Southampton City Council
TREASURY MANAGEMENT STRATEGY

2025/26

Contents

	SECTION 1 - INTRODUCTION
1.1	**BACKGROUND**
1.1.1	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.
1.1.2	Overall responsibility for treasury management (TM) remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's TM objectives. 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. Our current policy is shown in Annex 1 (Treasury Management Policy Statement).
1.1.3	Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.
1.2	**EXTERNAL CONTEXT**
1.2.1	Annex 2 summarises the economic outlook and events in the context of which the Council operated its treasury function during 2024/25 and forecast movement in interest rates.
1.2.2	To set the budget, it has been assumed that new investments for 2025/26 will be short-term and at an average rate of 3.88% and new long-term loans taken over the period of the strategy will be borrowed at an average rate of 5.00%.
1.3	**LOCAL CONTEXT**
1.3.1	On 31 December 2024 the Council held £381M of debt (£328M borrowing plus £53M other long-term liabilities) and £52M investments which is set out in further detail in Annex 3 (Existing Investment & Debt Portfolio Position and Projections).
1.3.2	The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), which is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. The CFR is reduced by the application of resources such as capital receipts, grants or revenue funds.
1.3.3	While usable reserves and working capital (balance sheet resources) are the underlying resources available for investment.
1.3.4	The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Table 1 shows that the Council has an increasing CFR due to the impact of the capital programme, a decreasing working balance surplus and funding up to £107M for Exceptional Financial Support (EFS) and will therefore need to borrow up to £431M over the forecast period. Annex 4 shows the projected movement on CFR between years.

1.3.5	Table 1: Balance Sheet Summary and Forecast

		31-Mar-24 Actual £M	31-Mar-25 Forecast £M	31-Mar-25 Forecast Movement in year £M	31-Mar-26 Forecast £M	31-Mar-27 Forecast £M	31-Mar-28 Forecast £M	31-Mar-29 Forecast £M
1	General Fund CFR	345.36	409.71	64.35	520.32	557.83	556.21	547.10
2	Housing CFR	182.05	205.65	23.60	248.71	267.93	286.30	301.27
3	**Total CFR**	**527.41**	**615.36**	**87.95**	**769.03**	**825.76**	**842.51**	**848.37**
4	Less Other Debt Liabilities*	(53.45)	(49.12)	4.33	(45.27)	(41.69)	(37.57)	(32.60)
5	**Loans CFR**	**473.96**	**566.24**	**92.28**	**723.76**	**784.07**	**804.94**	**815.77**
6	Less External Borrowing**	(312.60)	(308.00)	4.60	(293.00)	(280.00)	(267.00)	(254.00)
7	Internal (over) Borrowing	**161.36**	**258.24**	**96.88**	**430.76**	**504.07**	**537.94**	**561.77**
8	Balance sheet Resources	(186.69)	(173.50)	13.19	(174.02)	(178.77)	(178.77)	(178.77)
	Treasury Investments	35.86	48.00		48.00	48.00	48.00	48.00
9	**New Borrowing or (Investments)**	**10.53**	**132.74**	**110.07**	**304.74**	**373.30**	**407.17**	**431.00**

** Finance leases, PFI liabilities and transferred debt which form part of the Council's total debt*

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

1.3.6 Table 1 shows that the Council's CFR is rising over the next 3 years. This is due to investment in the capital programme, summarised below are the major projects expected to be undertaken:

- School SEND Expansion Programme
- Improving Outdoor Leisure Facilities
- Restoring the City's Heritage assets
- City Regeneration
- Energy Efficiency Investment in Homes (HRA)
- Improving Quality in Homes (HRA)

1.3.7 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 2025/26, as our committed borrowing (row 6) is significantly below our loans CFR (row 5).

1.4 **Liability Benchmark**

1.4.1 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £20M at each year-end to maintain sufficient liquidity but to further minimise credit risk.

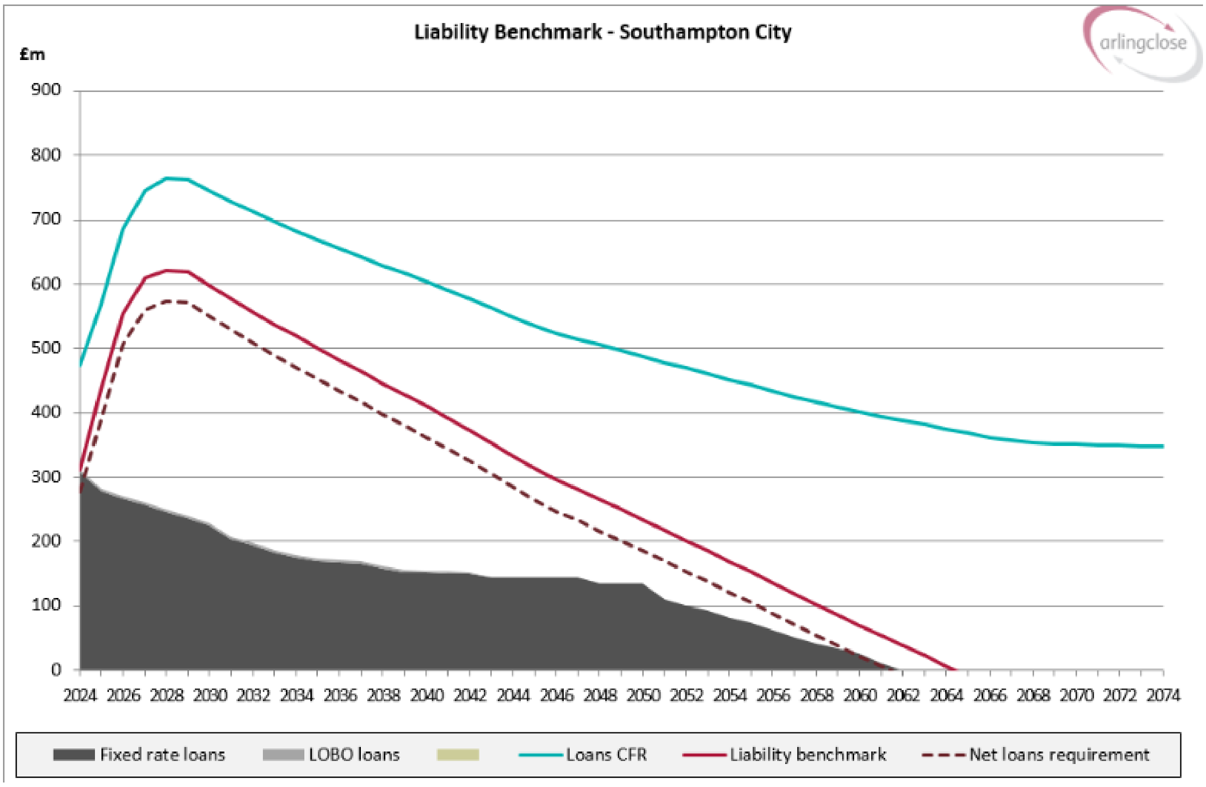
1.4.2 The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external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

	Table 2: Liability benchmark

	31/03/2024 Actual £M	31/03/2025 Forecast £M	31/03/2025 Forecast Movement £M	31/03/2026 Forecast £M	31/03/2027 Forecast £M	31/03/2028 Forecast £M	31/03/2029 Forecast £M
Loans CFR	**473.96**	**566.24**	**92.28**	**723.76**	**784.07**	**804.94**	**815.77**
Less Usable Reserves	(186.69)	(173.50)	13.19	(174.02)	(178.77)	(178.77)	(178.77)
Plus Minimum Investments	35.86	48.00	12.14	48.00	48.00	48.00	48.00
Liability Benchmark	**323.13**	**440.74**	**117.61**	**597.74**	**653.30**	**674.17**	**685.00**
Less Committed External Borrowing	(312.60)	(308.00)	4.60	(293.00)	(280.00)	(267.00)	(254.00)
Minimum Borrowing Need	**10.53**	**132.74**	**122.21**	**304.74**	**373.30**	**407.17**	**431.00**
Less HRA Borrowing Liability	(0.71)	(7.73)	(7.02)	(57.09)	(82.60)	(107.26)	(128.53)
GF Minimum Borrowing Need / (Investment)	**9.82**	**125.01**	**115.19**	**247.65**	**290.70**	**299.91**	**302.47**

1.4.3 Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes minimum revenue provision based on the life of the asset and income, expenditure and reserves all increasing by inflation. This is shown in the chart below together with the maturity profile of existing borrowing.

1.4.4 Chart 1 – Liability Benchmark



1.4.5 This demonstrates that even with lower investment balances that there is still an underlying need for the council to borrow during 2024/25 as our current committed debt at £308M will be below the benchmark of £441M.

	SECTION 2 - BORROWING STRATEGY
2.0	The Council currently holds £328M of loans, an increase of £15M since 31 March 2024, which was taken to partially fund the capital programme and replace maturing debt, this reflects the Council's policy of only borrowing when cash flows dictate or unless a particular good opportunity arises or to protect itself against an expected material increase in PWLB rates. The balance sheet forecast in Table 1 above shows that the total loans CFR is expected to increase by £92M in 2024/25 and by a further £157M in 2025/26 bringing the total loans CFR to £724M. As can be seen in table 2 committed borrowing at the end of 2024/25 is £308M, a reduction of £5M from the actual position at 31 March 2024, this reflects maturities in year of £31M and net new borrowing to date of £26M. If the forecast capital programme is achieved, reserves fall as predicted and £71M is required for EFS, then further borrowing of up to £133M will be required by 31 March 2025.
2.1	**Objectives**
2.1.1	The chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
2.2	**Strategy**
2.2.1	Given the significant cuts to public expenditure and to local government funding, the borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Short-term interest rates are currently higher than in the recent past but are expected to fall in the coming year and it is therefore likely to be more cost effective over the medium-term to either use internal resources, or to borrow short-term loans instead. The risks of this approach will be managed by keeping interest rate exposure within the limit set in the treasury management prudential indicators.
2.2.2	By doing so, the Council can reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist calculating the 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2025/26 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
2.2.3	If it was cost effective, additional sums could be borrowed to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.
2.2.4	Alternatively, forward starting loans could be taken, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost, without suffering a cost of carry in the intervening period. In addition, the Council may borrow further short-term loans to cover unexpected cash flow shortages.
2.3	**Sources of Borrowing**
2.3.1	The approved sources of long-term and short-term borrowing are: • HM Treasury's PWLB lending facility (formerly the Public Works Loan Board) • National Wealth Fund Ltd (formerly UK Infrastructure Bank Ltd) • any institution approved for investments (see below)

	• any other bank or building society authorised to operate in the UK • any other UK public sector body • UK public and private sector pension funds (except HCC 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
2.3.2	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 (PFI) • sale and leaseback
2.3.3	The Council has previously raised much of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield (except for refinancing of existing debt; including internal financing) the council intends to avoid this activity, and therefore retain its access to PWLB. Regeneration aims for investment remain acceptable, but all capital plans will be scrutinised by Government and will require the S151 officer to state they contain no 'invest for yield' proposals relying on borrowing.
2.3.4	**UK Municipal Bonds Agency plc (MBA)**
2.3.5	MBA 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. A report was considered by full Council on 10 February 2016. Any proposal to borrow from MBA will need a further report to Audit Committee and Full Council.
2.3.7	**Lender's Option Borrower's Option Loans (LOBOs)**
2.3.8	The Council holds £4M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council can either accept the new rate or repay the loan at no additional cost. The LOBOS have options during 2025/26 and with interest rates having risen recently, there is now a good chance that lenders will exercise their options. If so, the council will take the option to repay LOBO loans at no cost to do so to reduce refinancing risk.
2.4	**Short Term and Variable Rates**
2.4.1	Short term loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the TM indicators. Financial derivatives may be used to manage this interest rate risk,

	in line with the CIPFA code, external advice would be sought before entering into any agreement to ensure the implications are fully understood.
2.5	**Debt Rescheduling**
2.5.1	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. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.
	SECTION 3 – TREASURY INVESTMENT STRATEGY
3.0	The Council invests its money for three broad purposes: • because it has surplus cash from day-to-day activities (**treasury management investments**), • to support local public services by lending to or buying shares in other organisations (**service investments**), and • to earn investment income, as the main purpose (**commercial investments**). In the past 12 months, the treasury investment balance has ranged between £99M and £36M, and similar levels are expected to be maintained in the forthcoming year.
3.1	**Objectives**
3.1.1	The CIPFA Code requires funds to be invested prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. Whilst a return is sought, the aim of TM activity is not primarily commercial in nature, it reflects addressing the cashflow needs of the council and the need for prudence and risk minimisation with public cash holdings. The 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, however it should be noted that a lower rate is an acceptable offset for higher credit and less risk, for example a covered bond. The council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.
3.2	**Strategy**
3.2.1	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. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income but will be regularly reviewed. Most cash used for cash flow purposes is invested in money market funds, DMADF or with other Local Authorities.
3.3	**ESG Policy**
3.3.1	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 does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, priority will be given to 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.
3.4	**Business Model**
3.4.1	Under the new IFRS 9 standard, the accounting for certain investments depends on the "business model" for managing them. The aim is to achieve value from its internally managed treasury investments by collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
3.5	**Approved Counterparties**
3.5.1	The council may invest its surplus funds with any of the following counterparty types, subject to the cash limits (per counterparty) and time limits detailed below. The working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the S151 Officer.
3.5.2	Table 3: Approved Investment counterparties and Limits

Sector	Time limit Previous	Time limit New (capped)	Counterparty limit	Sector limit
The UK Government	50 years	3 years	Unlimited	n/a
Local authorities & other government entities	25 years	3 years	£10M	Unlimited
Secured investments *	25 years	3 years	£10M	Unlimited
Banks (unsecured) *	13 months	13 months	£5M	Unlimited
Building societies (unsecured) *	13 months	13 months	£5M	10%
Registered providers (unsecured) *	5 years	3 years	£10M	25%
Money market funds *	n/a	n/a	£10M & no more than 0.50% of any investment fund in total for non-government funds	Unlimited
Strategic pooled funds	n/a	n/a	£30M	50%
Real estate investment trusts	n/a	n/a	£20M	25%
Other investments *	5 years	3 years	£1M	5%

**This is the absolute limit, and the working limit will be monitored against actual cash flows and movement on reserves together with advice from TM advisors and adjusted each quarter as necessary by S151.*

Given the forecast need to borrow in 2025/26 the time limits have been updated to no longer than 3 years. Table 3 must be read in conjunction with the notes below.

3.6	**Investment Institutions**
3.6.1	**Minimum Credit Rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be considered. 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 £1M per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.
3.6.2	**UK Government:** Sterling-denominated investments with or explicitly guaranteed by the UK Government, including the Debt Management Account Deposit Facility, treasury bills and gilts. Deemed to be zero credit risk due to government's ability to create additional currency and may be made in unlimited amounts for up to 50 years.
3.6.3	**Local authorities and other government entities**: Loans to, and bonds and bills issued or guaranteed by, other 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.
3.6.4	**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, secured deposits 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.
3.6.5	**Banks and Building Societies (unsecured):** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts
3.6.6	**Registered Providers (unsecured):** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and 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.
3.6.7	**Money Market Funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the council diversifies its liquid investments over a variety of providers.

3.6.8	**Strategic Pooled Funds**: Bond, equity and property funds, including exchange traded funds, that offer enhanced returns over the longer term but are more volatile in the short term. These allow the 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 can be either withdrawn after a notice period or sold on an exchange, their performance and continued suitability in meeting the council's investment objectives will be monitored regularly. The council has been invested in the CCLA Local Authorities' Property Fund (CCLA LAPF) since 2014 (with tranches of investments made until 2017). The intention was to act as a long-term, patient investor, and seek a good level of income (particularly compared to cash prior to Bank Rate increasing during 2022 and 2023), while the capital value fluctuates over time depending on the value of the underlying assets. Considering the Council's changing circumstances, external environment and possible accounting treatment, the Council will actively consider opportunities to exit the investment, in an orderly manner, over time. Commercial property market values look to be at a relative low point and the Council, as a long-term investor, does not wish to sell at the bottom of a market cycle. Doing so would crystalise an overall capital loss on its investment, so disinvestment will not be undertaken immediately. It is felt that a sensible strategy will be to sell in tranches (up to £5m) into a rising market, in the medium-to-long term as the rates on which property prices are valued fall back and economic activity improves. The Fund has a minimum redemption period of 6 months and pricing performance is reported monthly and typically operates on a lag, meaning the final sale price is not known in advance. Exit opportunities therefore need to be considered in the wider context of fund, sector, market and economic movements and trends. The Council will continue to monitor changes and consider selling when it has observed a stabilised, improving position.
3.6.9	**Real estate investment trusts (REITS):** Shares in companies that invest mainly in real estate and pay most 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.
3.6.10	**Other investments**: This category covers treasury investments not listed above, for example unsecured corporate bonds and unsecured loans to companies and universities. Non-bank companies cannot be bailed-in but can become insolvent placing the investment at risk.
3.6.11	**Operational bank accounts**: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept to a minimum. 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.
3.6.12	Given the stresses placed on the council's budget, all forms of investment will be carefully monitored during the year. The S151 officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on core investment portfolio will be reported quarterly to Cabinet.

3.7	**<u>Risk Assessment and Credit Ratings</u>**
3.7.1	Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then: • no new investments will be made, • any existing investments that can be recalled or sold at no cost will be, and • full consideration will be given to the recall or sale of all other existing investments with the affected counterparty. Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") 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 review outcome 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.
3.8	**<u>Other Information on the Security of Investments</u>**
3.8.1	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 and reports in the quality financial press and analysis and advice from the council's TM 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.
3.9	**<u>Reputational aspects</u>**
3.9.1	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.
3.9.2	When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020 and 2022, this is not generally reflected in credit ratings but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest in, then surplus cash balances will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills, for example, or with other local authorities. This will reduce investment returns but will protect the principal sum.
3.10	**<u>Investment Limits</u>**
3.10.1	The revenue reserves and balances available to cover investment losses (excluding Schools, capital and HRA) are forecast to be £53M at 31st March 2025. In order that there is no immediate pressure on available reserves in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and specified investments, such as property funds) will be £10M. A group of banks under the same ownership will be treated as a single organisation. Limits, showing in Table 4 will also be placed on fund managers, investments in

	brokers' nominee accounts, foreign countries and industry sectors. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.
3.10.2	Table 4 –Investment Limits

	Cash limit
Any group of pooled funds under the same management	25% per manager unless under specific advice
Negotiable instruments held in broker's nominee account	£50M per broker
Foreign countries	£10M per country

3.11	**Liquidity Management**
3.11.1	The Council undertakes high level cash flow forecasting 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 being forced to borrow on unfavourable terms to meet 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 will spread its liquid cash over at least four providers (e.g. bank accounts and MMFs) of which at least two will be UK domiciled to ensure access to cash is maintained in the event of operational difficulties at any one provider.
	SECTION 4 - TREASURY MANAGEMENT PRUDENTIAL INDICATORS
4.0	The council measures and manages its exposure to risk with the following indicators.
4.1	**Background**
4.1.1	Typically, income (e.g. from taxes and grants) is received before it pays for its expenditure (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with CIPFA guidance.
4.1.2	During the financial year, investment balances have ranged between £36M and £99M and are currently £49M. Borrowing has ranged between £298M and £349M and is currently £328M.
4.2	**Security**
4.2.1	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. The average rating of our current portfolio is A+ which is above the target.

	Target
Portfolio average credit rating	A

4.3	**Liquidity**
4.3.1	The council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments and has set a £20M minimum threshold on cash available in instant access accounts, if balances

were to fall below this limit, we would consider taking short term loans which are available without given prior notice and at competitive rates.

4.4 **<u>Interest Rate Exposure</u>**

4.4.1 This indicator is set to control the exposure to interest rate risk. The upper limits are based on the one-year revenue impact of a 1% rise or fall in interest rates for existing variable rates on long term loans and assumed short term borrowing, offset by variable investments. The cost of an extra 1% per £1M is £10,000. We do not currently have any variable rate borrowing and any increase in short-term borrowing rates should be offset by an increase in short term investment income.

The liability benchmark (Table 2) has identified our borrowing need as, up to £410M by 2028/29 which could equate to an additional £12.71M in borrowing costs. The minimum borrowing need for 2025/26 has been used to set indicator limits below.

Interest rate risk indicator	**£M**
Upper limit on one-year revenue impact of a 1% **<u>rise</u>** in interest rates	3.1
Upper limit on one-year revenue impact of a 1% **<u>fall</u>** in interest rates	0.5

4.4.2 The main risk comes through the continued use of internal borrowing in place of fixed term long term debt for 2025/26. A 1% increase would equate to £10,000 for each £1M borrowed.

4.4.3 There is more exposure to an increase in interest rates than a reduction, as debt is higher than investments. A fall in interest rates of 1% would see investment income fall by about £0.48M but this would be offset by reduction in debt charges.

4.5 **<u>Maturity Structure of Borrowing</u>**

4.5.1 This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing as set below in Table 5.

4.5.2 <u>Table 5 – Refinancing rate risk indicator</u>

Period	**Lower Limit %**	**Upper Limit %**
Under 12 Months	0	50
12 months and within 24 months	0	50
24 months and within 5 years	0	50
5 years and within 10 years	0	55
10 years and within 20 years	0	60
20 years and within 30 years	0	65
30 years and above	0	75

CIPFA have recently recommended that the centre of the range is consistent with the liability benchmark. As shown in Table 5a the Council has complied with the indicator but will consider this recommendation when taking new debt.

4.5.3 Time periods start on the first day of each financial year and the maturity date of borrowing is the earliest date on which the lender can demand repayment. All LOBOs are now in their call options with a risk of being called so are shown as uncertain, but as they only represent 1% of the total debt portfolio an early call would not pose a material risk in refinancing.

4.5.4	Details of our current level of debt and maturity is shown in Table 5a below. This shows that all debt is within existing levels.
4.5.5	Table 5a – Current Debt

Analysis of Loans by Maturity	Lower Limit	Upper Limit	Compliance with Limit	Outstanding 31/12/2024 £M	% of Debt
Less than 1 Year	0	50	Yes	4.80	2
Between 1 and 2 years	0	50	Yes	13.00	4
Between 2 and 5 years	0	50	Yes	39.00	13
Between 5 and 10 years	0	55	Yes	72.50	23
Between 10 and 20 years	0	60	Yes	32.65	11
Between 20 and 40 years	0	60	Yes	144.85	47
Over 40	0	75	Yes	0.00	0
Uncertain Date**	0	5	Yes	4.00	1
				310.80	**100**

4.6	**Long-term treasury management investments**
4.6.1	The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury investments are shown below.
4.6.2	

	Current £M	2025/26 £M	2026/27 £M	2027/28 £M	2028/29 £M
Limit on principal invested beyond year end	30	30	30	30	30

4.6.3	Long-term investments with no fixed maturity date include strategic pooled funds and REITs but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.
	SECTION 5 - RELATED MATTERS
5.0	The CIPFA Code requires the TM strategy to include the following related matters.
5.1	**Monitoring, Reporting and Financial Implications**
5.1.1	The S151 Officer will report to Audit Committee TM activity / performance as follows: (a) Quarterly reporting of key prudential indicators as part of Budget Report monitoring. (b) A mid-year review against the strategy approved for the year (c) An outturn report on its treasury activity, no later than 30 September after the financial year end.
5.1.2	In addition, a quarterly update will be presented to Cabinet as part of Quarterly Revenue Financial Monitoring.
5.1.3	Investment income for 2025/26 is forecast at £2.06M based on an average portfolio of £47M at an average of 4.38%.

5.1.4	The forecast for borrowing costs in 2025/26 is £30.24M, of which £8.45M relates to the HRA. This is made up of interest on borrowing of £16.24M (based on an average debt portfolio of £436.28M at an average interest rate of 3.72% plus MRP and other costs of £10.46M. This is expected to rise to £40.76M (£11.78M HRA) by 2028/29 to accommodate the capital programme, utilisation of reserves, EFS financing and refinancing of borrowing. However, this will be subject to movement as the need for further borrowing becomes more certain. New long-term loans taken over the period of the strategy are budgeted at an average interest rate of 5.00%. based on our advisors' forecast.
5.1.5	Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then up to 50% of the revenue savings may be transferred to a treasury management reserve to cover the risk of capital losses or higher interest rates payable in future years.
5.2	**Policy on Use of Financial Derivatives**
5.2.1	Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes uncertainty over local authorities' use of standalone financial derivatives (i.e. those not embedded in a loan or investment).
5.2.2	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.
5.2.3	Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.
5.2.4	In line with the CIPFA code, the Council would seek and consider external advice before entering into any agreement to ensure implications are fully understood.
5.3	**Markets in Financial Instruments Directive**
5.3.1	The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the TM activities, the Chief Financial Officer believes this to be the most appropriate status.
5.4	**Housing Revenue Account Self-Financing and Limit on Indebtedness**

5.4.1	On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund (GF) and HRA pools. Since then, new long-term loans borrowed are assigned 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.
5.4.2	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. This balance will be measured, and interest transferred between the GF and HRA at an agreed rate. Housing Legislation does not allow impairment losses to be charged to the HRA and consequently any credit related losses on investments will be borne by the GF alone. It is therefore appropriate that the GF is compensated for bearing this risk, and all interest transferred to the HRA should be adjusted downwards. The rate used will be based on 6-month Gilt Rate. The rate of return on comparable investments with the government is lower and often referred to as the risk-free rate.
5.4.4	The HRA Business Plan supports several council strategies, including the Medium-Term Financial Strategy, to ensure plans are affordable and budgets are aligned to the assumptions detailed in those strategies. The specific HRA Business Plan can be seen in the report being submitted to Council on 26 February 2025.
5.4.5	The HRA by default will underwrite any programmes that are unable to self-fund.
5.5	**OTHER OPTIONS CONSIDERED**
5.5.1	The MHCLG Guidance and the CIPFA Code do not prescribe any TM strategy for local authorities to adopt. The S151 Officer, having consulted with relevant officers and members believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Alternative strategies, with their financial and risk management implications, are listed below.

5.5.2

Options	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 will 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 will 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 will 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 will be less certain