28th February 2024	ITEM: 23
Council	
Treasury Management Strategy 2024/25	
Wards and communities affected: All	**Key Decision:** Key
Report of: Cllr G Snell – Finance, Human Resources and Payroll	
Accountable Director: Steven Mair – Interim Chief Financial Officer/S151	
Accountable Assistant Director: Mike Jones - Interim Assistant Director for Strategic & Corporate Finance	
This report is public	
Version: Council	

Executive Summary

The Council is required to approve a Treasury Management Strategy before the start of each financial year. This is in accordance with the Chartered Institute of Public Accountancy Code of Practice on Treasury Management 2021.

The Council's Treasury Management Strategy sets out the parameters for the Council's planned treasury activity during 2024/25 under which the Treasury Team will manage activity. The strategy reflects the Council's proposed Capital Programme 2024/25 to 2028/29 as set out in a separate report on this agenda.

Commissioner Comment:

Commissioners support the recommendations as outlined in the report. The divestment programme will have a significant impact on borrowing requirements and final capitalisation requirements and will be closely monitored.

1. Recommendation(s)

That Council approve:

1.1. **the proposed Treasury Management Strategy for 2024/25**

1.2. **the proposed MRP Policy for 2024/25 as set out in Section 9**

1.3. **the proposed Borrowing Strategy as set out in Section 7**

That Council note:

1.4. **the requirement within the Prudential Code 2021 for quarterly reporting on the Council's Treasury Management activities. These reports will be presented quarterly during the year.**

2. Introduction and Background

2.1. This strategy sets out the treasury management activities for the financial year 1 April 2024 to 31 March 2025. The arrangements proposed in this strategy fully meet all statutory requirements, non-statutory guidance published by government and best practice as set out by the Chartered Institute of Public Finance and Accountancy (CIPFA). It is a requirement of CIPFA's Prudential Code that a strategy covering these areas is approved by Council prior to the start of the financial year and that Council should also approve any amendments to the original strategy. The previous version of this document was approved by Council on 1 March 2023 for the financial year 2023/24, this strategy updates the previous version in several areas, as well as providing greater clarity for Members on the scope of delegation, assumptions and risks surrounding the activities covered by this strategy.

2.2. The Treasury Management Strategies are key components in the way in which Thurrock Council manages its finances. They are costly areas of activity that are affected significantly by external factors such as interest rate changes, spending and income patterns (cash availability), and the wider economy. It is essential therefore that this area is carefully monitored, risks are recognised and managed, activity is controlled, and performance is reported to Members to ensure proper scrutiny and challenge. This strategy therefore sets out the parameters around which this will take place.

2.3. The Council's Treasury Management Strategy has been set in line with:

- The Local Government Act 2003
- The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended
- Statutory Guidance on Minimum Revenue Provision issued by MHCLG (now DLUHC) 2018 (fourth edition)
- Statutory Guidance on Local Government Investments issued by MHCLG (now DLUHC) 2018 (third edition)
- The Prudential Code issued by CIPFA 2021 Edition
- The Treasury Management Code of Practice issued by CIPFA 2021 Edition.

2.4. Changes to the Prudential and Treasury Management Codes and other Guidance include the following:

- The introduction of the Liability Benchmark as a treasury management indicator with material differences between the liability benchmark and actual loans being explained
- Long-term treasury investments, (including pooled funds), are likely to be classed as commercial investments
- Pooled funds are to be included in the indicator for principal sums maturing in years beyond the initial budget year
- Amendment to the knowledge and skills register for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority
- Reporting to members is to be done quarterly. Specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to Full Council and should be reported as part of the authority's integrated revenue, capital and balance sheet monitoring
- Environmental, Social and Governance (ESG) issues to be addressed within an authority's treasury management policies and practices TMPs.

2.5. The Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes:

a) Treasury management investments arises from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use.
b) Investments for service purposes (or service investments) are those taken or held primarily and directly for the delivery of public services (including housing, regeneration and local infrastructure) or in support of joint working with others to deliver such services. Service investments may or may not involve financial returns. Service investments will normally constitute capital expenditure under the 2003 Act. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".
c) Investments for commercial purposes represent those taken or held primarily for financial return and are not linked to treasury management activity or directly part of delivering services. Investments of this type will usually constitute capital expenditure under the 2003 Act. They are additional investments voluntarily taken primarily in order to generate net financial return or profit.

2.6. The main requirements within the 2021 edition of the Prudential Code relating to service and commercial investments include:

- Emphasising that borrowing for the primary purpose of debt-for-yield investment is not permissible under the Prudential Code.
- The inclusion of proportionality as an objective of the Prudential Code and requiring an assessment to ensure risks associated with service and commercial investments are proportionate to an authority's financial capacity – i.e. that plausible losses could be absorbed in existing budgets or usable reserves without unmanageable detriment to local services.
- It is not prudent for local authorities to make any investment or spending decision that will increase the Capital Financing Requirement (CFR), and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.
- An annual review should be conducted to evaluate whether commercial investments should be sold to release funds, as capital receipts to finance new capital expenditure or refinance maturing debt.
- A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream.
- Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

Government Intervention

2.7. The Council is in a precarious financial position, currently requiring unprecedented levels of support from government to enable a balanced budget to be set. One of the main reasons for this has been the investment in commercial activities (commonly known as 'debt for yield'), undertaken to generate a financial return (yield) and therefore support the finances of the Council. However, entering into these required the Council to increase its debt levels, mainly with short-term borrowing, to a level which was unsustainable and in excess of what would be considered manageable for a Council the size of Thurrock.

2.8. In increasing its debt for this purpose and financing from short-term arrangements, the Council did not recognise the additional risks around the necessity to refinance this debt more frequently, leaving the Council highly exposed to fluctuations in interest rates. This risk materialised during 2022/23 as rates rose significantly for the first time in a number of years, the Bank of England Base Rate increasing from 0.10% in December 2022 to 4.00% by the end of the 2022/23 financial year. At the time of preparing this strategy, 12-month interest rates through the Public Works Loans Board (PWLB) are around 5.5 to 6.0%. Due to the high levels of debt that needed refinancing, these rate rises impacted significantly on the cost of these loans to the Council. The Council, as part of the intervention measures applied by government, has agreed to reduce these debt levels and to consider how any remaining debt can be restructured in a more manageable way. Proposals for how this can be achieved are set out in this strategy.

2.9. As part of the intervention arrangements set out by government, in September 2022, Essex County Council were appointed to act as Commissioners to oversee the financial function of the Council. As part of their initial investigations, it was identified that the Council did not comply with the Prudential Code in two key areas:

- Debt for Yield activities
- Provisions for repayment of debt.

2.10. Taking each of these in turn:

a. **Debt for Yield activities** is the term used in the Code to describe investments made specifically for a financial return i.e. there is no service or treasury objective. The distinction between these activities and implications are discussed further in the Commercial Investments section of the strategy. The Council will therefore not be investing any further in these activities, except where there is a non-reversible contractual obligation to do so under an existing arrangement. Moreover, the Council has adopted a policy to disinvest from as many of these investments as possible, assumptions on the timing and value of these has been incorporated into this strategy.

b. **The provision for the repayment of debt** is an accounting adjustment required to comply with proper practice (CIPFA's Code of Practice on Local Authority Accounting) and is met from a charge to the Councils revenue accounts for the principal element of a loan arrangement over its term. This is known as the Minimum Revenue Provision (MRP) and is covered fully in Section 7 of the strategy. Prior to 2023/24, the Council had failed to make an MRP for debt incurred in making commercial investments, which is not permitted under the Statutory MRP Guidance issued by Department for Levelling Up, Housing and Communities (DLUHC). To ensure compliance, the Council will therefore ensure that an appropriate charge is made for all debt, regardless of its purpose, which will be backdated as though they had been made in the correct financial year. The Council will also make an appropriate charge for 2024/25 as set out in its MRP Policy as included in Section 9.

2.11. In addition to the issues highlighted above, the Council has also discovered non-compliance with the Prudential Code by borrowing to invest in areas that are not assessed as capital. Under the Code, the Council is only permitted to borrow for capital purposes and debt should not be incurred for these non-capital investments. It is the intention to disinvest these sums and repay the borrowing as soon as is practicable. Further detail on this is set out in Section 2.

2.12. While each of these issues has been contributory to the financial position the Council is now experiencing, it is essential that remedy is sought, which will include continued support from government in the form of Capitalisation Directions. These are mechanisms in which revenue expenditure can be financed from capital resources, not normally permitted. It should be noted that this support will impact the Councils debt position in the short to medium-term as it is expected that this support will be required for a number of years. The impact of these Capitalisation Directions has been included in this strategy.

2.13. To seek to address the issues outlined above, this strategy has been predicated on the following factors:

- The overall objective is to reduce debt and therefore the ongoing costs associated with it.
- The Council will seek to disinvest from its commercial investments and use sums received to reduce borrowing.

- The Council will undertake asset sales and use sums received to reduce borrowing further.
- The remaining debt will be restructured over time so as to be more manageable and to provide more certainty to the cost.
- The Council will fully comply with all statutory and non-statutory requirements covering the areas included in this strategy.

Treasury Management Policy Statement

2.14. In setting the Treasury Management Strategy, the Treasury Management Code recommends that the Treasury Management Strategy adopts the following to define the policies and objectives of its treasury management activities:

- The Council defines its treasury management activities as the management of the authority's borrowing, investments, and cash flows including its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.
- The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Authority and any financial instruments entered into manage these risks.
- The Council acknowledges that effective treasury management will provide support towards achievement of its business and service objectives. It is therefore committed to the principles of achieving best value for money in treasury management, and to employing suitable, comprehensive performance measurement techniques within the context of effective risk management

2.15. Appendix 1 sets out how the Council follows the key requirements of the Code.

2.16. The proposed Treasury Management arrangements are in accordance with both statutory requirements, non-statutory guidance published by Government and best practice as identified by CIPFA.

2.17. All decisions on overall Treasury Management (TM) policy and the setting of the annual Treasury Management Strategy are determined by Full Council. The same process will apply to any changes required to the relevant policy or strategy during a year. Thus, all matters relating to borrowing, investments and debt repayment are determined by Full Council. The Corporate Overview and Scrutiny Committee is responsible for scrutiny of performance in this area and the Cabinet is responsible for monitoring performance.

2.18. The major influencing factors for TM arrangements during 2024/25 are considered in Section 5 - Treasury Management.

2.19. The objective of this strategy is to establish a framework under which officers can carry out treasury activities. The control framework is established initially by what is permitted within the approved strategy, but further levels of control exist within the operational aspects of the activities. This means that just because something is permitted by the strategy, it does not

necessarily follow that the activity will take place. The Chief Finance Officer has the responsibility for this day-to-day decision making with the primary objective of always acting in the best interest of the Council's finances.

Revisions to the Strategy

2.20. The strategy has been prepared considering the statutory guidance and rules currently applicable. Any changes to these or to wider economic circumstances may require a revision to be made to the strategy.

2.21. A revised Treasury Management Strategy will be prepared and submitted to Full Council where the Chief Finance Officer considers that circumstances have changed sufficiently to require a variation to any of the provisions of this strategy.

3. Capital Expenditure

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

3.2. Table 1 below sets out the capital programme for the general fund and HRA for 2024/25 and the forecast period, following a major review of the capital programme during 2023/24. It should be noted that:

- while the programmes have been combined into a single table, the resourcing of the General Fund and HRA elements of the programme remain separate, thereby meeting the ring-fenced requirements of the HRA; and
- any debt costs resulting from loan financing by either fund is met by that respective fund.

3.3. The financial issues faced by the Council currently are largely General Fund and therefore it is the General Fund debt that needs to be managed, although it should be stressed that any HRA debt needs to also be affordable as these costs are met, in the main, from rental income.

Table 1 Capital spending and funding plans (Prudential indicator 1)

	2024/25 £m	2025/26 £m	2026/27 £m	2027/28 £m	2028/29 £m	Total Budget £m
Capital Expenditure:						
General Fund						
Adults & Childrens	18.892	10.700	3.200	3.200	3.200	39.192
Place	26.303	13.839	0.000	0.000	0.000	40.142
Public Realm	9.569	4.909	4.515	4.515	4.515	28.023
Corporate	1.349	1.233	1.933	2.355	1.605	8.475
Total General Fund	**56.113**	**30.681**	**9.648**	**10.070**	**9.320**	**115.832**
Housing HRA	39.760	18.419	58.810	43.675	14.405	175.069
Total Capital Expenditure	**95.873**	**49.100**	**68.458**	**53.745**	**23.725**	**290.901**
Capital Financing						
General Fund						
Capital receipts	(2.960)	(1.627)	(1.933)	(2.355)	(1.605)	(10.480)
Capital grants	(51.122)	(28.344)	(7.005)	(7.005)	(7.005)	(100.481)
Total General Fund	**(54.082)**	**(29.971)**	**(8.938)**	**(9.360)**	**(8.610)**	**(110.961)**
HRA						
Revenue Contributions	(15.394)	(5.469)	(14.881)	(10.001)	(11.478)	(57.223)
Capital receipts	(5.030)	(3.140)	(6.649)	(3.906)	(2.927)	(21.652)
Total HRA	**(20.424)**	**(8.609)**	**(21.530)**	**(13.907)**	**(14.405)**	**(78.875)**
Net Capital Financing need for the year	**21.367**	**10.520**	**37.990**	**30.478**	**0.710**	**101.065**
comprising:						
General Fund	2.031	0.710	0.710	0.710	0.710	4.871
HRA	19.336	9.810	37.280	29.768	0.000	96.194
Capitalisation Direction borrowing (Operational Expenditure less Funding)	**16.400**	**7.137**	**0.000**	**0.000**	**0.000**	**23.537**
Total Financing	**37.767**	**17.657**	**37.990**	**30.478**	**0.710**	**124.602**

3.4. Table 1 above shows the levels of Prudential Borrowing required to deliver the programme and this has been split for the General Fund and the HRA. This new borrowing will increase the Council's forecast debt, the implications of which are discussed in Section 4 – Debt Position.

3.5. Any new borrowing has two impacts on the revenue budget:

- the interest costs for any new debt will need to be met;
- as will the provision for repayment of debt (MRP).

3.6. The necessary costs for the above programme have been included in the revenue budgets for the relevant financial years and as such, the programme is fully financed.

3.7. It should be noted also that any future capital receipts that belong to the General Fund will be used for debt repayment, rather than to finance new capital expenditure, to assist with meeting the intervention objectives.

4. Commercial Investments

4.1. These investments include anything that would be categorised as 'debt for yield' under the revised regulations. Activity in this area is set out below.

4.2. The Council has previously made a number of commercial investments, in:

- investment assets for return
- loans to third parties
- shareholdings, and loans to limited companies and joint ventures.

4.3. Such investments may be treated as capital expenditure for prudential borrowing purposes even though they do not create physical assets in the Council's accounts, meeting the definition of capital expenditure as set out in Regulation 25 of the 2003 Regulations. A loan to a third party towards expenditure which would, if incurred by the authority, be capital expenditure, meets the definition of capital expenditure for the Council. Appropriate budgets in respect of these activities are agreed as part of the Council's budget setting and ongoing monitoring processes. The following table summarises this activity and the value held in the investment at 31/3/24:

4.4. **Table 2 Commercial investments**

Asset Class	Nominal value £m	Estimated carrying value £m
Specified investments Cash		
On call	20	20
Short-term notice	40	40
Total specified investments	**60**	**60**
Loans	**39**	**39**
Non-specified investments:		
Equity	31	13
Corporate Bonds	135	55
Total non-specified investments	**166**	**68**
Total	**265**	**167**

4.5. Following sales that took place during 2023/24, the table above shows that the Council currently has £60m held in specified investments (i.e. treasury cash investments) and £205m (£39m loans advanced to third parties and £166m invested in non-specified investments) invested in various commercial activities, all of which has been financed from borrowing and has therefore increased the borrowing requirement (CFR - see Section 4). A

portion of this investment was originally classified as capital and prudential borrowing was undertaken to invest. These investments (value of £125m in the table above) were subsequently found not to have met the requirement to be accounted for as capital and were therefore reclassified as revenue. This is contrary to the regulations and any sums will be recalled as soon as is practical to enable this borrowing to be repaid.

4.6. The Council continues to follow the policy of disposal and disinvestment from these arrangements at the earliest opportunity.

Limit on surplus funds held for more than 364 days (Prudential indicator 7)

4.7. In view of the Secretary of State's Direction, the Council will set the limit on surplus funds held for more than 364 days (i.e. non-specified investments) at £200m, reducing to £100m in 2027/28 in the expectation that the Council's investment divestment plan will be nearly complete by then.

5. Treasury Investments

5.1. This section of the strategy deals with investments made from a treasury perspective. These differ from those set out so far as these investments are not 'spending' but the investment of surplus cash balances to generate a return (yield). As such, the return on this investment is not the primary objective, unlike those undertaken for commercial reasons.

General objective and order of precedence

5.2. The general objective is to invest surplus funds prudently. Accordingly, priority is given to

1. Security – the relative safety of an investment,
2. Liquidity – the ease at which the investment can be converted back to cash and
3. Yield the financial return generated by the investment, in that order.

5.3. The highest rate of return is sought only after security and liquidity requirements are satisfied. This applies to both treasury and non-treasury investments.

Investment policy

5.4. The Authority's investment policy deals with investments in financial instruments held for treasury management purposes and is set with regard to the requirements of:

- DLUHC's Guidance on Local Government Investments ('DLUHC's Investment Guidance') (2018 edition), and
- CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes 2021 Edition ('the Treasury Management Code').
- CIPFA's Treasury Management Guidance Notes 2021

5.5. The Authority will aim to achieve the optimum return on its investments (yield) commensurate with the proper levels of security and liquidity and with regard to the Councils current risk appetite. In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs using high credit rated financial institutions, whilst investment rates remain elevated.

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

a. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings from the three main rating agencies, Standard & Poor's, Moody's and Fitch.

b. Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environment in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" (a financial arrangement that allows an investor to swap or offset their credit risk with that of another investor) and overlay that information on top of the credit ratings where applicable. This may mean that institutions fall out of, or can be added to, the approved counterparty list. Should this list need to be revised approval will be obtained from Chief Financial Officer. Building Societies will only be considered for inclusion if their assets are greater than £5bn in value.

c. This authority has defined the list of types of investment instruments that are authorised for use.

   - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity, if originally, they were classified as being non-specified investments solely due to the maturity period exceeding one year.
   - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration before being authorised for use.

d. Lending limits (amounts and maturity), for each counterparty will be as set out in the table below.

e. Transaction limits are set for each type of investment.

f. The Council will use specialist treasury consultants to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite in the context of the expected level of cash balances and need for liquidity throughout the year.

g. All investments will be denominated in sterling.

The Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year. The following table summarises the limits to be placed on treasury investments for this strategy:

Counterparty	Minimum Credit Rating*	Financial Limit per institution	Maximum maturity period	Change from limits in original 2023/24 TMS
Specified investments				
UK Government – Debt Management Office	N/A	Unlimited	Up to 1 year	Limit changed from £5m to unlimited
Local authorities	N/A	£10m	Up to 1 year	Limit increased from £5m to £10m
National Westminster Bank plc (the Council's bankers)	A	£40m	Overnight deposits	Unchanged
Fixed-term deposits with banks and building societies	A+	£10m	Up to 1 year	Limit increased from £5m to £10m
Overnight deposits with banks and building societies**	A+	£40m	Overnight deposits	Unchanged
Other Funds – CCLA Diversified Fund	N/A	N/A	N/A	Asset has been sold
Non-specified investments	No new investments (will not exceed current £279m balance)			Limit reduced from £1,047m to reflect Asset Divestment Plan

* Minimum credit rating refers to at least 2 ratings from Fitch, Moodys and Standard and Poors' rating services

** Building societies will also be considered if they have at least £5 billion in assets

5.7. Core cash and short-term (treasury) investments to be maintained at £40m. Treasury Management officers within the Corporate Finance Team will manage the cashflow levels through monitoring slippage within the capital programme and income through the Collection Fund. With the current debt reduction strategy, investing for longer periods is not an option for the Council as any surplus cash is only maintained for cashflow purposes. Any excess cash balances above what is required for cashflow purposes will be applied to reducing the Council's borrowing levels.

Creditworthiness Policy

5.8. As stated above, the primary principle governing the Council's investment criteria is the security of its investments followed by liquidity and yield.

5.9. After this main principle, the Council will ensure that:

- it maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the specified and non-specified investment sections below.
- it has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed.

5.10. The Chief Financial Officer will maintain a counterparty list in compliance with the above criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instruments

are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

5.11. Credit rating information is supplied by the Council's treasury advisors for all active counterparties that comply with the criteria. Any counterparty failing to meet the criteria will be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of the longer-term bias outside the central rating view) are provided almost immediately after they occur, and this information is considered before any investments are made. For instance, a negative Rating Watch being applied to a counterparty who is at the minimum criteria level would result in a suspension from use, with all others being reviewed in light of market conditions.

5.12. The Council considers the following relevant matters when proposing counterparties:

- the financial position and jurisdiction of the institution
- the market pricing of credit default swaps for the institution
- any implicit or explicit Government support for the institution
- Standard & Poor's, Moody's and Fitch short and long-term credit ratings.

5.13. When setting minimum sovereign debt ratings, Council will not set a minimum rating for the UK.

5.14. Changes to the credit rating will be monitored and, in the event that a counterparty is downgraded and no longer meets the minimum criteria specified, the following action will be taken immediately:

- no new investments will be made
- existing investments will be recalled if there are no penalties
- full consideration will be given to recall or sale of existing investments if this is possible.

Specified and Non-specified investments

5.15. The DLUHC's Guidance on Local Government Investments made under section 15(1) of the Local Government Act 2003, places restrictions on local authorities around the use of specified and non-specified investments.

5.16. **Specified investments** – A specified investment is defined as an investment which satisfies all of the conditions below:

- the investment and any associated cash flows are denominated in sterling
- the investment has a maximum maturity of one year
- the investment is not defined as capital expenditure
- the investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

5.17. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

- The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
- Supranational Bonds of less than one year's duration.
- A Local Authority, Housing Association, Parish Council or Community Council.
- Pooled investment vehicles (such as Money Market Funds) that have been awarded a high credit rating by a credit rating agency e.g., Standard and Poor's, Moody's and/or Fitch rating agencies.
- A body that is considered of a high credit quality (such as a bank or building society. This category covers bodies with a minimum Short-Term rating of A+ (or the equivalent) as rated by Standard and Poor's, Moody's and Fitch rating agencies.

5.18. In accordance with the Code, the Authority has set out additional criteria to limit the time and the amounts that can be invested in these bodies.

5.19. **Non-specified investments** – These are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration before being authorised for use. This strategy does not propose the use of non-specified treasury management investments for the period covered by this strategy.

5.20. For non-treasury investments, limits are based on the current holding of £205m. In line with the Secretary of State's Directions, the Council will continue to follow a strategy of divestment and not take on any further investment subject to any current contractual obligations.

Country of Domicile

5.21. Investments to be restricted to UK counterparties.

Schedule of investments

5.22. The criteria for providing a pool of high quality short, medium and long-term, cash-based investment counterparties along with the time and monetary limits for institutions on the Council's counterparty list are set out above.

Other considerations

5.23. To ensure sufficient liquidity, detailed cashflow forecasts will be kept to provide as accurate a picture as possible of the movement and timing of income and expenditure and the resulting daily cash balances.

5.24. When considering placing investments or temporary borrowing, officers will refer to the cashflow forecast to determine the best duration for the transaction.

6. Debt Position

6.1. All of the activities outlined in in Section 1 – Capital Expenditure and Section 2 – Commercial Investments of this strategy are capital in nature and to the extent that they are financed from borrowing, they create a requirement for the council to take on the associated debt.

6.2. At the initial stage, this is a requirement only, it does not necessarily follow that this will immediately be converted into actual debt. The council could choose, for example, to use existing cash balances to finance this spend until such point that the cash needed replenishing, at which point this would then require new debt, in the form of borrowing, to be taken on.

6.3. It is sometimes beneficial to take on new borrowing before the cash balances dictate that it is required. In order to adopt this approach to debt, it is necessary to have a mechanism to keep track of the debt requirement so that this can be matched to actual debt in the future. For the Council this mechanism is the capital financing requirement (CFR).

Capital Financing Requirement (CFR)

6.4. The CFR therefore represents current and historic unfinanced capital expenditure and sets a primary level of debt that, under normal circumstances, should not be exceeded. Any new debt requirement for the Council will result in the CFR being increased, it will be lowered by the application of MRP and any voluntary repayment of debt. It should be noted that MRP is not a requirement for the HRA, however it could choose to reduce its CFR with voluntary contributions to debt, known as a Voluntary Revenue Provision (VRP). The following table shows the current and projected level of CFR for the Council.

Table 3 Capital Financing Requirement forecast (Prudential Indicator 2)

	2023/24 Forecast £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m
CFR at 31 March						
General Fund	464	443	418	394	368	355
HRA	262	283	292	313	329	329
Capitalisation Direction	274	296	285	276	303	314
	1,000	**1,022**	**995**	**983**	**1,000**	**998**
Annual change						
General Fund	(544)	(21)	(25)	(24)	(26)	(13)
HRA	20	21	9	21	16	0
Capitalisation Direction	234	22	(11)	(9)	27	11
	(290)	**22**	**(27)**	**(12)**	**17**	**(2)**
Reason for change						
Net financing	34	23	10	22	17	1
Capitalisation Direction	235	69	59	51	43	25
Less repayment of debt from asset sale	(402)	(38)	(60)	(50)	(5)	0
Less MRP	(156)	(33)	(36)	(36)	(37)	(28)
	(289)	**21**	**(27)**	**(13)**	**18**	**(2)**

6.5. Table 3 above shows the split of the CFR between the General Fund, the HRA and the Capitalisation Direction (CD). As can be seen, the CD will initially increase the CFR before it begins to lower as a result of the repayment of debt from asset sales.

6.6. The other aspect of the CFR that needs to be noted is that any MRP which is applied to the debt will reduce the CFR alongside any debt repayment. Once any particular loan has been reduced to zero, either by its repayment in full, or by applying MRP until the balance is reduced to zero, MRP no longer needs to be made in respect of that loan. Therefore, as well as reducing the debt position, as required to comply with the intervention measures, there is a revenue advantage in the repayment of debt by applying capital receipts from asset sales, in the form of MRP reductions, which will be beneficial for the Council in the medium-term.

6.7. In order to properly assess the extent to which the Council is meeting the requirements set out by Government as part of the intervention measures it is necessary to consider the debt that relates to the General Fund and HRA separately. The issues facing the Council, as set out earlier in this strategy will affect just the General Fund, the HRA being a ring-fenced account that is, in the main, financed from council house rent payers and for this reason, there is a protection for the HRA from the types of expenditure that can charged to it. The commercial activities that are the main reason for the financial issues being faced, are therefore all part of the General Fund, as is the borrowing associated with them.

6.8. Table 4 below shows the movement in the borrowing by fund and compares the total to the overall CFR. This shows that General Fund borrowing is forecast to reduce from £1.3billion to £314million by March 2029. At the same time HRA borrowing is forecast to increase by £56m over the same period, which is to address constructional issues at the Blackshot and Teviot sites.

Table 4 Borrowing compared to the CFR (Prudential Indicators 4 and 5)

2022/23 Forecast £m		2023/24 Forecast £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m
1,293	General Fund	434	356	349	318	310	314
273	HRA	263	282	292	312	329	329
1,566	**Total Borrowing**	**697**	**638**	**641**	**630**	**639**	**643**
1,290	Capital Financing Requirement	1,000	1,022	995	983	1,000	998
(276)	**Under/(Over) borrowing**	**303**	**384**	**354**	**353**	**361**	**355**

6.9. The Table above also shows that the Council is under borrowed in comparison to the CFR. Because the CFR is a measure of the extent to which capital expenditure has been incurred but not yet fully financed, if external borrowing exceeds the CFR, then this would indicate that the Council is borrowing for a revenue purpose, which can occur on occasion.

6.10. The CFR figures depend on the accuracy of the balance sheet figures brought forward. As the last audited statement of accounts is 2019/20, the balances brought forward will probably change once audited, which will provide better assurance about the CFR calculation. Table 5 below shows that the Council's borrowing has exceeded the CFR in 13 out of the past 18 years. This is atypical and it indicates underlying issues in the way that the Council has accounted for capital expenditure in previous years.

Table 5 Borrowing compared to the CFR – historical position

Borrowing v CFR

	Long-term borrowing	Temporary borrowing	Capital Financing Requirement

Affordability

6.11. The objective of the affordability indicator is to ensure that the level of investment in capital assets proposed remains within sustainable limits and, in particular, highlight the impact of capital financing costs (i.e. MRP and interest) on the Council's "bottom line". The estimates of financing costs include current commitments and the proposals in the Council's budget report. Table 6 below sets out the expected ratio of capital financing costs to income for both General Fund and HRA activities:

Table 6 Ratio of capital financing costs to income (Prudential Indicator 4)

	2024/25 %	2025/26 %	2026/27 %	2027/28 %	2028/29 %
General Fund	32.99%	32.74%	32.57%	31.23%	24.53%
HRA	31.01%	30.50%	31.08%	31.06%	30.85%

6.12. By way of comparison, the ratio of capital financing charges for the General Fund and HRA at other unitary authorities tends to be around 5-7% and 25-33% respectively. Therefore, whilst the HRA ratio is roughly in line with other housing authorities, the General Fund ratio is considerably more and is a major pressure on the revenue budget.

Capital Receipts

6.13. A key assumption in the debt reduction strategy being followed is the continuing sale of assets in line with the Secretary of State's Direction to the Council, in particular the sale of the investment assets. As receipts are received from the disposal of assets they will be applied as follows:

- The cash received will repay borrowing; and

- ➢ The capital receipts will be applied to reduce the CFR in the year of receipt which in turn will reduce MRP in future years. Capital receipts will continue to be applied to those elements of the CFR which provide the greatest benefit to reduce MRP. In practice this means applying capital receipts to fund the Capitalisation Direction which has a comparatively short amortisation period of 20 years compared to the remainder of the capital programme which has a longer average residual asset life.

6.14. There is a degree of uncertainty over the quantum and timing of future capital receipts. Any slippage in the asset disposal programme will impact on both interest and MRP charges.

Borrowing in Advance of Need

6.15. Under the revised version of the Prudential Code, CIPFA has reinforced its definition of 'borrowing in advance of need'. This concept prohibits Councils from borrowing prior to cash being required and then invested purely to generate a financial return. There are exceptions which allow for this in circumstances such as:

- ➢ If it makes economic sense to convert internal borrowing to external borrowing to take advantage of preferential interest rates; or
- ➢ if cash is required for liquidity purposes to manage cash flows to meet current obligations such as creditor payments.

6.16. The 2021 Prudential Code clarifies that all 'debt for yield' activity is considered as borrowing in advance of need, as borrowing purely to undertake a commercial investment does not meet one of the exceptions above, nor does it meet any service objective.

6.17. The Council is under Direction from the Secretary of State to implement a strict reduction plan, which in turn means divesting of assets (both commercial investments and property) in order to bring debt down to an affordable and sustainable level. Continuing with the asset disposal strategy will mean that the Council is not borrowing in advance of need.

7. Borrowing Strategy

7.1. The Council's levels of borrowing and investments are calculated by reference to the current balance sheet and projected forward based on planned capital activity. The Council's key objectives when borrowing money are to balance interest costs with cost certainty over the period for which funds are required. A further objective is to provide sufficient flexibility to review the level and type of borrowing should the Council's long-term plans change.

7.2. Since 2011/12 the Council's borrowing strategy has been based on the use of temporary borrowing from other local authorities to fund both the capital programme and commercial investments. Until December 2021, this had provided the Council with the benefit of lower interest costs compared with those available through fixing borrowing through PWLB. However, since the beginning of 2022 interest rates have increasingly exposed the Council to significant fluctuations in interest costs. The Council has been unable to continue securing temporary borrowing from other local authorities since July 2022, as the wider financial issues at the Council became known in the sector. Consequently, the Council has replaced temporary borrowing with PWLB fixed term borrowing and this will be the main type of borrowing to be undertaken going forwards.

7.3. The increased levels of borrowing over the years and the associated high interest costs are not sustainable and affordable for the Council, along with the significant MRP charges, reiterating the importance of the debt reduction policy. Asset sales mainly through a divestment strategy will allow the Council to use capital receipts to repay borrowing and reduce interest costs and MRP charges.

7.4. Accordingly, the key factors influencing the 2024/25 strategy in respect of debt are:

- the need to reduce borrowing to a sustainable level,
- the current economic and market environment,
- MRP charges, and
- interest rate forecasts.

7.5. The Council is currently maintaining a fully borrowed position (including the Capitalisation Direction). This means that the capital borrowing need (the Capital Financing Requirement), has been fully funded with loan debt. Indeed Tables 4 and 5 in the previous section highlight that the Council's borrowing has historically exceeded the CFR and is forecast to do so in future. As stated, before external borrowing should not exceed the CFR on a permanent basis and this pattern indicates that there are underlying issues with the way in which capital expenditure has been accounted for in previous years.

7.6. Since September 2022 the Council has refinanced all temporary borrowing from other local authorities with PWLB borrowing for 12 months as it reaches maturity. This is a holding position that enables the Council to consider its borrowing needs further and to set a longer-term strategy. There is likely to be opportunity during the forecast period to replace this short-term PWLB borrowing with longer term borrowing, once there is more clarity about the timing of capital receipts, the debt that to be repaid from them and a longer term view about the prospects for long-term interest rates. The ultimate aim is to move towards a managed position which provides more certainty over interest costs but does not leave the Council in a position where it is incurring costs for debt that is not needed.

7.7. The Council has appointed Link Asset Management Services Ltd as treasury management advisors and part of the service is to assist the council to formulate a view on interest rates. Table 7 below gives the rates that have been included in this strategy which is based on their view as of November 2023.

Table 7 Forecast interest rates

	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34
Bank Rate	5.00%	3.25%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Temporary Loans	4.80%	4.00%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%
Investment Rate	4.50%	2.75%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Overdraft	5.50%	3.75%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
1 year PWLB	4.80%	4.00%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%
5 year PWLB	4.70%	3.80%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
10 year PWLB	4.70%	3.80%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
25 year PWLB	4.90%	4.20%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
50 year PWLB	4.70%	4.00%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%

7.8. The Bank of England Monetary Policy Committee (MPC) increased base rate from 5.0% to 5.25% on 3 August 2023 in response to help to bring inflation back to the 2% target sustainability in the medium term (2-3 years). It is widely expected that interest rates have peaked and will slowly begin to reduce back down, although this is forecast to take some time. This makes it critical that assets are disposed of promptly through the asset disposal programme. The application for capitalisation direction and exceptional support brings considerable uncertainty. To manage ongoing revenue budget pressures a capitalisation direction has been sought in 2022/23 and 2023/24 and will be required in subsequent years. This will create the need for some additional borrowing as the Council considers a path to financial sustainability.

Alternative Borrowing Options

7.9. Given that the Council is having to seek substantial exceptional support from central government in order to balance the budget lawfully, the Council has limited alternative borrowing options as it is not currently an attractive investment option for market lenders. Therefore, the primary source of borrowing will remain with PWLB for the foreseeable future.

Debt Reduction Strategy

7.10. In view of the unsustainably high level of borrowing highlighted in Tables 4 and 5 above and the Secretary of State's Direction to implement a "strict debt reduction plan", the strategy will be to use capital receipts for the asset disposal programme to repay borrowing. The loan debt portfolio at March 2024 is forecast to be £696m (both General Fund and HRA). Based on the average borrowing per head of population for unitary and London borough councils of £1,565 (at September 2023), this would indicate a target overall borrowing level of £276m should be aimed for. This degree of debt reduction is not possible given the value of the Council's asset base and will require Government assistance.

Limits on External Borrowing

7.11. The Prudential Code requires the Council to set two limits on its total external debt, as set out in Table 8 below.

Table 8 Overall borrowing limits (Prudential Indicators 3a and 3b)

	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m	2027/28 Forecast £m	2028/29 Estimate £m
Authorised Limit (Indicator 5a)	850	850	850	850	850
Operational Boundary (Indicaor 5b)	750	750	750	750	750
Gross projected debt	638	641	630	639	643

7.12. The limits are:

- **Authorised Limit for External Debt (Prudential Indicator 5a)** - The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. This is the limit prescribed by section 3(1) of the Local Government Act 2003 representing the maximum level of borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could

be afforded in the short term, but may not be sustainable in the longer term. The limit is based on the Operational Boundary plus a tolerance.

- **Operational Boundary (Prudential Indicator) -** This is the limit which external debt is not normally expected to exceed. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit. This has been set at the level of the CFR forecast plus a tolerance for a working capital (cash) requirement.

7.13. Limits reflect the inclusion of the projected Capitalisation Direction which is being sought annually from DLUHC. Following the approval of the pending Capitalisation Direction, the interim Chief Financial Officer reports that the Council will have complied with these prudential indicators in the current year and does not envisage significant difficulties for the future. This view takes into account and is based on current commitments, existing plans, and the proposals in this report.

Maturity Structure of Borrowing (Prudential Indicator)

7.14. Managing the maturity profile of debt is essential for reducing the Council's exposure to large, fixed rate sums falling due for refinancing within a short period, and thus potentially exposing the Council to additional cost. However, this is the approach the Council has adopted following the intervention since September 2022 as financial recovery plans are formed.

7.15. With limited access to inter authority loans and other money market borrowing, existing borrowing will be replaced with PWLB for a period no more than 12 months as it comes up to maturity in 2024/25. The Secretary of State's Direction requires that the Council implements action plans to ensure that its capital, investment and treasury management strategies are sustainable, affordable and debt is strictly reduced. Borrowing from the PWLB debt for no more than 12 months ensures that there is no build-up of cash balances unnecessarily and minimises the Council's exposure to high borrowing rates and should ensure that repayments will be manageable over the medium-term.

7.16. With uncertainty over rates, reliance on PWLB and a degree of uncertainty over the exact timing of debt repayment, the Council will need to retain a degree of flexibility in respect of its maturity structure and it is expected that this can be further refined over time. Table 9 below sets out current upper and lower limits for debt, which are deemed necessary for the above approach to be followed. This indicator is set to control the authority's exposure to refinancing risk. The principal repayment profile for current council borrowing remains within these limits.

Table 9 Debt maturity profile limits (Prudential Indicator 8)

Refinancing Risk Indicator	Upper Limit	Lower Limit
Under 12 Months	100%	0%
12 Months and Within 24 Months	50%	0%
24 Months and Within 5 Years	50%	0%
5 Years and Within 10 Years	50%	0%
10 Years and Within 40 Years	50%	0%
Over 40 Years	50%	0%

7.17. Table 10 below sets out the upper limits for the Council's exposure to interest rates that are either fixed or variable rate. In general, the Council will only use fixed rates for borrowing, so as to provide some certainty over interest costs. Some debt, such as LOBOs, does carry a variable rate, although all new borrowing through PWLB is highly likely to be fixed. Treasury investments through Bank Deposits or Money Market Funds are generally exposed to variable rates, with most fixed-term investments subject to an agreed rate.

Table 10 Interest rate exposures

	2023/24 Upper Limit	2024/25 Upper Limit
Limit on Fixed Interest Rates (Based on Net Debt)	100%	100%
Limit on Variable Interest Rates (Based on Net Debt)	60%	50%

7.18. The current Bank of England base rate stands at 5.25% It is expected that rates will start to fall during 2024/25, although this is largely based on whether inflation continues to move back towards the 2% target rate. For inter-authority borrowing, current rates are lower than the PWLB 12-month rate. With the Council having limited access to this option, a review of PWLB rates shows that there is very little difference between short-term and long-term PWLB rates, so there is no immediate advantage in converting any short-term debt into longer term loans.

7.19. The Council will therefore continue to refinance any debt requirements with short-term PWLB loans during 2024/25 until such time as there is greater clarity over the movement of rates.

Debt Rescheduling

7.20. There may be opportunities to generate savings by debt restructuring. However, these savings will need to be considered in the light of the current treasury position and the cost of early debt repayment, which usually incur significant penalties.

7.21. The reasons for any rescheduling to take place will include:

- generating cash savings and/or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhancing the balance of the portfolio by amending the maturity profile and/or the balance of volatility.

7.22. The Council has £29 million of loans which are LOBO loans (Lender Option Borrower 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. All of these loans, excluding one with Barclays, could now be amended at the request of the lender only and therefore retains an element of refinancing risk.

7.23. Rescheduling of current borrowing in the debt portfolio is unlikely to occur as there is still a large difference between premature redemption rates and new borrowing rates. In addition,

a high proportion of the debt is already on a short-term basis and will therefore need to be refinanced on a regular basis.

7.24. Should it make economic sense to proceed with a debt rescheduling opportunity it will be reported to Cabinet and Full Council as part of the regular treasury monitoring reports.

HRA Borrowing

7.25. On 1 April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. New long-term loans will be assigned in their entirety to one pool or the other, reflecting the need (CFR) of each fund as link to their capital plans. Interest payable and other costs and income arising from long-term loans will be charged or credited to the respective revenue account. These charges will be made at the annualised average rates assigned to either borrowing or investments.

7.26. The Council, through the HRA, continues to undertake new housing related schemes utilising borrowing. The abolition of the cap on housing debt has increased the funding flexibility available to the HRA to deliver its investment in both existing housing stock and new housing schemes, although any new borrowing plans for the HRA clearly need to remain affordable and sustainable and are governed by the Secretary of Direction to reduce borrowing.

8. Risk Management

Commercial Risks

8.1. The Council's non-specified investment portfolio (i.e. investments in commercial ventures such as the bond issues for solar and wind farms and for the credit funds) are subject to the same risk criteria as for specified investment under the Statutory Guidance on Local Government Investments issued by MHCLG in 2018, namely, security, liquidity and yield in that order. There was limited attention given to assessment of security and liquidity before making the investments and the sole focus would appear to have been on yield.

8.2. Because the Council fully borrowed to fund the investment portfolio, this exposed it to the following risks:

- Interest Rate risk because the Council financed the borrowing from short-term borrowing, this exposed it to any volatility in interest rates;
- Yield risk because by borrowing to finance the investments the strategy imposed a hurdle rate which had to be exceeded before the investments would yield a positive rate of return. The hurdle rate is the cost of finance and comprises the MRP and interest on the borrowing incurred. Given that interest rates are currently around 5% plus the 1% penalty rate and MRP is 5% on the Capitalisation Direction, the hurdle rate for making a positive return is 11% currently. None of the investments made have generated that level of return;
- Security risk in that no thought was given to the risk of loss in terms of the initial capital invested;
- Regulatory risk through excluding the expenditure on the commercial investments from the requirement to charge MRP contrary to statutory requirements.

Consequently, the Council is not only required to correct this going forwards, but also make a provision for past years in which it did not do so. This is an additional financial cost, which has also impacted on the assumed income from the investments;

- ➢ Regulatory risk from borrowing for some investments which were revenue investments. As stated previously, the Council cannot, without the express permission of Government, use borrowing to undertake anything other than capital expenditure and was therefore in breach of statutory requirements.

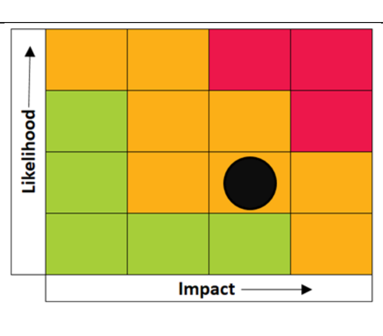
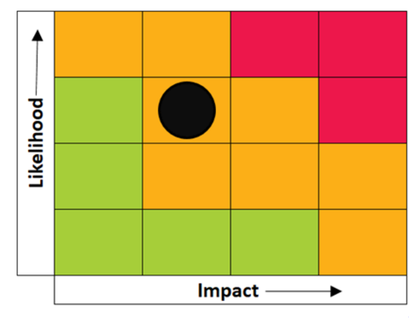
8.3. At this stage, given that a number of risks have materialised, and the Council is now pursuing a policy of disinvestment and debt reduction, it would not be helpful to assess the risks related to commercial activities specifically. The remainder of this section will therefore focus on the risks in respect of the Council's capital service expenditure and treasury activities.

Treasury Risks

8.4. The following are the main risks associated with these activities as well as the mitigations that have been put in place to minimise the likelihood and impact of these. The tables also include a heat map to demonstrate the assessment of these risks in respect of their likelihood and impact.

Financial Risks

Risk	Control Measure(s)
Security of investment: that a third party will fail to meet its repayment obligation.	Compliance with Investment Strategy, which defines approved investment counterparties and the arrangements for monitoring counterparty risk. The highest priority is given to security over liquidity and yield (see below). Credit rating and other counterparty information is constantly updated by advisers.
Liquidity: that cash will not be available when needed.	Priority is given to liquidity requirements over yield (see below). The Council has ready access to money markets to borrow funds when required, and to the Public Works Loan Board as lender of last resort. Investments normally include a proportion of funds at "call" (repayment on demand). Observance of limits set by the council as part of its Prudential Indicators.

	
Yield (interest rate): that volatility in interest rates will adversely affect the potential return on investments and/or cost of borrowing. The scope is dependent on adverse movements in market interest rates, which are outside the influence of the council.	Subject first to satisfying the requirements of security and liquidity (above), the council can access competitive markets for investment of funds and for short term borrowing. Access to TM advisors. Observance of limits set by the council as part of its Prudential and other TM Indicators. 

Compliance Risks

Risk	Control Measure(s)
Legal and regulatory: that the council or a third party fails to act in accordance with its legal powers or contractual obligation	The Council's TM practices are designed to comply with both its statutory duties and its own self-regulation through TM policies, strategies and the financial limits it sets for itself. These are reviewed as necessary to reflect any changes in law or best practice.
Fraud, error and corruption	As required by the Treasury Management Code of Practice, policy and strategies are determined by Full Council and scrutinised regularly by the Corporate Overview and Scrutiny Committee. Compliance with approved Treasury Management and Investment Strategies. The Chief Finance Officer has defined Treasury Management Practices (TMP) relating to design and operation of procedures to ensure as far as possible that any circumstances that may expose that council to such risks are identified and managed. A specific TMP deals with risk management and follows the advice in the Code. The training of management and staff involved in TM decisions and their implementation is kept under regular review.

Interest Rate Risk

8.5. This is a key risk facing the Council for the coming financial year and over the forecast period. While changes in interest rates have been built into the budgets for the next few years, the implication of setting these too low could be significant to the costs incurred.

8.6. Rates have been historically low for a number of years but rose significantly during 2022/23 as the economy has suffered from the effects of global events impacting global energy prices and inflation.

8.7. While it is expected that rates reduce over the next few years, the timing and scale of these changes are difficult to predict with any certainty. Table 6 sets out the interest rates currently assumed in the budget. It should be noted that these rates are predicting the level at the mid-year point, which is also the point in time when new borrowing cost is factored into the budget and forecast for the financial year in question.

8.8. Table 10 below shows the impact that interest rate rises of 0.5% and 1% in excess of those already budgeted for would have on the General Fund and HRA.
It should be noted that the figures relate to costs of new borrowing, or borrowing that will require refinancing, not existing long-term fixed-rate debt.

Table 11 Interest rate sensitivity

	2024/25 £000s	2025/26 £000s	2026/27 £000s	2027/28 £000s	2028/29 £000s	Total £000s
General Fund						
Base interest	12,946	10,479	11,571	10,830	10,773	
0.5% increase	1,696	1,470	1,503	1,405	1,399	**7,473**
1.0% increase	3,392	2,940	3,005	2,810	2,798	**14,945**
HRA						
Base interest	10,419	10,219	10,799	11,517	11,825	
0.5% increase	1,365	1,434	1,402	1,494	1,536	**7,231**
1.0% increase	2,730	2,867	2,805	2,989	3,071	**14,461**

8.9. This risk will therefore be monitored during the year and responded to, should adverse movement in interest rates begin to materialise.

9. Minimum Revenue Provision

Introduction

9.1. Following the intervention on 02 September 2022, there are certain actions to be taken by the Council, including the need to review its minimum revenue provision (MRP) policy to ensure prudent provision is made in accordance with the associated statutory requirements and guidance and to implement a debt reduction policy.,

9.2. The purpose of this section is to set out how the Council intends to discharge this duty in 2023/24.

Background

9.3. Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ('the 2003 Regulations') requires local authorities to 'charge to a revenue account a minimum revenue provision (MRP) for that year'. The minimum revenue provision is an annual amount set aside from the General Fund to meet the cost of capital

expenditure that has not been financed from available resources, namely: grants, developer contributions (e.g. s.106 and community infrastructure levy) revenue contributions, earmarked reserves or capital receipts.

9.4. MRP is sometimes referred to as the mechanism for setting aside monies to repay external borrowing. In fact, the requirement for MRP set aside applies even if the capital expenditure is being financed from the Council's own cash resources and no new external borrowing or other credit arrangement has been entered into.

9.5. Regulation 28 of the 2003 Regulations requires full Council to approve a Minimum Revenue Provision (MRP) Statement setting out the policy for making MRP and the amount of MRP to be calculated which the Council considers to be prudent. This statement is designed to meet that requirement.

9.6. In setting a prudent level of MRP local authorities must "have regard" to guidance issued from time to time by the Secretary of State for Housing, Communities and Local Government. The latest version of this guidance (version four) was issued by Ministry of Housing, Communities and Local Government (MHCLG) in February 2018.

9.7. The Department for Levelling Up, Housing and Communities (DLUHC) published a consultation on changes to the Capital Finance Regulations and the Statutory MRP Guidance in December 2023. A summary of the proposed changes is set out below. The changes being consulted upon will take effect from 1 April 2024. Consequently the MRP Policy Statement for 2024/25 must have regard to the proposed changes as well as the extant legislation and MRP Guidance.

9.8. In setting a level which the Council considers to be prudent, the Guidance states that the broad aim is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits to the Council.

Options for Making Minimum Revenue Provision for the Repayment of Debt

9.9. The Guidance sets out four “possible” options for calculating MRP, as set out below,

Option	Calculation method	Applies to
Option 1 – regulatory method	Applying the statutory formula set out in the 2003 Regulations (as amended) before it was revoked by the 2008 Regulations.	Only available for capital expenditure incurred before **1 April 2008** and government supported capital expenditure incurred after this date.
Option 2 – CFR method	Multiplying the CFR at the end of the preceding financial year by 4%.	Also only available for capital expenditure incurred before **1 April 2008** and government supported capital expenditure incurred after this date.
Option 3 – asset life method	Amortising expenditure over an estimated useful life for the relevant assets created using either the equal instalment or annuity method.	Available for any capital expenditure but must be used for capital expenditure incurred on or after **1 April 2008** that does not form part of the Authority’s government supported capital expenditure.
Option 4 – depreciation method	Making charges to revenue based on proper practices for depreciation as they apply to the relevant assets.	Also available for any capital expenditure but must be used for capital expenditure incurred on or after **1 April 2008** that does not form part of the Authority’s government supported capital expenditure.

9.10. As noted in the preceding table, revenue provision under Option 3 can be calculated in one of two ways – equal instalments or annuity method. The equal instalments method produces a profile of MRP charges of an equal amount in each year. The annuity method produces a profile of annual MRP charges that starts low but which increases in each successive year. Caution must be exercised in applying the annuity method, which is more commonly used as a method of establishing loan repayments. The statutory guidance on MRP indicates that this method may be appropriate where benefits are expected to increase in later years. It can be argued that the annuity method takes account of the time value of money.

9.11. The Guidance also includes specific recommendations for setting MRP in respect of revenue expenditure which is statutorily defined as capital expenditure under Regulation 25(1) of the 2003 Regulations (REFCUS). MRP must be calculated in accordance with Option 3 (as set out in the previous table). The maximum periods to be applied for amortising revenue expenditure defined by Regulation as capital expenditure are as set out in the table below:

Expenditure Type	MRP maximum amortisation period
Direction under s.16(2)(b) Revenue expenditure capitalised under Direction from the Secretary of State	20 years
Regulation 25 (1) (b) Loans or grants to third parties for capital purposes	Life of assets being financed by loan
Regulation 25 (1) (d) Purchase of shares in limited companies	20 years

<u>DLUHC consultation</u>

9.12. DLUHC published a consultation on changes to the Capital Finance Regulations and Statutory Guidance in respect of MRP in December 2023. This follows two earlier consultations in November 2021 and February 2022. The aim of the changes proposed is to strengthen the requirement for local authorities to make a prudent MRP provision, in response to two issues which have led to underpayment of MRP at a number of authorities including Thurrock:

(a) excluding a proportion of debt from the MRP determination in two areas:

(i) firstly, debt associated with investment properties or investments defined as capital expenditure, on the basis that such assets retain their capital value and that the asset can be sold at any time in the future to repay the associated debt. The Government have stated that this is not prudent. The proposals will amend the 2003 Capital Finance Regulations to make clear that MRP is required on such expenditure;

(ii) secondly, debt associated with making loan advances to third parties for a capital purpose. The argument put forward by authorities exempting such debt from MRP calculations is that the repayments of principal would be used to repay debt. This was an argument used by the Council in previous years' MRP Statements, but never actually was applied in practice. The proposed changes will require local authorities to continue to set aside MRP on "commercial loans" (defined as a loan undertaken for profit), but allows local authorities an exemption from charging MRP for non-commercial loans, but will require local authorities to set aside as MRP an amount for any expected credit loss calculated under IFRS9. In other words, for non-commercial loans as soon as there is evidence that the debtor might be unable to repay all or some of the loan, the authority would be required to set aside the full amount of the estimated loss.

(b) using capital receipts in place of charging MRP to revenue. Authorities following this approach would use capital receipts to pay for the amount of MRP due for the individual financial year. This practice effectively treated capital receipts as a revenue source, which is not permissible under Regulation 23 of the Capital Finance Regulations. The proposed changes to the Capital Finance Regulations make clear that capital receipts can only be used to reduce the overall level of the CFR, which in turn forms the basis for calculating the MRP charge, based on the residual CFR after the application of capital receipts.

9.13. In addition, paragraph 46 of the draft MRP Guidance states that for local authorities where the Government has made arrangements to intervene and has, or is in the process of, put in place financial support arrangement for the authority, that it may be appropriate to reflect the nature of any such financial support when determining a prudent level of MRP for the forthcoming financial year. The draft Guidance goes onto state that the authority must seek agreement from the Government on how any such assumptions with respect to support are reflected in the determination of MRP. The draft Guidance goes onto explain that paragraph 46 is not a new policy but clarifies an issue that previous editions of the Guidance was silent on. As such, the Government expects this to apply to prior periods (or MRP from prior periods).

Revised MRP Policy for 2024-25

9.14. In previous years, the Council has not applied MRP to its capital investments, on the basis that investments will generate future capital receipts and loan repayments that will be applied to repay borrowing. However, this has been reassessed and is inconsistent with current statutory guidance, which states that no categories of debt should be excluded from the requirement to make MRP.

9.15. The policy below has been updated to ensure compliance with statutory guidance. Notwithstanding that the MRP policies which the Council had approved in previous years did not follow the statutory MRP Guidance, legal advice obtained confirms that the MRP policies in those years were properly approved in line with the Council’s decision-making processes and thus lawfully set. Accordingly to bring the MRP Policy in line with the MRP Guidance, the changes will be affected from 1 April 2023. This means that the change in MRP policy will be executed over the residual CFR for each element of the CFR at 31 March 2023 and MRP amortised over the remaining asset lives at 31 March 2023.

9.16. For example, an investment asset acquired in 2019/20 with a ten year asset life would have a remaining asset life at 31 March 2023 of 7 years. Therefore MRP would be charged over 7 years rather than the original 10 years.

Pre-1 April 2008 Debt and Government Supported Debt

9.17. For all capital expenditure incurred pre-1 April 2008, and government supported debt arising on or after 1 April 2008, MRP is calculated on a 4% Reducing Balance basis. This method has been applied to ensure with compliance with Statutory Guidance which recommends the use of either Options 1 or 2 (as set out above).

Unsupported Borrowing (General)

9.18. For most of its future capital borrowing (debt) arising, the Council has adopted Option 3 (the asset life method). For general unsupported debt arising from 1 April 2008, and up to 31 March 2013, MRP is calculated using the equal instalments basis over the useful life of the relevant assets estimated when the capital expenditure was incurred.

9.19. In the main, for any general capital debt arising from 1 April 2013, the MRP is based on the ‘useful-life’ approach using the annuity method. The discount rate used in the annuity calculation varies with the life of the assets being financed, and links to the applicable Public Works Loan Board standard new loan rate for annuity loans (and applying the certainty rate discount of 0.2%). This is a compliant approach and the annual MRP charges for each asset reflects the time value of money.

9.20. Under this option, the estimated useful lives of assets should not exceed 50 years.

9.21. MRP usually begins in the financial year following that in which the expenditure was incurred. However, the statutory guidance allows for MRP to be deferred until the financial year following the one in which the assets become operational. This will mainly cover the more significant capital spend and regeneration schemes. These schemes are in various stages of development and construction work spans over more than one financial year. The Council will provide MRP on debt when such projects transfer the assets into use and therefore generating benefits to the Council. MRP will be aligned with the period of benefit consumption.

Unsupported Borrowing – Equity

9.22. For unsupported borrowing covering equity capital - for example the acquisition of shares in companies, MRP is calculated based on the asset useful life method using the annuity method. The maximum amortisation period for equity stated in statutory regulations is 20 years. The Council has considered further whether this should be shorter in line with the asset useful life for each of the individual equity capital investments. All equity capital investments have an asset useful life that is or exceeds 20 years and initial intentions were to hold these investments over a longer period, therefore the 20-year period has been applied. The amortisation payback period is currently under review as the Council's plans for holding and divesting of investments crystalise.

Unsupported borrowing - capital loans (Commercial Loans)

9.23. For unsupported borrowing covering loans for capital purposes, MRP is calculated usually based on the asset useful life method using the annuity method. These loans meet the definition of Regulation 25 (1) of the 2003 Regulations and are loans towards capital expenditure of third parties, meeting the Council's own definition of capital expenditure.

9.24. In the case of loan capital, where the capitalised expenditure can be linked to an asset, the estimated life of that asset is the maximum MRP period. The Council has provided loans to third parties outside the geographic area of Thurrock and therefore it is not deemed that there is a relationship of benefit consumption in line with asset life for the Council. In the case of the Council's loans the benefit consumption would be over the period that the Council is in receipt of investment returns/interest, which is effectively the loan period. MRP is calculated over the period of the loan as this is commensurate with the benefits to the Council and the is shown in the table below. This amortisation period is within the maximum period defined by the statutory regulations related to the life of the underlying assets.

Investment	Amortisation period - years	Basis for amortisation
Solar Farms	8-10	Loan period as benefit consumption is based on investment returns.
Regeneration Housing	5	Loan period as benefit consumption is based on investment returns

Unsupported borrowing - capital loans (Non-Commercial Loans)

9.25. For unsupported borrowing covering loans for capital purposes that are non-commercial, MRP is calculated based on the asset useful life method using the equal instalment method. These loans meet the definition of Regulation 25 (1) of the 2003 Regulations and

are loans towards capital expenditure of third parties or subsidiary undertaking, meeting the Council's own definition of capital expenditure.

9.26. In the case of loan capital, where the capitalised expenditure can be linked to an asset, the estimated life of that asset is the maximum MRP period. For the loan provided to the subsidiary undertaking, the life of the assets are 40 years with MRP starting in 2018/19, which is the year following that in which the assets become operational. In the case of the Royal Opera House loan, the MRP charge is calculated over the period of the loan as this is commensurate with the benefits to the Council.

IFRS 9

9.27. Under capital accounting, IFRS 9 impairment charges (expected and actual credit losses) for capital investments, will have an overall nil impact on the Council's GF balance. The impairment charge for an asset that has a falling value is the difference between current actual/expected asset value and the original cost/carrying value. Some authorities may use expected and actual credit losses as a proxy for the annual MRP for capital investment. However, as the Council is charging MRP on its capital investments from inception over the amortisation period, expected and actual credit losses under IFRS 9 will have a nil impact on MRP charges.

Capital Receipts

9.28. The Council will also apply capital receipts to reduce the CFR and thus repay its borrowing, having an impact of reducing MRP charges in future years. As part of a strategy to reduce debt, the council will use the capital receipts from the disposal of investments to repay borrowing. The Council, under its asset disposal strategy, is also reviewing non-investment assets for disposals to generate capital receipts to further reduce borrowing levels and costs.

Housing Revenue Account (HRA)

9.29. The duty to make MRP does not extend to cover borrowing or credit arrangements used to finance capital expenditure on housing assets. Housing assets means any land, dwellings or other property to which Section 74(1) of the Local Government Housing Act 1989 (duty to keep a Housing Revenue Account) applies.

9.30. This follows the rationale that assets held in the Housing Revenue Account are self-financing. Instead, local authorities are required to make an annual charge to their Major Repairs Reserve, to maintain the functionality of housing assets.

Annual MRP statement

9.31. The options adopted above ensure compliance to the current statutory requirements and ensures that a prudent charge is made to the Councils revenue account. The MRP Policy will be kept under review when the outcome of the DLUHC consultation on changes to the capital finance regulations and statutory guidance are finalised.

10. Prudential Indicators and Debt Forecast (Liability Benchmark)

10.1. The purpose of prudential indicators (PIs) is to provide a reference point or “dashboard” so that senior officers and Members can:

- Easily identify whether approved treasury management policies are being applied correctly in practice; and
- Take corrective action as required.

10.2. As the Council's S.151 officer, the interim Chief Financial Officer has a responsibility to ensure that appropriate PIs are set and monitored and that any breaches are reported to Members.

10.3. The interim Chief Financial Officer has confirmed that the PIs set out below are all expected to be complied with in 2023/24 and he does not envisage at this stage that there will be any difficulty in achieving compliance with the proposed indicators for 2024/25-2028/29.

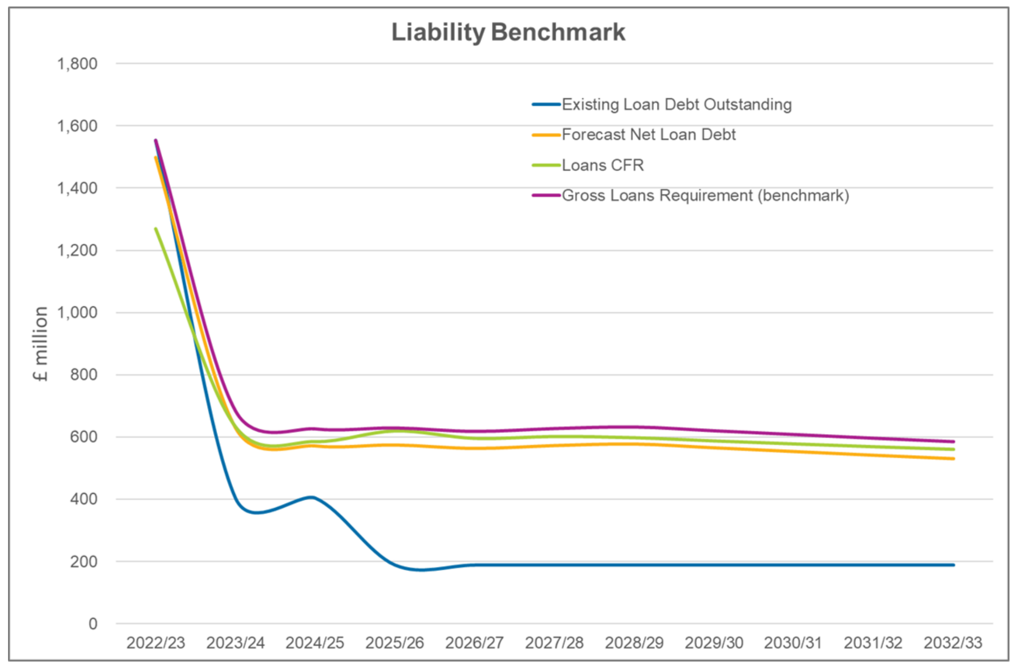
Table 12 Prudential indicators - summary

PI ref	Para Ref	Prudential Indicator	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m
1	24	Capital Expenditure	97	60	59	51	25
2	65	Capital Financing Requirement	1,022	995	983	1,000	998
		Debt Limits:					
3a	89	Authorised limit for external debt	850	850	850	850	850
3b	89	Operational debt boundary	750	750	750	750	750
4	69	Gross Debt	638	641	630	639	643
5	69	Net debt vs. CFR - under/(over) borrowed	384	354	353	361	355
6		Ratio of financing costs to net revenue stream					
	72	General Fund	32.99%	32.74%	32.57%	31.23%	24.53%
	72	HRA	31.01%	30.50%	31.08%	31.06%	30.85%
7	36	Limit on surplus funds held for more than 364 days (i.e. non-specified investments)	200	200	200	100	100
8		Maturity structure of borrowing					
	94	Upper limit under 12 months	100%	100%	100%	100%	100%
	94	Lower limit 10 years or more	0%	0%	0%	0%	0%

Debt Forecast (Liability Benchmark)

10.4. A further indicator required under the revised Codes is the Liability Benchmark. While it is described as an indicator, it is actually a series of inter-related measures that have been brought together to show how the Council is intending to manage its debt position over the MTFS period.

Table 13 Liability Benchmark



10.5. The purpose of this graph is to show the relationship between the statutory borrowing requirement (Loans CFR), the existing loans profile (Existing Loan Debt Outstanding) and the planned borrowing position (Gross Loans Requirement Forecast). This graph shows that the approach to debt assumed for the next 10 years as a minimum, is that the Council will need to hold debt at, or around, the level of its Capital Financing Requirement.

11. Reasons for Recommendation

11.1. Under the requirements of CIPFA's Treasury Management Code, the Council is required to approve a Treasury Management Strategy ahead of the new financial year. This report is part of the process when the report goes to Cabinet and then Council.

12. Consultation (including Overview and Scrutiny, if applicable)

12.1. This report has been reviewed by the Senior Management Team and by the Commissioners. The Corporate Overview and Scrutiny Committee can comment on the report prior to submission to Cabinet and Full Council.

13. Impact on corporate policies, priorities, performance and community impact

13.1. The report supports corporate compliance with the requirements to set a Treasury Management Strategy ahead of the new financial year.

14. Implications

14.1. Financial

Implications verified by: **Michael Jones**

Interim Assistant Director for Strategic and Corporate Finance

The financial implications are set out in the body of the report.

14.2. **Legal**

Implications verified by: **Jayne Middleton-Albooye**

Interim Head of Legal Services and Deputy Monitoring Officer

The Local Government Act 2003 (the 2003 Act) provides that a local authority has the power both to borrow and invest money, subject to affordable borrowing limits, for any purpose relevant to its functions and for the prudent management of its financial affairs. The Act requires the Council to determine and to keep under review how much money it can afford to borrow. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended, provide that, in complying with this duty, the Council must have regard to the Prudential Code for Capital Finance in Local Authorities published by CIPFA. The Council is also required to have regard to the CIPFA Treasury Management Code of Practice.

The CIPFA Treasury Management Code of Practice 2021 and the Secretary of State's Investment Code both require the Section 151 officer (Director of Finance) to present an Annual Treasury Management Strategy Statement, which includes an Annual Investment Strategy, for the forthcoming year for approval by the Full Council before the beginning of each financial year.

The CIPFA Prudential Code for Capital Finance in Local Authorities sets out various indicators that are to be used to support capital expenditure plans and treasury management decisions. The prudential and treasury indicators have to be set by the Full Council when the budget is set and are monitored during the year. The prudential indicators are included in section 4 of this report.

The Council is also required to approve a Treasury Management Policy Statement setting out the overarching framework for treasury management services within the Council. This statement is set out at paragraph 14 of this report and Appendix 1 sets out how the Council complies.

14.3. **Diversity and Equality**

Implications verified by: **Rebecca Lee**

Team Manager, Community Development and Equalities

The Treasury Management Strategy is a legal required that does not directly impact positively or negatively on individuals but has a purpose to ensure that the Councils treasury activities comply with all professional standards listed within the report.

A high level CEIA has been completed.

14.4. **Risks**

Section 8 of this reports details the risks. These are:
Commercial – a number of these have materialised and these are being mitigated by a policy of disinvestment and debt reduction.
Treasury – financial and compliance
Interest rate – subject to external forces, forecast reflect current anticipated rates

14.5. **Other Implications** (where significant)

None

15. Background Papers used in preparing the report (including their location on the Council's website or identification whether any are exempt or protected by copyright):

16. Appendices to the report

- Appendix 1 – CIPFA Treasury Management Code
- Appendix 2 – Glossary
- Appendix 3 - CEIA

Report Author:

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Interim Chief Finance Officer / s151

Finance