Appendix 5A

Treasury Management Strategy Statement

Policy on the Statutory Repayment of Loans Fund Advances and Annual Investment Strategy

Aberdeenshire Council
2024/25

INDEX

1.1 Background

The Council is required to operate a balanced revenue budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Council's 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 it 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 risk or cost objectives.

The contribution the treasury management function makes to the Council is 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.

CIPFA defines treasury management as:

> *"The management of the local authority's borrowing, investments and cash flows, including 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."*
>
> *"The successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks."*
>
> *"The acknowledgement that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable, comprehensive performance measurement techniques within the context of effective risk management."*

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities.

1.2 Reporting Requirements

1.2.1 Capital Strategy

The CIPFA 2021 Prudential and Treasury Management Codes require all local authorities to prepare a Capital Strategy report which will provide the following: -

- a high-level long-term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of the strategy is to ensure that all the Council's elected members fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite.

1.2.2 Treasury Management Reporting

The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers: -
   - the capital plans, (including prudential indicators)
   - a policy on statutory repayment of loans fund advances, (how residual capital expenditure is charged to revenue over time)
   - the Treasury Management Strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
   - an Annual Investment Strategy, (the parameters on how investments are to be managed)

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, the Council will receive quarterly update reports.

c. **An annual treasury report** – This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The scrutiny role is undertaken by the Policy Committee responsible for Finance.

Quarterly reports – In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to Full Council but do require to be adequately scrutinised. This role is undertaken by Business Services Committee.

1.3 Treasury Management Strategy for 2024/25

The strategy for 2024/25 covers two main areas:

Capital issues

- the capital expenditure plans and the associated prudential indicators
- the policy for statutory repayment of loans fund advances

Treasury management issues

- the current treasury position
- treasury indicators which limit the treasury risk and activities of the Council
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy; and
- the policy on use of external service providers

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and Scottish Government loans fund repayment regulations and investment regulations, particularly Finance Circulars 5/2010 and 7/2016.

1.4 Training

The CIPFA Treasury Management Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.

Furthermore, pages 47 and 48 of the Code state that they expect "all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance, and decision making – this applies to officers and elected members.

The scale and nature of this will depend on the size and complexity of the Council's treasury management needs. Organisations should consider how to assess whether treasury management staff and council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

As a minimum, the Council should carry out the following to monitor and review knowledge and skills:

- Record attendance at training and ensure action is taken where poor attendance is identified.
- Prepare tailored learning plans for treasury management officers and council members.

- Require treasury management officers and council members to undertake self-assessment against the required competencies.
- Have regular communication with officers and council members, encouraging them to highlight training needs on an ongoing basis."

A members' training sessions was provided by Link Group on 21 December 2022. Further training is planned for 2024/25

The training needs of treasury management officers are periodically reviewed.

A formal record of the training received by officers central to the Treasury function will be maintained by the Treasury Officer. Similarly, a formal record of the treasury management/capital finance training received by members will also be maintained by the Head of Finance.

1.5 Treasury Management Consultants

The Council uses Link Group, Link Treasury Services Limited as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

It also recognises that there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

2. THE CAPITAL PRUDENTIAL INDICATORS 2024/25 – 2026/27

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans are prudent, affordable and sustainable.

2.1 Capital Expenditure and Financing

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts: -

Capital expenditure	2022/23 Actual £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
General Services	84.439	98.155	95.613	118.546	93.853
Housing	67.388	72.609	50.312	58.472	55.076
Total	**151.827**	**170.764**	**145.925**	**177.018**	**148.929**

Other long-term liabilities - the above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of capital expenditure	2022/23 Actual £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Capital receipts	1.873	1.750	1.750	1.750	1.750
Capital grants	50.109	44.914	50.976	47.523	31.522
Revenue	12.173	10.862	15.914	16.857	17.556
Net financing need for the year	**87.672**	**113.238**	**77.285**	**110.888**	**98.101**

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as prudent annual repayments from revenue need to be made which reflect the useful life of capital assets financed by borrowing.

The CFR includes any other long-term liabilities (e.g., PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility by the PFI, PPP, finance lease provider and so the Council is not required to separately borrow for these schemes.

An estimate for the recognition of leases under International Reporting Standard 16 (IFRS 16) which is being implemented from 1 April 2024 has been made. Detailed data gathering is currently underway but precise figures will not be known until later in the year. Once full details are known, the CFR may need to be revised for approval.

The Council is asked to approve the CFR projections below:

	2022/23 Actual £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Capital Financing Requirement					
General Services	792.872	836.190	876.460	933.607	973.673
Housing	325.313	374.594	394.122	428.121	458.560
Total CFR	**1,118.185**	**1,210.784**	**1,270.582**	**1,361.728**	**1,432.233**
Movement in CFR	**68.838**	**92.599**	**59.798**	**86.146**	**70.505**

Movement in CFR represented by					
Net financing need for the year (above)	87,672	113.238	77.285	110.888	98.101
Less Loans Fund principal repayments and other financing movements including PFI/ finance lease principal repayments	(18.834)	(20.639)	(22.487)	(24.742)	(27.596)
Assets acquired under finance leases (estimate)	-	-	5.000	-	-
Movement in CFR	**68.838**	**92.599**	**59.798**	**86.146**	**70.505**

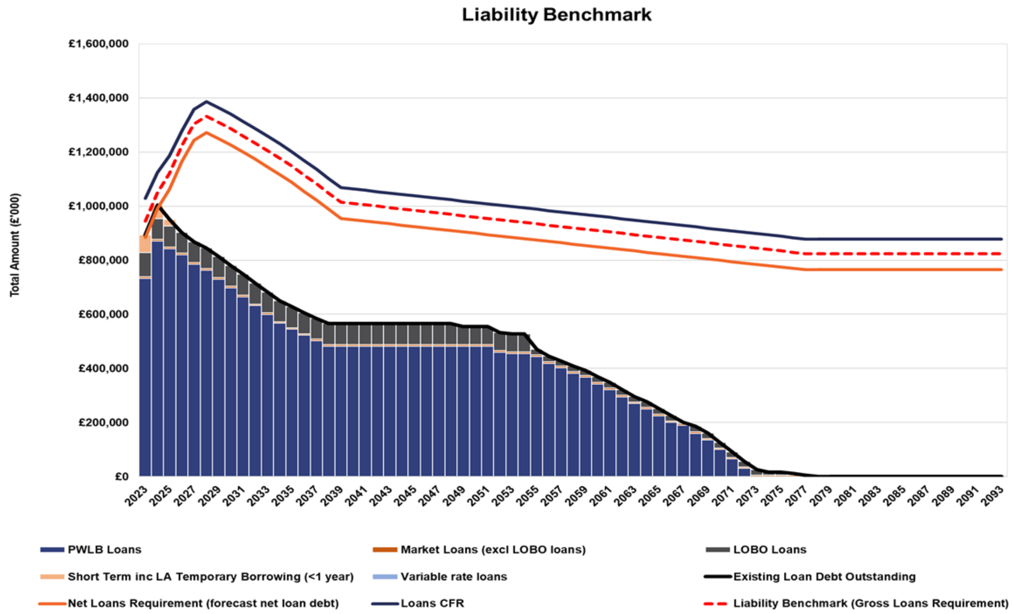
2.3 Liability Benchmark

The Council is required to estimate and measure the Liability Benchmark (LB) for the forthcoming financial year and the following two financial years, as a minimum.

There are four components to the LB: -

1. **Existing loan debt outstanding**: the Council's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned Loans Fund advances/Loans Fund principal repayments. It is important to note that only approved prudential borrowing is included in this measure (per the Capital Plan approved today up to 2027/28), whilst all other inputs are projected further forward. The graph therefore peaks in this 5-year period.
3. **Net loans requirement**: this will show the Council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned Loans Fund principal repayments and any other major cash flows forecast.

4. **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.



2.4 Core Funds and Expected Investment Balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

2.5 Statutory Repayment of Loans Fund Advances

The Council operates a consolidated loans fund under the terms of the Local Authority (Capital Finance and Accounting)(Scotland) Regulations 2016. The Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of the financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

The 2016 guidance sets out four options for the calculation of the repayment of loans fund advances, which are:

Option 1 – Statutory Method – this method allows repayments to be made as if the previous Schedule 3 to the 1975 Local Government (Scotland) Act was still in force but is no longer available as an option.

Option 2 – Depreciation Method – a complex method that links the calculated repayment to the depreciation charged each year and movement in the value of the asset.

Option 3 – Asset Life Method – a simpler alternative to the depreciation method, either on an equal instalment basis or on an annuity basis.

Option 4 – Funding/Income Profile Method – repayments calculated by assessing future income receivable from the use of the asset, if the asset created generates income.

Repayments for capital advances will be calculated using the **Asset Life Method** (option 3).

3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's Capital Strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions, and the Annual Investment Strategy.

3.1 Current Portfolio Position

The overall treasury management portfolio as at 31/03/23 and for the position as at 31/01/24 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	actual	actual	current	current
	31/03/23	**31/03/23**	**31/01/24**	**31/01/24**
Treasury investments	£m	%	£m	%
banks	8.500	100%	13.950	100%
local authorities		0%		0%
money market funds		0%		0%
Total managed in house	**8.500**	**100%**	**13.950**	**100%**
Total managed externally	**0.000**	**0%**	**0.000**	**0%**
Total treasury investments	**8.500**	**100%**	**13.950**	**100%**
Treasury external borrowing				
local authorities	65.040	7%	60.040	6%
PWLB	732.668	82%	812.459	85%
LOBOs	95.100	11%	83.100	9%
Total external borrowing	**892.808**	**100%**	**955.599**	**100%**
Net treasury investments / (borrowing)	**(884.308)**	**0**	**(941.649)**	**0**

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2022/23 Actual £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
External Debt					
Debt at 1 April	900.136	1,005.600	1,107.685	1,228.373	1,314.274
Other long-term liabilities (OLTL)	90.516	83.993	81.667	73.402	67.868
Actual gross debt at 31 March	**990.652**	**1,089.593**	**1,189.352**	**1,301.775**	**1,382.142**
The Capital Financing Requirement	**1,118.185**	**1,210.784**	**1,270.582**	**1,356.728**	**1,427.233**
Under / (over) borrowing	**127.533**	**121.191**	**81.230**	**54.953**	**45.091**

Within the range of prudential indicators there are several key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2024/25 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes account of current commitments, existing plans and the proposals in this budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational Boundary	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Debt	1,183	1,243	1,337	1,416
Other long-term liabilities	84	87	79	73
Total	**1,267**	**1,330**	**1,416**	**1,489**

The Authorised Limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short-term, but is not sustainable in the longer-term.

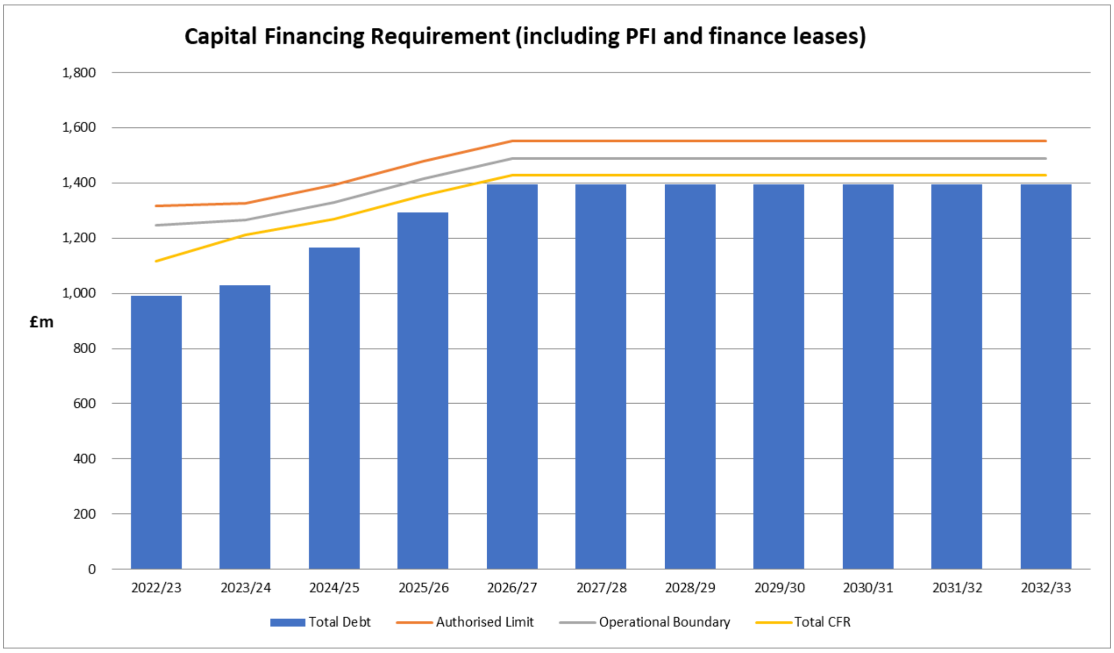
- This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all local authority plans, or those of a specific authority, although this power has not yet been exercised.

- The Council is asked to approve the following Authorised Limit:

Authorised Limit	**2023/24 Estimate £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**
Debt	1,243	1,303	1,397	1,476
Other long-term liabilities	84	92	84	78
Total	**1,327**	**1,395**	**1,481**	**1,554**

Other long-term liabilities (in both the Operational Boundary and the Authorised Limit above, and the borrowing projections) includes an estimate for the recognition of leases under IFRS16 from April 2024. Once full details are known, the Operational Boundary and/or the Authorised Limit may need to be revised for approval.

The graph below shows projections of CFR and borrowing.



3.3 Prospects for Interest Rates

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 08 January 2024. These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View 08.01.24													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

Additional notes by Link on this forecast table: -

- Our central forecast for interest rates was previously updated on 7 November and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least H2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent GDP releases have surprised with their on-going robustness).
- Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.
- In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

PWLB RATES

- The short and medium part of the gilt curve has rallied since the start of November as markets price in a quicker reduction in Bank Rate through 2024 and 2025 than held sway back then. This reflects market confidence in inflation falling back in a similar manner to that already seen in the US and the Euro-zone. At the time of writing there is c70 basis points difference between the 5 and 50 year parts of the curve.

Borrowing Advice

- Our long-term (beyond 10 years) forecast for Bank Rate remains at 3% and reflects Capital Economics' research that suggests AI and general improvements in productivity will be supportive of a higher neutral interest rate. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to factor in Bank Rate reductions for 2024 and later.

3.4 Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate remains elevated through to the second half of 2024.

Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates,* then and previously planned borrowing will be postponed (rather than taking borrowing at a higher rate than is necessary)

- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision-making body at the next available opportunity.

3.5 Policy on Borrowing in Advance of Need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Rescheduling

Rescheduling of current borrowing in our debt portfolio may be considered whilst premature redemption rates remain elevated but only if there is surplus cash available to facilitate any repayment, or rebalancing of the portfolio to provide more certainty is considered appropriate.

If rescheduling is to be undertaken, it will be reported to Business Services Committee, at the earliest meeting following its action.

3.7 Approved Sources of Long and Short-term Borrowing

The Council's Loans Fund may borrow from any other UK local authority or government guaranteed institution which includes the PWLB or successors. In addition, it may borrow from any bank, financial institution, insurance company or utility company which is governed by MiFID, the EU Markets in Financial Instruments Directive (2004/39/EC).

On Balance Sheet	**Fixed**	**Variable**
PWLB	●	●
UK Municipal Bond Agency	●	●
Local Authorities	●	●
Banks	●	●
Pension Funds	●	●
Insurance Companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock Issues	●	●
Local Temporary	●	●
Local Bonds	●	
Local Authority Bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance Leases	●	●

*(*Instruments highlighted in **bold** above are currently utilised by the Council)*

When taking new borrowing the debt maturity profile will be considered to ensure that an acceptable level of debt matures in any one year. This is in order to manage the refinancing risk of replacing maturing debt at unfavourable borrowing rates.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment Policy – Management of Risk

The Council's investment policy has regard to the following: -

The Council's investment policy implements the requirements of the following: -

- Local Government Investments (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010),
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code")
- CIPFA Treasury Management Guidance Notes 2021

The Council's investment priorities will be security first, portfolio liquidity second and then yield (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with regard to the Council's risk appetite.

In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods of up to 12 months with high credit rated financial institutions, as well as wider range fund options.

The above guidance from the Scottish Government and CIPFA places a high priority on the management of risk. This Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.

2. We will utilise our treasury consultants credit rating list and other information sources to develop the counterparty list.

3. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This Council has defined the list of types of investment instruments that the treasury management team are authorised to use in Appendix 5.4.

5. Lending limits, (amounts and maturity), for each counterparty will be set in our table of permitted investments.

6. This Council will set a limit for its investments which are invested for longer than 365 days, (see paragraph 4.4).

7. This Council has engaged external consultants, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Council in the context of the expected level of cash balances and need for liquidity throughout the year.

8. All investments will be denominated in sterling.

9. As a result of the change in accounting standards for 2022/23 under IFRS 9, this Authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

However, the Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.
The above criteria are unchanged from last year.

4.2 Creditworthiness Policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Authority will ensure that: -

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Head of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list.

Surplus money in the Council's Loans Fund may only be advanced to a pool of high quality investment counterparties which fall within the following criteria:-

- any other UK local authority or government guaranteed institution.
- any bank, financial institution, insurance company or utility company which meets the following criteria:
    i. it is UK, EU, Australian or Canadian based.
    ii. it falls into one of the groups of banks, financial institutions or insurance companies and the institution have a credit rating of P-1 (or better) form

Moody's or a rating of F-1 (or better) from Fitch. Or where the organisations are deemed UK government backed.

iii. the Council's own bankers.

- any money market fund that meets the following criteria:
  i. it is a Sterling denominated fund domiciled within the UK or EU, a member of the Institutional Money Market Fund Association (IMMFA) and is regulated under The European Money Market Fund Regulation (EU) 2017/1131. The Regulation was implemented in full on 21 March 2019.
  ii. it carries a Money Market Fund rating of Aaa-mf from Moody's or a rating of AAAmmf from Fitch or a rating of AAAm from S & P.

Fund Balances on Trust Fund and Common Good Funds may be invested:

- in the Council's Loans Fund
- in Companies which meet the same criteria as above for the Council's Loans Fund.

Use of additional information other than credit ratings.

Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, rating Watches/Outlooks) will be applied to compare the relative security of differing investment opportunities.

Environmental, Social & Governance (ESG) Considerations

The Council currently considers credit ratings when investing, the agencies providing the ratings incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings and as such ESG considerations are already incorporated to an extent.

The Council will continue to work with and follow the advice of its financial advisors when looking at ways in which to incorporate further ESG factors into their own assessment service

Time and monetary limits applying to investments.

No more than £25 million will be lent to and be outstanding with any one borrower at one time, except for (i) the Debt Management Office where the limit will not be capped and (ii) UK government backed institutions and the Council's bankers, where the limit will be £30 million. The borrower group limit is also £30 million.

The proposed criteria for permitted investments are shown in Appendix 5.4 below.

4.3 Limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

a) **Non-financial investments**. All future investments will be subject to investigation and scrutiny by relevant officials of the Council on a case-by-case basis to ensure that they are prudent and thereafter, if considered that the investment will meet investment criteria as agreed by the relevant committees of the Council, will be reported to the required committees of the Council for approval.

b) **Country limit**. The maximum country exposure limit of £30 million will apply, except of the UK where the limit will not be capped.

4.4 Investment Strategy

The primary objective of investment of surplus funds is to minimise risk and maintain the security of funds and liquidity. Investment opportunities are identified through detailed forecasting and monitoring of interest rate trends and returns optimised using a list of approved organisations.

The Council's investment priorities are:

a) The security of capital

b) The liquidity of its investments

Investment returns expectations.
The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to have peaked at 5.25% in Q4 2023.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows: -

Average earnings in each year	
2023/24 (residual)	5.30%
2024/25	4.55%
2025/26	3.10%
2026/27	3.00%
2027/28	3.25%
Years 6 to 10	3.25%
Years 10+	3.25%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, Money Market Funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.

Investment treasury indicator and limit

Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

Upper limit for principal sums invested for longer than 365 days			
£m	**2024/25**	**2025/26**	**2026/27**
Principal sums invested for longer than 365 days	£20m	£20m	£20m
Current investments as at 31/12/23 in excess of 1 year maturing in each year	£0	£0	£0

4.5 Investment Performance / Risk Benchmarking

The Council is a member of Link's investment benchmarking group and performance is measured against similar sized authorities on a quarterly basis.

4.6 End of Year Investment Report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

5 APPENDICES

5.1 Prudential and treasury indicators

5.2 Interest rate forecasts

5.3 Economic background

5.4 Treasury management practice 1 – credit and counterparty risk management

5.5 The treasury management role of the section 95 officer

5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2024/25 – 2026/27

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

5.1.1 Capital Expenditure

Capital expenditure	2022/23 Actual £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
General Services	84.439	98.155	95.613	118.546	93.853
HRA	67.388	72.609	50.312	58.472	55.076
Total	**151.827**	**170.764**	**145.925**	**177.018**	**148.929**

5.1.2 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators: -

5.1.3 Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the cost of capital, (borrowing and other long-term obligation costs net of investment income), against the net revenue stream.

%	2022/23 Actual	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
General Services	6.4%	6.4%	6.9%	7.6%	8.1%
HRA	11.1%	12.1%	13.0%	14.14%	15.0%

The estimates of financing costs include current commitments and the proposals in this budget report.

The %s above include the PFI/PPP borrowing commitments

5.1.4 Fixed and Variable Interest rate exposures

Exposure to variable interest rates means that the Council is exposed to higher borrowing costs in the event of sudden increases in interest rates. The upper limits are:

%	2024/25	2025/26	2026/27
Fixed rate exposure upper limit	100%	100%	100%
Variable rate exposure upper limit	40%	40%	40%

5.1.5 Maturity Structure of Borrowing

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Maturity structure of fixed interest rate borrowing 2024/25		
	Lower	**Upper**
Under 12 months	0%	30%
12 months to 2 years	0%	30%
2 years to 5 years	0%	50%
5 years to 10 years	0%	75%
10 years to 20 years	25%	90%

5.2 INTEREST RATE FORECASTS 2023-2026

Link Group Interest Rate View 08.01.24													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

PWLB forecasts are based on PWLB certainty rates.

Additional notes by Link on this forecast table:

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is even.

Downside risks to current forecasts for UK gilt yields and PWLB rates include: -

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).

- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- **Geopolitical risks,** for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- Despite the tightening in Bank Rate to 5.25%, the **Bank of England allows inflationary pressures to remain elevated** for a long period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- **The pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, which may prove inflationary, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields compensating.

LINK GROUP FORECASTS

We expect the MPC will keep Bank Rate at 5.25% until the second half of 2024, to combat on-going inflationary and wage pressures, even if they have dampened somewhat of late. We do not think that the MPC will increase Bank Rate above 5.25%.

Gilt yields and PWLB rates

The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation continues to fall through 2024.

Our target borrowing rates are set **two years forward** (as we expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below: -

PWLB debt	Current borrowing rate as at 08.01.24 p.m.	Target borrowing rate now (end of Q4 2025)	Target borrowing rate previous (end of Q3 2025)
5 years	4.53%	3.70%	3.80%
10 years	4.67%	3.90%	3.80%
25 years	5.19%	4.20%	4.20%
50 years	4.97%	4.00%	4.00%

Borrowing advice: Our long-term (beyond 10 years) forecast for Bank Rate remains at 3% and reflects Capital Economics' research that suggests AI and general improvements in productivity will be supportive of a higher neutral interest rate. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to factor in Bank Rate reductions for 2024 and later.

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are set out below.

Average earnings in each year	Now	Previously
2023/24 (residual)	5.30%	5.30%
2024/25	4.55%	4.70%
2025/26	3.10%	3.20%
2026/27	3.00%	3.00%
2027/28	3.25%	3.25%
2028/29	3.25%	3.25%
Years 6 to 10	3.25%	3.25%
Years 10+	3.25%	3.25%

As there are so many variables at this time, caution must be exercised in respect of all interest rates forecasts.

5.3 ECONOMIC BACKGROUND – Link Group

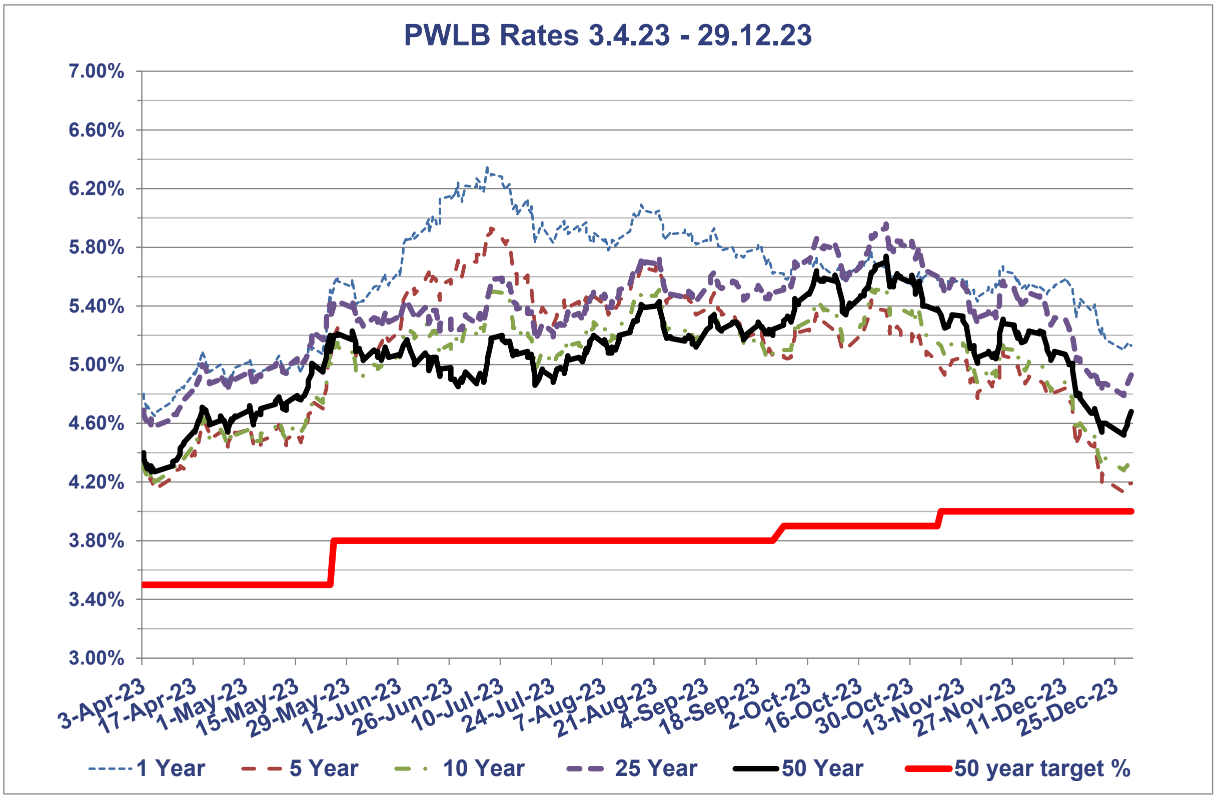
- The third quarter of 2023/24 saw:
  - A 0.3% decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
  - A sharp fall in wage growth, with the headline rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;
  - CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
  - Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;
  - The Bank of England holding Bank Rate at 5.25% in November and December;
  - A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.
- The revision of GDP data in Q2 to a 0.1% fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.
- However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.
- The 0.3% fall in retail sales volumes in October means that after contracting by 1.0% (which was downwardly revised from -0.8%) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.
- Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with the Halifax house price index recently pointing to a 1.7% year on year increase whilst Nationwide's December data pointed to a -1.8% year on year decrease. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

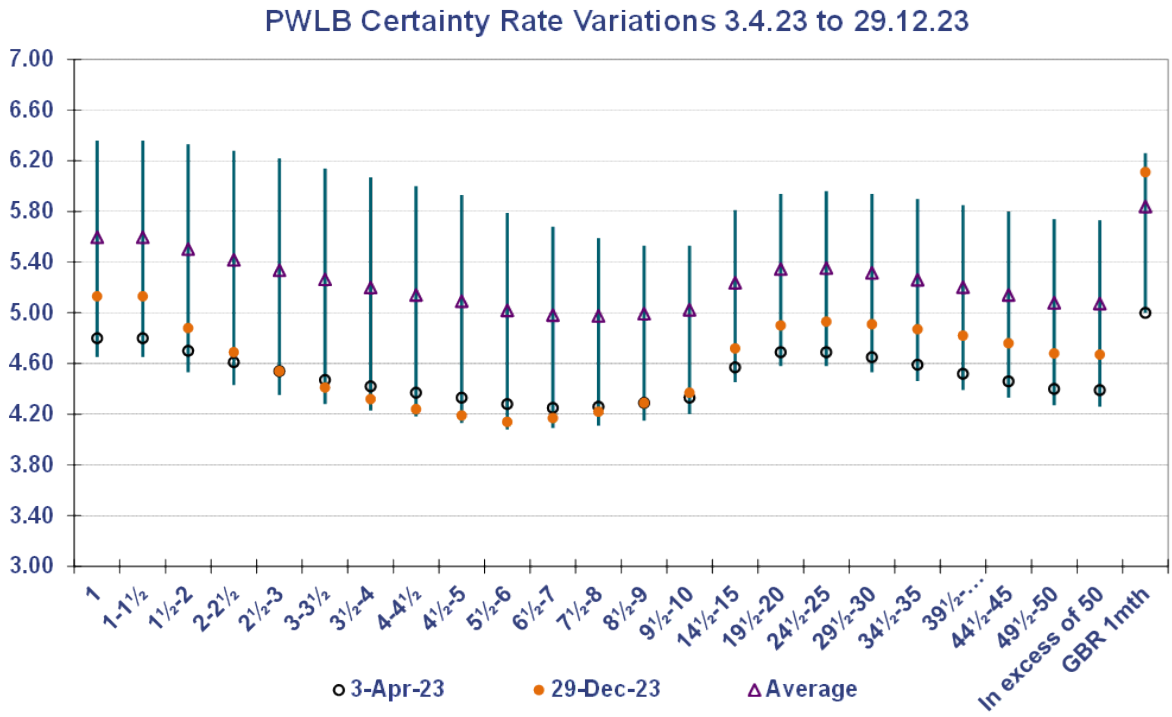
- Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.
- The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6%, which meant the headline rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.
- The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.
- CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.
- The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.
- Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why we think the Bank of England won't feel comfortable cutting interest rates until mid 2024.

- The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% in early January, with further declines likely if the falling inflation story is maintained.
- Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.
- The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February 2023. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein PWLB rates, is clear to see, prior to the end of year rally based on a mix of supportive domestic and international factors.

PWLB RATES 3.4.23 - 29.12.23





HIGH/LOW/AVERAGE PWLB RATES FOR 3.4.23 – 29.12.23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.60%	5.09%	5.03%	5.35%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

MPC meetings 2nd November and 14th December 2023

- On 2nd November, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.
- Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.

In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024

5.4 TREASURY MANAGEMENT PRACTICE (TMP1) – PERMITTED INVESTMENTS

The Council approves the following forms of investment instrument for use as permitted investments as set out in table 1 and 2 below

Table 1: Annual Investment Strategy: - Permitted Investments Schedule – Treasury and Common Good Funds

Investment Category	Name	Applicable to Treasury and Common Good Investments	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period
Deposits	Call Accounts	Yes	Instant access	None	£25m (£30m*)	n/a
Deposits	Business Reserve Accounts – Notice Accounts	Yes	Notice	None	£25m (£30m*)	24 mths
Securities Issued or guaranteed by governments	DMO (Debt Management Office)	Yes	Term deposit	None	unlimited	12 mths
Deposits	Fixed Term Deposits	Yes	Term deposit	None	£20m	24 mths

Investment Category	Name	Applicable to Treasury and Common Good Investments	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period
Collective Investment Schemes structures as open-ended investment companies	Money Market Funds	Yes	Instant access	None	£20m	12 mths
Collective Investment Schemes structures as open-ended investment companies	Ultra-Short Dated Bonds	Treasury investments only	Today + 3 Days	Minimal - Pooled cash investment vehicle which provides very low market risk. These will primarily be used as liquidity instruments.	£10m	12 mths
Securities Issued or guaranteed by governments	Treasury Bills	Yes	Term Deposit / Secondary Market	Yes if not held to term	Treasury investments - £25m Common Good Fund investments - £10m	24 mths
Deposit	Certificate of Deposits	Yes	Term Deposit / Secondary Market	Yes if not held to term	£10m	24 mths
Securities Issued or guaranteed by governments	Trust Funds: Heritable Property	Treasury investments only	notice	Yes	unlimited	unlimited

Investment Category	**Name**	**Applicable to Treasury and Common Good Investments**	**Liquidity Risk**	**Market Risk**	**Limit Per Counterparty/ Investee £'s**	**Maximum Period**
Securities Issued or guaranteed by governments	Common Good Funds: Heritable Property	Common Good investments only	notice	Yes	unlimited	unlimited
Securities Issued or guaranteed by governments	Trust Funds: Government Stocks	Treasury investments only	notice	Yes	£1m	unlimited
Securities Issued or guaranteed by governments	Common Good Funds: Government Stocks	Common Good investments only	notice	Yes	£1m	unlimited
All shareholding, unit holding and bond holding	Trust Funds Shareholdings: Investment Trusts	Treasury investments only	notice	Yes	£1m	unlimited
All shareholding, unit holding and bond holding	Common Good Funds Shareholdings: Investment Trusts	Common Good investments only	notice	Yes	£1m	unlimited
All shareholding, unit holding and bond holding	Trust Funds Shareholdings: Unit Trusts	Treasury investments only	notice	Yes	£1m	unlimited

Investment Category	Name	Applicable to Treasury and Common Good Investments	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period
All shareholding, unit holding and bond holding	Common Good Funds Shareholdings: Unit Trusts	Common Good investments only	notice	Yes	£1m	unlimited

Treasury and Common Good Investment Minimum Credit Criteria – see Annual Investment Strategy above

* UK government backed institutions and the Councils bankers limit will be £30 million

Table 2: Annual Investment Strategy: - Permitted Investments Schedule – Non-Treasury

Investment Category	Name	Minimum Credit Criteria	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period
Loans made to third parties are investments	Adhoc loans including existing long-term debtors	Service Delivery Objectives	Term	Appropriate Due diligence undertaken before loans made	Unlimited	Unlimited
Loans made to third parties are investments	Support for Aberdeenshire Business Scheme	Service Delivery Objectives*	Term	Appropriate Due diligence undertaken before loans made	£25,000 unless heritable security obtained	60 months
Loans made to third parties are investments	Assistance for Aberdeenshire Business - Significant Financial Support	Service Delivery Objectives*	Term	Appropriate Due diligence undertaken before loans made	unlimited	unlimited
Investment Property	Investment Land and Buildings held for economic development purposes	Service Delivery Objectives*	notice	Appropriate Due diligence undertaken before loans made	unlimited	unlimited
Investment Property	Investment Land and Buildings for regeneration purposes.	Development Appraisal Criteria (per Estates)	notice	managed	unlimited	unlimited
Investment Property	Purchase and lease back arrangements.	Development Appraisal Criteria (per Estates)	notice	managed	unlimited	unlimited
Deposit	Hub-Co DBFM – Subordinated Debt (Own)	n/a – Council Shareholder	Term (25 Years)	Service delivery - managed	£1.5 million	25 year

Investment Category	Name	Minimum Credit Criteria	Liquidity Risk	Market Risk	Limit Per Counterparty/ Investee £'s	Maximum Period
Deposit	Hub-Co DBFM – Subordinated Debt (Other)	n/a – Council Shareholder	Term (25 Years)	Service delivery - managed	£1.5 million	25 year
All shareholding, unit holding, and bond holding/ Loans made to third parties are investments	Limited Liability Partnership – NHT Variant	n/a – Council Shareholder	Term (40 years)	House price market	£25 million	40 years
Loans made to third parties are investments	LAMS – Council as Guarantor	Security over property/ Service Delivery Objectives	Repayment Term	managed	£100,000	30 years
Loans made to third parties are investments	Empty Homes Initiative	Security over property/ Service Delivery Objectives	On receipt of rental.	Service delivery - managed	£50,000	10 years
Loans made to third parties are investments	Housing Equity Release Loans	Security over property/ Service Delivery Objectives	On sale of property	Housing market - managed	£50,000	unlimited

Investment Category	**Name**	**Minimum Credit Criteria**	**Liquidity Risk**	**Market Risk**	**Limit Per Counterparty/ Investee £'s**	**Maximum Period**
Loans made to third parties are investments	Credit Unions	Authorised by the Prudential Regulation Authority as Category 5 Credit Union meeting capital financing requirements and Security over property	Repayment Term	Monitored	£150,000	12 months rolling
All shareholding, unit holding and bond holding	Shareholdings General	Service Delivery Objectives	notice	Yes	£1m	unlimited

* 1994 Local Government Scotland Act 1994 s171 - Power to Carry Out Economic Development activities

Treasury risks
All the investment instruments in tables 1 & 2 are subject to the following risks: -

1. **Credit and counterparty risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have the highest, relative, level of creditworthiness.

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument.

3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

4. **Interest rate risk**: this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. This Council has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report.

5. **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

Controls on treasury risks

1. **Credit and counterparty risk:** this Council has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes.

2. **Liquidity risk:** the Council has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

3. **Market risk:** this Council does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value.

4. **Interest rate risk**: the Council manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.

5. **Legal and regulatory risk:** this Council will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations. This applies to all types of investment instruments.

Unlimited investments

Aberdeenshire Council has given the following types of investment an **unlimited** category: -

1. **Debt Management Agency Deposit Facility.** This is considered to be the lowest risk form of investment available to local authorities as it is operated by the Debt Management Office which is part of H.M. Treasury i.e., the UK Government's sovereign rating stands behind the DMADF. It is also a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts.

Objectives of each type of investment instrument

Regulation 25 requires an explanation of the objectives of every type of investment instrument which an Authority approves as being 'permitted'.

1. DEPOSITS

The following forms of 'investments' are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date or is held at call.

a) **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk. The longest period for a term deposit with the DMADF is 6 months.

b) **Term deposits with high creditworthiness banks and building societies.** This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term). In addition, longer-term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer-term investment is made, that cash is locked in until the maturity date.

c) **Call accounts with high creditworthiness banks and building societies.** The objectives are as for 1b. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

d) **Money Market Funds (MMFs).** By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or capabilities to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g., a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still getting much better rates of return than available through the DMADF.

e) **Ultra-short dated bond funds.** These funds are similar to MMFs, can still be AAA rated but have Variable Net Asset Values (VNAV) as opposed to a traditional MMF which has a Constant Net Asset Value (CNAV). They aim to achieve a higher yield and to do this either take more credit risk or invest out for longer periods of time, which means they are more volatile. These funds can have WAM's and Weighted Average Life (WAL's) of 90 – 365 days or even longer. Their primary objective is yield and capital preservation is second. They therefore, are a higher risk than MMFs and correspondingly have the potential to earn higher returns than MMFs.

f) **Treasury bills.** These are short term bills, (up to 18 months but usually 9 months or less), issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.

g) **Certificates of deposit (CDs).** These are shorter term securities issued by deposit taking institutions (mainly financial institutions). They are negotiable instruments, so can be sold ahead of maturity and also purchased after they have been issued. However, that liquidity can come at a price, where the yield could be marginally less than placing a deposit with the same bank as the issuing bank.

5.5 THE TREASURY MANAGEMENT ROLE OF THE SECTION 95 OFFICER

The S95 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- ensuring that the Capital Strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council
- ensure that the Council has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the Council does not undertake a level of investing which exposes the Council to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long-term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by the Council
- ensuring that the Council has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following : -
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*
    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*
    - *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*
    - *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*