

Appendix B - RBC Treasury Management Strategy Statement 2025/26

Introduction

- 2.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.
- 2.2 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.
- 2.3 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

External Context

Economic background:

- 2.4 The impact on the UK from the government's Autumn Budget, slower expected interest rate cuts, a short-term boost to but modestly weaker economic growth over the medium term, together with the impact from President-elect Trump's second term in office and uncertainties around US domestic and foreign policy, will be major influences on the Authority's treasury management strategy for 2025/26.
- 2.5 The Bank of England's (BoE) Monetary Policy Committee (MPC) held Bank Rate at 4.75% at its December 2024 meeting, having reduced it to that level in November and following a previous 25bp cut from the 5.25% peak at the August MPC meeting. At the December meeting, six Committee members voted to maintain Bank Rate at 4.75% while three members preferred to reduce it to 4.50%.
- 2.6 The November quarterly Monetary Policy Report (MPR) expected Gross Domestic Product (GDP) growth to pick up to around 1.75% (four-quarter GDP) in the early period of the BoE's forecast horizon before falling back. The impact

from the Budget pushes GDP higher in 2025 than was expected in the previous MPR, before becoming weaker. Current GDP growth was shown to be zero (0.0%) between July and September 2024 and 0.4% between April and June 2024, a further downward revision from the 0.5% rate previously reported by the Office for National Statistics (ONS).

- 2.7 ONS figures reported the annual Consumer Price Index (CPI) inflation rate at 2.6% in November 2024, up from 2.3% in the previous month and in line with expectations. Core CPI also rose, but by more than expected, to 3.6% against a forecast of 3.5% and 3.3% in the previous month. The outlook for CPI inflation in the November MPR showed it rising above the MPC's 2% target from 2024 into 2025 and reaching around 2.75% by the middle of calendar 2025. This represents a modest near-term increase due to the ongoing impacts from higher interest rates, the Autumn Budget, and a projected margin of economic slack. Over the medium-term, once these pressures ease, inflation is expected to stabilise around the 2% target.
- 2.8 The labour market appears to be easing slowly, but the data still require treating with some caution. The latest figures reported the unemployment rate rose to 4.3% in the three months to October 2024 and economic inactivity fell to 21.7%. Pay growth for the same period was reported at 5.2% for both regular earnings (excluding bonuses) and for total earnings. Looking ahead, the BoE MPR showed the unemployment rate is expected to increase modestly, rising to around 4.5%, the assumed medium-term equilibrium unemployment rate, by the end of the forecast horizon.
- 2.9 The US Federal Reserve has continued cutting interest rates, bringing down the Fed Funds Rate by 0.25% at its December 2024 monetary policy meeting to a range of 4.25%-4.50%, marking the third consecutive reduction. Further interest rate cuts are expected, but uncertainties around the potential inflationary impact of incoming President Trump's policies may muddy the waters in terms of the pace and magnitude of further rate reductions. Moreover, the US economy continues to expand at a decent pace, rising at an (upwardly revised) annual rate of 3.1% in the third quarter of 2024, and inflation remains elevated suggesting that monetary policy may need to remain more restrictive in the coming months than had previously been anticipated.
- 2.10 Euro zone inflation rose above the European Central Bank (ECB) 2% target in November 2024, hitting 2.2% as was widely expected and a further increase from 2% in the previous month. Despite the rise, the ECB continued its rate cutting cycle and reduced its three key policy rates by 0.25% in December. Inflation is expected to rise further in the short term, but then fall back towards the 2% target during 2025, with the ECB remaining committed to maintaining

rates at levels consistent with bringing inflation to target, but without suggesting a specific path.

Credit outlook:

- 2.11 Credit Default Swap (CDS) prices have typically followed a general trend downwards during 2024, reflecting a relatively more stable financial period compared to the previous year. Improved credit conditions in 2024 have also led to greater convergence in CDS prices between ringfenced (retail) and non-ringfenced (investment) banking entities again.
- 2.12 Higher interest rates can lead to a deterioration in banks' asset quality through increased loan defaults and volatility in the value of capital investments. Fortunately, the rapid interest rate hikes during this monetary tightening cycle, while putting some strain on households and corporate borrowers, has not caused a rise in defaults, and banks have fared better than expected to date, buoyed by strong capital positions. Low unemployment and robust wage growth have also limited the number of problem loans, all of which are positive in terms of creditworthiness.
- 2.13 Moreover, while a potential easing of US financial regulations under a Donald Trump Presidency may aid their banks' competitiveness compared to institutions in the UK and other regions, it is unlikely there will be any material impact on the underlying creditworthiness of the institutions on the counterparty list maintained by Arlingclose, the authority's treasury adviser.
- 2.14 Overall, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast (December 2024):

- 2.15 The Authority's treasury management adviser Arlingclose expects the Bank of England's MPC will continue reducing Bank Rate through 2025, taking it to around 3.75% by the end of the 2025/26 financial year. The effect from the Autumn Budget on economic growth and inflation has reduced previous expectations in terms of the pace of rate cuts as well as pushing up the rate at the end of the loosening cycle.
- 2.16 Arlingclose expects long-term gilt yields to remain broadly at current levels on average (amid continued volatility), but to end the forecast period modestly lower compared to now. Yields will continue remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will be short-term volatility due to economic and (geo)political uncertainty and events.

- 2.17 A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix A.
- 2.18 For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate/yield of 4.6%%, and that new long-term loans will be borrowed at an average rate of 5.8%.

Local Context

- 2.19 On 7th January 2025, the Authority had no borrowing and £13m of treasury investments. This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

| | 31.3.24 Actual £m | 31.3.25 Estimate £m | 31.3.26 Forecast £m | 31.3.27 Forecast £m | 31.3.28 Forecast £m |
|-------------------------------|--|--|--|--|--|
| Capital financing requirement | 6.7 | 10.9 | 12.5 | 10.5 | 10.5 |
| Less: External borrowing ** | 0 | 12.5 | 24.4 | 36.4 | 47.4 |
| Internal borrowing | 6.7 | -1.6 | -11.9 | -25.9 | -36.9 |
| Less: Usable Reserves | -17.0 | -17.0 | -15 | -14.0 | -12.0 |
| Less: Working Capital | -4.9 | -4.9 | -4.9 | -4.9 | -4.9 |
| Treasury investments | 15.2 | 23.5 | 31.8 | 44.8 | 53.8 |

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

- 2.20 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.
- 2.21 The Authority has an increasing CFR due to the capital programme, but minimal investments but will be funding the programme through internal borrowing.
- 2.22 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2025/26.
- 2.23 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £0.2m at each year-end to maintain sufficient liquidity but minimise credit risk.

2.24 The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Table 2: Prudential Indicator: Liability benchmark

| | 31.3.24 Actual £m | 31.3.25 Estimate £m | 31.3.26 Forecast £m | 31.3.27 Forecast £m | 31.3.28 Forecast £m |
|------------------------------|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Loans CFR | 6.7 | 10.9 | 12.5 | 10.5 | 10.5 |
| Less: Usable Reserves | -17.0 | -17.0 | -15 | -14.0 | -12.0 |
| Less: Working Capital | -4.9 | -4.9 | -4.9 | -4.9 | -4.9 |
| Net loans requirement | -15.2 | -11.0 | -7.4 | -8.4 | -6.4 |
| Plus: Liquidity allowance | 2.0 | 2.0 | 2 | 2.0 | 2.0 |
| Liability benchmark | -13.2 | -9.0 | -5.4 | -6.4 | -4.4 |

2.25 Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £2m average a year, minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year.

Borrowing Strategy

2.26 The Authority currently holds £104 million of loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £7.4m in 2025/26. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £60 million.

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

2.28 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Short-term interest rates are currently higher than in the recent past but are expected to fall in the coming year and it is therefore likely to be more cost

effective over the medium-term to either use internal resources, or to borrow short-term loans instead. The risks of this approach will be managed by keeping the Authority's interest rate exposure within the limit set in the treasury management prudential indicators, see below.

- 2.29 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of [internal / short-term] borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2025/26 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- 2.30 The Authority has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.
- 2.31 In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.
- 2.32 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:
- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
 - National Wealth Fund Ltd (formerly known as UK Infrastructure Bank Ltd)
 - any institution approved for investments (see below)
 - any other bank or building society authorised to operate in the UK
 - any other UK public sector body
 - UK public and private sector pension funds (except Local Government Pension Scheme)
 - capital market bond investors
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

- 2.33 **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:
- leasing
 - hire purchase
 - Private Finance Initiative
 - sale and leaseback
- 2.34 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.
- 2.35 **Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).
- 2.36 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

Treasury Investment Strategy

- 2.37 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's treasury investment balance has ranged between £1 and £18.5 million, and similar levels are expected to be maintained in the forthcoming year.
- 2.38 **Objectives:** The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return,

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

- 2.39 **Strategy:** As demonstrated by the liability benchmark above, the Authority expects to be a long-term investor and treasury investments will therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income to support local public services.
- 2.40 The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Authority may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by adding diversification to the strategic pooled fund portfolio.
- 2.41 **ESG policy:** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.
- 2.42 **Business models:** Under the IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
- 2.43 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the limits shown.

Table 3: Treasury investment counterparties and limits

| Credit rating | Banks unsecured | Banks secured | Government | Corporates | Registered Providers |
|---|-------------------|-------------------------|-------------------------|------------------|----------------------|
| UK Govt | n/a | n/a | £ Unlimited 50 years | n/a | n/a |
| AAA | £3 m 5 years | £3m 20 years | £3m 50 years | £3m 20 years | £1m 20 years |
| AA+ | £3m 5 years | £3m 10 years | £3m 25 years | £3m 10 years | £1m 10 years |
| AA | £3m 4 years | £3m 5 years | £3m 15 years | £3m 5 years | £1m 10 years |
| AA- | £3m 3 years | £3m 4 years | £3m 10 years | £3m 4 years | £1m 10 years |
| A+ | £3m 2 years | £3m 3 years | £3m 5 years | £3m 3 years | £1m 5 years |
| A | £3m 13 months | £3m 2 years | £3m 5 years | £3m 2 years | £1m 5 years |
| A- | £3m 6 months | £3m 13 months | £3m 5 years | £3m 13 months | £1m 5 years |
| None | £1.5m 6 months | n/a | £3m 25 years | £1m 5 years | £500k 5 years |
| Pooled funds and real estate investment trusts | | £2.5m per fund or trust | | | |

- 2.44 **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 taken into account.
- 2.45 For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £500,000 per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.
- 2.46 **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.

- 2.47 **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.
- 2.48 **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.
- 2.49 **Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
- 2.50 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.
- 2.51 **Strategic pooled funds:** Bond, equity and property funds, including exchange traded funds, that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date but can be either withdrawn after a notice period or sold on an exchange, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.
- 2.52 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term but are more volatile especially as the share price reflects

changing demand for the shares as well as changes in the value of the underlying properties.

- 2.53 **Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and unsecured loans to companies and universities. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.
- 2.54 **Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £2.0m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.
- 2.55 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

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

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

- 2.57 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.
- 2.58 **Investment limits:** The Authority's revenue reserves available to cover investment losses are forecast to be £17 million on 31st March 2025 and £15 million on 31st March 2026. In order that no more than 42% 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 £5 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.
- 2.59 Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £2m in operational bank accounts count against the relevant investment limits.
- 2.60 Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

| | Cash limit |
|---|-----------------|
| Any single organisation, except the UK Central Government | £5m each |
| UK Central Government | unlimited |
| Any group of organisations under the same ownership | £5m per group |
| Any group of pooled funds under the same management | £5m per manager |
| Negotiable instruments held in a broker's nominee account | £5m per broker |
| Foreign countries | £5m per country |
| Registered providers and registered social landlords | £2.5m in total |
| Unsecured investments with building societies | £2.5m in total |
| Loans to unrated corporates | £1m in total |
| Money market funds | £20m in total |
| Real estate investment trusts | £2.5m in total |

- 2.61 **Liquidity management:** The Authority uses detailed spreadsheets to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority’s medium-term financial plan and cash flow forecast.
- 2.62 The Authority will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Prudential Indicators

- 2.63 The Authority measures and manages its exposures to treasury management risks using the following indicators.
- 2.64 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

| Credit risk indicator | Target |
|---|---------------|
| Portfolio average credit [rating / score] | A |

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

| Liquidity risk indicator | Target |
|--------------------------------------|---------------|
| Total cash available within 3 months | £2.5m |

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

| Interest rate risk indicator | Limit |
|--|--------------|
| Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates | £500,000 |
| Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates | £500,000 |

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

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

| Refinancing rate risk indicator | Upper limit | Lower limit |
|---------------------------------|-------------|-------------|
| Under 12 months | 50% | 0% |
| 12 months and within 24 months | 50% | 0% |
| 24 months and within 5 years | 50% | 0% |
| 5 years and within 10 years | 50% | 0% |
| 10 years and above | 100% | 0% |

2.69 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment

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

| Price risk indicator | 2025/26 | 2026/27 | 2027/27 | No fixed date |
|---|---------|---------|---------|---------------|
| Limit on principal invested beyond year end | £1.0m | £0.5m | £0m | £0m |

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

Related Matters

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

2.73 **Financial derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable

deposits). The general power of competence in section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

- 2.74 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 2.75 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.
- 2.76 In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.
- 2.77 **Markets in Financial Instruments Directive:** The Authority has retained retail client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a smaller range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Director of Finance believes this to be the most appropriate status.

Financial Implications

- 2.78 The budget for investment income in 2025/26 is £203.6k based on an average investment portfolio of £4.5 million at an interest rate of 4.5%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.
- 2.79 Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then 50% of the revenue savings will be transferred to a treasury management reserve to cover the risk of capital losses or higher interest rates payable in future years.

Other Options Considered

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

| Alternative | Impact on income and expenditure | Impact on risk management |
|---|--|---|
| Invest in a narrower range of counterparties and/or for shorter times | Interest income will be lower | Lower chance of losses from credit related defaults, but any such losses may be greater |
| Invest in a wider range of counterparties and/or for longer times | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses may be smaller |
| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain |
| Reduce level of borrowing | Saving on debt interest is likely to exceed lost investment income | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain |

Appendix A – Arlingclose Economic & Interest Rate Forecast – December 2024

Underlying assumptions:

- As expected, the Monetary Policy Committee (MPC) held Bank Rate at 4.75% in December, although, with a 6-3 voting split and obvious concerns about economic growth, presented a much more dovish stance than had been expected given recent inflationary data.
- The Budget measures remain a concern for policymakers, for both growth and inflation. Additional government spending will boost demand in a constrained supply environment, while pushing up direct costs for employers. The short to medium-term inflationary effects will promote caution amongst policymakers.
- UK GDP recovered well in H1 2024 from technical recession, but underlying growth has petered out as the year has progressed. While government spending should boost GDP growth in 2025, private sector activity appears to be waning, partly due to Budget measures.
- Private sector wage growth and services inflation remain elevated; wage growth picked up sharply in October. The increase in employers' NICs, minimum and public sector wage levels could have wide ranging impacts on private sector employment demand and costs, but the near-term impact will likely be inflationary as these additional costs get passed to consumers.
- CPI inflation rates have risen due to higher energy prices and less favourable base effects. The current CPI rate of 2.6% could rise further in Q1 2025. The Bank of England (BoE) estimates the CPI rate at 2.7% by year end 2025 and to remain over target in 2026.
- The MPC re-emphasised that monetary policy will be eased gradually. Despite recent inflation-related data moving upwards or surprising to the upside, the minutes suggested a significant minority of policymakers are at least as worried about the flatlining UK economy.
- US government bond yields have risen following strong US data and uncertainty about the effects of Donald Trump's policies on the US economy, particularly in terms of inflation and monetary policy. The Federal Reserve pared back its expectations for rate cuts in light of these issues. Higher US yields are also pushing up UK gilt yields, a relationship that will be maintained unless monetary policy in the UK and US diverges.

Forecast:

- In line with our forecast, Bank Rate was held at 4.75% in December.
- The MPC will reduce Bank Rate in a gradual manner. We see a rate cut in February 2025, followed by a cut alongside every Monetary Policy Report publication, to a low of 3.75%.

- Long-term gilt yields have risen to reflect both UK and US economic, monetary and fiscal policy expectations, and increases in bond supply. Volatility will remain elevated as the market digests incoming data for clues around the impact of policy changes.
- This uncertainty may also necessitate more frequent changes to our forecast than has been the case recently.
- The risks around the forecasts lie to the upside over the next 12 months but are broadly balanced in the medium term.

| | Current | Mar-25 | Jun-25 | Sep-25 | Dec-25 | Mar-26 | Jun-26 | Sep-26 | Dec-26 | Mar-27 | Jun-27 | Sep-27 | Dec-27 |
|----------------------------------|---------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.25 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 |
| Central Case | 4.75 | 4.50 | 4.25 | 4.00 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| Downside risk | 0.00 | -0.25 | -0.25 | -0.50 | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 |
| 3-month money market rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.25 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 |
| Central Case | 4.90 | 4.60 | 4.35 | 4.10 | 3.90 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 |
| Downside risk | 0.00 | -0.25 | -0.25 | -0.50 | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 |
| 5yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Central Case | 4.34 | 4.30 | 4.20 | 4.10 | 4.00 | 3.90 | 3.90 | 3.95 | 4.00 | 4.05 | 4.05 | 4.05 | 4.05 |
| Downside risk | 0.00 | -0.50 | -0.60 | -0.65 | -0.65 | -0.70 | -0.70 | -0.75 | -0.75 | -0.80 | -0.80 | -0.80 | -0.80 |
| 10yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Central Case | 4.56 | 4.55 | 4.45 | 4.30 | 4.20 | 4.20 | 4.20 | 4.20 | 4.25 | 4.25 | 4.25 | 4.25 | 4.25 |
| Downside risk | 0.00 | -0.50 | -0.60 | -0.65 | -0.65 | -0.70 | -0.70 | -0.75 | -0.75 | -0.80 | -0.80 | -0.80 | -0.80 |
| 20yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Central Case | 5.05 | 5.00 | 4.90 | 4.80 | 4.70 | 4.65 | 4.65 | 4.65 | 4.65 | 4.65 | 4.65 | 4.65 | 4.65 |
| Downside risk | 0.00 | -0.50 | -0.60 | -0.65 | -0.65 | -0.70 | -0.70 | -0.75 | -0.75 | -0.80 | -0.80 | -0.80 | -0.80 |
| 50yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Central Case | 4.52 | 4.70 | 4.60 | 4.50 | 4.40 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 |
| Downside risk | 0.00 | -0.50 | -0.60 | -0.65 | -0.65 | -0.70 | -0.70 | -0.75 | -0.75 | -0.80 | -0.80 | -0.80 | -0.80 |

PWLB Standard Rate = Gilt yield + 1.00%

PWLB Certainty Rate = Gilt yield + 0.80%

PWLB HRA Rate = Gilt yield + 0.40%

National Wealth Fund (NWF) Rate = Gilt yield + 0.40%

Appendix B – Existing Investment & Debt Portfolio Position

| | 20/01/2025 | 20/01/2025 |
|---|-------------------------|---------------------|
| | Actual Portfolio | Average Rate |
| | £m | % |
| External borrowing: | 103.9 | 3.59 |
| Total external borrowing | 103.9 | 3.59 |
| Treasury investments: | | |
| Banks, MMF & building societies (unsecured) | 6.5 | 4.9 |
| Government (incl. local authorities) | 10.0 | 4.7 |
| Total treasury investments | 16.5 | 4.8 |
| Net Debt | 87.4 | |