 **Short-Term and Variable Rate Loans:** Short-term and variable rate 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).

5.13 **Debt Rescheduling:** 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 current high interest rates means that more favourable debt rescheduling opportunities may arise than in previous years, and opportunities will be kept under review with support from Arlinglcose.

6 Treasury Investment Strategy

6.1 On a day-to-day basis the Council can hold significant invested funds representing income received in advance of expenditure requirements, in addition to balances and reserves held. In the past 12 months, the Council's treasury investment balance has ranged between £51 million and £106 million, reflecting in particular the profiles of capital spending, grant funding, short-term borrowing levels and long-term debt repayments. Treasury investment levels are expected to reduce over the forthcoming year based on forecast capital expenditure plans, and the spending of grants in 2024/25 that have been received in the current year.

6.2 **Objectives:** The CIPFA 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. 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 try, whilst balancing the above, 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 Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

6.3 **Strategy:** As demonstrated by the liability benchmark above, the Authority expects to be a long-term borrower, but is likely to use internal resources to defer borrowing for as long as possible in the expectation of interest rate reductions by the end of 2024/25. This will inevitably diminish the funds available for investment, but there will be opportunities in the first half of the year to take advantage of current yields, albeit the focus will remain on relatively short-term, low risk opportunities. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income, and the Authority will work with its brokers to investigate other, appropriate lending opportunities.

6.4 In order to prioritise the security of investments, the Council sets limits on the amounts placed with different institutions and as to the duration of the investment. This is to maintain a diversified investment portfolio and to align amounts and durations of investments to the perceived risks associated with different counterparties.

6.5 **ESG policy:** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the 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.

6.6 **Business Models:** 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.

6.7 **Approved Counterparties:** The Authority may invest its surplus fund with any of the counterparty types in Table 4 below, subject to the limits shown.

6.8 The counterparty limits set out below do allow for a wider range of investment opportunities to be taken up than have been used by the Council to date. Should the circumstances arise under which this would be appropriate, this would allow an increased diversification of the overall portfolio and in some instances, increase the security of investments made. The take up of any new investment opportunities will be closely managed by Officers in the Treasury Management Group, following advice given by the Council's Treasury Management Advisers.

Table 4: Treasury Investment Counterparties and Limits

Approved Investment Counterparties	Time Limit	Cash Limit	Sector Limit
The UK Government	50 years	Unlimited	N/A
Local Authorities* & Other Government Entities	25 years	£5M each	Unlimited
** as defined in the Local Government Act 2003*			
Banks and Building Societies - Secured			
long-term credit ratings no lower than AA- (or equivalent)	25 years	£5M each	Unlimited
long-term credit ratings no lower than AA (or equivalent)	25 years	£4M each	
long-term credit ratings no lower than A- (or equivalent)	25 years	£3M each	
Banks and Building Societies - Unsecured			
long-term credit ratings no lower than AA- (or equivalent)	100 days	£5M each	Banks - Unlimited Building societies - £6M in total
long-term credit ratings no lower than AA (or equivalent)	100 days	£4M each	
long-term credit ratings no lower than A- (or equivalent)	100 days	£3M each	
The Council's **current account banker** - provided long-term credit rating no lower than BBB- (or equivalent)	next day	£3M each	
Corporates or **Registered Providers** with long-term credit ratings no lower than A- (or equivalent)	5 years	£3M each	£5M in total
Money Market Funds			
long-term credit ratings no lower than A- (or equivalent)	N/A	£5M each	Unlimited
unrated or long-term credit ratings under A- (or equivalent)	N/A	£4M each	
Strategic Pooled Funds and Real Estate Investment Trusts (incl. money market funds)			
long-term credit ratings no lower than A- (or equivalent)	N/A	£5M each	£10m in total
unrated or long-term credit ratings under A- (or equivalent)	N/A	£4M each	

Other Investment Limits	Cash Limits
Any group or organisation under the same ownership	Group or overall limit same as would be set for parent company
Foreign Countries - limited to those with sovereign credit rating of AA+ or better (from all agencies)	£5M each
UK investments will not be limited by the UK's sovereign credit rating	
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.	

6.9 Cash flow surpluses can be considered as falling into three categories -

(a) **Short-term funds** that are required to meet cash flows occurring in the next month or so, and for which the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash.

(b) **Medium-term funds** that may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks, building societies and other local authorities. A spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks.

(c) **Long-term funds** that are not required to meet any liquidity need and can be invested with a greater emphasis on achieving higher returns. Security remains fundamental however, as any losses from defaults will impact on the total return. Liquidity is of lesser concern, although it should still be possible to sell investments with due notice if large cash commitments arise unexpectedly. This is where a wider range of instruments, including structured deposits, certificates of deposit, gilts, corporate bonds and pooled funds in bond, equity and property funds, could be used to diversify the portfolio.

6.10 The overall Investment Strategy will be to prioritise security of funds and maintain a mix of short-term (largely instant access) and medium-term investments to generate investment income as market conditions permit. If the Council expects to have funds available for long-term investment, the Council will consider its options for such funds, including potential investment in strategic pooled funds. However, long-term investment is unlikely in 2024/25 give the aspiration to defer borrowing.

6.11 **Government:** Loans to, and bonds and bills issued or guaranteed by, national government, 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. Before taking the decision to lend to another local authority, their financial position will be reviewed. Where a local authority to whom we have made a loan issues a Section 114 notice (meaning expenditure of the authority incurred in a financial year is likely to exceed the resources available to it) we will recover the funds at the end of the agreed term and carry out further due diligence work before considering further lending.

6.12 **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.

6.13 **Banks and building societies (unsecured):** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

6.14 **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.

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

6.16 **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the 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.

6.17 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with 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.

6.18 **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 Authority's investment at risk.

6.19 **Operational Bank Accounts:** The Authority 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 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.

6.20 **Risk Assessment and Credit Ratings:** 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 at no cost will be recalled and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

6.21 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.

Where a credit rating agency awards a different rating to a particular class of investment instrument as opposed to the credit rating of the counter-party as a whole, the Council will base its investment decisions on the instrument credit rating rather than the counterparty credit rating.

6.22 **Other Information on the Security of Investments:** 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.

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

6.24 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. 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. The Authority will continue to seek information and advice from Arlingclose when assessing the creditworthiness of potential counterparties.

6.25 **Liquidity Management:** The Council uses a cash flow model to determine the 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. Furthermore, a prudent level of funds is maintained in ‘instant access’ investments, to cover most likely eventualities. However to mitigate risk further, it is possible to borrow funds to cover short-term needs.

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

7 Treasury Management Prudential Indicators

7.1 The Council measures and manages its exposures to treasury management risks using the following indicators:

7.2 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk - i.e. to prevent too much debt maturing at any one time, with a risk the Council will have to refinance at the rates then prevailing. The limits for up to 24 months continue to be relaxed to allow for a higher level of short-term borrowing.

The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	30%	0%
10 years and above	95%	20%

This indicator applies to the financial years 2024/25 and 2025/26, from the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. Where there is a prospect that a LOBO may be called, this has been reflected in setting these limits.

7.3 **Long term treasury management investments:** 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 limits on the total principal sum invested to final maturities beyond the period end will be:

	2024/25 £M	2025/26 £M	2026/27 £M
Limit on principal invested beyond year end	7.0	5.0	3.0

So a maximum of £7M can be invested for a period of greater than one year, a maximum of £5M for a period of greater than two years and a maximum of £3M for a period of greater than three years.

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.

The Indicators above are "standard" Treasury Management Indicators that are generally adopted by local authorities, in line with individual circumstances. These indicators have not directly addressed the key treasury priorities of Security and Liquidity, though these issues are already closely tracked throughout the year. However, working in conjunction with the Council's Treasury Advisers, options for the formal monitoring of performance in regard to these priorities remain under consideration.

7.4 **Interest Rate Risk:** CIPFA has withdrawn the previous recommendation for standard indicators for Upper Limits on Fixed and Variable Interest Rate Risk. Nonetheless, this Council recognises that it must have regard to the risk that fluctuations in interest rates could create an unexpected burden on its finances, and will therefore continue to monitor its exposure to Fixed and Variable Interest Rate Risk. In addition, without setting a formal limit, this Council will also monitor, on an ongoing basis, the potential impact of a 1% change in interest rates on its current borrowing and investment portfolio.

The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2024/25 £M	2025/26 £M	2026/27 £M
Upper limit on Fixed Interest rate exposures	260.1	270.7	275.7
Upper limit on Variable Interest rate exposures	115.6	120.6	123.0

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.

8 Related Matters

8.1 **Financial Derivatives:** 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).

8.2 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.

8.3 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.

8.4 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.

8.5 **Markets in Financial Instruments Directive (MiFID):** The Authority has opted up to professional client status with its providers of financial services, including advisers, 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 Authority's treasury management activities, the Strategic Director of Finance and Resources believes this to be the most appropriate status.

9 Financial Implications

9.1 Excluding PFI costs (which are offset by Government grant funding), the budget for debt interest payable in 2024/25 is £6.4 million (including the interest element of payments to LCC for debt managed on our behalf), reflecting:

(a) £6.0 million interest payable, at an average interest rate of around 3.9%, on the long-term debt portfolio (forecast to average £112 million over the year),

(b) up to £0.4 million for short-term borrowing, at interest rates averaging 5.25%. This is a prudent estimate given that, as described elsewhere in this strategy, internal resources will be used to defer borrowing for as long as possible.

Projected investment income in 2024/25 is around £3.0 million, based on an average investment portfolio of circa £65 million, and interest rates averaging 4.60%.

If actual levels of investments and borrowing and/or actual interest rates differ from those forecast, performance against budget will be correspondingly different.

10 Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Strategic Director of Finance and Resources, having consulted with the Executive Member for Finance and Governance, 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.

Alternative	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 fully 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