North Somerset Council

Report to the Executive

Date of Meeting: 7 February 2024

Subject of Report: Treasury Management Strategy 2024/25

Town or Parish: All

Officer/Member Presenting: Mike Bell, Leader of the Council

Key Decision: Yes

Reason:
Financial implications within the report are in excess of £500,000 and impact on all wards and communities within North Somerset.

Recommendations
The Executive is requested to;

Recommend to Council for approval;

i) the Treasury Management Strategy for 2024/25, as described throughout the report and shown in **Appendix 1**,

ii) the Prudential Indicators for 2024/25, as shown in **Appendix 2,**

iii) the Minimum Revenue Provision Statement for 2024/25, as shown in **Section 3.5**.

1. Summary of Report

The purpose of the report is to present the council's annual ***treasury management strategy*** (TMS) for the 2024/25 financial year, for recommendation onto Council for consideration and approval, as required by statute.

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The report contains details of;

- how the council plans to manage its cash-flows and resources in the year ahead to ensure effective treasury management,
- the proposed Prudential & Treasury Indicators for 2024/25, and
- the proposed policy for making Minimum Revenue Provision in respect of the repayment of the council's external debt, within the revenue budget.

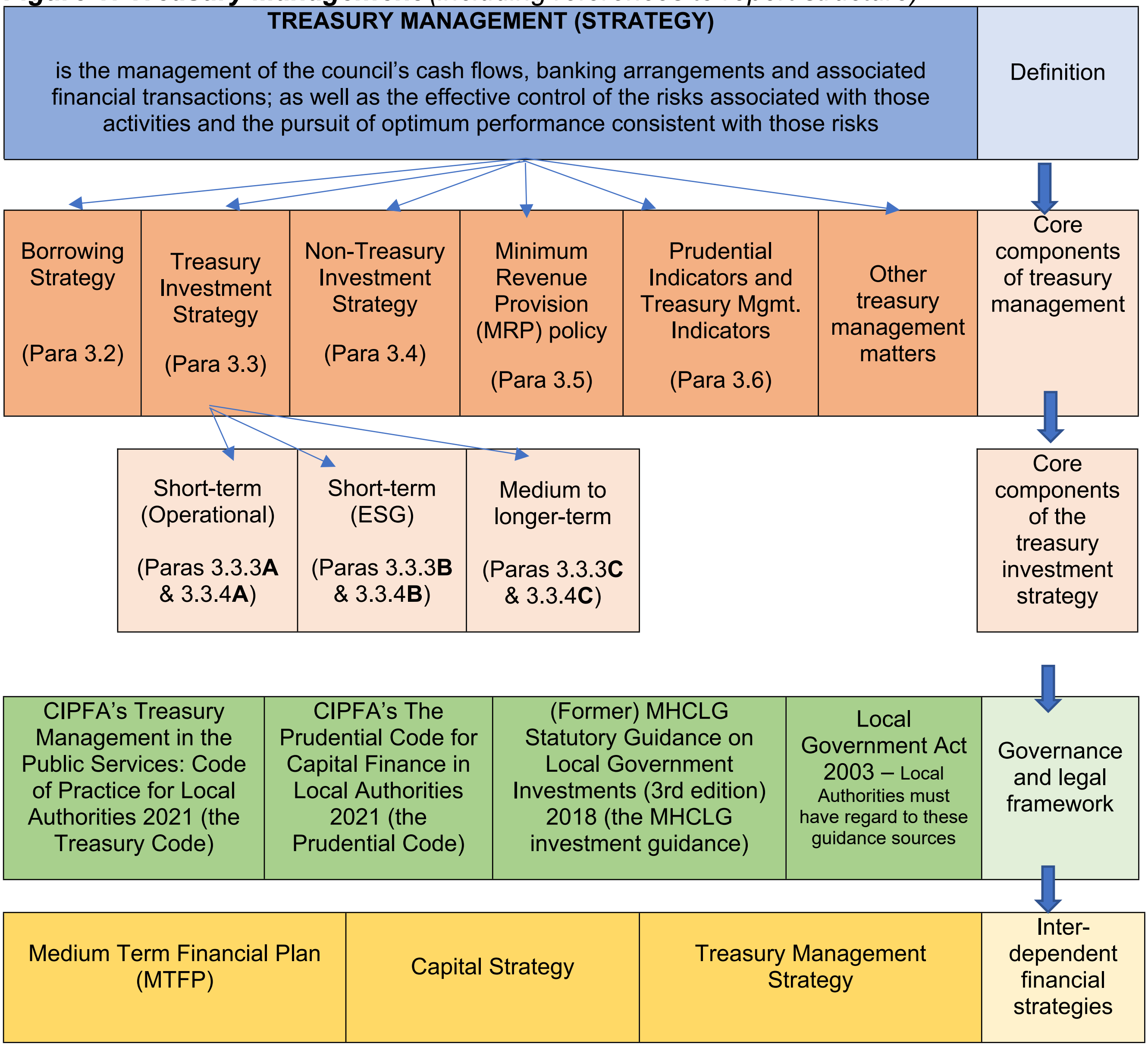
Again, statute requires that each of these areas are required to be approved by Council.

2. Policy

The council's budget process should ensure that all resources are planned, aligned, and managed effectively to achieve the corporate aims and objectives of the council. The council's treasury related strategies link directly into the revenue and capital budget planning processes and all aim to support effective service delivery across the council, in this year, as well as across the medium term.

Treasury management, its definition, constituent parts and its relationships with other policies and regulation is depicted in Figure 1 below.

Figure 1: Treasury Management *(including references to report structure)*



Each of the core components of treasury management, as noted above, are summarised in **Section 3** with further technical detail provided within the Treasury Management Strategy in **Appendix 1**.

3. Details

3.1 Introduction and background

The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is therefore to ensure that this cash flow is adequately planned, with cash being available when it is needed. Much of the day-to-day **treasury** activity is linked to investing surplus monies in low-risk counterparties or instruments commensurate with the councils' low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet council risk or cost objectives, subject to it being appropriate and affordable having considered premature redemption costs.

The contribution the **treasury management** function makes to the council is therefore critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

As expected, given the nature of the transactions undertaken in this area, together with the significant amount and types of risk involved, treasury management is heavily regulated both in terms of legal statute, technical investment guidance provided by government departments as well as Codes of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). The council is required to adhere to and give due regard, to all these relevant frameworks.

CIPFA defines treasury management as "the management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks." This definition not only describes the various elements of treasury management activity, it also demonstrates how interlinked they are with other, which can make it difficult to explain the council's technical and strategic plans for the year ahead, in a way that can be easily understood.

The report has therefore been drafted to summarise the council's proposed approach for the 2024/25 financial year within each of the following sections, with further detail contained within the appendices at the end of the paper.

- **Borrowing strategy** – paragraph 3.2
  To support the council's capital spending plans

- **Treasury investment** strategy – paragraph 3.3
  A) To support the daily operations of council services
  B) To ensure that the council is a responsible investor
  C) To manage longer-term cash-flows and generate financial returns to support the annual revenue budget

- **Non-treasury investment** strategy – paragraph 3.4
  To support place-making ambitions across the district and to support the annual revenue budget

- Minimum revenue provision policy – paragraph 3.5
- Prudential indicators and treasury management indicators 3.6

3.2 Borrowing Strategy

3.2.1. Background and local context:

In some instances, the council may find itself in a position whereby it may need to borrow short-term loans to cover unplanned cash flow shortages arising from operations. However, most of the council's borrowing activity is linked to its capital spending plans.

CIPFA's Prudential Code for Capital Finance in Local Government, requires the council to determine that all its capital expenditure and investment decisions are affordable, prudent, and sustainable, and it must ensure that it sets limits on the amount that it can afford to borrow in the context of wider capital planning.

To understand whether new borrowing plans can be deemed affordable, the council must first understand its current borrowing position and then overlay planned changes.

On 30th November 2023, the council held £164.6m of borrowing which it has drawn down over several years to fund previous capital expenditure.

- £129.4m of this debt is held with the Public Works Loan Board (PWLB) at an average rate of 4.00%
- £2.1m of this debt is held with Salix at an average rate of 0%
- £0.6m of this debt is held with local councils at an average rate of 4.04%
- £10.8m of this debt relates to debt managed by Bristol City Council, in respect of the former Avon County Council organisation
- £21.7m of this debt relates to long-term leasing arrangements, the largest of which relates to the Sovereign Centre

The prudential indicators associated with the council's long-term borrowing position (as noted in the report to Audit Committee in November 2023) show that existing loans are sustainable and affordable which is a reliable platform to move forward from.

The summary below details the estimated level of borrowing that are likely to be required over the next few years to fund the schemes that are included within the current capital programme, as well as those being requested for approval in the Capital Strategy report for 2024/25.

Table 2: Estimated level of borrowing

EXPENDITURE BUDGET	2023/24 £'000	2024/25 £'000	2025/26 £'000	2026/27 £'000	2027/28 £'000	TOTAL £'000
Approved Programme	**104,968**	**169,638**	**123,709**	**47,230**	**1,825**	**447,370**
- Planned additions to the programme	0	1,350	3,841	1,799	2,799	**9,789**
DRAFT CAPITAL PROGRAMME	**104,968**	**170,988**	**127,550**	**49,029**	**4,624**	**457,159**

FUNDING RESOURCES	2023/24 £'000	2024/25 £'000	2025/26 £'000	2026/27 £'000	2027/28 £'000	TOTAL £'000
Earmarked Grants and contributions	80,004	141,717	85,994	2,576	1,799	**312,090**
Unsupported Borrowing	15,138	25,651	35,699	37,119	1,325	**114,932**
Capital Receipts	1,500	1,500	1,500	1,500	1,500	**7,500**
Revenue Contributions	7,553	1,729	0	7,143	0	**16,425**
Other Capital Resources	773	391	4,357	691	0	**6,212**
	104,968	**170,988**	**127,550**	**49,029**	**4,624**	**457,159**

As can be seen from the table above, the overall level of new borrowing required over the period to 2028 is currently estimated to be £114.932m, with approximately £40.789m of this new borrowing being required to finance capital expenditure before the end of March 2025.

The summary above and all the borrowing calculations in this report only reflect proposals which are to be included within the council's approved capital programme. Should any further increases in borrowing or forward funding decisions subsequently be made beyond these levels, then further council approval would be required to re-state prudential indicators, and additional revenue resources identified to fund debt repayment costs.

The council may also borrow additional sums to pre-fund future years' requirements, providing that this does not exceed the authorised limit for borrowing, which is currently set at £262m.

3.2.2. Summary of current position:

The council currently holds £164.6m of long-term debt.

3.2.3. Objectives:

The council's main objectives when borrowing will be to achieve a low but certain cost of finance, while retaining flexibility should plans change in future.

3.2.4. Proposed Strategy for 2024/25:

Given the significant cuts to public expenditure and in particular to local government funding, 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 at a 15-year high but are expected to fall in the coming years and it is therefore likely that 'external' borrowing decisions will be deferred in respect of the 2024/25 financial year and the focus would instead be to draw-down and access the council's internal borrowing through reducing cash balances.

During 2024 we will review all borrowings and debt facilities to ensure these continue to meet updated code requirements and deliver value for money for local taxpayers. The review will aim to ensure that we streamline our processes and decision making in order to maximise any contribution to the wider financial pressures faced by the council as well as to support the MTFP. Findings from the review will be reported to the Audit Committee within the regular in-year treasury management reporting framework, and any changes arising will be taken forward in consultation with the Section 151 Officer.

3.2.5. Borrowing strategy beyond 2024/25:

Given the levels of planned investment the council recognises that it may be required to borrow externally over the period 2025-2028 however, before any future borrowing is considered, officers would seek advice from the council's treasury management advisors (Arlingclose) in relation to the potential costs of different options and to ensure an option proposal aligned to the objectives.

Whilst the council has previously raised most of its long-term borrowing from the PWLB it will consider long-term loans from other sources in the future, including banks, pension funds, and other local authorities, and will investigate the possibility of issuing bonds and similar instruments, to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. An important point for local authorities to note is that they are no longer able to draw down loans from the PWLB if any of their capital spending plans relate to buying investment assets primarily for yield. Given that the council does not intend to borrow for yield, then it is likely that we will retain access to PWLB loans if needed.

3.3 Treasury investment strategy

3.3.1. Background and local context

Given that the <u>primary</u> purpose of treasury management is linked to the management of day-to-day cash-flows, then it must be accepted that the council will make investment decisions on an almost daily basis to smooth cash-flows and ensure that cash is planned and available when needed. These decisions and transactions are known as **treasury investments** and sums are often placed in short-term, low risk, highly liquid products which is commensurate with the council's low-risk appetite.

In addition to the daily cash-flows that are related to the annual budget, at any one time the council's balance sheet will show that it is also holding surplus cash-flows in respect of prior year activities, examples include the receipt of capital grants in advance of spending plans and the retention of monies within reserves, which may be held to fund future spending or be held to manage risk. It is necessary for these funds to also be placed in treasury investments during the year however, it is possible that some of these investments could be placed in a more strategic way that is more aligned to the nature and timescale of the relevant cash-flow, i.e., investments could be made across a longer-period of time if it is understood that the monies may not be required for a specific period of time.

Irrespective of whether the treasury related investment is placed for a short or a longer period, it is essential that **all** such investments are placed in accordance with the both the legal framework as well as the council's approach to risk and defined objectives.

Before considering its Strategy for treasury investments for the year ahead it is therefore important to firstly understand the following, some of which are described in more detail throughout the report and the appendices;

- the current level of investment balances held and performance,

- current regulatory framework and future changes,
- annual cash-flow forecasts for the year ahead,
- planned profile of spending linked to capital receipts, grants, and reserves,
- new investment plans,
- market conditions, interest rates and future expectations,
- Environmental, Social and Governance (ESG) related considerations, and
- any other strategic decisions that may have been taken elsewhere within the council's treasury management strategy (i.e., borrowing strategy, approach to risk, required asset allocations, choice of assets).

3.3.2. Summary of current position:

In the past 12 months, the council's treasury investment balance has ranged between £162m and £213m which is an increase over the levels in the previous 12 months. A review has been undertaken which show that this is, to a large extent, linked to the ability of the council to lever in external funding for large capital projects which reduces the need to draw down on the council's core cash-flows. For example, in 2023/24 the council received over £20m for funding of its Bus Service Improvement Plan. The council also received most of its Integrated Care Board care funding in the first half of the year.

To a lesser extent the increase in cash available for investment is linked to legacy issues relating to Covid-19 and more recently the cost of living pressures, notably surrounding the cash flows related to the many support packages and intervention measures that the government continues to put place. Forecasts do indicate that all of the above cash levels are expected to reduce by 31 March 2025 as any sums received in advance are defrayed, paid to businesses, providers and in the case of any unspent government support packages, returned to the government.

The majority of the council investments are held as short-term, with the duration being less than 1 year; £10m is held as long-term investments as the investments were placed several years ago for strategic purposes.

Arlingclose facilitate regular benchmarking programs to assess how the council's treasury management investment decisions and outcomes compare with other local authorities. Recent results show that the council's investment portfolio is not considered high risk, and, whilst investment returns have increased due to the current economic environment, the portfolio is providing returns in line with the risks being taken. This supports the council's approach in recent years whereby it has chosen to place funds prudently to protect monies and reduce exposure to risk.

Market conditions currently show that interest rates have likely reached their peak, which means that it will be important to consider the ongoing impact of interest rates on future treasury investment related decisions.

Financial modelling shows that the council will continue to hold surplus cash-flows over the short-term until such time as spending plans catch up with monies currently being held to fund them. The council is able to financially benefit from this by generating interest when the surplus funds are invested, and activity undertaken in recent months has meant that the council has been able to improve the budget situation in the current financial year.

An assessment has been carried out to see how much additional income could continue to be generated over the short-term, when cash-flows and interest rates remain higher than the base budget. The council recognises that this is not a sustainable position into the longer-term as the cash-flows and interest rates will both reduce over time and has therefore only been reflected as a short-term measure within the MTFP. Further detail is contained within the MTFP report.

The ‘*borrowing strategy*’ described in para 3.2.4 above recommends that external borrowing is not taken, but spending will instead be offset against current surplus cash balances, i.e., it will be funded internally. This will mean that lower levels of surplus cash balances may be available during 2024/25.

3.3.3. **Objectives:** i.e., what we would like to happen

The council’s **treasury investment** objectives for the year ahead cover the following areas;

A) Continued support of daily operational activity of the council as a whole to support business as usual activity ensuring compliance with current external regulation and internal guidance.

The council must ensure that its’ treasury investments support the management of core cash-flows on a daily basis so that services can continue to be delivered to residents and this is achieved through the management of short-term cash deposit type investments.

There is currently a robust governance framework in place to cover these activities with approval levels and institutions clearly defined within the approved strategy and this is supported by routine reporting to the Audit Committee.

In terms of treasury related objectives, both the CIPFA Code and the MHCLG Guidance require councils to have underlying objectives supporting investment, with two of these being;

- Security – protecting the capital sum invested from loss; and
- Liquidity – ensuring the funds invested are available for expenditure when needed

The generation of yield is distinct from these two prudential objectives although guidance says that this <u>does not</u> mean that local authorities are recommended to ignore potential revenues but, recognises that it would be reasonable to consider what yield could be obtained, consistent with these priorities once proper levels of security and liquidity are determined, as well as the council’s own appetite to risk.

B) For the council to pay regard to recent changes in investment guidance and to become a ‘responsible investor’ through the development of its treasury investment strategy which actively considers environmental, social and governance (ESG) principles when investing in the short-term. ESG policies involve central factors in measuring the sustainability and ethical impact of an investment within an organisation or sector.

ESG considerations are increasingly becoming an important factor in global investors’ decision making, but the framework for evaluating investment opportunities is still developing and therefore the council’s own approach to ESG investments is also currently limited and does not reflect ESG scoring or other real-time ESG criteria at an individual investment level.

It is proposed that the council supports progress in this area by approving a commitment to become a responsible investor and more specifically, that part of its short-term treasury investment activity (up to £6m) should be centred on delivering ESG outcomes.

C) Management of medium to longer-term investments – the council previously made a series of decisions following the identification of funds that were unlikely to be called upon in the short-term, to place these in a longer-term type investment.

The types of investments made, as well as the underlying objectives for these investments, often differ from the day-to-day short-term deposits. Whilst they still follow the CIPFA Code and the MHCLG Guidance in terms of security, the balance between liquidity and return become more blended. Previous decisions relating to these investments show that one of the core objectives was to bring a steady income stream into the councils' annual revenue budget. Whilst short-term interest rates can vary quite a lot over a relatively short period of time, some longer-term investments often provide a more stable annual return.

3.3.4. Treasury Investment Strategy for 2024/25: i.e., what we are planning to do to achieve the objectives for the year.

Given the breadth of different objectives and requirements within the overall treasury function it is not possible to summarise the council's investment strategy within a single paragraph and so efforts have been made to summarise the different strands of the investment strategy across the following;

- **A)** **Short-term investments** covering **daily operations** - the council will continue to place the majority of its short-term treasury investments in fixed and variable-term cash deposits with a range of counter-parties, which are often described as traditional investments.
- **B)** Increase resilience by increasing the number of Money Market Fund counterparties.

This Strategy would ensure liquidity is maintained to support the council's daily operational activities, it limits the council's exposure to interest rate risk losses, reduces the risk of capital losses as well as minimising exposure to credit risk through diversification of counter-parties and countries. These will be achieved through the application of limits on the amount and period of its investments with individual counterparties, and in individual countries.

B) **Short-term investments** focused on **ESG** outcomes –the council will consider options for investments of up to £6 million of short-term funds with institutions who ring-fence the use of such funds for ESG-related matters.

The framework, scope, governance, and investment criteria has been developed through consultation with the Audit Committee and treasury advisers over the past 12 months.

It is anticipated that any new investments will give due regard to the current credit ratings for security as they would need to remain in line with the wider council policy however, where appropriate and at the council's discretion, some flexibility will be provided to allow for slightly longer durations of investment and potentially lower returns to support the ESG focus.

When investing in banks and funds, the council would seek to 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.

C) **Longer term investments** - the council will continue to monitor and assess the performance of its existing medium to longer-term investments to ensure that they continue to meet the required core objectives, which are largely in alternative investment products although has <u>**no plans**</u> to place any more funds in long-term investments during 2024/25.

This is largely because of the work that has been done to review the medium-term capital financing requirements of the council, linked to borrowing plans, which shows that a large proportion of medium-term funds will be required and would therefore not be available to be locked away.

This Strategy continues to recognise that the current level of longer-term cash balances are appropriately balanced over the period, and that these investments provide some diversification of the portfolio in terms of product, counter-party / credit risk, and inflationary risk. Over recent years it has been seen that in a low interest rate environment these types of investment will often provide higher rates of return compared to traditional investments however, it must be accepted that they may also potentially provide a capital loss should prices fall beyond the initial investment levels. Any capital loss generated would need to be reflected within the council's annual revenue budget from April 2025, which is when the extended statutory override period expires.

3.3.5. Approved counterparties and limits:

The council may undertake treasury related investments of surplus funds with any of the counterparty types below, subject to the limits shown.

Table 3: Approved counterparties and limits

Sector	Overall Limit[1]	In-house Limit	Tradition Limit	Time Limit	Sector Limit
UK Central Government	**no limit**	unlimited	unlimited	50 years	no limit
UK Local Authorities[3]	**£15m**	£10m	£5m	25 years	no limit
Banks* and other organisations* (unsecured) whose lowest published long-term credit rating from Fitch, Moody's and Standard and Poor's is:					
AAA	**£30m**	£30m	£0m	5 years	no limit
AA+	**£25m**	£25m	£0m	5 years	no limit
AA	**£22m**	£22m	£0m	4 years	no limit
AA-	**£20m**	£16m	£4m	3 years	no limit
A+	**£18m**	£14m	£4m	2 years	no limit
A	**£16m**	£12m	£4m	13 months	no limit
A-	**£13m**	£9m	£4m	13 months	no limit
UK Building societies (unsecured) that have an asset size of more than £0.4bn*	**£10m**	£6m	£4m	13 months	£50m
Money market funds[2] and similar pooled vehicles whose lowest published credit rating is AAA*	**£15m**	£15m	£0m	N/A	no limit
Pooled Investment funds	**£5m per fund**	*£5m per fund*	£0m	N/A	£10m
ESG-focussed short term deposits	**£6m**	£6m	£0m	13 months	no limit
The Council's Bank accounts	**net £9m**	net £9m	£0m	no limit	no limit

[1] limits shown are per organisation.
[2] as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003
[3] as defined in the Local Government Act 2003
**There is no intention to restrict investments to banks and building society deposits, and investments may be made with any public or private sector organisation that meets the credit rating criteria above.*

This table must be read in conjunction with the notes and details in **Appendix 1**

3.3.6. Investment limits:

The maximum that could be lent to any one organisation (other than the UK Government) will therefore **be £30m**. This will limit the potential loss in the case of a single financial institution. It should be noted that a group of banks under the same ownership will be treated as a single organisation for limit purposes.

3.3.7. Minimum credit rating:

Treasury investments in the sectors marked with an asterisk 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 considered.

3.4 Non-treasury investment strategy

Non-treasury investments often include purchases which are deemed to be capital expenditure in nature, whether that be the purchase of financial assets, such as share capital in any body corporate or non-financial assets, such as the purchase of land or buildings.

To date, the council has not purchased share capital as this would provide potential exposure and further risk in terms of capital losses, which goes against the legal and regulatory framework in place for treasury related investments.

The council does however have non-treasury investments in the form of property through the commercial investment portfolio. The commercial strategy was approved by Council in January 2019, following professional advice provided by Montagu Evans. The strategy established a framework under which the council could acquire a portfolio of investments in commercial property which generate an income stream which can be used to contribute to the revenue budget pressures, whilst potentially providing capital appreciation over the longer-term.

Under this arrangement two assets have been acquired and the arrangements for the governance and management of associated risks of the council's service investments and commercial property investments is detailed in Section 5 of the Treasury Management Strategy shown at **Appendix 1**.

<u>**No further**</u> commercial investments are being sought as this would be prohibited under the new borrowing permissions, which do not allow councils to borrow to generate a yield. There are no proposed changes to this area of the strategy for 2024/25.

3.5 Minimum Revenue Provision Statement

When the council funds capital expenditure by long-term borrowing, the costs are charged to the council tax-payer in future years, reflecting the long-term use of the assets procured. There are two elements to this cost – the interest on borrowing is charged in the year it is payable, and the principal (or capital) element is charged as a "minimum revenue provision" (MRP).

The Local Government Act 2003 requires the council to have regard to the former Ministry for Housing, Communities and Local Government's guidance on Minimum Revenue Provision (the MHCLG Guidance), most recently issued in 2018.

The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The MHCLG Guidance requires the council to approve an Annual MRP Statement each year and recommends several options for calculating a prudent amount of MRP. The council's policy adopts options recommended in the Guidance, as well as locally determined prudent judgements in applying the recommended methodologies.

It is recommended that the council continues to apply the following policy to determine its MRP for 2024/25:

a. For capital expenditure incurred before 1st April 2008, the MRP for 'Supported borrowing' will be determined by writing down the Council's Capital Financing Requirement using a 'straight line' basis over the estimated average life of the relevant assets of 33 years. This approach results in the council charging the same value each year for this element of the MRP.

b. For capital expenditure incurred after 31st March 2008, the MRP for 'Prudential borrowing' will be determined by charging the expenditure over the expected useful life of the relevant asset, starting in the year after the asset becomes operational.

c. For assets acquired by finance leases, and for the transferred debt from Avon County Council, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

d. Where former operating leases have been brought onto the balance sheet on 1st April 2024 due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.

e. Capital expenditure incurred during 2024/25 will not be subject to an MRP charge until 2025/26.

The MRP associated with the capital spending approvals has been included within the budget for 2024/25 and the planned spending for 2024/25 has been factored into the council's medium term financial plan for 2024/25.

Temporary arrangements are currently in place to recognise that the council had previously set aside more than the required minimum provision, and temporarily reduces the MRP chargeable on pre-2008 expenditure over eight years in order to regularise the position. This temporary arrangement comes to an end next year which will result in the MRP on pre-2008 expenditure increasing to the full 33-year rate. This is reflected in the MTFP, and capital financing impacts are featured in this report as well as the MTFP report.

3.6 Prudential Indicators

Under the Local Government Act 2003, and the associated CIPFA Prudential Code for Capital Finance in Local Authorities, ‘Prudential Indicators’ relating to the revenue implications of capital programme decisions need to be approved by members and considered when setting the revenue and capital budgets.

The CIPFA Treasury Management Code of Practice also requires locally decided indicators relating to treasury activities to be approved. These indicators provide information to Members on the affordability of the council’s borrowing plans, and whether the impact of treasury management actions on the council’s revenue budget are sustainable. The indicators are detailed in **Appendix 2**.

4. Consultation

The Audit Committee has a key role to play in reviewing the council’s treasury management arrangements and practices, and they routinely receive performance monitoring reports on the subject covering both prior and current years, as well as reports which provide an opportunity for discussion to take place to consider the proposed strategy for the year ahead. The latest reports were considered by the Committee in November 2023 and a further report will be considered at the meeting in January 2024.

Over recent years Member training and workshops have been provided to support understanding of technical matters, with the latest session held being in December 2023. The timing of the session enabled further opportunities to consider the proposed Strategy for 2024/25.

Previous briefings were facilitated by Arlingclose, the council’s external advisors and featured information relating to the legal framework, the definitions and differences between capital and treasury investments and impacts, the types of investments available to the council and how these might fit in with the council’s borrowing plans, as well as further information to understand the more strategic factors which are likely to influence treasury strategy decisions of a council. It is proposed that they also attend future briefings.

5. Financial Implications

Financial implications are contained throughout the report. Treasury management decisions impact on both the revenue budget and the balance sheet in current and future years. However, an additional summary has been included to provide a high-level overview of the key components linked with capital financing and investment decisions.

	2023/24 Forecast £000	**2024/25 Estimate £000**
Interest payable on borrowing	5,300	5,161
Interest receivable on investments	-1,551	-6,286
Minimum revenue provision	6,572	7,754
Total	**10,321**	**6,629**
MRP analysis;		
- Supported Borrowing Minimum Revenue Provision	900	1,220
- Prudential Borrowing Minimum Revenue Provision	4,855	5,720

- Ex-Avon Loan Debt Minimum Revenue Provision	452	434
- Finance Leases Minimum Revenue Provision	365	380*

* The figures above currently exclude the potential impact of the adoption of IFRS16 – Leases in 2024/25. The adoption of this accounting standard may result in an increased capital financing requirement, and a consequent increase in minimum revenue provision charge following a review of the council's lease arrangements. Assets, lease liabilities, and capital financing requirement values will be restated once this work has been completed.

6. Legal Powers and Implications

Under the Local Government Act 2003 s1, and s12, local authorities may:
- invest money or borrow money:
- for any purpose relevant to their functions
- for prudent financial management

Under Local Government Act 2003 s2, and s13, local authorities must not:
- exceed their affordable borrowing limit
- borrow in foreign currency
- mortgage their property as security for loans borrowed

Under Local Government Act 2003 s3, s14, and s15, local authorities must:
- set and review affordable borrowing limits / authorised limits
- have regard to guidance published by CLG and CIPFA
    - CLG Investment Guidance
    - CIPFA Code of Practice on Treasury Management
    - CIPFA Prudential Code

The council has adopted 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 it to approve a treasury management strategy before the start of each financial year.

Under this guidance, the role of the (Full) Council is to:
- Set the budget and capital programme, including debt and investment interest, and the Minimum Revenue Provision
- Approve the Capital Strategy
- Approve the Treasury Management Strategy (which includes the (Non-Treasury) Investment Strategy)
- Approve the Prudential Indicators
- Approve Treasury Management Indicators
- Approve the MRP policy statement

Under the Local Authorities (Functions and Responsibilities) (England) Regulations 2000, local authorities must not delegate the approval of an annual strategy to any committee or person.

The role of the Executive is to consider these strategies, and, if appropriate, recommend them for approval by Council.

Treasury risk management at the council 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 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 CIPFA Code.

7. Climate Change and Environmental Implications

Over recent years the council has made concerted efforts to better understand the extent to which its overarching treasury management strategy has or may have on climate change and other environmental implications. This has been a challenge because many of the decisions relating to either borrowing or investments will have few direct impacts although there could be many indirect impacts though the ongoing actions or decisions of other organisations.

For example, when the council places a short-term fixed cash deposit type investment with either a bank, building society or another local authority, then its contractual arrangement is linked to the terms of that trade deal (e.g., value, maturity date, interest rate etc). The details relate to the temporary exchange of the cash sum and there are no other restrictions about what will happen with money. The counter-party 'could' then choose to invest it into something that is not supported by the council.

Until recently the council recognises that it has had limited choice or options in this area however, some degree of change is expected to happen following the emergence of Environmental, Social and Governance (ESG) policies. This is where organisations are choosing to bring other considerations into their treasury strategies and decision-making processes and also introduce new investment products or services to the market.

The council welcomes the introduction of ESG policies and hopes that they will provide a broader range of opportunities that can be considered within future investment decisions, particularly those that will deliver positive outcomes for climate change and the environment more generally.

The ESG investment policy is set out in **Appendix 4** and will not detract from the core functions that need to take place within the existing treasury management strategy, i.e., the management of cash-flows and also meeting the requirements within the approved revenue budget, but it will provide an opportunity to ensure that climate and other environmental implications are considered and reported on.

The council's ESG investment policy must still be compliant with the external and internal regulatory framework and would therefore continue to give focus to security and liquidity, then yield.

8. Risk Management

Members will be aware that there is a direct link between the levels of risk and the levels of return achieved on investment, although there are many other factors which also affect the capital financing budgets.

The council's treasury management activities expose it to a variety of financial risks, notably:

a. credit risk – the risk that other parties might fail to pay amounts due to the council. Includes bail-in risk – the risk that shareholders and depositors in banks and building societies bear losses in the event of counter-party's failure or reduction in net asset value,

b. liquidity and re-financing risk – the risk that the council might not have funds available to meet its commitments to make payments as they fall due,
c. market risk (interest rate and price risks) – the risk that financial loss might arise for the council because of changes in such measures as interest rates, investment valuations, and stock market movements.

The council's Treasury Management Strategy sets out the council's approach to managing these risks.

A summary of the risks relating to treasury management that the council is exposed to, and the mitigation arrangements in place through the Treasury Management Strategy, is detailed at **Appendix 3.**

The priority of the Treasury Management Strategy will continue to be the reduction of risk to safeguard public resources.

The risk appetite of the council is low to give priority to the security of its investments. The council will also aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity.

It should be noted that the council's Treasury Management Strategy sets out how the council manages and mitigates these risks but cannot eliminate risks completely.

9. Equality Implications

Have you undertaken an Equality Impact Assessment? N/A

10. Corporate Implications

The safeguarding of public money is critical to the council's reputation, and the measures contained within the report are intended to address member and public concerns and ensure an appropriate balance of return on investment whilst ensuring managing associated risks.

11. Options Considered

This report has been developed alongside the Medium Term Financial Plan and revenue budget and the Capital Strategy, which supports the capital programme, which means that decisions are fully integrated. It also sets out the council's expectation for interest rates and highlights the uncertainties and risks in the forecast due to market conditions.

The report considers those aspects of treasury policy that change annually or more frequently, highlighting the council's views or interpretation of factors that may influence treasury management decisions and proposes how these matters will be dealt with during 2024/25.

The CIPFA Code and MHCLG statutory guidance require the authority to set out its approach to non-treasury investments. A summary of the impact and the council's approach is included in **paragraph 3.4** of this report.

The council's Treasury Management Strategy is broadly consistent with the previous strategy and is developed from and complies with the council's Treasury Management Policy and takes account of the CIPFA code and MHCLG guidance referred to above. That being said, a new recommendation has been included with regards to making a commitment to become a responsible investor in the future.

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Appendices:

1. Treasury Management Strategy for 2024/25
2. Prudential Indicators for 2024/25
3. Treasury Risk Register
4. ESG investments policy
5. Glossary of Terms
6. Arlingclose Economic & Interest Rate Forecast – December 2023

Background Papers:

Treasury Management Strategy 2023/24

Other relevant guidance includes:

- CIPFA – The Prudential Code for Capital Finance in Local Authorities 2021
- MHCLG – Statutory Guidance on Local Government Investments (3rd edition) 2018
- CIPFA - Treasury Management in Public Services – Guidance notes for local authorities 2021

1 EXECUTIVE SUMMARY

Treasury management is the management of the council's cash flows, borrowing and investments, and the associated risks. The council has and will continue, to borrow and invest substantial sums of money and is therefore exposed to wide range of risks which could have material consequences, such as the loss of invested funds. The successful identification, monitoring, and control measures in respect of financial risk are therefore central to the council's prudent financial management and operation within this area.

The council maintains an overarching treasury management 'strategy' which is supported by a range of individual policies which aim to describe some of the principles and practices to which the different areas of treasury related activity will comply.

It is important to note that this document contains a lot of detailed and sometimes technical information that will outline the risks and issues pertaining to the management of the council's cash-flows and ultimately inform any decisions that may be taken as a result.

Decisions that relate to this area are clearly significant however they are not undertaken in isolation but instead are driven by many factors and considerations, whether those be external influences (such as guidance, regulation, or market forces) as well as internal influences (such as other financial and operational strategies, council priorities or the approach to risk).

Given that an overarching strategy cannot document or describe all of those issues in detail, this document is not intended to be a prescriptive listing of all of the council's considerations or processes, the document will instead provide sufficient information to outline the council's approach and framework in core areas.

Alongside this policy, the council must have regard to the (former) Ministry for Communities and Local Government (MHCLG) guidance (the MHCLG guidance), under section 15(1)(a) of the Local Government Act 2003. This guidance provides for each authority to determine its own controls within a given framework.

Any external investment managers employed by the council are required, contractually, to comply with this Strategy.

Given that the underlying regulatory framework supporting treasury management activities remains broadly unchanged from 2023/24, as have the council's Corporate Plan aims and objectives, it is not proposed to make significant changes to the Strategy for 2024/25 financial year.

One area of change will however be the council's decision to become known as a responsible investor and the inclusion of an ESG focused investment policy in **Appendix 4**. Further details and supporting information are contained throughout the report and the strategy document.

2 STRATEGY OVERVIEW

Under the Local Government Act 2003, the council may invest money or borrow money:
- for any purpose relevant to its functions, and
- for prudent financial management.

The council could potentially invest its money for three broad purposes:
- Treasury management investments – i.e., management of operational cashflows. Investment of surplus cash balances generated as a result of its day-to-day activities, for example when income is received in advance of expenditure,
- Service investments - to support local public services by lending to, or buying shares in other organisations, and
- Non treasury related investments - to earn investment income, usually rental income, and to provide capital appreciation, from a portfolio of property investments.

The Strategy for 2024/25 in respect of the following aspects of the treasury management function is based upon the S151 Officer’s views on risks and interest rates, supplemented with advice provided by the council's treasury advisors, currently Arlingclose Ltd.

The strategy covers:
- Section 3 - current treasury portfolio
- Section 4 - the treasury investment strategy
- Section 5 - the non-treasury investment strategy
- Section 6 - the borrowing strategy
- Section 7 - interest rates and economic outlook
- Section 8 - other treasury management matters

3 CURRENT TREASURY PORTFOLIO

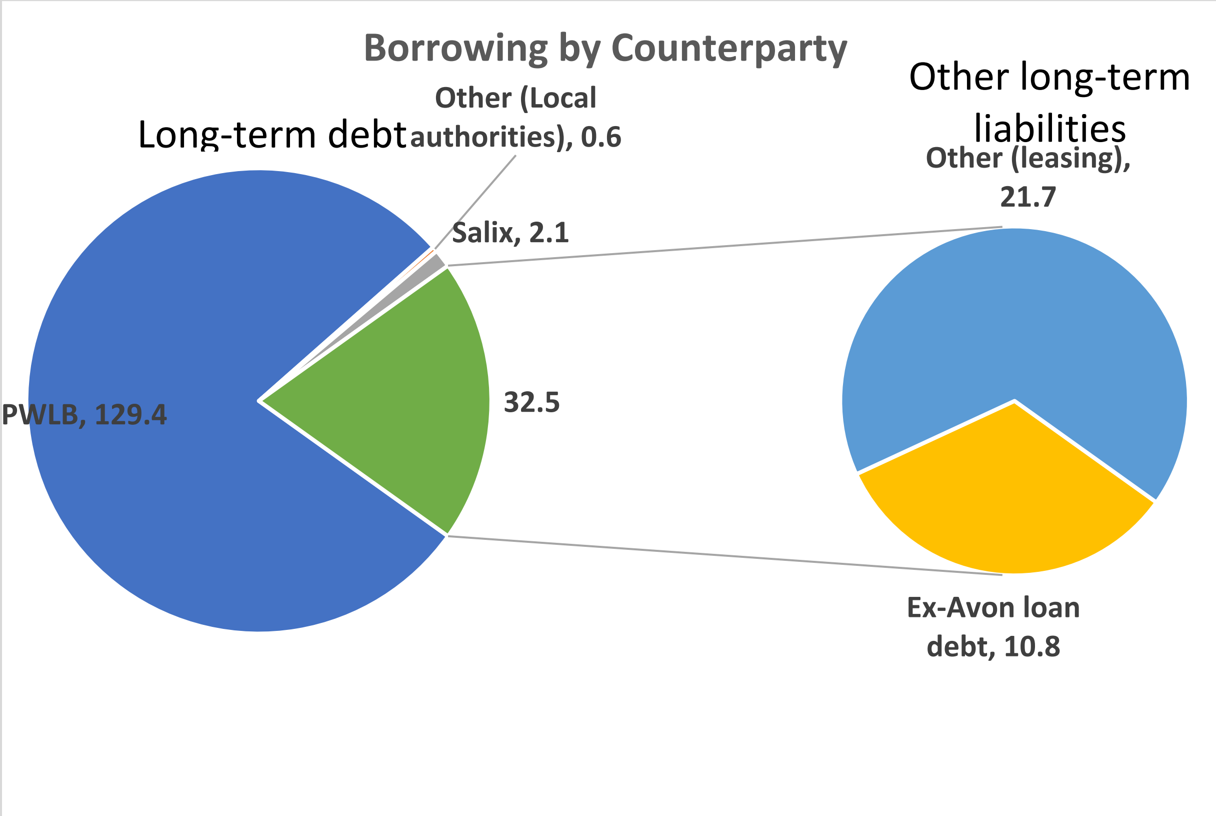
The Council's current treasury portfolio, as at 30th November 2023 is as follows:

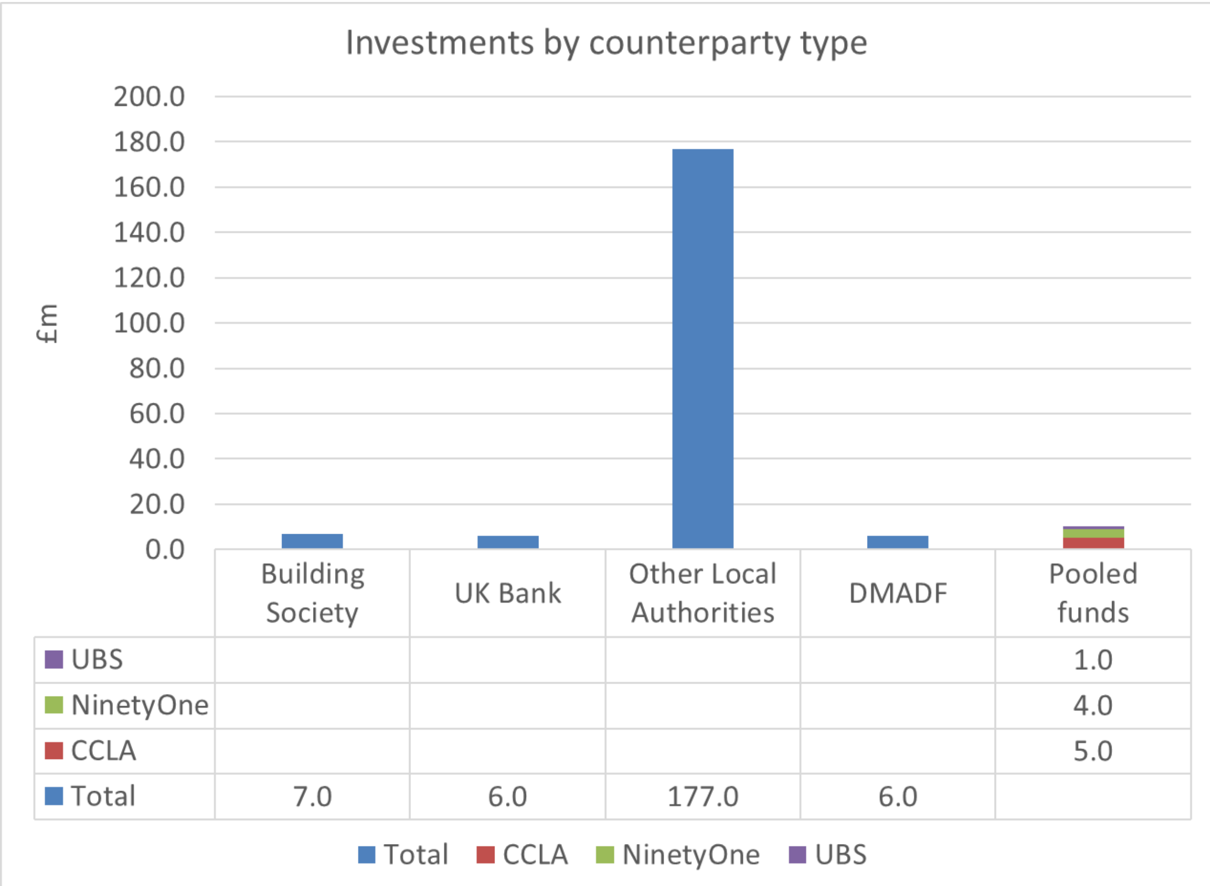
Table 4: Current portfolio of borrowing and investment balances

LONG-TERM DEBT	**Principal £m**		**Average rate**	**Average term**
Fixed rate – Public Works Loans Board Salix - Other (Local authorities)	£129.4 £2.0 £0.6	£132.0	4.00% 0.00% 4.04%	1-36 years 1-5 years Notice
Other long-term liabilities; - Ex-Avon loan debt - Other (leasing) *	 £10.8 £21.7	£32.5	 4.75% 4.60%	 1-30 years 1-40 years
TOTAL DEBT		**£164.5m**		
SHORT-TERM TREASURY INVESTMENTS	**Principal £m**		**Average rate**	**Average term**
Managed in-house; - UK banks - Local authority/ DMO	 £6.0 £180.0	£186.0	 5.09% 4.85%	 12 months 10 months
Cash managed by Tradition; - Local authority - Building Society	 £3.0 £7.0	£10.0	4.13%	12 months
LONG-TERM TREASURY INVESTMENTS	**Principal £m**		**Average rate**	**Average term**
Managed in-house; - CCLA - UBS Multi Asset Income Fund - Ninety-One Diversified Income Fund	 £5.0 £1.0 £4.0	£10.0	 4.90% 4.90% 3.88%	 3-5 years 3-5 years 3-5 years
TOTAL TREASURY INVESTMENTS		**£206.0m**		
TOTAL NET INVESTMENT		**£41.5m**		

**The lease principal, rate, and term as at the previous year end (31st March 2023) - updated figures will be calculated at the end of the financial year.*

Chart 4: Current portfolio of borrowing and investment balances


Borrowing by Counterparty
Long-term debt
Other long-term liabilities
Other (Local authorities), 0.6
Salix, 2.1
PWLB, 129.4
32.5
Other (leasing), 21.7
Ex-Avon loan debt, 10.8

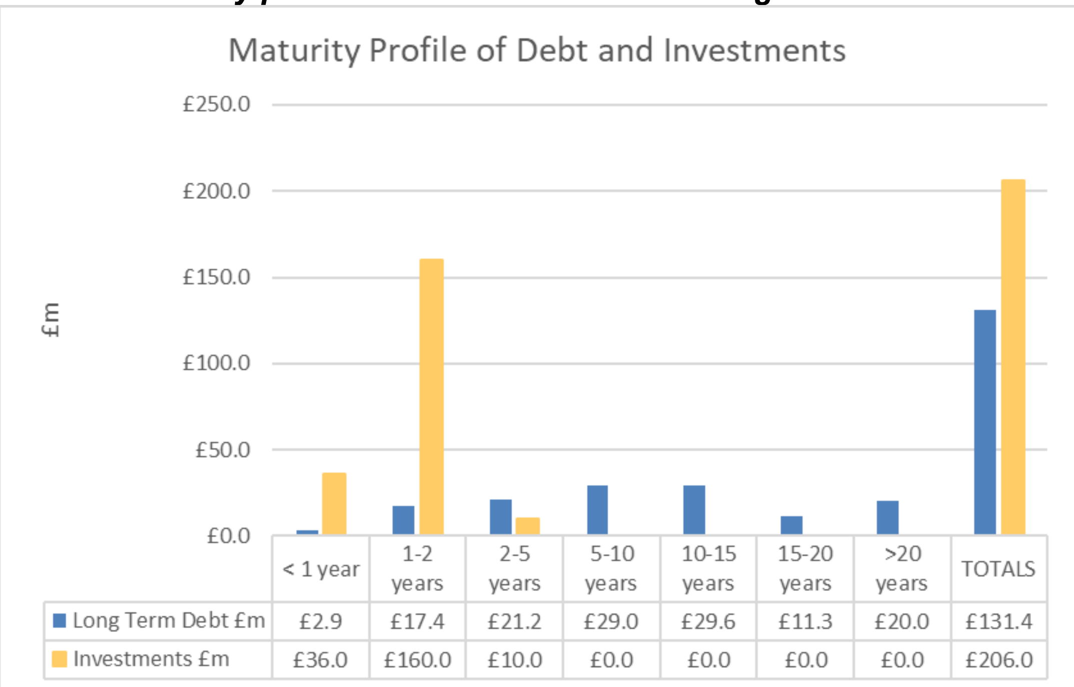

Investments by counterparty type
£m
200.0
180.0
160.0
140.0
120.0
100.0
80.0
60.0
40.0
20.0
0.0
Building Society
UK Bank
Other Local Authorities
DMADF
Pooled funds
UBS 1.0
NinetyOne 4.0
CCLA 5.0
Total 7.0 6.0 177.0 6.0
Total CCLA NinetyOne UBS

The maturity profile of the Council's PWLB borrowing, and investments is as follows (excluding Avon loan debt and lease liabilities):

Table 5: Maturity profile of the Council's PWLB borrowing and investments

MATURITY PROFILE	PWLB LONG TERM DEBT £m	INVESTMENTS £m	NET DEBT / (INVESTMENT) £m
Maturing Jan to March 2024	£2.9	£36.0	(£33.1)
Maturing 2024/25 & 2025/26	£17.4	£160.0	(£142.6)
Maturing 2026/27 to 2028/29	£21.2	£10.0	£11.2
Maturing 2029/30 to 2033/34	£29.0	£0	£29.0
Maturing 2034/35 to 2038/39	£29.6	£0	£29.6
Maturing 2039/40 to 2043/44	£11.3	£0	£11.3
Maturing after 2043/44	£20.0	£0	£20.0
TOTALS	**£131.4**	**£206.0**	**(£74.6)**

Chart 5: Maturity profile of the Council's borrowing and investments



4 TREASURY INVESTMENT STRATEGY

4.7 The council typically receives its income in cash (e.g., from taxes and grants) before it pays for its expenditure in cash (e.g., through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local bodies and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from CIPFA.

4.8 **Objectives:** Both the CIPFA Code and the MHCLG Guidance require councils to invest their 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 aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

4.9 **Strategy:** 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. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income.

4.10 The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the council may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by adding diversification to the strategic pooled fund portfolio.

4.11 The council's current investment strategy allows surplus cash balances to be managed by two treasury teams, each having distinct and separate controls and flexibilities. This allows the council to spread risk by investing in different financial products, and utilising experienced external cash managers, who do not have responsibilities for managing the council's daily cash-flows. The treasury teams are;

a. Tradition UK Ltd
b. In-house Treasury Team

4.12 **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 council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level.

4.13 The council has developed a framework for ESG related investments through consultation with the Section 151 Officer, members of the Audit Committee and also the council's treasury management advisors Arlingclose. It is anticipated that the credit rating of security of such deposits would need to remain in line with the wider council policy however, where appropriate and at the council's discretion, some flexibility will be provided to allow for slightly longer durations of investment and potentially lower returns to support the ESG focus.

4.14 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.

4.15 The ESG investment policy will not detract from the core functions that need to take place within the existing treasury management strategy, i.e., the management of cash-flows and meeting the requirements within the approved revenue budget. The policy ensures that climate and other environmental implications are considered and reported on. The ESG Investment Policy is included in **Appendix 4.**

4.16 **Business models:** Under the IFRS 9 standard, 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.

4.17 **Approved counterparties:** The approved counterparties and notes are included in **Table 3** in the main body of the report. Further details on each of the permitted counterparties are included below.

4.18 The maximum duration of the investment will depend upon its lowest published long-term credit rating, time limits are included within the table.

4.19 Long-term investments will be limited to 50% of the counter-party limit (except the UK Government). The combined value of short-term and long-term investments with any organisation will not exceed the limits for investments in the table above.

4.20 **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.

4.21 **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.

4.22 **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.

4.23 **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.

4.24 **ESG-focussed short term deposits:** Some banks and credit institutions now offer deposit accounts where the funds raised by the banks in these accounts are ring fenced to only be lent on for activities with an ESG focus. Such deposit accounts afford the same protections as other deposits with the bank hence allowing the council to support the ESG agenda whilst acting within the strict requirements for security and liquidity.

4.25 **Operational bank accounts:** 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 £9m* 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 council maintaining operational continuity.

4.26 * It is possible, rarely, that significant amounts of funding (for example government grants) may be received unexpectedly towards the end of a banking day, at which point it is not possible to place these funds with a suitable approved counterparty until the following day. This would not be considered a breach of the £9m limit provided the surplus cash is appropriately invested at the earliest opportunity on the following banking day.

4.27 **Risk assessment and credit ratings**: One of the ways that the council manages credit risk is by using credit ratings.

4.28 The council uses long-term credit ratings from the three main rating agencies, Fitch Ratings Ltd, Moody's Investors Service Inc and Standard & Poor's Financial Services LLC, to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.

4.29 Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as 'investment grade', while ratings of BB+ and below are described as 'speculative grade'. The council's credit rating criteria are set to ensure that it is unlikely that the council will hold speculative grade investments, despite the possibility of repeated downgrades.

4.30 Credit ratings are obtained and monitored by the council's treasury advisers on at least a monthly basis, who will notify changes in ratings as they occur.

4.31 **Other Information on the security of investments:** The council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will 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.

4.32 **Reputational aspects:** 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 considered when making investment decisions.

4.33 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.

4.34 Investment Limits

4.35 The council's revenue reserves that may be deemed as 'available' and could potentially be called up to cover investment losses should the need arise are forecast to be £70 million on 31st March 2024 and £44 million on 31st March 2025, although it should be noted that these are currently being held for other purposes are would not expect to be needed. In order that no more than 75% 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) will be £30 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

4.36 Credit risk exposures arising from non-treasury investments, financial derivatives and balances in operational bank accounts count against the relevant investment limits.

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

Table 6: Additional investment limits

	Cash limit
Any group of pooled funds under the same management	£15m per manager
Foreign countries	£12m per country (£8m in-house & £4m cash-manager)

4.38 Liquidity management

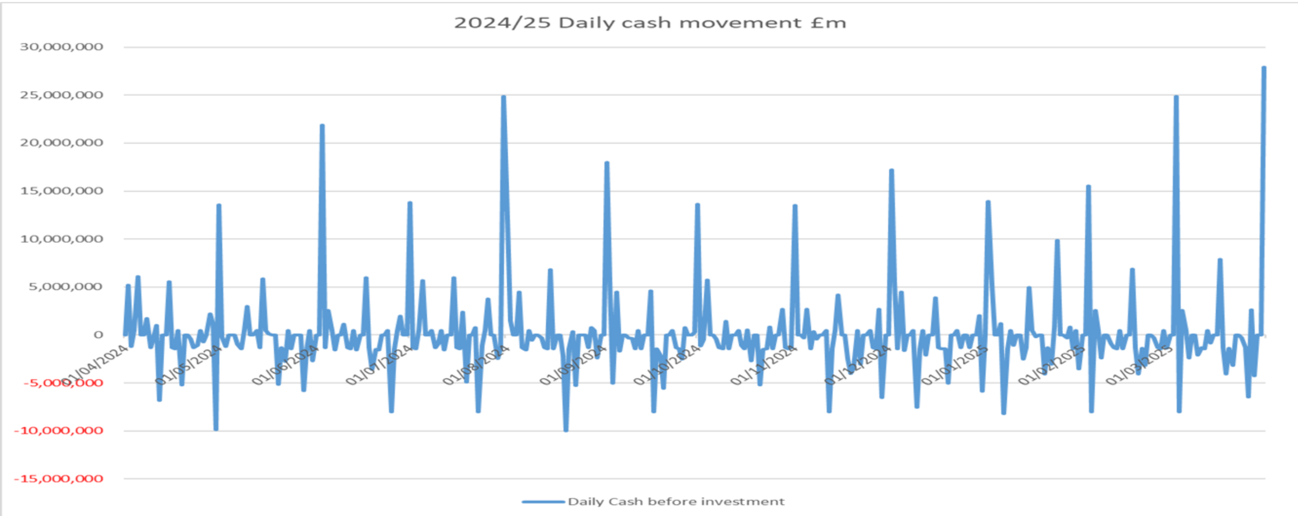
4.39 The council uses a series of control spreadsheets to monitor and forecast the council's cash flows, to determine the maximum period for which funds may prudently be committed, and to manage the council's exposure to liquidity and re-financing risks. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated 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 plan and cash flow forecast.

4.40 The council will spread its liquid cash amongst 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.

4.41 The council has an agreed overdraft facility, and access to sources of cash such as borrowing from the PWLB, and other counterparties, such as banks and other local authorities. In addition, the council's investment holdings can be readily realised, if required.

4.42 Management of cash-flows

Table 7: Daily cash-flow movements can be seen in the table below.



4.43 Although the cash-flow movements could be described as fluctuating or potentially even volatile, trends do begin to emerge when the nature of the movements are understood, for example;

- Significant inflows include council tax and business rates income, government grants and subsidy used to support and fund parts of the annual revenue budget including schools, contributions from stakeholders in respect of funding agreements (e.g., health partners), grants and contributions used to fund capital projects. Some of these inflows follow a regular pattern, which may be weekly, bi-weekly, monthly, or quarterly and others do not, they simply arrive into the council's bank accounts.

- Significant outflows include monthly payments to staff, pension providers and government agencies, payments to suppliers 3 times each week covering both revenue and capital spending, payment of housing benefits, payments to major preceptors such as Fire, Police, Environment Agency, Town and Parish councils.

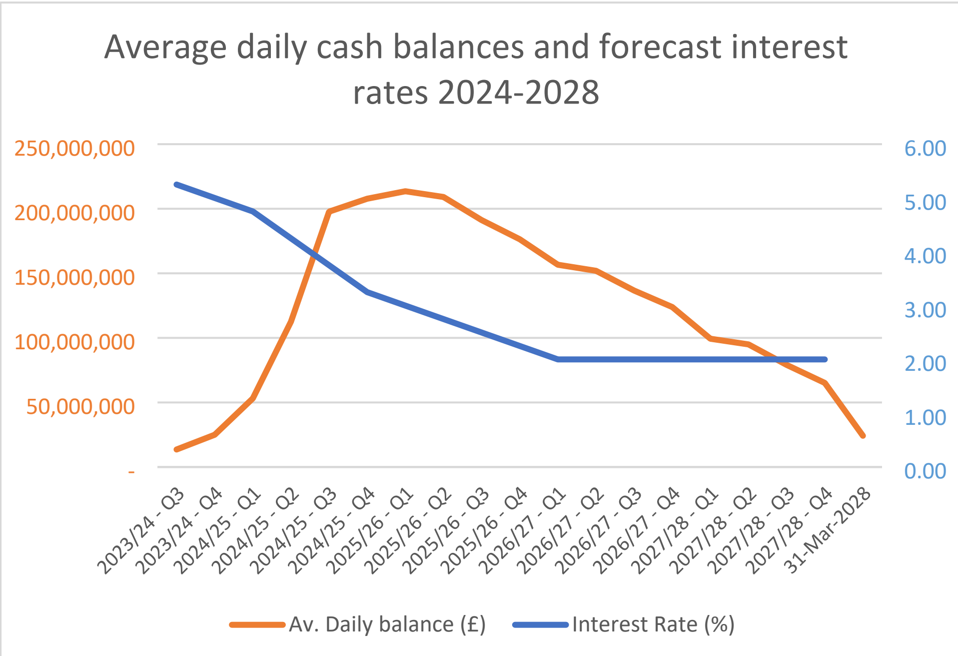
4.44 Over the past three years the council's cash-flows have been significantly impacted by government support packages for both Covid and more recently, the cost of living/ energy pressures, as it has received significant amounts of additional funding and support packages, both in relation to the council's own budget, as well as when it has been acting as an agent for the government by passporting monies onto individuals, suppliers, and businesses.

4.45 Whilst the new capital investment spending totals are anticipated for next year, the spending profiles associated with them have yet to be developed in any detail although it is estimated that less spending will be incurred during the first quarter of the year.

4.46 The annual cash flow principles have been continued across the MTFP period, which has helped support the forecast investment income in the MTFP.

4.47 Table 8 below shows the average daily cash balances increasing as the current investments mature over the next 12 months, and then start to fall over the remaining period.

Table 8: Extended average daily cash balances and interest rate assumptions 2024-2028.



4.48 The intended borrowing strategy for 2024/25 recommends that external borrowing is not taken, but spending will instead be offset against current surplus cash balances, i.e., it will be funded internally, which means that cash-flow forecasts for next year will decrease from current levels.

5 NON-TREASURY INVESTMENT STRATEGY

4.49 This non-treasury management investment strategy focuses on the council's service investments and commercial property investments.

4.50 Service investments: Loans

4.51 Loans to social enterprises and local businesses may potentially be considered where they contribute to the council's overall objectives, through inclusion in the MTFP, treasury management and capital strategies. Where investment in regeneration and infrastructure in North Somerset clearly support local public services, and stimulate local economic growth, financing may also potentially be considered on projects that offer adequate security and returns, subject to the council having sufficient resources available to it at that time.

4.52 The only loan approved to date is an amount of £0.9m lent to a care home provider in 2008. The care provider has subsequently made repayments (including interest) in line with its agreed schedule. The outstanding balance at the time of writing is £0.8m.

4.53 Commercial investments: Property

4.54 The council's Commercial Investment Strategy was approved by Council in January 2019. In line with this strategy, the council has made two investments in commercial property to earn investment income, through a combination of rental and car parking income, whilst potentially providing capital appreciation over the long-term.

4.55 The investments made under the strategy were all agreed in previous years and consist of one outright purchase funded from long term borrowing, the North Worle District Centre, and one property acquired under a finance lease, the Sovereign Centre in Weston-super-Mare. There were no purchases or sale of assets during the 2023/24 financial year and there are no current plans to undertake any further commercial investments in the future.

4.56 In February 2021 the Executive approved a revised Sovereign Centre Business Plan, setting out the challenges, opportunities, and a new vision for the property. As part of this Business Plan, some of the vacant retail space within the centre has been converted into office space to diversify away from pure retail use.

4.57 After servicing costs, fees and borrowing costs, and a £0.1m use of the smoothing reserve, these assets are budgeted to generate an annual net return to the revenue budget of £0.0m (2023/24 £0.0m).

4.58 Commercial property investments are likely to be less liquid than financial investments, as property may take time to sell in certain market conditions. The council's commercial property investments are considered sufficiently proportionate to its overall investment and borrowing balances to not be likely to significantly impact on the council's overall liquidity position.

4.59 The council has no plans to dispose of its commercial investment properties currently.

6 BORROWING STRATEGY

4.60 <u>Local context</u>

4.61 Forecast changes to the capital financing requirement and borrowing forecasts are shown in the balance sheet analysis in the table below.

Table 8: Capital Financing Requirement vs forecast borrowing

	Forecast 31/3/24 £m	Estimate 31/3/25 £m	Estimate 31/3/26 £m	Estimate 31/3/27 £m	Estimate 31/3/28 £m
Overall CFR*	190.2	206.9	230.3	255.1	242.8
Less: External borrowing **	175.7	173.8	177.3	173.0	130.3
Positive value Implies: Internal borrowing	**14.5**	**33.1**	**53.0**	**82.1**	**112.5**

**includes capital expenditure included in the Capital Strategy, but not yet approved*

***includes finance leases and Ex-Avon loan debt that form part of the Council's total debt*

4.62 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

4.63 The council's Capital Strategy forecasts indicate that it is likely to need to borrow to finance its planned capital expenditure. The decision of whether, and when, to take external borrowing will be made considering current and forecast interest rates. The council may choose to finance this borrowing requirement from its operational cash resources, known as 'internal borrowing'. This reduces interest costs and exposure to other risks.

4.64 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. The table in para 6.2 above shows that the Authority expects to comply with this recommendation during 2024/25.

4.65 **Sources of borrowing:** the approved sources of long-term and short-term borrowing are:

a) HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
b) Other Local Authorities and Pension Funds (except the Avon Pension Fund)
c) UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues
d) Funds administered by the West of England Combined Authority including
   i) Revolving Infrastructure Fund
   ii) Local Growth Fund
   iii) Economic Development Fund
e) any institution approved for investments (see above)
f) any other bank or building society on the Financial Services Authority list
g) UK Infrastructure Bank Limited
h) Retail investors via a regulated peer-to-peer platform
i) Any other UK public sector body

4.66 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

a) leases
b) private finance initiative schemes
c) sale and leaseback
d) revolving infrastructure grants

4.67 The council's debt portfolio is managed to ensure that the maturity profile will not leave any one future year with a high level of repayments that could present difficulties in refinancing. Fixed rate loans are usually taken to lock into known interest rates, thus protecting against fluctuations and providing certainty when managing and setting the budget.

4.68 Whilst the above deals with past or present borrowing requirements, it is also possible to borrow in advance of need where there is a clear business case for doing so and only for the approved capital programme or to finance future debt maturities, as permitted by the guidance. Borrowing in advance of need introduces additional credit and interest risk. Whilst there is no present intention to borrow in advance, all risks will be considered as part of any borrowing decision, should conditions favour such action.

4.69 Furthermore, 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. 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.

7 INTEREST RATES AND ECONOMIC OUTLOOK

4.70 **Economic background:** 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.

4.71 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%.

4.72 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.

4.73 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.

4.74 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.

4.75 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.

4.76 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.

4.77 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.

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

4.79 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.

4.80 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.

4.81 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.

4.82 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.

4.83 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.

4.84 **Interest rate forecast (December 2023):** 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.

4.85 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.

4.86 A more detailed economic and interest rate forecast provided by Arlingclose is in **Appendix 6.**

4.87 For the purpose of setting the budget, it has been assumed that new short-term treasury investments will be made at an average rate/yield of 4.25%. No new long-term borrowing will be undertaken, which means that interest payments will not be required, although MRP will be a factor.

8 OTHER TREASURY MANAGEMENT MATTERS

4.88 The CIPFA Code requires the council to include the following in its treasury management strategy:

4.89 **Financial Derivatives**: Councils may make 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).

4.90 In line with the CIPFA Code, the council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications. The council has no plans to make use of financial derivatives in 2024/25.

4.91 **Markets in Financial Instruments Directive:** 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 Section 151 Officer believes this to be the most appropriate status.

1.1 INTRODUCTION

Having adopted both the CIPFA Treasury Management in the Public Services Code of Practice, and the Prudential Code for Capital Finance in Local Authorities, the council is required follow the elements within the Guidance and set 'indicators' which demonstrate that it follows good practice and has implemented and operates within appropriate systems of control before making capital financing and treasury management decisions.

1.2 PRUDENTIAL INDICATORS 'PRUDENTIAL CODE':

The Prudential Code aims to improve the transparency of investment decisions. The Code include the requirement to produce a Capital Strategy, and the inclusion of prudential indicators within the report to allow the reader to understand the forecast the council's overall debt levels, in conjunction with the capital programme and investment decisions, and how this external borrowing will be repaid.

*The figures below currently exclude the potential impact of the adoption of IFRS16 – Leases in 2024/25. The adoption of this accounting standard is likely to result in new "right of use" assets being created on the council's balance sheet following a review of the council's lease arrangements. Assets, lease liabilities and capital financing requirement values will be restated once this work has been completed.

1.2.1 Capital Expenditure

This indicator details the Capital Expenditure to be incurred by the council. The revised programme for 2023/24 and totals for the proposed programmes for 2024/25 to 2027/28, as set out in the Capital Strategy, are shown below.

Table 1.2.1: Capital expenditure in £ millions

Capital Expenditure	**Forecast 2023/24**	**Estimate 2024/25***	**Estimate 2025/26**	**Estimate 2026/27**	**Estimate 2027/28**
Total Capital Expenditure	105.0	171.0	127.6	49.0	4.6

1.2.1 Capital Financing Requirement

The council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £28m during 2024/25. Based on the forecast figures for expenditure and financing, the council's estimated CFR is as follows:

Table 1.2.2: Estimates of Capital Financing Requirement in £ millions

	Forecast 2023/24	**Estimate 2024/25***	**Estimate 2025/26**	**Estimate 2026/27**	**Estimate 2027/28**
CFR	190.2	206.9	230.3	255.1	242.8
Less: CFR re finance leases	21.3	20.9	20.5	20.1	19.7
Less: CFR re ex Avon debt	10.8	10.4	10.0	9.6	9.2

Loans CFR	**158.1**	**175.6**	**199.8**	**225.4**	**213.9**

Projected levels of the council's total outstanding debt (which comprises borrowing, leases and transferred debt) are shown below, compared with the capital financing requirement (see above).

1.2.3 Actual external debt and the Capital Financing Requirement

In this indicator, projected levels of the council's total outstanding external debt (which comprises borrowing and leases) are compared with the Capital Financing Requirement. The Capital Financing Requirement measures the council's underlying need to borrow for a capital purpose for the current and future year. The actual Capital Financing Requirement as at the year-end is included in each year's statutory accounts.

Table 1.2.3: Gross external debt and the Capital Financing Requirement in £ millions

Gross external debt and the Capital Financing Requirement	**Forecast 2023/24**	**Estimate 2024/25***	**Estimate 2025/26**	**Estimate 2026/27**	**Estimate 2027/28**
CFR	190.2	206.9	230.3	255.1	242.8
Total Debt (incl leases & ex-Avon)	175.7	173.8	177.3	173	130.2

Statutory guidance is that total debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from the table above, the council expects to comply with this requirement in the medium-term.

1.2.4 *Borrowing and the Liability Benchmark*

Liability benchmark: To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £50m at each year-end. This benchmark is currently £52.6m and is forecast to rise to £128.0m over the next three years.

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.

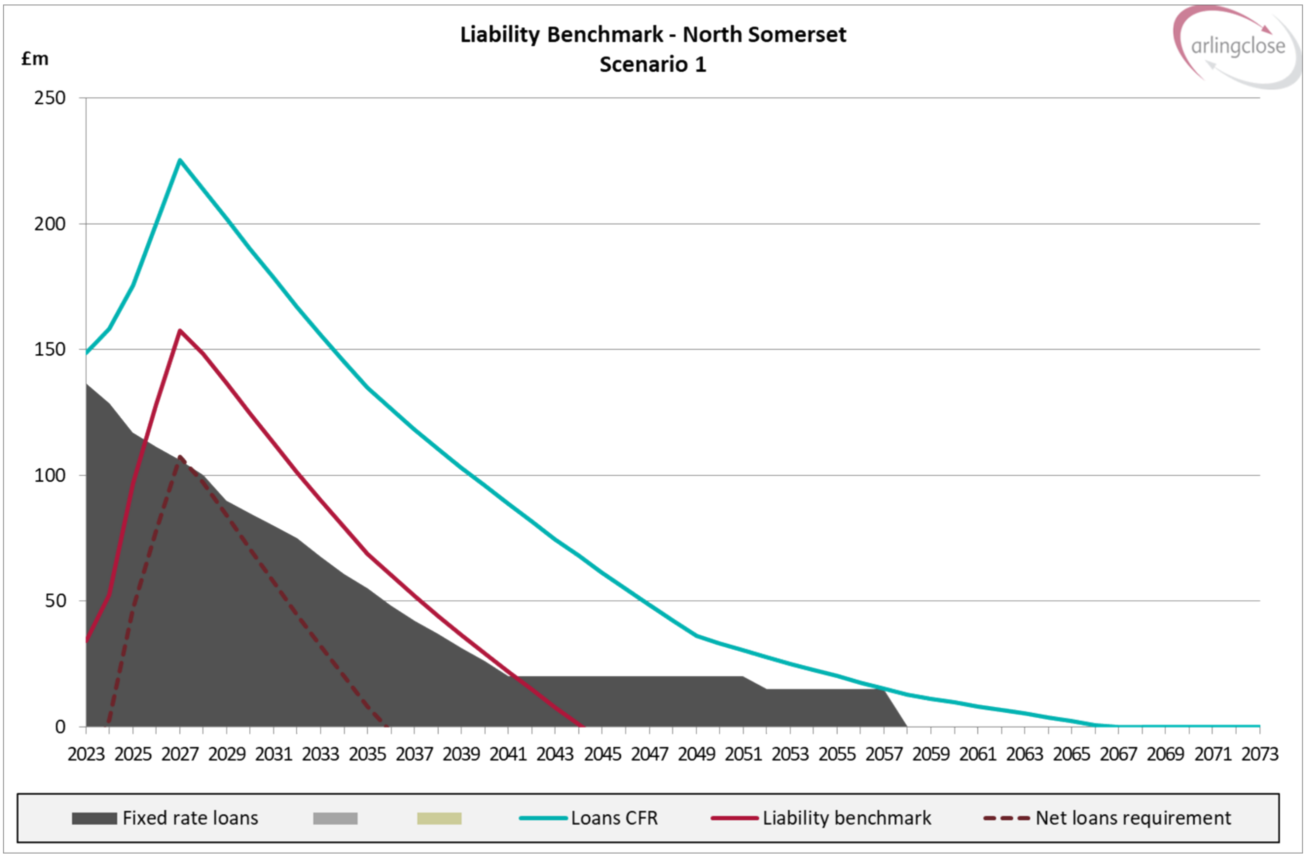
Table 1.2.4: Borrowing and the Liability Benchmark in £ millions

Position at 31 March	**Forecast 2023/24**	**Estimate 2024/25***	**Estimate 2025/26**	**Estimate 2026/27**	**Estimate 2027/28**
"Loans CFR" from 1.2.2 above	158.1	175.6	199.8	225.4	213.9
Less: Balance sheet resources	-155.5	-128.6	-121.7	-117.9	-116.3
Net loans requirement	**2.6**	**47.0**	**78.1**	**107.5**	**97.6**

Plus: Liquidity allowance	50.0	50.0	50.0	50.0	51.3
Liability benchmark	**52.6**	**97.0**	**128.1**	**157.5**	**148.9**

The liquidity allowance has been calculated as the strategic pooled funds balance of £10m plus an amount that we don't want cash balances to fall below. This would therefore be around £50m.

Following on from the medium-term forecasts in table 1.2.4 above, the long-term liability benchmark assumes no capital expenditure funded by borrowing after 2027/28, minimum revenue provision on new capital expenditure based on asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in the chart below together with the maturity profile of the council's existing borrowing:



The chart is indicating that the current debt portfolio (the grey shaded area) is predominantly more than the projected borrowing requirement (the red line, liability benchmark) illustrated where the top of grey area is above the red line. The difference between the two is surplus cash. However, it also indicates that there may be a small c.£1m net borrowing requirement in 2027 (where the red line moves above the grey area).

1.2.5 <u>Authorised borrowing limit and Operational limit</u>

The council is required to set an 'affordable borrowing limit' (also termed the 'authorised limit for external debt') each year. In line with statutory guidance, a, lower, "operational boundary" is also set, as a warning level should debt approach the affordable borrowing limit.

The **authorised limit** is the 'affordable borrowing limit' which the council is required to set in section 3 of the Local Government Act 2003 and cannot be exceeded without acting ultra vires. The authorised limit is set at a higher level than the operational boundary to provide headroom for unexpected borrowing requirements.

The **operational boundary/ limit** should be the council's best estimate of the most likely, prudent, maximum levels of debt to be held during the years in question. The boundary can be exceeded in the short-term should the council need to undertake temporary borrowing, or debt rescheduling, but should not be exceeded for new long-term borrowing proposals.

Table 1.2.5: *Authorised limit and operational boundary for external debt in £ millions*

Authorised limit and operational boundary for external debt	**2023/24 limit**	**2024/25 limit**	**2025/26 limit**	**2026/27 limit**
Authorised limit – borrowing	225	202	181	168
Authorised limit – leases & ex-Avon debt	40	60	60	60
Authorised limit – total external debt	**265**	**262**	**241**	**228**
Operational boundary – borrowing	208	182	166	155
Operational boundary – leases & ex-Avon debt	35	50	50	50
Operational boundary – total external debt	**243**	**232**	**216**	**205**

It is currently estimated that long-term borrowing at the end of 2023/24 will be **£160.6m** (PWLB debt £126.9m, Salix £1.5m, Ex Avon loan debt £10.8m, and finance leases £21.4m).

Treasury Management

The council's Treasury Management Strategy aims to keep sufficient, but not excessive, cash available to meet the council's spending needs, while managing the associated risks. Surplus cash is invested until required to produce a return, while shortages of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

The council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. Due to decisions taken in the past, the council currently has £164.5m external borrowing, charging an average interest rate of 4.8%, and £206m treasury investments, earning an average rate of 4.80%.

1.2.6 Affordability - Ratio of Financing Costs to Net Revenue Stream

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans, the MRP, and loans fund repayments are charged to revenue, offset by any investment income receivable. The net annual charge is known as the council's financing costs. In this indicator, financing costs are compared to the net revenue stream i.e., the amount funded from Council Tax, business rates and general government grants, to provide a measure of the affordability of the council's forecast borrowing.

Table 1.2.6: Proportion of financing costs to net revenue stream

	Forecast 2023/24	Estimate 2024/25	Estimate 2025/26	Estimate 2026/27	Estimate 2027/28
Net Financing costs (£m)	£10.6m	£6.8m	£9.9m	£12.3m	£13.2m
Proportion of net revenue (%)	5.0%	3.0%	4.4%	5.3%	5.5%

The Treasury Management and investment indicators are included in this report below.

1.3 TREASURY MANAGEMENT INDICATORS: ‘TREASURY CODE’

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

1.3.1 Security: Credit risk indicator

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

Table 1.3.1: Credit risk indicator:

Credit risk indicator	Target
Portfolio average credit rating	A-

1.3.2 Interest rate exposures

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:

Table 1.3.2: Interest rate risk indicator:

Interest rate risk indicator	Limit (£m)
Upper limit on one-year revenue impact of a 1% rise in interest rates	2.0
Upper limit on one-year revenue impact of a 1% fall in interest rates	2.0

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.

1.3.3 Maturity structure of borrowing

Refinancing risk is the risk that a borrower cannot refinance by borrowing to repay existing debt. To address this risk, limits are set of the proportions of the council’s borrowing which are due to fall due in specified periods.

Table 1.3.3: Upper & lower limits on borrowing maturities, as a % of total borrowing:

Maturity Structure of Borrowing	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within five years	40%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

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.

1.3.4 Long-term treasury management investments

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

Table 1.3.4: Long term treasury management investments in £ millions:

Price risk indicator	2024/25	2025/26	2026/27	No fixed date
Limit on principal invested with maturities longer than 365 days beyond year end	£40m	£40m	£40m	£10m

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

1.4 NON-TREASURY MANAGEMENT INDICATORS: 'INVESTMENT GUIDANCE'

The council has set the following quantitative indicators to allow elected members and the public to assess the council's total risk exposure resulting from its investment decisions.

1.4.1 Total risk exposure

The first indicator below shows the council's total exposure to potential investment losses. This includes amounts the council is contractually committed to lend but have yet to be drawn down and guarantees the council has issued over third-party loans.

Table 1.4.1: Total investment exposure in £ millions

Total investment exposure	Actual Held as at 31/03/23 £m	Forecast Held as at 31/03/24 £m	Forecast Held as at 31/03/25 £m
Treasury management investments	154.0	178.4	197.1
Service investments: Loans	0.8	0.8	0.8
Commercial investments: Property*	23.5	23.5*	23.5*
TOTAL EXPOSURE	**178.3**	**202.7**	**221.4**

** Commercial investment properties are re-valued annually by the council's valuers - valuations as at 31/3/24 are not yet available and cannot be forecast with reasonable certainty.*

1.4.2 How investments are funded

Current government guidance is that these indicators should include how investments are funded. Since the council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with.

In accordance with best professional practice, North Somerset Council does not associate its borrowing with particular items or types of expenditure. The council manages its treasury position, borrowings, and investments in accordance with its approved Treasury

Management Strategy and practices. In day-to-day cash management, no distinction is made between revenue cash and capital cash. External borrowing arises because of all the financial transactions of the council, and not simply those arising from capital spending. The council may choose to finance capital expenditure from its existing operational cash resources, rather than undertaking external borrowing, to minimise interest costs.

1.4.3 Rate of return received on investments

This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 1.4.3: Investment rate of return (net of all costs)

Investments net rate of return	**Actual 2022/23 %**	**Forecast 2023/24 %**	**Forecast 2024/25 %**
Treasury management investments	1.79	4.85	4.85
Service investments: Loans	4.62	7.05	7.05
Commercial investments: Property	1.81	0.00	0.00
ALL INVESTMENTS	**1.85**	**3.68**	**3.68**

Treasury management risk register

Appendix 3

	Risk area	Initial Risk Score: Likelihood	Initial Risk Score: Impact	Initial Risk Score: Score	Potential mitigation	Risk Score After Mitigation: Likelihood	Risk Score After Mitigation: Impact	Risk Score After Mitigation: Score
1	**Credit risk** - Loss of principal and/or interest due to counter-parties not being able to meet principal / interest payments as they fall due. Includes losses due to 'bail in' requirements. - Potential delays in being able to access funds. - Emerging markets carry a higher risk of financial loss than more developed markets, as they may have less developed legal, political, economic or other systems.	4	5	20	- Measurement of risk (use of credit ratings, CDS spreads, balance sheet analysis). - Monitoring of TM advisor advice, news, discussions with brokers, and reacting to events (eg both trading and regulatory). - Setting appropriate lending limits per counter-party re amounts, period and country of investment. - Diversification between lenders, lender types, countries. - Exposure to equity and tradable debt instruments only through diversified funds.	2	5	10
2	**Liquidity risk** Running out of accessible cash, leading to inability to make payments as they are due. - Needing to borrow at higher cost than otherwise available. - Needing to sell assets / investments at short notice / at lower prices. - Not having available counter-parties to invest in.	3	4	12	- Daily cash flow forecasting. - Overdraft facility agreed. - Ready access to sources of cash from eg PWLB, other local authorities and banks and building societies. - Holding investments that can be readily realised.	2	4	8
3	**Interest rate risk** The ongoing impacts associated with higher interest rates, which could increase borrowing costs or provide an opportunity to increase returns on external investments.	3	5	15	The council's capital strategy will aim to manage capital spending within an overall affordability envelope which means that it could scale back on spending in other areas if borrowing rates increase beyond budget levels.	2	5	10
4	**Inflation risk** The value of cash balances is eroded over time due to inflation (notably when interest rates on investments are lower than inflation)	4	4	16	- Monitoring of TM advisor advice, news, discussions with brokers re economic outlook, and expected inflation and related interest rate movements. - Identify balances not likely to be needed in the short term for operational cash flows, and invest these balances in longer term to generate sufficient income to at least match inflation.	3	4	12
5	**Currency risk** The risk of loss from fluctuating foreign exchange rates when an investor has exposure to foreign currency or in foreign-currency-traded investments	3	3	9	- Local authorities are not allowed to borrow or invest in foreign currencies. All transactions must be in sterling.	1	1	1
6	**Regulatory and political risk** Risk that changes in regulations or leglislation may have an adverse impact on the Council's finances, including: - Uncertainty in the economic outlook, and hence uncertainty over future interest rates and economic growth, and hence inflation, and government expenditure. - Changes in PWLB / other borrowing rates impact on the Council's borrowing costs - Changes in PWLB regulations limit availability/criteria of borrowing. - Changes in MiFID 2 regulatory requirements may increase costs and decrease access to markets.	4	3	12	- Monitoring of TM advisor advice, news, discussions with brokers, and reacting to events (eg both trading and regulatory). - On-going professional training and development of treasury management officers. - On-going training and updates to members on Treasury Management. - Regular review and update of overall Treasury Management Strategy. - Regular review and update of mix of borrowing and investments held to ensure the portfolio continues to meet the objectives of the Treasury Management Strategy.	3	3	9

Key: Scores: 1 (Lowest)-5 (Highest)

ESG Investment Policy

1.1 The council has developed the following framework for Environmental, Social and Governance (ESG) considerations and incorporated this ESG investment policy within the 2024/25 treasury management strategy.

1.2 CIPFA Treasury Management Code 2021 includes the requirement that a council's credit and counterparty policies should set out its policies and practices relating to ESG investment considerations, although it is not implied that this policy will currently include ESG scoring or other real-time ESG criteria at individual investment level.

1.3 The ESG investment policy will not detract from the core functions that need to take place within the existing treasury management strategy, i.e., the management of cash-flows and meeting the requirements within the approved revenue budget. The policy ensures that climate and other environmental implications are considered and reported on.

1.4 The council will continue to;

- avoid any direct treasury investments in companies related to fossil fuel exploration and extraction;
- engage with advisors to explore and assess the potential for any future investment opportunities in funds with a renewable energy & sustainability focus;
- maintain funds placed in a "Green Deposit Account," which is an investment facility that ensures deposits are linked to a wide range of projects in the pursuit of transition to a lower carbon economy. These projects cover a variety of themes including energy efficiency renewable energy, green transport, sustainable food, agriculture and forestry and greenhouse gas emission reductions.

1.5 In addition to the above, the ESG Investment policy includes the following set of ESG principles:

- The council's ESG investment policy must still be compliant with the external and internal regulatory framework, and will therefore continue to give focus to security and liquidity, then yield.
- When investing in banks, the council will seek to prioritise banks that are signatories to the UN Principles for Responsible Banking and the Net Zero Banking Alliance;
- When investing in funds, the council will seek to prioritise funds operated by managers that are signatories to the UN Principles for Responsible Investment, the UK Stewardship Code and/or the Net Zero Asset Managers Alliance;
- Direct involvement and financing of green energy projects is treated as capital expenditure, and as such is not covered within the remit of treasury management.

1.6 The signatories, principles, and alliances referred to above are referred to in more detail in para 4.12 below.

ESG investment strategy 2024/25

1.7 The following ESG investment strategy is proposed for adoption in 2024/25;

- To set aside an initial sum of up to £6m to invest specifically in ESG-related investments;

- Counterparty value and term limits will still be adhered to – for example if the counterparty limit in the approved strategy is £10m then this limit includes both ESG and non-ESG investment products;

- The duration of ESG investment to be less than 12 months – the council is expected to have a borrowing requirement in the next 2-5 years therefore a longer term ESG investment would not be suitable.

ESG Liquidity investing options

1.8 The council recognises there are few options for ESG liquidity investing, and in addition to the principles above will also consider investment in the following:

- HSBC Sterling ESG Liquidity Fund considers ESG criteria in its investment selection;

- Local authorities and housing associations (subject to suitable due diligence).

Local authorities and housing associations

1.9 Housing associations are usually charitable organisations that attempt to meet the UK's social housing needs.

1.10 Local authorities act under statute to meet the societal requirements of residents, including education, welfare for less able/disadvantaged groups, social housing, etc.

Reporting

1.11 The performance of the council's ESG investments will be reported within the various treasury management reports to the Audit Committee during 2024/25.

UN Principles, Net Zero Alliances, and the UK Stewardship Code

1.12 When investing in banks or funds, the ESG investment policy refers to signatories of various UN principles, the UK stewardship code or membership of Net Zero alliances. Additional information about each of these ESG initiatives is included below.

Investing with banks - UN Principles for Responsible Banking (UNPRB)

1.13 The aim of the UN Principles for Responsible Banking is to accelerate a positive global transition for people and the planet.

1.14 It has over 330 signatories with total assets of c.US$84 trillion, representing over half of global banking industry (data as at Dec-23). Through the Principles, outlined below, banks take action to align their core strategy, decision-making, lending, and investment with the UN Sustainable Development Goals (UN SDGs), and international agreements such as the Paris Climate Agreement.

1.15 The six Principles are:

- Alignment with the UN SDGs, the Paris Agreement, and relevant national and regional frameworks;
- Continuously increasing positive impacts while reducing the negative impacts on people and the environment resulting from the bank's activities, products, and services;
- Working responsibly with clients and customers to encourage sustainable practises and enable economic activities that create shared prosperity for current and future generations;
- Proactively and responsibly consulting, engaging, and partnering with relevant stakeholders to achieve society's goals;
- Committing to the Principles through effective governance and a culture of responsible banking;
- Being transparent and accountable for the bank's positive and negative impacts and contribution to society's goals.

Investing with banks - Net-Zero Banking Alliance

1.16 The Net-Zero Banking Alliance was launched in April 2021 by 43 founding members and has since grown to about 40% of global banking assets. The Alliance supports the implementation of decarbonisation strategies, providing an internationally coherent framework and guidelines in which to transition of the real economy to net-zero emissions.

1.17 Banks commit to:

- Transition the operational and attributable GHG emissions from their lending and investment portfolios to align with pathways to net-zero by 2050 or sooner;
- Within 18 months of joining, set 2030 targets (or sooner) and a 2050 target, with intermediary targets to be set every 5 years from 2030 onwards;
- Focus their first 2030 targets on priority sectors where the bank can have the most significant impact, i.e., the most GHG-intensive sectors within their portfolios, with further sector targets to be set within 36 months;
- Annually publish absolute emissions and emissions intensity in line with best practice and within a year of setting targets, disclose progress against a board-level reviewed transition strategy setting out proposed actions and climate-related sectoral policies;
- Take a robust approach to the role of offsets in transition plans.

Fund managers (MMFs and strategic funds) - UN Principles for Responsible Investment (UN PRI)

1.18 The United Nations defines Responsible Investment as “a strategy and practice to incorporate environmental, social and governance factors in investment decisions and active ownership,” complementing traditional financial analysis and portfolio construction techniques.

1.19 The UN’s Principles of Responsible Investment (PRI) promote the incorporation of ESG into investment decision-making. Its approach is outlined in six guiding principles for investors in their role as asset owners.

- incorporation of ESG issues;
- active ownership;
- seeking appropriate disclosure on ESG issues from investee entities through the Global Reporting Initiative;
- wider promotion of the principles in the investment industry;
- working together to enhance effectiveness; and
- reporting on activities and progress made.

Fund managers (MMFs and strategic funds) - The UK Stewardship Code

1.20 The UK Stewardship Code 2020 views active ownership as the “responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society”.

1.21 The Code has a strong focus on stewardship activities and outcomes. It expects signatories to progress beyond articulating their stewardship policies and comprises a set of “apply and explain” principles, to boost transparency and disclosure. The Code’s 12 principles focus on "Purpose and Governance", "Investment Approach", "Engagement" and "Exercising Rights and Responsibilities".

1.22 Signatories to the 2020 Code report annually with specific evidence for each reporting period on the Code’s application, including activities and outcomes, successes, and setbacks, all described succinctly and in plain English.

Fund managers (MMFs and strategic funds) - Net-Zero Asset Managers initiative

1.23 Launched in December 2020 and now with 315+ signatories with US$57 trillion of assets under management (04-Dec-23), its goal is to accelerate the transition towards global net-zero emissions by 2050 and for asset managers to play their part in helping deliver the goals of the Paris Agreement and ensuring a just transition. Managers also support investing aligned with net zero emissions by 2050 or sooner.

1.24 The commitments of this initiative include setting interim targets for 2030. Managers will be accountable through their annual climate-related financial disclosures and their climate action plan. It does not mean that asset managers will need to divest a given asset as engagement and stewardship are important levers and may have more impact on real economy emissions than by simply divesting.

Authorised Limit – the maximum amount of external debt at any one time in the financial year.

Bank Rate – the Bank of England base rate.

Capital Financing Requirement – financing needs of the council – i.e., the requirement to borrow.

CIPFA - the Chartered Institute of Public Finance and Accountancy. The institute is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work, in public service bodies, in the national audit agencies and major accountancy firms.

CLG – Communities and Local Government – see MHCLG.

Counterparty – the organisation the council is investing with.

Credit Rating – an assessment of the credit worthiness of an institution.

Creditworthiness – a measure of the ability to meet debt obligations.

ESG – Environmental, Social and Governance based investment decisions.

Finance Lease - a finance lease is a lease that is primarily a method of raising finance to pay for assets, rather than a genuine rental. The latter is an operating lease. The key difference between a finance lease and an operating lease is whether the lessor (the legal owner who rents out the assets) or lessee (who uses the asset) takes on the risks of ownership of the leased assets. The classification of a lease (as an operating or finance lease) also affects how it is reported in the accounts.

Gilts – long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange.

LIBID – London Interbank BID Rate – the interest rate at which London banks are willing to borrow from one another.

MHCLG – Ministry of Housing, Communities and Local Government. The Government department that sets policy on supporting local government, communities and neighbourhoods, regeneration, housing, planning building and the environment and fire. The name for this Government department has recently changed and is now known as **DLUHC**, which is the **Department for Levelling Up, Housing and Communities**.

Minimum Revenue Provision - the minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing.

Money Market - the market in which institutions borrow and lend.

Money Market Rates – interest rates on money market investments.

Ninety-One – one of the council's cash managers who invest in multi-asset funds. They were previously known as Investec.

Operational Boundary – the most likely, prudent but not worst-case scenario of external debt at any one time.

Pooled Funds – investments are made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification, and professional money management.

Prudential Code – a governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the council are affordable, prudent, and sustainable and that treasury management decisions are taken in accordance with good practice.

Prudential Indicators – indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment.

PWLB (Public Works Loans Board) - a central government agency which provides long and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities can borrow to finance capital spending from this source.

Sovereign – the countries the council can invest in.

Tradition UK Ltd – is one of the council's cash managers who manage £10m of investments on our behalf. Tradition place funds in fixed term cash deposits with a range of financial institutions.

Treasury Management – the management of the council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risk associated with those activities and the pursuit of optimum performance with those risks.

Treasury Management Practices – schedule of treasury management functions and how those functions will be carried out.

Variable Net Asset Value money market funds – the principal invested may fluctuate below that invested.

1.1 Underlying assumptions:

1.2 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.

1.3 The MPC's message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.

1.4 Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the more timely PMI figures suggest that the services sector is recovering from a weak Q3. Tighter policy will however bear down on domestic and external activity as interest rates bite.

1.5 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.

1.6 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.

1.7 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.

1.8 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.

1.9 There is a heightened risk of fiscal policy and/or geo-political events causing substantial volatility in yields.

1.10 Forecast:

1.11 The MPC held Bank Rate at 5.25% in December. We believe this is the peak for Bank Rate.

1.12 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.

1.13 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.

1.14 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%