Appendix I - Treasury Management Strategy Statement 2024/25

Introduction

1.0 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

2.0 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3.0 Investments held for service purposes are considered separately within the Investment Strategy.

External Context

4.0 The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be major influences on the Council's treasury management strategy for 2024/25.

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

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

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

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

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

10.0 Having increased its key interest rate to a target range of 5.25-5.50% in August 2023, the US Federal Reserve appears now to have concluded the hiking cycle. It is likely this level represents the peak in US rates following a more dovish meeting outcome in December 2023.

11.0 US GDP grew at an annualised rate of 4.9% between July and September 2023, ahead of expectations for a 4.3% expansion and the 2.1% reading for Q2. But the impact from higher rates has started to feed into economic activity and growth will weaken in 2024. Annual CPI inflation was 3.1% in November.

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

Credit outlook

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

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

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

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

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

18.0 However, the Council's counterparties remain well-capitalised. The Council will continue to utilise our Treasury adviser's advice on both recommended institutions and maximum duration, as well as reflecting economic conditions and the credit outlook in our approach.

Interest rate forecast (Dec 2023)

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

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

21.0 For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 4%, and that new long-term loans will be borrowed at an average rate of 5.5%.

Local Context

22.0 At 31st December 2023, the Council held £828.0m of borrowing (£758.0m long term and £70.0m short term) and £135.5m of investments. This is set out in further detail at ***Appendix 2***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31/03/2023 Actual £m	31/03/2024 Forecast £m	31/03/2025 Forecast £m	31/03/2026 Forecast £m	31/03/2027 Forecast £m
Capital Financing Requirement	1,146.1	1,261.9	1,442.1	1,655.4	1,685.1
Other debt liabilities*	36.2	32.5	74.9	70.4	67.7
Loans CFR	**1,182.3**	**1,294.4**	**1,517.0**	**1,725.8**	**1,752.7**
(less) External borrowing**	(781.0)	(707.6)	(697.2)	(686.9)	(676.5)
Internal (Over) Borrowing	**401.3**	**586.8**	**819.8**	**1,039.0**	**1,076.2**

(less) Balance Sheet Resources	(517.8)	(517.8)	(517.8)	(517.8)	(517.8)
New borrowing (or Treasury Investments)	**(116.5)**	**69.0**	**302.0**	**521.2**	**558.4**

* Leases and PFI liabilities that form part of the Council's total debt
** shows only loans to which the Council is committed and excludes optional refinancing

23.0 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's strategy has been to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. This means the Council has minimised its interest costs by utilising internal resources over the short term instead of undertaking more expensive external borrowing. As our internal resources are being depleted, there is an increasing need for the Council to undertake new external borrowing to fund the capital programme. However, whilst deferring external borrowing and using internal resources minimises debt interest costs, internal resources will need to be replenished at a later date. This could expose the Council to interest rate risk whereby interest rates could be higher (or lower) than the present day.

24.0 The Council will need to borrow up to £503.7m over the forecast period to support the financing of the capital programme. Table 2 sets out the Councils current and future years capital programme and capital financing.

25.0 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2024/25.

Table 2: Capital Programme

£m	2023/24	2024/25	2025/26	2026/27	2027/28	Total
Corporate Landlord	10.1	14.2	19.0	10.8	28.2	82.3
South Kilburn	13.6	27.2	0.1	0.1	0.0	41.1
Regeneration	9.0	64.7	110.4	7.2	0.0	191.4
St Raphael's	0.8	0.3	19.5	0.0	0.0	20.6
Public Realm	26.6	23.8	11.7	1.0	1.0	64.2
Schools	12.4	24.7	26.3	7.3	3.3	73.9
Housing GF	98.4	106.1	48.1	30.7	3.6	286.9
Housing HRA	49.9	57.3	100.3	33.3	9.9	250.8
Total Capital Programme	**220.9**	**318.3**	**335.5**	**90.5**	**46.0**	**1,011.2**
Financed by						
Grants & Other Contributions	42.9	52.9	33.6	7.3	3.3	140.0
S106 & CIL	8.0	27.5	16.7	0.0	0.0	52.2
Capital Receipts	10.6	1.8	26.0	19.5	26.1	84.0
Reserves	1.8	2.7	1.3	1.4	0.0	7.0

Major Repairs Allowance	15.0	22.6	21.4	0.0	0.0	58.9
Revenue Contribution	8.6	11.6	1.7	9.0	0.5	31.3
Prudential Borrowing	134.1	199.3	234.9	53.4	16.1	637.8
Total Capital Financing	**220.9**	**318.3**	**335.5**	**90.5**	**46.0**	**1,011.2**

26.0 Table 3 details the cost of delivering the Council's capital programme as well as servicing existing debt relating to past capital programmes.

Table 3: Capital financing costs

£m	2023/24	2024/25
Interest Payable	25.34	26.54
Debt expenses	0.14	0.14
MRP	9.75	9.75
Sub-total	**35.23**	**36.43**
Interest receivable	(11.39)	(11.39)
Total Capital Financing Budget	**23.84**	**25.04**

<u>Liability Benchmark</u>

27.0 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 that cash and investment balances are kept to a minimum level to maintain sufficient liquidity but minimise credit risk.

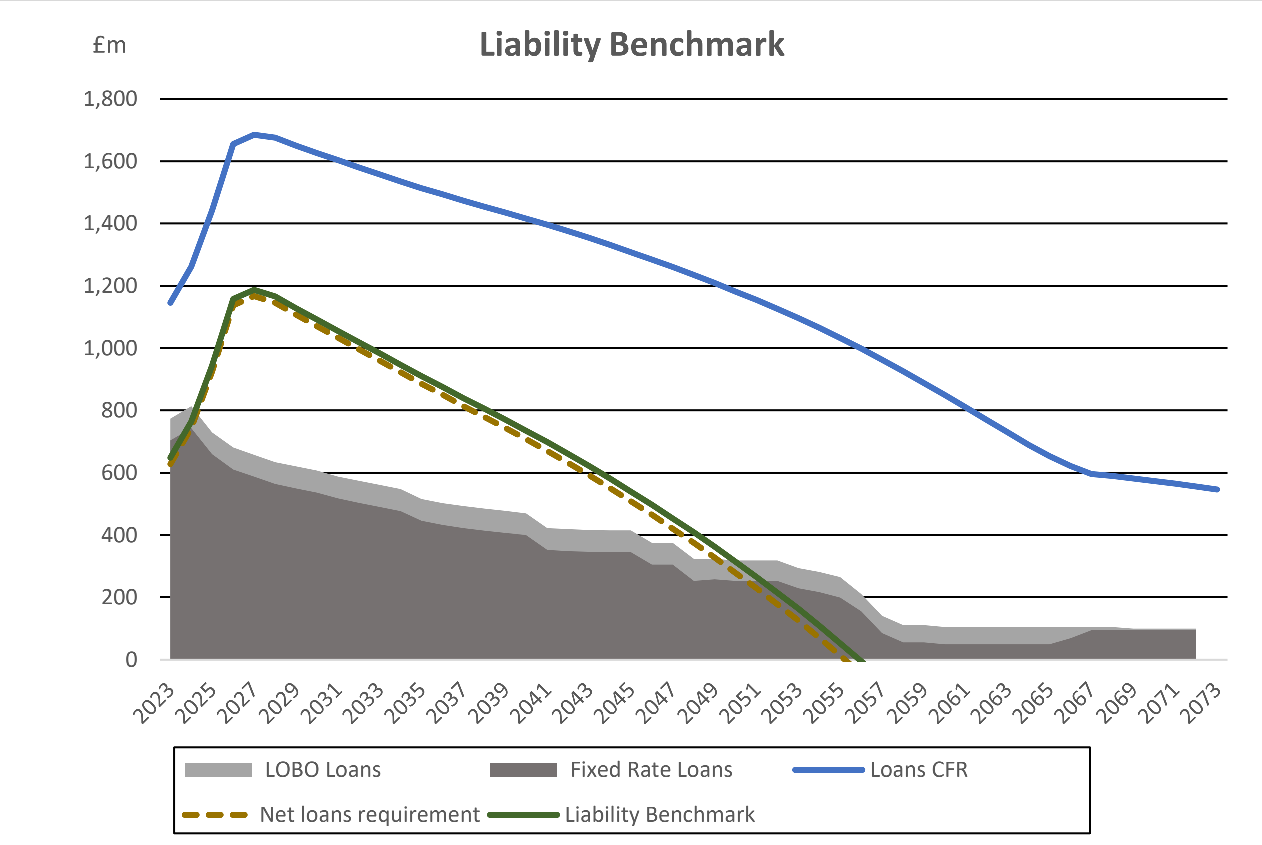
28.0 The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external 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 4: Prudential Indicator: Liability benchmark

	31/03/2023	**31/03/2024**	**31/03/2025**	**31/03/2026**	**31/03/2027**
	Actual	**Forecast**	**Forecast**	**Forecast**	**Forecast**
	£m	**£m**	**£m**	**£m**	**£m**
Loans CFR	1,182.3	1,294.4	1,517.0	1,725.8	1,752.7
(less) Balance Sheet Resources	(517.8)	(517.8)	(517.8)	(517.8)	(517.8)
Net loans requirement	**664.5**	**776.6**	**999.2**	**1,208.0**	**1,234.9**
Liquidity Allowance	20.0	20.0	20.0	20.0	20.0

Liability Benchmark	**684.5**	**796.6**	**1,019.2**	**1,228.0**	**1,254.9**

29.0 Following on from the medium-term forecasts in Table 4, the long-term liability benchmark assumes Minimum Revenue Provision (MRP) on new capital expenditure based on a 5–50-year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year. A higher asset life will be used where a professional opinion has been obtained. The chart below shows the profile of the Capital Financing Requirement (CFR) reducing by the MRP together with the maturity profile of the Council's existing borrowing.



30.0 The Loan CFR (Blue lines) represents the need to fund capital expenditure through borrowing. The Liability benchmark (Green Line) represents the level of borrowing requirement once reserves and working capital has been considered. Where the liability benchmark exceeds the Council's current borrowing levels (Grey area), this indicates the real need to borrow. The liability benchmark assumes LOBO loans will be held to maturity and the Lender not to exercise early repayment. In reality the Lender could exercise the call option for early repayment.

Borrowing Strategy

31.0 As of 31 December 2023, the Council holds £828.0m million of loans, an increase of £47.0m compared to balances held at the start of the financial year (£781.0m). The balance sheet forecast in Table 1 shows that the Council expects to borrow up to £558.4m by 2026/27, however, this is largely dependent on how the capital programme progresses. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £1.7 billion.

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

33.0 **Strategy:** Given the significant cuts to public expenditure and local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Interest rates have increased across the yield curve over the past year. The Council will continue to work closely with our Treasury advisors Arlingclose to ensure borrowing occurs at optimal points avoiding the worst of the market volatility. Short-term interest rates are currently at a 15-year high but are expected to fall in the coming years and it is therefore likely to be more cost effective over the medium-term to either use internal resources, or to borrow short-term loans instead. The Council's Borrowing Strategy is to maintain its debt portfolio Pool Rate within this range of 3-4%. As at 31st December 2023 the average Debt Pool Rate (excluding PFI) was 4.01%.

34.0 To ensure long term stability of the debt portfolio, a proportion of the portfolio will be funded by long term borrowing using a little and often approach. Where is affordable, this can help provide certainty to ensure the ongoing viability for capital programme schemes in these volatile markets.

35.0 **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)
- 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 including the Greater London Authority
- UK public and private sector pension funds (except the local Brent Pension Fund)
- Capital market bond investors
- Retail investors via a regulated peer-to-peer platform
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

36.0 **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
- Similar asset-based finance

37.0 **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 if 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 by the Corporate Director for Finance and Resources in consultation with the Lead Member for Finance.

38.0 The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-terms loans from other sources including banks, pensions and local authorities, and will review the appropriateness 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 not available to local authorities planning to buy investment assets primarily for yield. The Council has not undertaken such borrowing and has no plans to in future, which ensures continuing access to PWLB borrowing facilities.

39.0 In addition to the above, the Council may borrow short-term loans to cover temporary cash flow pressures from other Local Authorities or public sector bodies and banks.

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

41.0 **LOBOs:** The Council holds £70.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. None of the Council's LOBOs have option dates during 2024/25. Due to higher market rates, there is now an elevated risk that some existing LOBO's may require refinancing at higher rates or will require repaying upon future break dates. The Council will assess the financial implications of the best approach and either repay the LOBO loan using existing cash resources (where applicable) or raise new loans.

42.0 **Short-term and variable rate loans:** These loans leave the Council 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 77 below).

43.0 **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 Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. Current high interest rate environment gives rise to favourable rescheduling opportunities. Such opportunities will be kept under review by Officers. Any decision to undertake debt rescheduling will be the subject of a separate report by the Corporate Director for Finance and Resources in consultation with the Lead Member for Finance.

Treasury Investment Strategy

44.0 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the first half of 2023/24, the Council's treasury investment balance has ranged between £56.1m and £122.0m. When cash balances are high the Council will defer the decision to borrow for the capital programme until such time cash balances deplete. Cash balances are forecasted to reduce over time as the Council is a net borrower.

45.0 **Objectives:** The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing. The ESG Policy is discussed below.

46.0 **Strategy:** As demonstrated by the liability benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments such as Local Authority deposits or Money-Market Funds. Cash invested beyond the liquidity duration will be in accordance with the investment instruments set out in Table 5. However, it is anticipated that the Council will not have significant cash balances to invest into long durations. The Council will maintain a minimum investment balance of £10m to ensure the Council complies with the requirements to be a professional client under MIFID II regulations.

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

48.0 Currently, the majority of the Council's surplus cash remains invested in short-term money market funds. The average rate of interest received on short-term investments during the year to December 23 was 5.3% with an average duration of 1 day and an average weighted risk rating of A+. Due to the Council's borrowing requirement, there is unlikely to be scope to improve the short-term investment returns achieved as liquidity of the surplus funds will play a key role.

49.0 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

50.0 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in table 5, subject to the limits shown.

Table 5: Investment Limits

	Credit Quality	Cash limit	Time Limit
Any single organisation, except a Government entity	A- Or equivalent	£20m	n/a
UK Government	Any	Unlimited	50 years
Local Authorities & other government entities	Any	Unlimited	25 years
Banks (unsecured)*	A- Or equivalent	£20m	13 months
Building Societies (unsecured)*	A- Or equivalent	£20m	13 months
Registered providers and registered social landlords*	A- Or equivalent	£20m	5 years
Secured investments*	A- Or equivalent	£20m	5 years
Money market funds*	A- Or equivalent	Lower of 5% of total net assets of the fund or £20m	n/a
Strategic pooled funds*	A- Or equivalent	£20m	n/a
Real estate investment trusts*	A- Or equivalent	£20m	n/a
Other Investments*	A- Or equivalent	£50m	5 years

51.0 **Minimum Credit Rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose long-term credit rating is no lower than A-. The Council uses the lowest rating quoted by the main rating agencies, as recommended by CIPFA. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be considered. Within these criteria the Corporate Director for Finance and Resources will have discretion to accept or reject individual institutions as counterparties based on any information which may become available.

52.0 **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.

53.0 **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. There is no upper limit to the maximum credit loss that the Council could suffer in the event of a bail-in scenario. See section 61 below for arrangements relating to operational bank accounts. Investments in unsecured deposits will be limited to £20m.

54.0 **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. Investments with registered providers will be limited to £20m in 2024/25.

55.0 **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. The Council and its advisors remain alert for signs of credit or market distress that might adversely affect the Council. Investments in secured deposits will be limited to £20m.

56.0 **Money market funds (MMFs):** 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. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times. Deposits will not exceed 0.5% of the net asset value of the MMF. In addition, each Fund will be limited to a maximum deposit of £20m.

57.0 The investment strategy will provide flexibility to invest cash for longer periods in order to access higher investment returns. The upper limit for lending beyond a year is £50m. In practice, lending for more than one year will be only to institutions of the highest credit quality and at rates which justify the liquidity risk involved. Marketable instruments may have longer maturities, though the maturity will be considered in conjunction with the likely liquidity of the market and credit quality of the institution. Other than UK Central Government the Council may invest its surplus funds subject to a maximum duration of 25 years.

Alternative investment options will include:

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

Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly. Although considered as pooled funds, MMF's are discussed separately in section 56. The Council currently has no investments in Pooled Funds (other than MMFs) at present but may make prudent use of them in the future. Investments in pooled funds will be limited to £20m in 2024/25. A Statutory Override is in place until 31 March 2025 to mitigate the accounting valuation risk impacting on the Comprehensive Income & Expenditure Account. Once the Override expires any fair value gains/losses will need to be recognised in the Comprehensive Income & Expenditure Account thus impacting on the Councils reserve balances.

59.0 **Real estate investment trusts (REITs):** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. The risk with any investments in REITs is that shares cannot be withdrawn but can be sold on the stock market to another investor which leaves the Council open to market risk. Investments in REITs will be limited to £20m in 2024/25.

60.0 **Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Council's investment at risk.

61.0 **Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. The Council banks with National Westminster Bank (NatWest) who meet the Council's minimum credit criteria. Should Natwest's creditworthiness deteriorate below the Council's minimum credit criteria, then as far as is consistent with operational efficiency, no money will be placed with NatWest and credit balances in the various Council accounts will be kept to a minimum level.

62.0 **Unrated Counterparties**: 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 £200,000 per counterparty as part of a diversified pool e.g., via a peer-to-peer platform.

63.0 **Risk Assessment:** Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Any institution will be suspended or removed should any factors give rise to concern, and caution will be paramount in reaching any investment decision regardless of the counterparty or the circumstances. Should an entity's credit rating be downgraded so that it does not meet the Council's approved criteria then:

- No new investments will be made.
- Full consideration will be made to the recall or sale of existing investments with the affected counterparty.

64.0 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.

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

66.0 Having an appropriate lending list of counterparties, remains critically important to protecting Brent's cash investments. A list of extremely secure counterparties would be very small, and the limits with each would be correspondingly high. This would expose the Council to a risk of an unlikely but potentially large loss. This arises because the arrangements for dealing with banks in difficulty now require a loss to be imposed on various categories of liabilities of the banks to allow the bank to recapitalise itself and continue in business (sometimes referred to as bail in).

67.0 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2022; 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

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

69.0 **Investment limits:** The Council's revenue reserves available to cover investment losses are forecast to be £471.2 million on 31st March 2024. In order that no more than 10% 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 and Council subsidiaries) will be £20 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

Liquidity management: The Council uses internal purpose-built cash flow modelling tools to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast. The Council aims to spread its liquid cash over at least two 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

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

71.0 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Table 6: Credit risk indicator

Credit risk indicator	Target
Portfolio average credit rating	A

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

Table 7: Liquidity risk indicator

Liquidity risk indicator	Target
Total cash available within 3 months	£20m

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

Table 8: Interest rate risk indicator

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£5m
Upper limit on one-year revenue impact of a 1% fall in interest rates	£5m

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

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

Table 9: Refinancing rate risk indicator

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	40%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	60%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and within 40 years	75%	0%
Over 40 years	75%	0%

Time periods start on the first day of each financial year. LOBOs are classified as maturing on the next call date i.e., the earliest date that the lender can require repayment.

75.0 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Table 10: Price risk indicator

Price risk indicator	2023/24	2024/25	2025/26
Limit on principal invested beyond year end	£50m	£50m	£50m

Related Matters

76.0 The CIPFA Code requires the Council to include the following in its treasury management strategy.

77.0 **Financial Derivatives:** A Derivative is a contract between two or more parties to hedge against the risk associated with the performance of an underlying asset. Local authorities have previously made use of financial derivatives embedded into its loans and investments both to reduce interest rate risk and to reduce costs or increase income at the expense of greater risk.

78.0 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).

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

80.0 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

81.0 In line with the CIPFA Code, the Council will seek external advice and consult with Members before entering into financial derivatives to ensure that it fully understands the implications however there are no current plans to enter this type of arrangement. This will include analysis of the impact on interest rate, refinancing, counterparty, market, regulatory and legal risks, together with an assessment on the effectiveness of the derivative.

82.0 **Housing Revenue Account:** On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g., premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

83.0 **Markets in Financial Instruments Directive:** The MiFID II regulations took effect from January 2018 which saw the council reclassified as a retail client with the opportunity to opt up to professional client status. Retail clients have access to increased protection however this would be balanced against potentially higher fees and access to a more limited range of products. The Council has opted up to professional client status with its providers of financial services, including advisors, banks, brokers and fund managers. Given the size and range of the Council's treasury management activities, the Corporate Director for Finance and Resources believes this to be the appropriate status for the Council's treasury management activities.

84.0 **Financial Implications:** The draft capital financing budget of £25.0m for 2024/25 has been calculated based on the reduction in balances available for investment and the increased external borrowing required.

85.0 **Other Options Considered:** The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Council 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.

Table 11: Alternative Strategies

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 1 – Arlingclose Economic & Interest Rate Forecast – 19th December 2023

Economic Updates

- UK inflation and wage growth remain elevated but have eased over the past two months fuelling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.

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

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

- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.

- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.

- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant loosening in the future to boost activity.

- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium- term level for Bank Rate.

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

Interest Rate Updates

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

- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. We see rate cuts from Q3 2024 to a low of around 3% by mid-2026.

- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.

- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

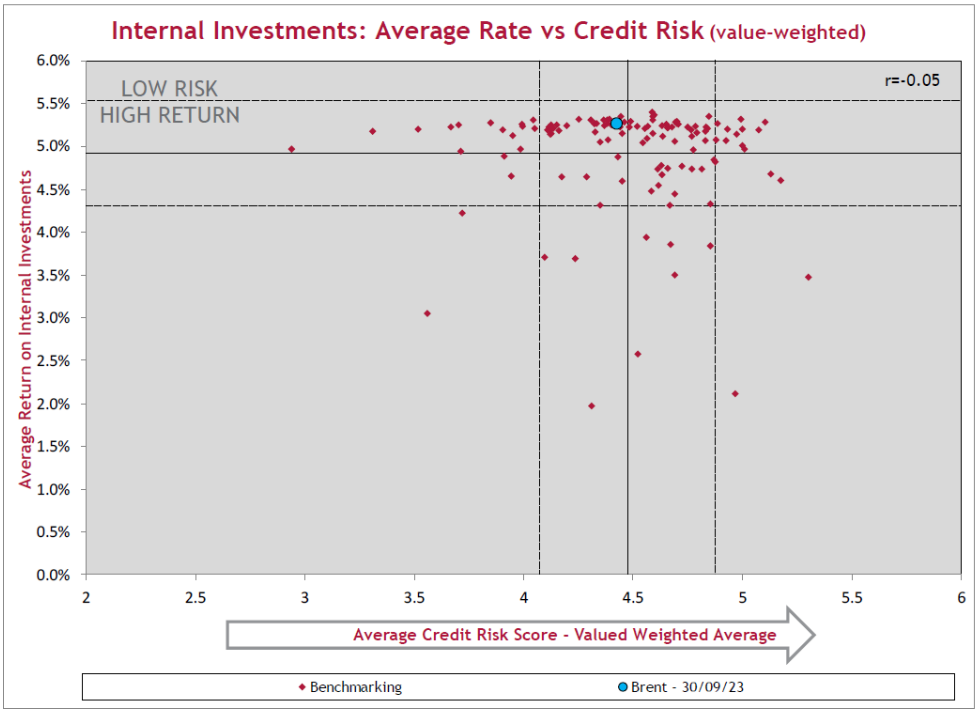
	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.40	5.40	5.40	5.30	5.15	4.80	4.30	4.10	3.80	3.50	3.25	3.05	3.05
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.77	3.75	3.75	3.75	3.70	3.60	3.50	3.50	3.40	3.30	3.30	3.30	3.35
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
10yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.72	3.75	3.80	3.80	3.80	3.80	3.80	3.80	3.75	3.65	3.60	3.65	3.70
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
20yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.16	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.25
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
50yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.76	3.80	3.85	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.95	3.95	3.95
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB HRA Rate (Maturity Loans) = Gilt yield + 0.40%
UKIB Rate (Maturity Loans) = Gilt yield + 0.40%

Appendix 2 – Existing Investment & Debt Portfolio Position

	31/12/2023 Actual Portfolio £m	31/12/2023 Average Rate %
Long-term borrowing		
Public Works Loan Board	592.5	4.0%
LOBO's	70.5	4.6%
Other loans	95.0	2.4%
Short-term borrowing		
Local Authorities	70.0	5.7%
Total External Borrowing	**828.0**	**4.0%**
Other long-term liabilities:		
Private Finance Initiative	26.9	-
Finance Leases	7.7	-
Total other long-term liabilities	**34.6**	
Total gross external debt	**862.6**	
Treasury investments:		
Banks & building societies (unsecured)	**-**	**-**
Government (incl. local authorities)	**50.5**	**5.27%**
Money Market Funds	**85.0**	**5.32%**
Total treasury investments	**135.5**	**5.30%**
Net debt	**727.1**	

Appendix 3 – Internal Investments: Average Rate vs Credit Risk



A credit rating of 4 is equivalent to credit score of AA-. The Council has a target rating of A which is a rating of 6. The current portfolio has a credit rating of A+ (Credit score 5) which exceeds our target rating.