Notice of Meeting and Agenda

Midlothian

Audit Committee

Venue: **Council Chambers/Hybrid,**
Midlothian House, Dalkeith, EH22 1DN

Date: **Monday, 29 January 2024**

Time: **11:00**

Executive Director : Place

Contact:

Clerk Name: Democratic Services
Clerk Telephone:
Clerk Email: democratic.services@midlothian.gov.uk

Further Information:

This is a meeting which is open to members of the public.

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1 Welcome, Introductions and Apologies

2 Order of Business

Including notice of new business submitted as urgent for consideration at the end of the meeting.

3 Declaration of Interest

Members should declare any financial and non-financial interests they have in the items of business for consideration, identifying the relevant agenda item and the nature of their interest.

4 Minute of Previous Meeting

5 Public Reports

6 Private Reports

No items for discussion

7 Date of Next Meeting

The next meeting will be held on Monday, 18 March 2024 at 11:00am.

Minute of Meeting

Audit Committee
Monday 29 January 2024
Item No: 4.1

Midlothian

Audit Committee

Date	Time	Venue
Tuesday 30 October 2023	2.00 pm	Council Chamber/Hybrid

Present:

Councillor Smaill (Chair)
Councillor Bowen
Councillor McCall
Councillor McEwan
Councillor Russell (substitute)

In Attendance:

Grace Vickers	Chief Executive
Alan Turpie	Legal and Governance Manager/Monitoring Officer
Kevin Anderson	Executive Director Place
Fiona Robertson	Executive Director Children, Young People & Partnerships
Derek Oliver	Chief Officer Place
David Gladwin	Chief Financial Officer
Duncan Stainbank	Chief Internal Auditor
Janet Ritchie	Democratic Services Officer
Hannah Forbes	Democratic Services Assistant

1. Welcome and Apologies for Absence

The Chair welcomed Claire Gardiner and Paticia Fraser, Audit Scotland and intimated apologies on behalf of Councillor Milligan and welcomed Councillor Imrie who would be substituting for Councillor Milligan.

The Chair drew the committee's attention to the issues with today's meeting and that the accounts had been circulated late but also highlighted that the agenda pack had been published but then was not available due to a technical issue but considering that the deadline for the accounts was 31 October 2023 +and the fact that the bulk of the accounts had been published in June in the interest of the council and the public that all the matters are considered today including the prior minutes of the previous meeting and unless anyone has a different view on that basis the meeting would proceed.

2. Order of Business

The order of business was as detailed in the agenda previously circulated.

3. Declarations of interest

No declarations of interest were intimated at this stage of the proceedings.

4. Minutes of Previous Meetings

4.1 The minute of the meeting of 7 March 2023, carried over from the last meeting was submitted and approved as a correct record.

4.2 The minute of the meeting of 26 June 2023 was submitted and approved as a correct record.

4.2 The Action log was submitted and noted.

1. Responsible Treasury Management: ongoing
2. Internal Audit Mid-Term Performance Report 2022/23: Completed
3. Internal Audit work to February 2023: Recommended for Closure
4. Internal Audit Work to February 2023: Recommended for Closure
5. Internal Audit Work to May 2023: Recommended for Closure.
6. Unaudited Accounts 2022/23: Recommended for Closure.

5. Public Reports

Report No.	Report Title	Submitted by:
5.1	Annual Audit Report to Members and the Controller of Audit - year ended 31 March 2023	External Auditors
Outline of report and summary of discussion		

This report summarises the findings from the 2022/23 annual audit of Midlothian Council (the Council). The scope of the audit was set out in an annual audit plan presented to the June 2023 meeting of the Audit Committee. Audit appointment from 2022/23.

Claire Gardiner apologised for the delay in receiving the reports and thanked the committee for their patience. Ms Gardiner then explained the approach to the reporting and that normally at this stage the committee would receive a much longer annual audit report but to preserve the quality of the audit it has been split with a fuller audit report coming to the next meeting which will include the wider scope and best value and that the audit report presented to today's meeting would focus on the annual accounts and accounts process.

Ms Gardiner proceeded to present the annual audit report to members highlighting the first report brings conclusion of the audit and highlights that there was an unmodified opinion which was attached as appendix A to this report and advised that there were no issues to highlight. Ms Gardiner also advised that there were two unadjusted errors highlighted in this letter and full details are contained within Appendix 2 to the audit report. Ms Gardiner also drew the committee's attention to Appendix B which was a letter of representation and highlighted the main sections within the letter and asked that before approving this letter, committee members are asked to consider their knowledge of any frauds, non-compliance with laws and regulations or post balance sheet events.

In response to a question raised by Councillor Smaill with regards to adjustments, Ms Gardiner provided clarity with regards to adjustments which were included in the annual accounts and would be covered in the next section and the adjustments which were not included were just above the triviality level so would not expect any adjustments to be made. Mr Gladwin also provided some clarity on the two unadjusted errors. Following this discussion Ms Gardiner confirmed that the officers of the Council were clear to sign off these accounts.

Ms Gardiner presented the Audit of 2022/23 annual accounts highlighting in her introduction that they were independent throughout the audit and that they comply with the Financial Reporting Council's Ethical Standard. Ms Gardiner also highlighted that they intend to issue an unmodified audit opinion and provided a brief overview of the Exhibits covering Materiality values (Exhibit 1); Significant findings and key audit matters (Exhibit 2); Significant risks of material misstatement (Exhibit 3); Identified areas of audit focus (Exhibit 4) and key findings from review of key controls (Exhibit 5).

The Chair thanks the external auditors for all their work.

Decision
The Audit Committee approved the letter of representation was signed and returned with the signed annual accounts.
Action
Section 75 Officer/External Auditors

Report No.	Report Title	Submitted by:
5.2	Annual Accounts for the year ended 31 March 2023	Chief Financial Officer & Section 95 Officer
Outline of report and summary of discussion		
The purpose of this report was to present the Council's audited Financial Statements for 2022/23 to Audit Committee and to provide a brief overview of findings during the audit process. Mr Gladwin, Chief Financial Officer & Section 95 Officer presented this report to the committee outlining the main changes to the accounts from those reviewed at the Audit committee in June 2023 and highlighting the work undertaken to finalise the accounts. Mr Gladwin commented that Audit Scotland had indicated that the working papers submitted to them to support the accounts were of a good standard and colleagues within finance and across the council provided good support to the Audit team. Mr Gladwin expressed his personal thanks to the finance team for their dedication and hard work. Mr Gladwin in responding to a question raised by the Chair with regards to the impact of the new interest rate, advised on the commitment to pay interest below the level currently on the market and confirmed that we have a positive treasury position with long term loans at an attractive interest rate and if the council were to repay one of those loans early there would be a financial benefit from doing so and that was what was reflected in the fair value but the council would then have to replace that borrowing which would have a net financial hit on the council rather than a benefit. The Chair asked the Chief Finance Officer to comment on the ratio of finance costs to net revenue stream which measures how affordable the council's capital plans are and the 0.38% figure. Mr Gladwin confirmed that the ratios in context of the capital plan prioritisation discussions are currently higher and will continue to go up as we add to the capital plan and provided an explanation on the two ratio rates presented in the table was due to the financial flexibility the council took advantage of in 2021/22 and 2022/23 and advised that these rates will go up. The Chair further raised movement on the housing revenue account and the valuation of the council's stock and the impact this has on the council. In responding Mr Gladwin confirmed that this has no impact on the operation of the revenue account and provided an explanation on the movement which was due to revaluation of the housing stock in 2021/22 which resulted in an increase to the overall stock and in 2022/23 due to an increased discount rate this showed a reduction.		

The Chair referred to the table which shows a spend on housing and asked if the council was building houses competitively to the private market. Mr Gladwin advised on the increase in stock and the value of the capital expenditure and that it reflects a large amount of work in progress and the two big factors which have affected this are inflation and build costs and the standard of these builds.

Mr Gladwin in responding to a question raised by the provost confirmed that the Croyden loan was paid in full, and all interest obligations were met. Mr Gladwin further confirmed that the council has not deposited money with any local authorities for a long time and post-meeting confirmed for the minute that there are currently no local authority deposits in place.

Mr Gladwin in responding to comments made by Councillor Imrie and the Chair with regards to the growth in Midlothian and the impact on the council and the services it provides and the grant received from the Scottish Government, advised that later this year we will be advised on the up to date Scottish government grant based on the updated methodology which reflects the statistics which have come out of the census and other regular statistics and expects Midlothian to receive a higher share of the national pot. He further advised to support this he will pulling together an analysis of the grant over the last two or three years looking at the statistical measures on each of the grants to try and get an understanding of key statistics that are affecting us as a council and will bring back a report to council. He further confirmed that the figures should have been updated to reflect the latest population and confirmed there has been subsequent information provided so apologised that this had not been updated but assured the committee that they are looking at the growth information and discussions are ongoing.

Councillor Bowen raised a question in relation to capital projects and any trigger mechanism in place if a capital project was going over budget and also enquired if it would be appropriate to have two Councillors on the Capital Plan Asset Management board which was at present entirely officers. Mr Gladwin in responding advised that there were several gateways and controls in place if expenditure exceeded the prescribed measures laid out and that automatic reporting was triggered which ensures this was identified at an early stage and then reported to council and also reviewed at the Capital Plan Asset Management board. Mr Gladwin in responding to a follow up question by the Chair confirmed the difference between capital expenditure which relates to a cash amount and the valuation of an asset which was done on a different basis and would not be a cash adjustment.

Mr Anderson provided clarity on the remit of Capital Plan Asset Management board which was an officer forum and advised that any projects which come through this forum that are not externally funded are reported to council either in the governance reporting or as a standalone item therefore Members are involved and in terms of the capital plan prioritisation Members are fully involved in the different sessions which have been taking place and the regular updates to the Business Transformation Steering Group.

Further discussion took place on the reporting of any overspends and the governance route for this being reported to Members. The Chair suggested that

this was taken away and brought back following further discussions within the individual groups.
Decision
The Audit Committee: • Agreed that Members would discuss the governance arrangements in place for reporting any capital projects overspends within their individual groups and provided further feedback to officers. • Approved the 2022/23 audited accounts for signature considering the appointed auditor's report for 2022/23.
Action
Elected Members/Executive Director, Place and Chief Financial Officer/Section 95 Officer

Report No.	Report Title	Submitted by:
5.3	Risk Management Update – Strategic Risk Profile Quarter 1 2023/24	Chief Officer Place
Outline of report and summary of discussion		
The purpose of this report was to provide Audit Committee with: • An update on the risk responses Midlothian Council has implemented during Q1 2023/24 to respond to the current risk climate • Assurance that Midlothian Council took a proportionate and planned approach to prepare and respond to the current risk climate • The risk evaluation of current strategic risks and opportunities for the Council Mr Oliver, Chief Officer Place presented this retrospective report highlighting that this report provides the risk landscape and organisational response to the most significant risks faced by the Council in Q1 in 2023/24. He further advised that Section 3 of the cover report provides a summary of risk responses and evaluations. The Chair proposed that specific risks were identified on the two major projects that this council has that other councils don't have, Hillend and Lothian Energy acknowledging that there are reporting mechanisms in place for Hillend but there has been some delays in this project and also suggested that following on from the announcement that there may be a council tax freeze next year that this is expanded on within the report that we may not have the flexibility of increasing the council tax in 2024/25. The provost also expressed her agreement to these suggestions being added to the risk report.		

The provost further commented on the Strategic issues and raised why Brexit was a high and not critical risk. Mr Oliver advised that this was monitored and advised on the Economic Recovery Plan and also the ambitious plan for the next 5 years and the organisational impact to the Council. Following on from a further question raised by the provost Mr Oliver advised that in terms of the pandemic this hit everyone and in terms of Midlothian Council's response the emergency plans kicked in and that the impact of this had been captured in various risks. He further advised that a pandemic plan was in place and provided an explanation on why this was now considered low impact on the council. Councillor McEwan raised questions with regards to delays to Hillend and the exposure risk with loss of income and if the council had any compensatory claims to the companies who are holding up the delays. Mr Stainbank advised on proposed internal review which would start once there was a solution to the current delay problems as this would allow them to assess how the processes worked thereafter. Mr Anderson advised that he was limited on what he could report but scrutiny was given to the situation. The Chair congratulated and thanked Mr Oliver for the work after the severe weather in clearing the drains at Fala and Fala Dam and the provision of sandbags.
Decion
Audit Committee noted the current risk landscape and organisational response to the most significant risks in Quarter 1 (Q1) 2023/24 (1 April to 30 June 2023).

Report No.	Report Title	Submitted by:
5.4	Audit Committee Annual / End of Term Report 2022/23	Chair of the Audit Committee
Outline of report and summary of discussion		
The purpose of this report was to provide Members with the Audit Committee Annual / End of Term Report 2022/23, which sets out how the Audit Committee has performed against its remit and the effectiveness of the Audit Committee in meeting its purpose based on the annual self-assessments of the Committee against best practice and provides assurances to the Council. It was important that the Council's Audit Committee fully complies with best practice guidance on Audit Committees to ensure it can demonstrate its effectiveness as a scrutiny body as a foundation for sound corporate governance of the Council. The Chartered Institute of Public Finance and Accountancy (CIPFA) Audit Committees Practical Guidance for Local Authorities and Police 2022 Edition (hereinafter referred to as CIPFA Audit Committees Guidance) includes the production of an annual report on the performance of the Audit Committee for submission to the Council. The Audit Committee Annual / End of Term Report 2022/23 was appended to this report as Appendix 1 for consideration. Midlothian Council adopts the 2022 revisions to this best practice.		

The Chair in presenting this report highlighted some of the key points of the report including the good attendance, the checklist and training provided to members and commented very positively on the session on internet IT security with Ian Wragg Wragg which was very informative.
Decision
The Audit Committee approved the Audit Committee Annual / End of Term Report 2022/23 (Appendix 1) and its self-assessments using the CIPFA Audit Committees Guidance (Appendices 2 and 3) and agreed that the Audit Committee Annual / End of Term Report 2022/23 should be presented to the Council.
Action
Chair of the Audit Committee

Report No.	Report Title	Submitted by:
5.5	Internal Audit Work to September 2023	Chief Internal Auditor
Outline of report and summary of discussion		
The purpose of this report was to provide members of the Audit Committee with details of the recent work carried out by Internal Audit and the findings and recommended audit actions agreed by Management to improve internal controls and governance arrangements. The Internal Audit Annual Plan 2023/24 was approved by the Audit Committee on 7 March 2023. Internal Audit has carried out work associated with the delivery of the Plan to meet its objective of providing an opinion on the efficacy of the Council's risk management, internal control and governance. An Executive Summary of the final Internal Audit assurance reports issued, including audit objective, findings, good practice and recommendations (where appropriate), and the Chief Internal Auditor's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, was shown in Appendix 1. The Internal Audit function conforms to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017) including the production of this report to communicate the results of the reviews. The Chief Internal Auditor presented this report outlining the main sections in the report highlighting a summary of the key findings and recommendations as set out in the report. In response to a question raised by the Chair with regards to payments made by cash in one of the libraries and no option to pay by card, the Chief Internal Auditor and the Executive Director Place confirmed that the aim was to be a cashless council but at the moment this was not always possible in some of the services the council provides but the council will continue to be digital by default and roll this out where effective.		

Mr Stainbank in responding to a question raised by the Chair with regards to the implications of the loss of collection of council tax confirmed from that the audit work there would not be a figure for this but the expectation was that the longer it takes the more difficult it was to collect and that this was not on the audit plan at present but if required collectability could be considered.

Decision

The Audit Committee:

a) Considered the Executive Summaries of the final Internal Audit assurance reports issued associated with the delivery of the approved Internal Audit Annual Plan 2022/23 and 2023/24;

b) Noted the Internal Audit Consultancy and Other Work carried out in accordance with the approved Internal audit Charter; and

c) Acknowledged the assurance provided on internal controls and governance.

Report No.	Report Title	Submitted by:
5.6	Council House Building Programme - Progress Update 2023	Executive Director, Place

Outline of report and summary of discussion

Following presentation to Council on 10 October 2023, this report updates the Audit Committee on the status of the overall housing programme, on approved sites and proposed new sites for the Council new build affordable housing programme and other initiatives.

The Executive Director Place, Kevin Anderson confirmed that this paper had been considered at council and outlined the main sections as contained within the report and the factors contributed to the delays in the housing programme.

In responding questions raised by the Chair with regards to the cost of passive housing to non-passive housing and option of purchasing existing properties to refurbish, Mr Anderson provided an explanation on the standards which are required and the reasons why they tend to purchase previous council properties and confirmed that are options with new builds under Section 75 requirements but highlighted that the private sector do not have to comply with the energy efficiencies for Scottish social housing.

Mr Anderson in responding to questions raised by Councillor McEwan confirmed that there were 6 passive houses in the Buccleuch street development and 4 flatted developments which were not passive house as they were existing properties. Mr Anderson also confirmed that they would provide a breakdown of detail with regards to properties and would provide this detail at the workshop session arranged. With regards to the question raised on asset register and appropriate values Mr Anderson advised that this was a pilot project and beyond individual cost this will be reviewed in a year's time for total cost and benefit to the individual, he also advised that the total cost value will have a variation, and this will be considered with insurers and valuers.

Action: Mr Anderson to report back in due course on the actual cost per unit of the 10 houses within the Buccleuch Street development.

Councillor Imrie raised a question with regards to the cost of passive house standards and if this was reflected in the rent. In response Mr Anderson advised that there was a premium applied for new developments for the first 10 years supplement to the rent but there was no additional levy in terms of it being a passive house.

Mr Anderson in responding to a question raised by Councillor Imrie regarding ongoing costs to the council, confirmed that there will be additional ongoing revenue costs that the council as the landlord will have. Mr Oliver also confirmed the ongoing costs to the building maintenance with regards to training requirements.

Councillor Bowen commented on using the word delivered which indicates they are complete, but this is not the case and asked if this could this be made clearer. In responding Mr Anderson advised with regards to terminology this will be made clearer in future reporting and provided an explanation on the different variations on housing completions.

Mr Anderson in responding to a further question from the Chair with regards the Newbattle site and the cost implications in future for having to purchase land for passive housing, advised that there may be additional cost but there will also be benefits from these and with the expertise and timescales in delivering this should also reduce the unit cost.

Decision

Audit Committee:

a) Noted the content of this report and the progress made on Phases 2 to 5;

b) Noted the sites now underway to complete Phase 4 and Phase 5, projected handover programme and progress related to Open Market Purchases;

c) Noted the potential Phase 5 sites currently under consideration to progress; and

d) Noted the projected costs/budget expenditure in this report.

6. Private Reports

None

7. Date of Next Meeting

Date of Next Meeting: Tuesday 29 January 2024 at 11am.

The meeting terminated at 15.30 pm

Minute of Meeting

Audit Committee
Monday 29 January 2024
Item No: 4.2

Audit Committee – Special meeting

Date	Time	Venue
Tuesday 5 December 2023	11:00am	Council Chamber/Hybrid

Present:

Councillor Milligan (Chair)
Councillor Smaill
Councillor Bowen
Councillor McCall (MS Teams)
Councillor Imrie (substitute for Councillor McEwan)

In Attendance:

Grace Vickers	Chief Executive
Kevin Anderson	Executive Director Place
Nick Clater	Head of Adult Services
Alan Turpie	Legal and Governance Manager / Monitoring Officer
David Gladwin	Chief Financial Officer
Gary Thomson	Senior Finance Officer
Duncan Stainbank	Chief Internal Auditor
Derek Oliver	Chief Officer Place
Saty Kaur	Chief Officer Corporate Solutions
Claire Gardiner	Audit Scotland
Patricia Fraser	Audit Scotland
Robert Dick	Audit Scotland
Janet Ritchie	Democratic Services Officer

1. Welcome and Apologies for Absence

The Chair took the opportunity to welcome those in attendance to the meeting. Apologies were intimated on behalf of Councillor McEwan, and that Councillor Imrie was in attendance as substitute.

2. Order of Business

The order of business was as detailed in the agenda.

3. Declarations of interest

No declarations of interest were intimated at this stage of the proceedings.

4. Minutes of Previous Meetings

No previous minutes were submitted to this meeting.

5. Public Reports

Report No.	Report Title	Submitted by:
5.1	Annual Audit Report to Members and the Controller of Audit year ended 31 March 2023.	Audit Scotland External Auditors

Outline of report and summary of discussion

This report summarises the findings from the 2022/23 annual audit of Midlothian Council (the Council). The scope of the audit was set out in an annual audit plan presented to the June 2023 meeting of the Audit Committee.

This Annual Audit Report comprises:

- significant matters arising from an audit of Midlothian Council's annual accounts.
- conclusions on the following wider scope areas that frame public audit as set out in the Code of Audit Practice:
  - Financial Management
  - Financial Sustainability
  - Vision, Leadership, and Governance
  - Use of Resources to Improve Outcomes.
- conclusions on Midlothian Council's performance in meeting its Best Value duties.

Claire Gardiner, Audit Scotland presented this report advising that this report concludes the 2022/23 audit work, and that section 1 was previously presented to the committee along with the annual report and that today the focus would be the wider section of the report. Ms Gardiner outlined the relevant sections of the report and highlighted the key findings and areas of focus as detailed within the report.

Ms Gardiner thanked all the council staff involved in this and the financial statements audit work and highlighted that this first year has been challenging but commented on the good progress in getting to know the team.

Thereafter Ms Gardiner in responding to a question raised by Councillor Smaill regarding the budget setting and the adverse variances in particular regarding Hillend and the reduction in the contribution to the Integration Joint Board, advised that this will be a consideration as part of the audit work next year and Ms Gardiner highlighted that this is an area of ongoing challenge and was across most Councils where there are significant challenges in the budget setting. Councillor Smaill advised that the Internal Audit team are looking at the Hillend situation and commented positively on the work done by Mr Oliver on the business maintenance services.

The Chair, Councillor Milligan commented positively on the budget setting process which was done fairly, openly and transparently and that the chief officers of the Integration Joint Board (IJB) were advised at the start of the budget setting process that a percentage of savings would be looked at across all services and one of the consequences of the budget cutting savings was the funding of the transformation programme to move on to electronic appointments. Councillor Milligan also highlighted that the IJB advised that they have received fair funding from Midlothian over the years and that the challenge for the IJB will be to find smarter ways of working. Councillor Milligan also commented on the Hillend situation and the dependency on both the revenue budget and capital budget and how these are both linked and that council is short of what they require for capital funding and the only way to increase this is by revenue cost for borrowing therefore these both must be linked for forth coming budgets.

The Chief Financial Officer, Mr Gladwin confirmed the comments made by Councillor Milligan with regards the IJB and provided clarity on the Hillend situation advising that the issues were not related to the loan charges but the income expected from the alpine coaster and advised that the business case was carefully pulled together and scrutinised by officers and that the income target had not been achieved but highlighted that this was a unique situation with Hillend due to the civil work and the complexities with the water pipes and this could not have been anticipated so this has been the contributor to the loss income in the financial year.

Mr Gladwin then provided an explanation on reserves advising that although the audit report is accurate and is a fair reflection of these figures these could be misunderstood and he provided an explanation on the details of the reserves and what is earmarked, committed reserves, repairs and renewal fund and the general fund and also details on the underspends and overspends for last year. He further highlighted the reserves need be viewed intelligently and that when the figures appear in national reports, they can be misunderstood and misrepresented and highlighted the sound financial planning reasons behind reserves that Midlothian Council hold.

The Chair also commented on the reserves supporting the explanations from the Chief Financial Officer.

The Provost, Councillor McCall commented on the positive report highlighting the positive partnership working with community planning partners, comments on leadership, engaging with communities, gender balance and engaging in local equality groups. Councillor McCall also acknowledged that the report highlighted that Midlothian Council is the only council in Scotland with an all-female council leadership team.
Decision
The Audit Committee approved this report and recommended that it is presented to Council.
Action
Chief Financial Officer

Report No.	Report Title	Submitted by:
5.1a	Midlothian Council Best Value Thematic Work 2022/23	Audit Scotland, External Auditors
Outline of report and summary of discussion		
Patricia Fraser, external auditor presented the Midlothian Council Best Value Thematic Work 2022/23 highlighting the work performed and the production of this report marks the move to more regular reporting on how the Council is performing regarding its duty of best value and that an overarching best value assurance report and this will be due on the last year of the audit appointment and provided an explanation on the best value reporting leading up to 2026/27. Ms Fraser advised that the thematic report was a positive report with some areas highlighted which present challenges to the Council. Ms Fraser also highlighted from the work carried out including discussions with officers and members and review of plans, strategies, and committee minutes it was clear that Midlothian council continues to demonstrate ongoing commitment to best value. It was noted that all the recommendations in the 2019 report had been actioned and furthermore the council continues to develop performance reporting and medium-term financial planning as well as strengthening officer member relationships. Ms Fraser then highlighted some of the key messages as detailed in the report and commented on the Transformation blueprint which aligns with the five-year budget strategy to 2027/28. Ms Fraser further highlighted some of the main sections as contained within the report and advised that robust financial planning and delivery of the transformation blueprint are critical to delivering financial sustainable services in the medium to long-term and that management have provided responses to addressing the risks associated with these actions and are included in appendix 1 of the report. Ms Fraser expressed her sincere thanks to officers and members of the council for the assistance they provided in performing the work and producing this report, particularly Mr Gladwin. Councillor Smaill raised the concerns with regards to the population in Midlothian and that it is not reflected in the settlement from the Scottish government and asked the Chief Financial Officer if there was any update on this situation.		

Councillor Milligan also commented on the population growth and provided an overview of actions that have already taken place to address this and advised that the paragraph on page 53 should be amended as the funding allocation does not align with the growth in population.

Mr Gladwin agreed that perhaps the wording should be amended in paragraph 53 and provided an update on discussions which have taken place and advised on a future meeting to discuss the position Midlothian is in and that the funding does not sit alongside the growth. Mr Gladwin also advised on what they were hoping to achieve at this meeting and provided an update on the work that has been done with regards to the census figures. Councillor Milligan provided further details on the work that has been undertaken to highlight the growth in Midlothian with the Scottish Government highlighting that this has been ongoing for many years.

Ms Fraser welcomed the discussion and advised that she was happy to amend the report to reflect the discussion that had taken place and confirmed that after these amendments had been done to the report, the revised report would be sent to Mr Gladwin.

The Chief Executive thanked Ms Fraser for her comments and asked if the publication of the census data could be referenced as well and explained that the Council considered 2022 census data at October 2023 Council meeting and where they previously thought Midlothian was growing at 15.8% it was growing faster at 16.1% so this was something that had to be closely monitored. The Chief Executive also highlighted although their estimates were relatively accurate the data was still out and highlighted that this council was growing across all age groups, and this had an impact on revenue and capital spend. She further advised that it was agreed at the October council meeting to write formally to UK government, Scottish government and COSLA to ask that the most up to date census data be considered in any funding applications for Midlothian.

Ms Kaur in responding to a question raised by Councillor Smaill with regards to workforce planning and the workforce comparative to other Scottish councils, confirmed we are quite a lean council, but we are not alone on this and explained some of the challenges in recruitment in some sectors of the council, but also advised that this was being addressed. Ms Kaur also highlighted some of the digital transformation work, which was taking place, the work through apprenticeships and grow your own staff. Ms Kaur highlighted that at Cabinet there was a discussion about working with the workforce and celebrating successes and officers were keen to expand on this. Ms Kaur further advised on some of the work around foster carers, recruitment campaigns, different ways of working and generic working and the work done with neighbourhood services.

The Chair also commented on the staffing situation in Midlothian compared with other councils and the challenges Midlothian face.

Mr Fraser confirmed to the committee that the thematic review next year would be on workforce planning and innovation.

The Chair highlighted on P54 (paragraph 67) that 600 people attended a budgeting event and highlighted that nothing had happened within the last 2 or 3

years so was unsure what this referred too. The Chair also highlighted that the consultation detailed in paragraph 68 was all done online. Councillor Bowen also advised on a typo on page 44 of the report and in response Ms Fraser confirmed that she would check on the comments from the Chair and also confirmed they had identified some other typos within the report, and this would be proofread before the report was finalised.
Decision
Audit Scotland would make the necessary checks and amendments to the document as discussed prior to it being finalised.
Action
Audit Scotland.

Report No.	Report Title	Submitted by:
5.2	Treasury Management Mid-Year Review Report 2023/24	Chief Financial Officer
Outline of report and summary of discussion		
The purpose of this report was to inform members of the Audit Committee, and subsequently Council, of the Treasury Management activity undertaken during the first half of 2023/24 and the forecast activity for the second half of 2023/24 in accordance with the Treasury Management and Annual Investment Strategy approved by Council on 21 February 2023. It also provided an update to the Treasury and Prudential Indicators for 2023/24. The Chief Financial Officer, Mr Gladwin on presenting this report highlighted the main sections as contained within the report and outlined the contents of the appendices attached. Mr Gladwin introduced Gary Thomson who was in attendance to answer any questions as Gary provided strategic direction for the council's treasury function. Councillor Smaill expressed his congratulations on the report and the confidence the council now has on the treasury management, Councillor Smaill followed on with questions regarding reduction on deposits and capital spend and secondly on debt rescheduling. Mr Gladwin in responding to Councillor Smail's first question advised that he was correct on his assumption that the cash balances are running down as the capital expenditure catches up and the council is in a position not to take more borrowing because of the cash balances and advised that they do not want to lock into borrowing at high interest rates so looking at ways to minimise this. Mr Gladwin advised with regards to debt rescheduling, the Council has done this in the past although not a lot and advised that this is not something they would jump into without getting a detailed appraisal on what benefits this would bring as they must ensure they are not getting short term gains for long term pressures, Mr Gladwin then passed over to Mr Thomson to provide further clarity on this.		

Mr Thomson advised with regard to debt rescheduling they would be looking at that on a discounted cash flow basis and one of the options that has been actively looked at was the replacement of the PWLB Annuities loan explaining that in paying this off early although there would be a premium this would be spread over the remaining life of the loans but this would be offset on the discounted cash flow basis by the saving on the interest cost on the loan which would no longer be incurred.

Mr Gladwin in responding to a further question raised by Councillor Smaill regarding the council becoming an active trader of the deposit positions, advised that the current treasury policies and practices would not allow the council to do this so it is not something that would be considered. Any changes to existing practices would have to be discussed at the Audit Committee and approved through Council.

The Chair commented that this was a very good report and goes some way to get the council back up to number 1 in the performance chart. The Chair also commented that it would be interesting to know if the Council was sitting mid-market what the difference would be from being the top players as a comparative council. He expressed his thanks to David Gladwin, Gary Thomson, and the rest of the finance team for the fantastic report.

The Chair also expressed his thanks to the External Auditors for their time and support and thanked everyone for their attendance.

Decision

The Audit Committee noted the report and in particular, noted the following recommendations which are proposed to be put to Council on 19 December 2023:-

a) Note the report and the treasury activity undertaken in the period to 30 September 2023, as outlined in Section 5;
b) Note the actual and forecast activity during the second-half of the year as outlined in Section 6;
c) Approve the technical revisions to the Prudential Indicators in Section 7 of this report;
d) Note the loans fund rate performance relative to other Scottish Local authorities, as outlined in Section 8, and the cash saving (compared to the Scottish Average) that the Treasury Management function brings to support the Council's in-year revenue budget.

6. Private Reports

None

7. Date of Next Meeting

Date of Next Meeting: Monday 29 January 2024 at at 11am.

The meeting terminated at 11:58 am

Midlothian

Action Log

No	Subject	Date	Action	Action Owner	Expected completion date	Comments
1	**Responsible treasury management**	06/12/2022	Session with members to be organised with regard to Responsible treasury management/ethical issues.	Chief Financial Officer	Ongoing	Carry forward, paper coming forward regarding CSG and ethical depositing coming later in the year.
2	**Annual Accounts for the year ended 31 March 2023**	30/10/2023	Agreed that Members would discuss the governance arrangements in place for reporting any capital projects overspends within their individual groups and provided further feedback to officers	Committee		
3	**Council House Building Programme – Progress Update 2023**	30/10/2023	Mr Anderson to report back in due course on the actual cost per unit of the 10 houses within the Buccleuch Street development	Kevin Anderson	TBC	

Treasury Management and Investment Strategy 2024/25 & Prudential Indicators

Report by David Gladwin, Chief Financial Officer & Section 95 Officer

Report for Decision

1 Recommendations

The Audit Committee is invited to comment on this report before it is presented to Council. In particular, Audit Committee should note the following recommendations which are proposed to be put to Council on 27 February 2024:-

a) Approve the restriction of the Authorised Limit to the value of the Capital Financing Requirement at 31 March 2025 (£545.673 million), pending finalisation of the General Services Capital Plan Prioritisation;

b) Note that there are no other material changes proposed to the Treasury Management and Investment Strategy (TMIS) for 2024/25 from the strategy currently in place, other than to update the Prudential Indicators (Section 5 and Appendix 2), to reflect the revised capital plans;

c) Note the retention of the current approach for the repayment of loans fund advances as outlined in Section 6 and that any changes arising from the Scottish Government's consultation on the Amendment to the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 will be reflected in a revised TMIS if required; and

d) Accordingly approve the Treasury Management and Investment Strategy for 2024/25.

2 Purpose of Report/Executive Summary

In accordance with the Treasury Management Code of Practice, the annual Treasury Management & Investment Strategy (TMIS) & Prudential Indicators report is required to be adequately scrutinised before being recommended to the Council. For Midlothian, this role is undertaken by the Audit Committee, with this report being presented to Audit Committee on 29 January 2024 prior to consideration by Council on 27 February 2024.

The purpose of the report to Council will be to provide an update on the implementation of the Council's TMIS 2023/24, and to make recommendations to facilitate consideration of the 2024/25 Strategy, specifically the TMIS for 2024/25, the Prudential and Treasury indicators contained therein, and the approach to the statutory repayment of loans fund advances.

Any revisions arising from Audit Committee consideration of the report on 29 January 2024 will be incorporated into the final version of the report to Council on 27 February 2024.

Date: 18 January 2024
Report Contact:
Gary Thomson, Senior Finance Business Partner
gary.thomson@midlothian.gov.uk

3. Update on implementation of TMIS for 2023/24

3.1 Borrowing

The Council's borrowing position as set out in the 2023/24 Treasury Management Mid-Year Review Report was £321.754 million at 31 March 2023, and six months later was £321.314 million on 30 September 2023.

The principal source of borrowing is the UK Debt Management Office's Public Works Loans Board (PWLB) and fixed rate loans are taken at a time and tenure which takes cognisance of the PWLB rates (derived from the UK Gilts market) and the management of maturity risk in the long term across the Council's loan portfolio.

The Council's loan portfolio, as at 17 January 2024, is shown in table 1 below:-

Table 1: Current Loan Portfolio as at 17 January 2024

Loan Type	Principal Outstanding £000's	Weighted Average Rate
PWLB Annuity	452	8.91%
PWLB Maturity	284,128	2.90%
LOBO	20,000	4.51%
Market Loans	16,221	2.68%
Salix Loans	70	0.00%
Total Loans	**320,871**	**3.00%**

The repayment profile of this debt is shown in graphical and tabular form below:-

Figure 1: Loan Maturity Structure

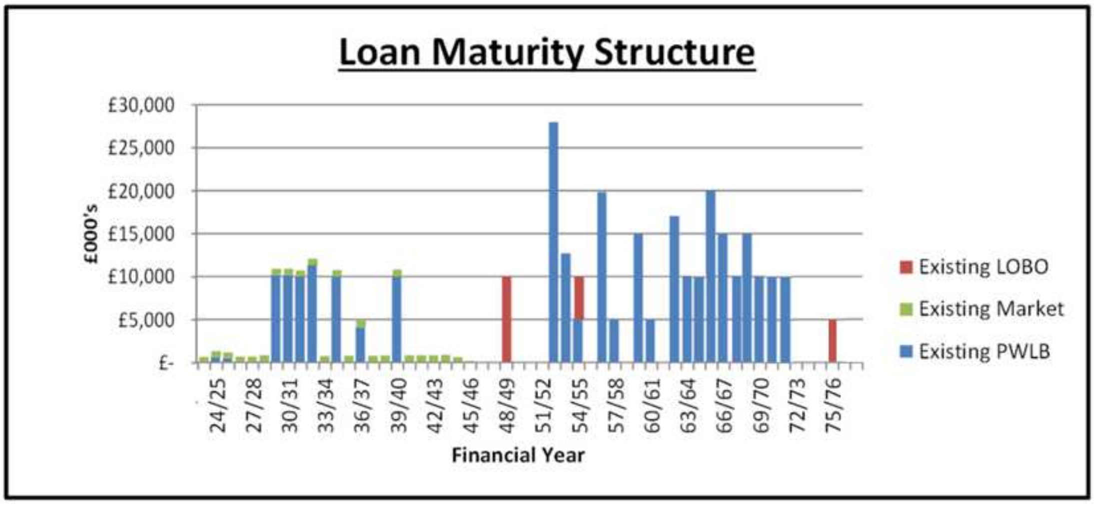


Table 2: Loan Maturity Profile

Financial Year	2023/24 Remaining £000's	2024/25-2025/26 £000's	2025/26-2027/28 £000's	2028/29-2032/33 £000's	2033/34-2037/38 £000's	2038/39+ £000's
Debt Maturing	0	1,426	2,795	45,136	32,239	239,275
% of total portfolio	0.00%	0.44%	0.87%	14.07%	10.05%	74.57%

As can be noted in the graph and table above, proactive Treasury Management by the Council in the last decade has placed the Council in an extremely strong refinancing position for its existing external debt portfolio, with only £4.221 million, or just 1.31%, of the Council's total Loan Portfolio of £320.871 million requiring refinancing over the current and forthcoming four financial years.

This extremely low short-term exposure to refinancing risk has put the Council in a strong position to plan its new borrowings in advance, take advantage of any dips in longer-term borrowing rates from PWLB (as demonstrated above) and other sources, and maintain a low weighted average coupon rate on external debt.

3.2 Deposits

The Council's position for funds on deposit fluctuates on a daily basis, with the 2023/24 Treasury Management Mid-Year Review Report setting out the position at 31 March 2023 of £113.982 million and six months later on 30 September 2023, at £111.344 million.

The position at 17 January 2024, as set out in Table 3 below, totals £72.416 million.

Table 3: Current Deposits as at 17 January 2024

Deposit Type	Principal Outstanding £000's	Weighted Average Rate
Bank Call Accounts	7,343	5.09%
Money Market Funds	35,073	5.32%
Bank Fixed Term Deposits	30,000	4.98%
Total Deposits	**72,416**	**5.15%**

The cash balances above represent the following:

- Funds held in Bank Fixed Term Deposits and Money Market Funds which are cash backing £65.073m of the Council's projected useable reserves (at 31 March 2024);
- A balance held in instant access bank accounts and Money Market Funds which are used for day to day liquidity to meet cashflow requirements;

The Council’s current deposit portfolio is broadly reflective of the wider UK Local Authority position, as noted in the Treasury Management & Annual Investment Strategy Statement – 2024/25 Detailed in Appendix 3, Section 4.4.

4. Treasury Management & Investment Strategy 2024/25

4.1 Main Objectives of TMIS 2024/25

The objectives of the current and proposed TMIS are:-

- To secure long-term borrowing to fund capital investment, through locking in to long-term interest rates and de-risking the Council's Capital Financing Requirement (CFR);

- To ensure short-term liquidity to manage the Council's day-to-day cashflow. This is achieved through the utilisation of instant access Money Market Fund and Bank Accounts, with the amount held in these reflecting the Council's level of working capital and fluctuating throughout the year due to a number of factors;

- To cash back the Council's usable reserves.

No material changes are proposed to the current 2023/24 TMIS which was scrutinised by Audit Committee in January 2023 and approved by Council in February 2023, other than for the following:-

a) Approve the restriction of the Authorised Limit to the value of the Capital Financing Requirement at 31 March 2025 (£545.673 million), pending finalisation of the General Services Capital Plan Prioritisation;

Similarly no changes are recommended to the Permitted Investments.

More detail on the borrowing and investment strategy for 2024/25 is provided in Sections 4.2, 4.3 and 4.4 below.

4.2 Borrowing Requirement 2023/24 to 2027/28

The Council's capital plans contain projections of capital expenditure and income over the forthcoming financial years. Any expenditure not financed directly by income, requires funding through borrowing.

The projected borrowing requirement arising from the Council's Capital Plans, the Midlothian Energy Limited (MEL) Shareholder Injection, and the maturing long-term loans that require to be refinanced, over the period 2023/24 to 2027/28 is shown in table 4:-

Table 4: Total Borrowing Requirement over the period 2023/24 to 2027/28

	2023/24 £000's	2024/25 £000's	2025/26 £000's	2026/27 £000's	2027/28 £000's	Total £000's
Capital Expenditure						
General Services	64,921	108,857	121,975	89,765	12,128	**397,645**
HRA	52,125	99,585	91,901	36,647	26,128	**306,386**
Total Capital Expenditure	**117,046**	**208,442**	**213,876**	**126,412**	**38,256**	**704,031**
Total Available Financing	-46,865	-64,914	-34,333	-19,432	-10,893	**-176,437**
Principal Debt Repayments	-9,206	-10,760	-11,670	-12,557	-14,195	**-58,388**
Capital Expenditure less available Financing	**60,974**	**132,767**	**167,873**	**94,423**	**13,168**	**469,206**
MEL Shareholder Injection	710	3,560	0	0	0	**4,270**
Maturing Long-term Loans	830	1,426	1,355	851	700	**5,162**
Total Borrowing Requirement	**62,514**	**137,753**	**169,228**	**95,274**	**13,868**	**478,638**

Note that the Capital Expenditure and Financing in the table above is based on the Council's existing Capital Plans which will be updated to reflect Quarter 3 Monitoring for 2023/24 and future year budget reprofiling, prior to submission of this report to the Council meeting of 27 February 2024.

4.3 Borrowing Strategy for remainder of 2023/24 and 2024/25

Borrowing is undertaken to finance the Council's approved Capital plans and to do so in the most cost-effective way. As can been noted from Table 4 above the Council has a significant borrowing requirement across the current and forthcoming four financial years (2023/24 to 2027/28).

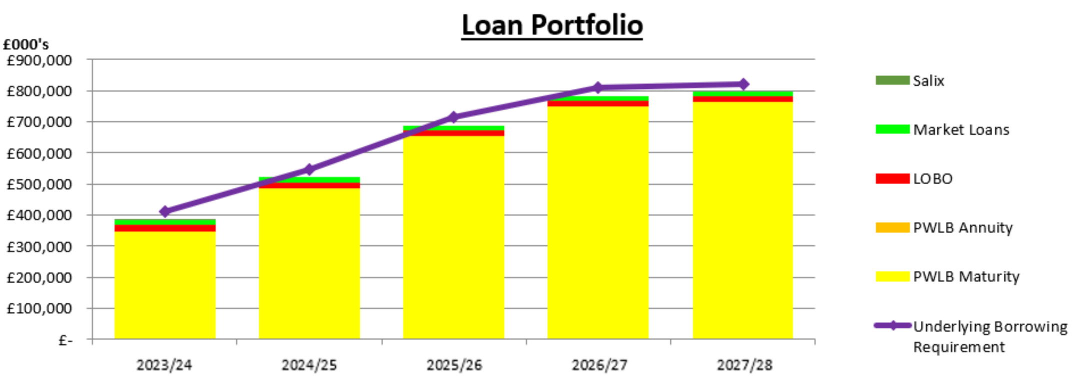
This TMIS provides for this capital investment to be underpinned by long-term borrowing, recognising the current interest rate environment, the significant borrowing requirement arising from the Council's capital plans, and the long term benefits of de risking the delivery and affordability of these capital plans by locking into the certainty brought by PWLB fixed rate loans.

The Council's **external loan debt** at 31 March 2024 is projected to be **£384.346 million**. Based on the Council's historic and current approved Capital Plans, the **Underlying Borrowing Requirement (UBR) –** which is the Council's underlying need to borrow for capital purposes (excluding the long-term liability arising from PFI/DBFM projects) – at 31 March 2024 is expected to equate to **£409.346 million**.

This means that the Council is expected to be **£25.000 million (6%) under-borrowed** at the end of the 2023/24 financial year i.e. the Council has funded the majority (94%) of its underlying borrowing requirement as at 31 March 2024. In the current economic climate, this is a prudent approach which balances (a) de-risking the longer term borrowing requirement at current longer term borrowing rates; against (b) the current year and forthcoming financial year budget projections. As noted in Section 3.1 above, the Council has an extremely low short-medium term exposure to refinancing risk and is therefore in a strong position to plan its new borrowing requirements in advance, taking advantage of any dips in longer-term borrowing rates from PWLB and other sources, and maintain a low weighted average coupon rate on external debt.

The **Underlying Borrowing Requirement** is projected to rise to **£821.137 million by 31 March 2028** – more than double the current Underlying Borrowing Requirement. The profile of this, and the projected external loan portfolio to fund the Underlying Borrowing Requirement over the period 2023/24 to 2027/28, is shown in graphical format below.

Figure 3: Loan Portfolio & Underlying Borrowing Requirement



Interest Rates

The current PWLB yield curve is bell shaped with the low point in the curve is at the 5 year mark (4.40%) with rates trending upwards towards the 20-30 year tenor (5.25%) before easing back slightly to sit at c. 5.10% in the 50 year duration. Current rates have generally eased off 30-40bps from levels reported at the time of the 2023/24 Treasury Management Mid-Year Review Report to Council, with no material change to the medium term forecast for rates.

The yield curve is expected to remain bell shaped over the short-medium term, with a gradual shift downwards of the entire curve by c. 40-60bps over the next 12 months and a further 40-50bps over the subsequent 12 months. This is forecast to bring longer-term borrowing rates down to between 4.10-4.60% by March 2025 and between 3.70%-4.20% by March 2026. Further commentary on this is provided in Appendix 3 Section 3.3.

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

The funding of the Council's in-year and forward CFR is typically for infrastructure with long asset lives (50-60 years), and the tenor of PWLB and market loans are typically drawn with this in mind.

Borrowing Strategy

Consideration for any new borrowing in the remainder of the 2023/24 financial year and during the 2024/25 financial year, to fund the Council's in-year CFR, will seek to balance:-

a) the security/certainty of current relatively high longer-term borrowing rates of upwards of 5.25% in the 30-50 year duration (which are forecast to drop by 60bps within one year and 100bps within 24 months) and the potential additional budgetary pressure that this brings in both the short/medium and longer term; with

b) the option to borrow initially for a shorter-term duration from PWLB or other markets, for 3 to 5 years (at say c. 4.40%), to allow the Council to fund the immediate in-year borrowing requirement. Based on current interest rate forecasts (see Appendix 3 Section 3.3), this would then allow the Council the option to refinance this borrowing at initial 3-5 year maturity with less expensive, longer term borrowing, e.g. a 45 to 47 year tenor in, say, 36 months at a forecast rate of c. 3.90%.

As noted in Section 3.1, the Council's proactive Treasury Management over the last decade has put the Council in a strong refinancing position for its external debt portfolio which allows the Council to slot in shorter dated external borrowing into the current debt maturity profile to fund the current & forthcoming in-year borrowing requirements, to allow the Council to navigate past the current expected hump in longer-term borrowing rates.

It is expected that any further long-term borrowing that is undertaken during 2023/24 and 2024/25 to finance the current & future year capital plans will be sourced by drawing new PWLB loans at the Certainty Rate (which has been available to the Council since 2012 and is priced at Gilts+80bps), and/or the HRA rate. The HRA rate is available to all Councils to fund HRA capital expenditure, at a rate that is priced at Gilts+60bps. On 22 November 2023, the availability over which Councils can draw HRA rate borrowing from PWLB was extended to 30 June 2025.

Both the General Services and HRA capital programmes are being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour, and the ratios of financing costs to the net revenue streams. The Council's borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, to achieve optimum value and risk exposure in the medium-long-term. The impact particularly of the General Services Capital Plan Prioritisation – which will be reported to Council in February 2024 – will have a significant bearing on this.

Appendix 3 Section 3.3 provides forecasts for interest rates from the Council's Treasury Management advisor, Link Treasury Solutions Limited. Council officers, in conjunction with Link, will continue to monitor daily long-term borrowing rates in order to take advantage of any dips in the market or to de-risk any change in the medium-longer term forecast for gilt yields.

Forward Borrowing
The opportunity also continues to exist to consider further loans on a 'forward dealing' basis, and officers will continue to explore the viability of these loans as part of securing the long term borrowing required to meet the Council's Underlying Borrowing Requirement.

Debt Rescheduling

As noted in the Mid-Year Review Report, now that the whole of the yield curve has shifted higher there may be opportunities for debt rescheduling in the remainder of the financial year.

This would involve the Council repaying loans prematurely (both market and PWLB) whilst high discount rates on premature repayment prevail.

Any debt rescheduling will be considered when the difference between the refinancing rate and the redemption rate is most advantageous and the situation will be continually monitored in order to take advantage of any perceived anomalies in the yield curve. The reasons for any rescheduling taking place would include:

- the generation of cash savings at minimum risk;
- to reduce the average interest rate;
- to amend the maturity profile and/or the balance of volatility of the debt portfolio.

Council officers will explore debt rescheduling opportunities with Link Treasury Solutions; with only prudent and affordable debt rescheduling that considers both the short and medium-longer term impact being considered.

4.4 Investment Strategy for remainder of 2023/24 and 2024/25

No changes are proposed to the Investment Strategy from that approved by Council in the 2023/24 TMIS.

Council should note that in parallel to securing its external borrowing to finance the capital financing requirement, the strategy means that Council should continue to cash back the Council's useable reserves. In doing so, the Council are able to continue to minimise the extent of under-borrowing and at the same time de-risk the Council's forward borrowing requirement; whilst also ensuring that all deposits are securely placed with high creditworthy counterparties, complying with the CIPFA Treasury Management Code principles of security, liquidity and then yield – in that order.

All deposits will be placed with high creditworthy counterparties in accordance with the approved creditworthiness policy as outlined in Appendix 1, with a tenor reflective of the expected drawdown of useable reserve forecasts, and at a yield commensurate with this.

The list of Permitted Investments in Appendix 1 also remains unchanged from that approved by Council in the 2023/24 TMIS.

As required by the CIPFA Treasury Management Code, Local authorities "must not borrow to invest for the primary purpose of financial return." Midlothian Council does not and has not borrowed to invest for the primary purpose of financial return.

Environmental, Social and Governance (ESG) in credit and counterparty policies (Treasury Management Practice 1)

As noted in the 2023/24 TMIS, the inclusion of ESG criteria continues to be an emerging area in the Local Authority environment which will require ongoing monitoring.

For the 2024/25 financial year, the Council's priorities of security, liquidity and then yield remain paramount and unchanged (and in that order), with ESG criteria an added 4th element to consider in the decision making process.

For short term investments with counterparties, this Council utilises the Link creditworthiness service which uses the ratings provided by Fitch, Moody's and Standard & Poor's to assess creditworthiness, which in themselves include analysis of ESG factors, and specifically the "G" element, when assigning ratings. Of the 3 elements of ESG, the most important element when considering treasury deposits is the Governance aspect – given the majority of treasury deposits undertaken by Midlothian Council are naturally short dated in duration, poor governance can have a more immediate impact on the financial circumstances of an entity and potential for a default event that could impact the amount of principal returned on the deposit.

Those financial institutions viewed as having poor/weak corporate governance are generally less well credit rated in the first instance or have a higher propensity for being subject to negative rating action, and the Council's existing creditworthiness policy will therefore take this into account.

Environment and Social factors are also important, but relate more to the long-term impact. Council should note that in relation to the security aspect of Treasury deposits, placing an undue weight on the Environmental and Social factors in the decision making process could have an adverse effect of limiting the list of potential counterparty options, thus decreasing diversification. This could then in turn lead to a widening of credit (security) criteria, or those with a stronger "ESG" performance, in order to restore a balance of diversification across the deposit portfolio, potentially increasing credit risk – and placing the cornerstone of prudent investing at risk.

The inclusion of ESG criteria therefore remains an area which requires ongoing review. Council officers, in conjunction with the Council's treasury advisers Link, will therefore continue to monitor and assess ongoing developments and emerging standards in this area, and methods in which the Council can incorporate ESG factors into our creditworthiness assessment process, and report back to Council accordingly.

5 Prudential Indicators – Midlothian Council

The Prudential Code for Capital Finance in Local Authorities requires that Councils can demonstrate that their Capital Plans are affordable, prudent and sustainable, taking into account the financial provisions made in current and future revenue budgets; and that Treasury Management decisions are taken in accordance with good practice.

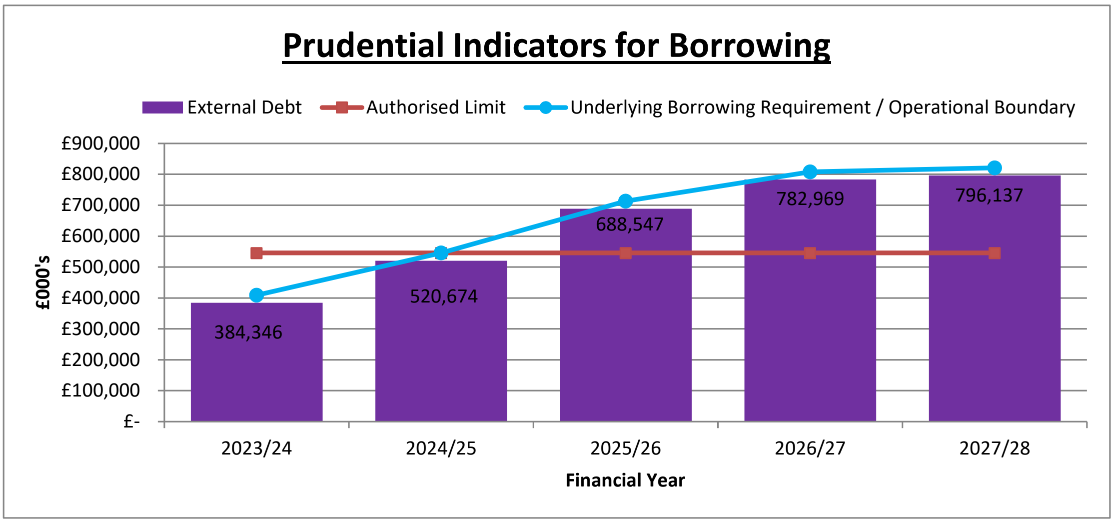
The Prudential Indicators that Councils need to consider relate to both actual, historic outcomes, and future estimated outcomes (covering the same period as the Council's Capital Plans), as follows:-

- Actual outcomes for 2022/23;
- Revised estimates of the 2023/24 indicators; and
- Estimates of indicators for 2024/25 to 2027/28.

The Prudential Indicators required by the Code are listed individually in Appendix 2.

The key Prudential Indicators relating to the Underlying Borrowing Requirement, the expected Gross External Debt, and the proposed Authorised Limit, are shown in graphical format below.

Figure 4: Prudential Indicators for Borrowing



The Capital Financing Requirement (CFR) denotes the Council's underlying need to borrow for capital purposes. The CFR includes borrowing arising as a result of the Council's Capital Plans, plus the long-term liability arising from the Council's PPP/DBFM contracts. The **Underlying Borrowing Requirement** as shown in Figure 4 above strips out the latter of these (long-term liability arising from the Council's PPP/DBFM contracts) from the CFR.

The **Authorised Limit for Borrowing** represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It is the expected maximum borrowing need with some headroom for unexpected movements.

The Authorised Limit for Borrowing for the 2024/25 financial year has been calculated to equate to the maximum value of the Underlying Borrowing Requirement in 2024/25. This equates to £545.673 million as outlined in Table 5 below.

Table 5: Authorised Limit for Borrowing: Calculation

Authorised Limit for Borrowing	**Amount £000's**
CFR – General Services (31 March 2025)	228,109
CFR – HRA (31 March 2025)	317,564
Proposed Authorised Limit for Borrowing	**545,673**

Council is therefore asked to approve an authorised limit for borrowing of £545.673 million.

6 Statutory repayment of loans fund advances

Under the Local Government Finance Circular 7/2016, Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of each financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

The TMIS retains the methodology adopted in 2023/24 – that is as follows:-

6.1 New Assets

In accordance with Finance Circular 7/2016, for all advances made in relation to the provision of a new asset, the policy will be to defer the commencement of the first principal repayment of the loans fund advance until the financial year following the one in which the asset is first available for use.

6.2 Prudent Repayment of Loans Fund Advances

Finance Circular 7/2016 provides a variety of options to Councils for the profiling of the repayment of each loans fund advance, so long as the principle of prudence is maintained. There are 4 options available: (a) Asset Life method; (b) Statutory method; (c) Depreciation method; and (d) Funding/income profile method.

In line with the policy adopted in 2023/24, the Asset Life method shall be used for those assets in Table 6.

Table 6: Asset Classes to adopt the “Asset Life” method

Infrastructure	**Current Loans Fund Advance Period**
New Primary Schools/Extensions	60
New Leisure Centres	60
New Offices	60
Road Upgrades	50
Street Lighting Columns	50
Structures/Bridges	50
Footway/Cyclepaths	50
Town Centre Environmental Improvements	50
New Care Homes	45
Children’s Play Equipment	20

* *Average loans fund advance length*

The annual repayments under the “Asset Life” method for those asset classes as noted above will be calculated using the asset lives and will use the annuity method, to ensure consistency of approach with the Statutory method for all other asset classes (see below). The annuity interest rate that will be used to calculate loans fund principal repayments under the “Asset Life” method will be the in-year loans fund rate, which for 2023/24 is currently estimated to be 2.29%.

For all other asset classes, the policy will be to maintain the practice of previous years and apply what is termed “the Statutory Method” – following the principles of Schedule 3 of the Local Government (Scotland) Act 1975 – with all loans fund advances being repaid by the annuity method. The annuity rate that is proposed to be applied to the loans fund repayments varies and will be the in-year loans fund rate, reflecting the Council’s current loan and investment portfolio. The loans fund rate for 2023/24 is forecast to be 2.29%

Whilst neither the Depreciation nor the Funding/income profile methods are currently proposed, Council officers will continue to monitor whether it is appropriate to use this for future capital projects.

6.3 Scottish Government Consultation

The Scottish Government issued a formal consultation on 28 November 2023 on the Amendment to the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016. This consultation outlined proposed changes to the methodology for the repayment of loans fund advances. The consultation closed on 22 December 2023 with Midlothian Council, the Scottish Local Authority Directors of Finance Group, and Link Treasury Solutions Limited amongst those submitting formal responses to the consultation. The outcome of any changes to these Regulations will be reflected in a revised 2024/25 TMIS if required.

7. Report Implications

7.1 Resource

There are no direct resource implications arising from this report.

7.2 Digital

None

7.3 Risk

The strategies outlined in this report are designed to maintain the effectiveness of the overall risk management arrangements for Treasury activity. Providing the limits outlined in the strategies are observed they will support the controls already in place in the Treasury Management Practices within which the treasury function operates.

The Prudential Indicators contained in Appendix 2 maintain the effectiveness of the overall risk management of Capital Investment and Treasury Management.

7.4 Ensuring Equalities

There are no equality issues arising from this report.

7.5 Additional Report Implications

See Appendix A.

Appendix A: Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Not applicable.

A.2 Key Drivers for Change

A.3 Key Delivery Streams

Themes addressed in this report:

- [ ] One Council Working with you, for you
- [x] Preventative and Sustainable
- [ ] Efficient and Modern
- [ ] Innovative and Ambitious
- [ ] None of the above

A.4 Delivering Best Value

The report does not directly impact on Delivering Best Value.

A.5 Involving Communities and Other Stakeholders

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Link Asset Services, the Council’s appointed Treasury Consultants.

A.6 Impact on Performance and Outcomes

The strategies to be adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and investment. This in turn helps to ensure that the Council’s capital expenditure is sustainable in revenue terms.

A.7 Adopting a Preventative Approach

Not applicable.

A.8 Supporting Sustainable Development

Not applicable.

Background Papers:-

Appendix 1:- Permitted Investments
Appendix 2:- Prudential Indicators
Appendix 3:- Treasury Management & Annual Investment Strategy Statement – 2024/25 Detailed

Permitted Investments Appendix 1

The Council uses the Link creditworthiness service for specific categories of permitted investments. This utilises credit ratings from the three main credit rating agencies – Fitch, Moody's and Standard & Poors, along with credit watches, outlooks, CDS spreads and country sovereign ratings in a weighted scoring system with an end product of a series of colour coded bands which indicate the relative creditworthiness of specific categories of counterparties for investment.

These colour codes are used by the Council to determine the maximum suggested duration for investment with that counterparty. These are as follows:-

Link Asset Services Colour Code	**Maximum Suggested Duration for Investment**
Yellow	6 years*
Dark Pink	6 years**
Light Pink	6 years**
Purple	2.5 years
Blue	1.25 years***
Orange	1.25 years
Red	7 months
Green	120 days
No colour	Not to be used

* *Note the yellow colour category is for:- UK Government Debt, or its equivalent, Money Market Funds (MMF's), and collateralised deposits where the collateral is UK Government Debt*

** *Dark Pink for Ultra Short Dated Bond Funds with a credit score of 1.25; Light Pink for Ultra Short Dated Bond Funds with a credit score of 1.5*

*** *Only applies to nationalised or semi-nationalised UK banks*

Note that the maximum suggested durations listed above have been extended by 1 year (when compared to the suggested maximum durations provided by Link) for the Yellow, Dark Pink, Light Pink categories (and so to 6 years); the Purple category by 6 months to 2.5 years; the Blue and Orange categories by 3 months to 1.25 years; the Red category by a month to 7 months, and the Green category by 20 days to 120 days. This is to allow flexibility around these durations on the margins e.g. the placement of a 13 month fixed term deposit for a counterparty rated Orange or Blue. A thorough appraisal of the additional risk involved in extending the duration of any deposit (marginally) beyond the maximum suggested by Link, against any enhanced value to the portfolio, will be undertaken prior to the placement of any deposit.

1.1 Deposits

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Debt Management Agency Deposit Facility	--	Term	No	**100%**	**6 months**
Term deposits – local authorities	--	Term	No	**100%**	**5 years**
Call accounts – banks and building societies	Green	Instant	No	**100%**	**1 day**
Term deposits / Notice Accounts – banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**

1.2 Deposits with counterparties currently in receipt of government support / ownership

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
UK nationalised banks – Call accounts	Blue	Instant	No	**100%**	**1 day**
UK nationalised banks – Term Deposits / Notice Accounts	Blue	Term	No	**100%**	**1.25 years**
UK nationalised banks – Fixed term deposits with variable rate and variable maturities: - Structured deposits	Blue	Term	No	**100%**	**1.25 years**
Non-UK(high sovereign rated country) nationalised banks – Call accounts	Green	Instant	No	**100%**	**1 day**
Non-UK (high sovereign rated country) nationalised banks:- Term Deposits / Notice Accounts	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**
Non-UK (high sovereign rated country) nationalised banks:- Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**

If forward deposits are made, the forward period plus the deal period equate to the maximum maturity period.

1.3 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Government Liquidity Funds	AAA	Instant	No	**100%**	**1 day**
Money Market Funds CNAV	AAA	Instant	No	**100%**	**1 day**
Money Market Funds LVNAV	AAA	Instant	No	**100%**	**1 day**
Money Market Funds VNAV	AAA	Instant	No	**100%**	**1 day**
Ultra Short Dated Bond Funds with a credit score of 1.25	AAA	T+1 to T+5	Yes	**100%**	**1 week**
Ultra Short Dated Bond Funds with a credit score of 1.5	AAA	T+1 to T+5	Yes	**100%**	**1 week**
Bond Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**
Gilt Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**

1.4 Securities issued or guaranteed by governments

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max %?£m of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	Yes	**100%**	**50 years**
UK Government Gilts	UK sovereign rating	Sale T+1	Yes	**100%**	**50 years**
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	Sale T+3	Yes	**100%**	**50 years**
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**

1.5 Securities issued by corporate organisations

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Certificates of deposit issued by banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**
Commercial paper other	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**
Floating rate notes	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**
Corporate Bonds other	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**

1.6 Other

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Local authority mortgage guarantee scheme.	Blue	Term	No	**50%**	**5 years**
Loans to Third Parties	n/a	Term	No	**£25m**	**25 years**
Subordinated Debt Subscription to Newbattle Centre SPV	n/a	Term	No	**£0.326m**	**22 years**
Midlothian Energy Limited	n/a	Term	No	**£10.2m**	**n/a**

Treasury Risks and Mitigating Controls for each type of investment are as outlined in the Treasury Management & Annual Investment Strategy Statement – 2023/24 Detailed – Appendix 5.3. The Council's Treasury Management Practices have also been updated in line with the new CIPFA Prudential and Treasury Management Codes which were approved by Audit Committee on 6 December 2022.

Prudential Indicators Appendix 2

1. Prudential Indicators for Affordability

These indicators provide an indication of the impact of the capital investment plans on the Council's overall finances.

1.1 Estimates of Ratio of Financing Costs to Net Revenue Stream

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

Ratio of Financing Costs to Net Revenue Stream						
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
General Services	0.38%	0.76%	2.40%	4.37%	5.62%	5.95%
HRA	36.03%	42.47%	48.01%	52.14%	55.00%	56.97%

The figures above are based on the current General Services and HRA Capital Plans.

1.2 HRA Ratios

The following indicator identifies the ratio of overall debt on the HRA account compared to annual house rent revenue.

HRA Debt as a % of Gross Revenue						
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
HRA debt £000's	£ 209,129	£ 244,290	£ 317,564	£ 390,437	£ 418,804	£ 436,365
HRA Revenues £000's	32,165	32,492	34,719	38,546	41,828	43,276
Ratio of HRA Debt to Revenues %	650%	752%	915%	1013%	1001%	1008%

The following indicator identifies the ratio of overall debt on the HRA account per HRA dwelling.

HRA Debt per Dwelling						
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
HRA debt £000's	£ 209,129	£ 244,290	£ 317,564	£ 390,437	£ 418,804	£ 436,365
Number of HRA dwellings	7,372	7,470	7,675	8,029	8,284	8,289
Debt per dwelling £	£ 28,368	£ 32,703	£ 41,376	£ 48,628	£ 50,556	£ 52,644

1.3 Net Income from Service & Commercial Investments as a proportion of Net Revenue Stream

A new indicator, which is a requirement of the new Prudential Code, identifies the ratio of net income from service and commercial investments as a proportion of the net General Services revenue stream.

Net Income from Service Investments as a proportion of Net Revenue Stream						
%	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	Actual £000's	Estimate £000's	Estimate £000's	Estimate £000's	Estimate £000's	Estimate £000's
Income from Service Investments	34	34	34	34	34	34
Net Revenue Stream	254,015	257,849	259,731	261,670	263,667	265,723
%	0.01%	0.01%	0.01%	0.01%	0.01%	0.01%

2. Prudential Indicators for Capital Expenditure

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.

2.1 Estimated Capital Expenditure

This indicator shows the gross capital spend included in the relevant capital plans.

Capital Expenditure	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
General Services						
Children, Young People & Estates	£ 5,300	£ 29,096	£ 45,647	£ 104,189	£ 81,483	£ 8,610
Asset Management	£ 11,439	£ 14,204	£ 18,682	£ 10,597	£ 9,982	£ 5,912
Transport, Energy & Infrastructure	£ 551	£ 3,412	£ 17,122	£ 3,254	£ 425	£ 425
Regeneration & Development	£ 1,059	£ 15,380	£ 18,371	£ 721	£ 800	£ -
Other	£ 5,014	£ 3,334	£ 11,574	£ 6,104	£ 701	£ 528
Provision for return of contingencies	£ (41)	£ (506)	£ (2,539)	£ (2,890)	£ (3,627)	£ (3,347)
Total General Services	**£ 23,322**	**£ 64,921**	**£ 108,857**	**£ 121,975**	**£ 89,765**	**£ 12,128**
Total HRA	**£ 51,710**	**£ 52,125**	**£ 99,585**	**£ 91,901**	**£ 36,647**	**£ 26,128**
Combined Total	**£ 75,032**	**£ 117,046**	**£ 208,442**	**£ 213,876**	**£ 126,412**	**£ 38,256**

2.2 Financing of Capital Expenditure

This indicator shows how the Capital Expenditure forecasts are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital Expenditure and Available Financing	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
Capital Expenditure						
General Services	£ 23,322	£ 64,921	£ 108,857	£ 121,975	£ 89,765	£ 12,128
HRA	£ 51,710	£ 52,125	£ 99,585	£ 91,901	£ 36,647	£ 26,128
Total	**£ 75,032**	**£ 117,046**	**£ 208,442**	**£ 213,876**	**£ 126,412**	**£ 38,256**
Financed by:						
Capital receipts	£ 3	£ 60	£ -	£ -	£ -	£ -
Capital grants	£ 20,203	£ 26,397	£ 38,962	£ 19,791	£ 7,231	£ 7,121
Capital reserves	£ 3,000	£ 2,473	£ 7,694	£ -	£ -	£ -
Developer/Other Contributions	£ 5,353	£ 17,935	£ 18,258	£ 14,542	£ 12,201	£ 3,772
Net financing need for the year	**£ 46,473**	**£ 70,181**	**£ 143,528**	**£ 179,543**	**£ 106,980**	**£ 27,363**

2.3 Estimated Capital Financing Requirement

This indicator measures the Council's maximum underlying need to borrow for capital purposes and other long term liabilities over the next three years.

Capital Financing Requirement (CFR)	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
Capital Financing Requirement						
CFR – General Services	£ 138,532	£ 165,056	£ 228,109	£ 323,109	£ 389,164	£ 384,772
CFR – HRA	£ 209,129	£ 244,290	£ 317,564	£ 390,437	£ 418,804	£ 436,365
CFR – PFI Schemes	£ 92,433	£ 88,739	£ 84,815	£ 80,661	£ 76,277	£ 71,663
Total CFR	**£ 440,094**	**£ 498,085**	**£ 630,488**	**£ 794,207**	**£ 884,246**	**£ 892,800**
Movement in CFR	**£ 37,230**	**£ 57,991**	**£ 132,404**	**£ 163,719**	**£ 90,039**	**£ 8,554**
Movement in CFR represented by						
Net financing need for the year (previous table)	£ 46,473	£ 70,181	£ 143,528	£ 179,543	£ 106,980	£ 27,363
MEL Shareholder Injection	£ -	£ 710	£ 3,560	£ -	£ -	£ -
Less Scheduled Debt Amortisation	£ (5,762)	£ (9,206)	£ (10,760)	£ (11,670)	£ (12,557)	£ (14,195)
Less net PFI Finance Lease Principal Payments	£ (3,481)	£ (3,694)	£ (3,924)	£ (4,154)	£ (4,384)	£ (4,614)
Movement in CFR	**£ 37,230**	**£ 57,991**	**£ 132,404**	**£ 163,719**	**£ 90,039**	**£ 8,554**

3. Prudential Indicators for Prudence

3.1 Net Borrowing Requirement

This indicator shows the amount of external borrowing required to finance the current debt outstanding on capital projects.

Net Borrowing Requirement	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
External Debt						
Debt at 1 April	£ 323,271	£ 321,753	£ 384,346	£ 520,674	£ 688,547	£ 782,969
Actual/Expected change in Debt	£ (1,518)	£ 62,593	£ 136,328	£ 167,873	£ 94,423	£ 13,168
Other long-term liabilities (OLTL) at 1 April	£ 95,914	£ 92,433	£ 88,739	£ 84,815	£ 80,661	£ 76,277
Actual/Expected change in OLTL	£ (3,481)	£ (3,694)	£ (3,924)	£ (4,154)	£ (4,384)	£ (4,614)
Actual/Expected Gross Debt at 31 March	**£ 414,186**	**£ 473,085**	**£ 605,489**	**£ 769,208**	**£ 859,246**	**£ 867,800**
The Capital Financing Requirement	**£ 440,094**	**£ 498,085**	**£ 630,488**	**£ 794,207**	**£ 884,246**	**£ 892,800**
Under / (over) borrowing	**£ 25,908**	**£ 25,000**	**£ 25,000**	**£ 25,000**	**£ 25,000**	**£ 25,000**
Deposits						
Cash & Cash Equivalents	£ 15,982	£ 25,000	£ 25,000	£ 25,000	£ 25,000	£ 25,000
Short-Term Investments	£ 98,000	£ 70,000	£ 57,000	£ 57,000	£ 57,000	£ 57,000
Total Deposits	**£ 113,982**	**£ 95,000**	**£ 82,000**	**£ 82,000**	**£ 82,000**	**£ 82,000**

4. Prudential Indicators for External Debt

4.1 Operational Boundary

This is the limit beyond which external debt is not normally expected to exceed and will be the focus of day to day treasury management. Typically, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

For this Council:-

- the Operational Boundary for Borrowing has been calculated to equate directly to the value of the CFR for General Services and HRA combined, over the current financial year and the following 4 financial years (2023/24 to 2027/28); and
- the Operational Boundary for Other Long-Term Liabilities has been calculated to equate directly to the in-year CFR for Other Long-Term Liabilities, given the known contractual provisions for the repayment of debt within the Council's two PPP agreements.

Operational Boundary					
	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
Operational Boundary - Borrowing	£ 409,346	£ 545,673	£ 713,546	£ 807,969	£ 821,137
Operational Boundary - Other long term liabilities	£ 88,739	£ 84,815	£ 80,661	£ 76,277	£ 71,663
Total	**£ 498,085**	**£ 630,488**	**£ 794,207**	**£ 884,246**	**£ 892,800**

Should the Operational Boundary be breached, for example as a result of a decision taken to borrow in advance (should market conditions indicate that it is prudent to do so), this will be reported to Council at the next available opportunity.

4.2 Authorised Limit of Total External Debt

This indicator sets the limit for total external debt.

The Authorised Limit for Borrowing for the 2024/25 financial year has been calculated to equate to the maximum value of the Underlying Borrowing Requirement in 2024/25. This equates to £545.673 million as outlined below.

Authorised Limit for Borrowing	
	£000's
CFR - General Services at 31 March 2025	£ 228,109
CFR - HRA at 31 March 2025	£ 317,564
Authorised Limit for Borrowing	**£ 545,673**

5. Prudential Indicators for Treasury Management

5.1 Upper limits on Fixed and Variable Interest Rates

This indicator limits the amount of external debt that may be held at fixed or variable rates. These limits are proposed to be as follows:-

Upper Limits on Exposure to Fixed and Variable Interest Rates 2024/25	
Interest rate exposures	**Upper Limit**
Limits on fixed interest rates based on gross debt	100.00%
Limits on variable interest rates based on gross debt	30.00%
Limits on fixed interest rates based on investments	100.00%
Limits on variable interest rates based on investments	100.00%

5.2 Maturity Structure of Borrowing

This indicator sets the upper and lower limits of the time scales within which external debt may be held.

The Treasury Management Code of Practice requires that LOBO's with a call date in the next 12 months are classified as short-term borrowing rather than longer-term (10 year+) borrowing.

In addition, the Code also recommends that where an authority's debt is typically very long term (i.e. for a period of greater than 10 years), that authorities should break down the period in excess of 10 years into several ranges, for example 10 to 20 years, 20 to 30 years, etc.

With the above in mind, the proposed upper and lower limits for each maturity band are shown below, with the overall aim to ensure a spreading approach to avoid a cluster of high value loans maturing/requiring refinancing within a short period of time.

Maturity Structure of Borrowing 2024/25		
Maturity structure of fixed interest rate borrowing 2024/25	**Lower**	**Upper**
Under 12 months	0.00%	50.00%
12 months to 2 years	0.00%	50.00%
2 years to 5 years	0.00%	50.00%
5 years to 10 years	0.00%	50.00%
10 years to 20 years	0.00%	50.00%
20 years to 30 years	0.00%	50.00%
30 years to 40 years	0.00%	50.00%
40 years to 50 years	0.00%	50.00%
50 years and above	0.00%	50.00%
Maturity structure of variable interest rate borrowing 2024/25	**Lower**	**Upper**
Under 12 months	0.00%	30.00%
12 months to 2 years	0.00%	30.00%
2 years to 5 years	0.00%	30.00%
5 years to 10 years	0.00%	30.00%
10 years to 20 years	0.00%	30.00%
20 years to 30 years	0.00%	30.00%
30 years to 40 years	0.00%	30.00%
40 years to 50 years	0.00%	30.00%
50 years and above	0.00%	30.00%

5.4 Total Principal Sums Invested for Periods Longer than 365 Days

This indicator relates to the total level of investments held for periods longer than 365 days.

Principal Sums Invested for > 365 Days		
Limit		£70m

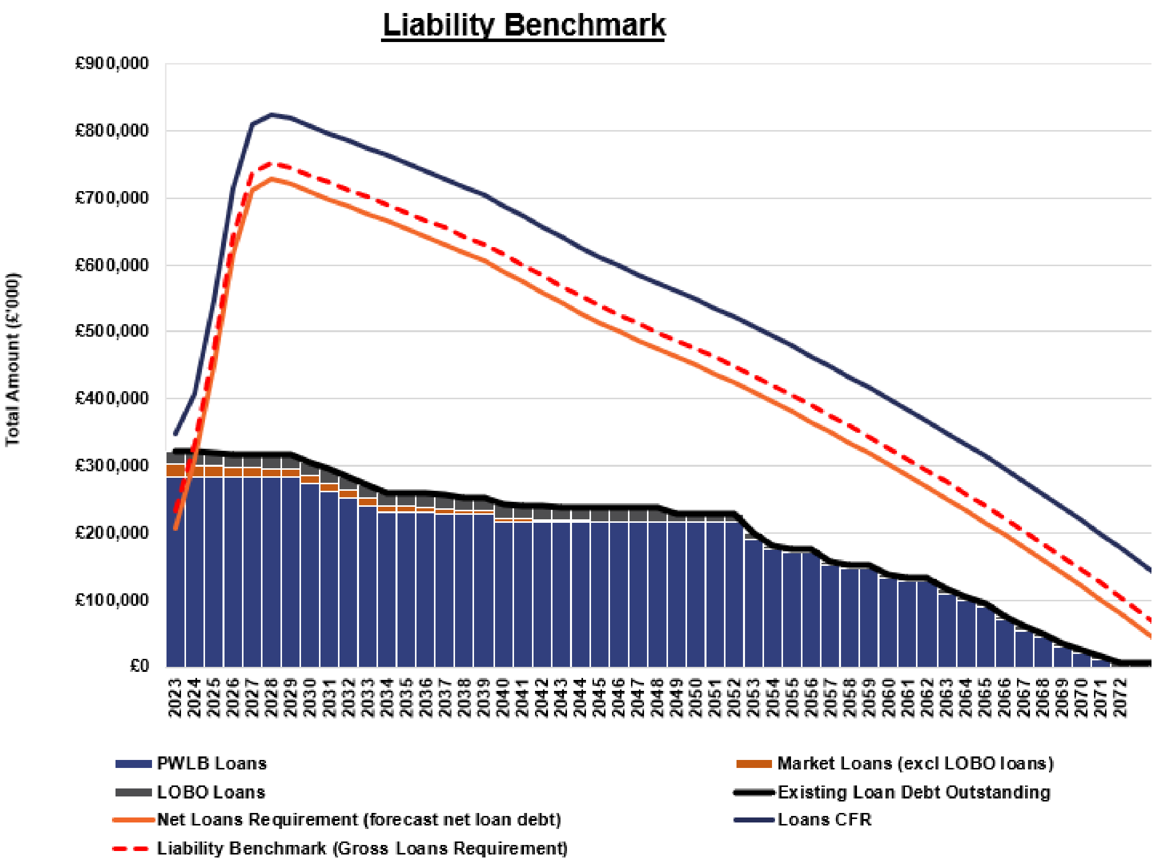
The current strategy as outlined in the body of these reports is to continue to cash-back the Council's balance sheet reserves. It is expected that the majority of this will be in the form of fixed term deposits and/or certificates of deposit. Given expected reserve forecasts and the current interest rate environment, in particular the short-medium term forecast for the Council's Capital Fund and HRA Reserve, the limit for prinicipal sums invested for > 365 days has been retained at £70m.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access accounts and money market funds.

5.5 Liability Benchmark

The "Liability Benchmark" identifies future borrowing needs across the short, medium and longer terms, against the maturity profile of the Council's existing loan portfolio.

The Council's Liability Benchmark in graphical format is as shown below.



There are four components to the Liability Benchmark: -

1 **Existing loan debt outstanding**: the Council's existing loans that are still outstanding in future years – shown as the stacked bar elements of the figure above.

2 **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned Loans Fund advances/Loans Fund principal repayments.
3 **Net loans requirement**: this shows the Council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned Loans Fund principal repayments and any other major cash flows (drawdowns/enhancement of reserves) forecast.
4 **Liability benchmark (or gross loans requirement)**: this equals net loans requirement plus short-term liquidity/working capital allowance.

The Liability Benchmark Indicator identifies the Council's expected future capital financing requirement, as driven by the Council's approved Capital Plans – and therefore the Council's future borrowing needs; along with how this matches to the existing debt maturity profile. It is therefore a key tool to support the financing risk management of the capital financing requirement.

As can be noted from the figure above, the Council has a significant borrowing requirement (which equates to £478.638 million) in the short-medium term, arising as a direct result of the Council's approved Capital Plans. The proposed approach to securing this borrowing need for the 2024/25 financial year is outlined in the main body of this report, Section 4.3.

The Liability Benchmark also outlines the profile of the Council's CFR over the medium-long term, against the Council's existing debt portfolio maturity profile. As can be seen from the figure above, the profile of the CFR movements in the medium-long term broadly matches the movements in the Councils external debt portfolio over this period.

The Debt Liability Benchmark will assist the Council with plotting the tenor of borrowing to finance the Council's approved capital plans that is undertaken in the remainder of 2023/24 and the forthcoming 2024/25 period, to ensure that this aligns with the Council's future expected CFR profile and Liability Benchmark projections, taking into account the profile of existing loan maturities as identified in the figure above.

Appendix 3

Treasury Management Strategy Statement
and Annual Investment Strategy

Midlothian Council
2024/25

INDEX

1 INTRODUCTION

1.1 Background

The main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. As such, the second part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are deposited with low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

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

CIPFA defines treasury management as:

> *"The management of the local authority's borrowing, investments and cash flows, 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."*

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

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA Prudential and Treasury Management Codes require all local authorities to prepare an additional report, a capital strategy report, which provides the following:

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

The aim of the capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.2.2 Treasury Management Reporting

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

a) **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:
   - the capital plans (including prudential indicators) for 2023/24 to 2027/28;
   - a policy for the statutory repayment of debt, (how residual capital expenditure is charged to revenue over time);
   - the treasury management strategy (how the investments and borrowings are to be organised) for 2024/25, including treasury indicators; and
   - a permitted investment strategy for 2024/25 (the parameters on how investments are to be managed).

b) **A mid year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the actual treasury strategy is meeting the strategy outlined in advance of the year, or whether any policies require revision.

c) **An annual treasury outturn report** – This provides details of a selection of actual prudential and treasury indicators for the previous financial year and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee with this report being presented to Audit Committee prior to consideration by Council. Revisions arising from Audit Committee consideration of the report on 29 January 2024 will be incorporated into the final version of the report to Council on 27 February 2024.

1.3 Treasury Management Strategy for 2024/25

The strategy for 2024/25 covers two main areas:

Capital issues

- the capital expenditure plans and the prudential indicators (Section 2 of this report);
- The policy for the statutory repayment of loans fund advance (Section 2.4 of this report).

Treasury management issues

- policy on use of external service providers (Section 1.5);
- the current treasury position (Section 3.1);
- treasury indicators which limit the treasury risk and activities of the Council (Section 3.2);
- prospects for interest rates (Section 3.3);
- the borrowing strategy (Section 3.4);
- policy on borrowing in advance of need (Section 3.5);
- debt rescheduling (Section 3.6);
- the investment strategy (Section 4.1); and
- creditworthiness policy (Section 4.2).

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and The Scottish Government Local Authority (Capital Finance & Accounting) (Scotland) Regulations 2016.

1.4 Training

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

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

Organisations need to consider how to assess whether treasury management staff and board/ council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

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

- Record attendance at training.
- Prepare tailored learning plans for treasury management officers and board/council members.
- Require treasury management officers and board/council members to undertake self-assessment against the required competencies.
- Have regular communication with officers and board/council members, encouraging them to highlight training needs on an ongoing basis."

In further support of the revised training requirements, CIPFA's Better Governance Forum and Treasury Management Network have produced a 'self-assessment by members responsible for the scrutiny of treasury management', which is available from the CIPFA website to download. This was presented to members of the Audit Committee and Council as part of the Council's Treasury Management 2021-22 Mid-Year Review Report.

A formal record of Knowledge & Skills Schedule has been developed as part of the Council's Treasury Management Practices. This will be periodically reviewed to assess suitability, and updated to reflect ongoing training, knowledge and skills gained. Similarly, a formal record of the treasury management/capital finance training received by members will also be periodically reviewed and updated.

1.5 Treasury management consultants

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

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

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

2 THE CAPITAL PRUDENTIAL INDICATORS 2023/24 – 2027/28

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.

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The table below summarises the Capital Expenditure forecasts:-

Table 1: Capital Expenditure

	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
General Services						
Children, Young People & Estates	£ 5,300	£ 29,096	£ 45,647	£ 104,189	£ 81,483	£ 8,610
Asset Management	£ 11,439	£ 14,204	£ 18,682	£ 10,597	£ 9,982	£ 5,912
Transport, Energy & Infrastructure	£ 551	£ 3,412	£ 17,122	£ 3,254	£ 425	£ 425
Regeneration & Development	£ 1,059	£ 15,380	£ 18,371	£ 721	£ 800	£ -
Other	£ 5,014	£ 3,334	£ 11,574	£ 6,104	£ 701	£ 528
Provision for return of contingencies	£ (41)	£ (506)	£ (2,539)	£ (2,890)	£ (3,627)	£ (3,347)
Total General Services	**£ 23,322**	**£ 64,921**	**£ 108,857**	**£ 121,975**	**£ 89,765**	**£ 12,128**
Total HRA	**£ 51,710**	**£ 52,125**	**£ 99,585**	**£ 91,901**	**£ 36,647**	**£ 26,128**
Combined Total	**£ 75,032**	**£ 117,046**	**£ 208,442**	**£ 213,876**	**£ 126,412**	**£ 38,256**

The table below shows how the Capital Expenditure forecasts are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Table 2: Capital Expenditure and Available Financing

	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
Capital Expenditure						
General Services	£ 23,322	£ 64,921	£ 108,857	£ 121,975	£ 89,765	£ 12,128
HRA	£ 51,710	£ 52,125	£ 99,585	£ 91,901	£ 36,647	£ 26,128
Total	**£ 75,032**	**£ 117,046**	**£ 208,442**	**£ 213,876**	**£ 126,412**	**£ 38,256**
Financed by:						
Capital receipts	£ 3	£ 60	£ -	£ -	£ -	£ -
Capital grants	£ 20,203	£ 26,397	£ 38,962	£ 19,791	£ 7,231	£ 7,121
Capital reserves	£ 3,000	£ 2,473	£ 7,694	£ -	£ -	£ -
Developer/Other Contributions	£ 5,353	£ 17,935	£ 18,258	£ 14,542	£ 12,201	£ 3,772
Net financing need for the year	**£ 46,473**	**£ 70,181**	**£ 143,528**	**£ 179,543**	**£ 106,980**	**£ 27,363**

Note: The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

2.2 The Council's borrowing need (the Capital Financing Requirement)

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

The CFR does not increase indefinitely, as annual repayments from revenue need to be made which reflect the useful life of capital assets financed from borrowing. From 1st April 2016, Local Authorities may choose whether to use scheduled debt amortisation (loans pool charges) or another suitable method of calculation in order to repay borrowing.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme already include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £95.914m of such schemes within the CFR. The Council is asked to approve the CFR projections below:

Table 3: Capital Financing Requirement (CFR)

	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
Capital Financing Requirement						
CFR – General Services	£ 138,532	£ 165,056	£ 228,109	£ 323,109	£ 389,164	£ 384,772
CFR – HRA	£ 209,129	£ 244,290	£ 317,564	£ 390,437	£ 418,804	£ 436,365
CFR – PFI Schemes	£ 92,433	£ 88,739	£ 84,815	£ 80,661	£ 76,277	£ 71,663
Total CFR	**£ 440,094**	**£ 498,085**	**£ 630,488**	**£ 794,207**	**£ 884,246**	**£ 892,800**
Movement in CFR	**£ 37,230**	**£ 57,991**	**£ 132,404**	**£ 163,719**	**£ 90,039**	**£ 8,554**
Movement in CFR represented by						
Net financing need for the year (previous table)	£ 46,473	£ 70,181	£ 143,528	£ 179,543	£ 106,980	£ 27,363
MEL Shareholder Injection	£ -	£ 710	£ 3,560	£ -	£ -	£ -
Less Scheduled Debt Amortisation	£ (5,762)	£ (9,206)	£ (10,760)	£ (11,670)	£ (12,557)	£ (14,195)
Less net PFI Finance Lease Principal Payments	£ (3,481)	£ (3,694)	£ (3,924)	£ (4,154)	£ (4,384)	£ (4,614)
Movement in CFR	**£ 37,230**	**£ 57,991**	**£ 132,404**	**£ 163,719**	**£ 90,039**	**£ 8,554**

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 2.1 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

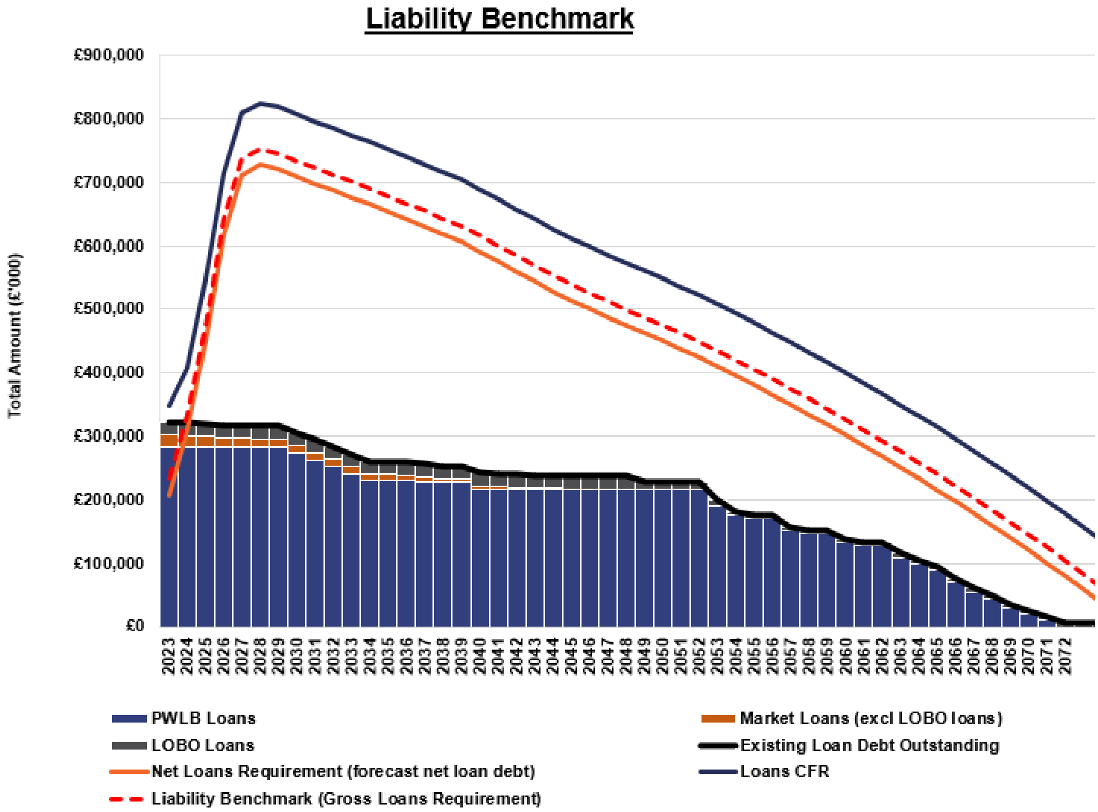
2.3 Liability Benchmark

A third prudential indicator is the Debt Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

There are four components to the Liability Benchmark: -

1. **Existing loan debt outstanding**: the Council's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned Loans Fund advances/Loans Fund principal repayments.
3. **Net loans requirement**: this shows the Council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned Loans Fund principal repayments and any other major cash flows (drawdowns/enhancement of reserves) forecast.

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



2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Table 4: Balance Sheet Resources						
Reserve	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
HRA Balances	£ 32,143	£ 34,384	£ 35,762	£ 37,087	£ 38,367	£ 39,100
General Fund Balances	£ 9,877	£ 7,000	£ 5,000	£ 5,000	£ 5,000	£ 5,000
Earmarked reserves	£ 24,317	£ 4,399	£ 2,000	£ -	£ -	£ -
Provisions	£ 4,138	£ 4,000	£ 3,900	£ 3,800	£ 3,700	£ 3,600
Capital Fund	£ 20,107	£ 17,984	£ 10,290	£ 10,290	£ 10,290	£ 10,290
Total Reserves / Core Funds	**£ 90,582**	**£ 67,767**	**£ 56,952**	**£ 56,177**	**£ 57,357**	**£ 57,990**
Working capital*	£ 49,308	£ 52,233	£ 50,048	£ 50,823	£ 49,643	£ 49,010
Under/over borrowing	£ 25,908	£ 25,000	£ 25,000	£ 25,000	£ 25,000	£ 25,000
Expected investments	**£ 113,982**	**£ 95,000**	**£ 82,000**	**£ 82,000**	**£ 82,000**	**£ 82,000**

**Working capital balances shown are estimated year-end; these may be higher mid-year*

2.5 Statutory repayment of loans fund advances

Under the Local Government Finance Circular 7/2016, Council is now required to set out its policy for the statutory repayment of loans fund advances prior to the start of each financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

It is proposed to retain the methodology adopted in 2023/24 – that is as follows:-

New Assets

In accordance with Finance Circular 7/2016, for all advances made in relation to the provision of a new asset, the policy will be to defer the commencement of the first principal repayment of the loans fund advance until the financial year following the one in which the asset is first available for use.

Prudent Repayment of Loans Fund Advances

Finance Circular 7/2016 provides a variety of options to Councils for the profiling of the repayment of each loans fund advance, so long as the principle of prudence is maintained. There are 4 options available: (a) Asset Life method; (b) Statutory method; (c) Depreciation method; and (d) Funding/income profile method.

In line with the policy adopted in 2023/24, the Asset Life method shall be used for those assets in Table 6.

Table 5: Asset Classes to adopt the "Asset Life" method

Infrastructure	**Curren Loans Fund Advance Period**
New Primary Schools/Extensions	60
New Leisure Centres	60
New Offices	60
Road Upgrades	50
Street Lighting Columns	50
Structures/Bridges	50
Footway/Cyclepaths	50
Town Centre Environmental Improvements	50
New Care Homes	45
Children's Play Equipment	20

* *Average loans fund advance length*

The annual repayments under the "Asset Life" method for those asset classes as noted above will be calculated using the asset lives and will use the annuity method, to ensure consistency of approach with the Statutory method for all other asset classes (see below). The annuity interest rate that will be used to calculate loans fund principal repayments under the "Asset Life" method will be the in-year loans fund rate, which for 2023/24 is currently estimated to be 2.21%.

For all other asset classes, the policy will be to maintain the practice of previous years and apply what is termed "the Statutory Method" – following the principles of Schedule 3 of the Local Government (Scotland) Act 1975 – with all loans fund advances being repaid by the annuity method. The annuity rate that is proposed to be applied to the loans fund repayments varies will be the in-year loans fund rate, reflecting the Council's current loan and investment portfolio. The loans fund rate for 2023/24 is forecast to be 2.21%

Whilst neither the Depreciation nor the Funding/income profile methods are currently proposed, Council officers will continue to monitor whether it is appropriate to use this for future capital projects.

3 Borrowing

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

3.1 Treasury management portfolio position

The overall treasury management portfolio as at 31 March 2023 and for the position as at 17 January 2024 are shown below for both borrowing and investments.

Table 6: Portfolio Position 31 March 2023 and 17 January 2024

Loan Type	31 March 2023 Principal Outstanding £000's	31 March 2023 Weighted Average Rate	17 January 2024 Principal Outstanding £000's	17 January 2024 Weighted Average Rate
PWLB Annuity	505	8.91%	452	8.91%
PWLB Maturity	284,128	2.90%	284,128	2.90%
LOBO	20,000	4.51%	20,000	4.51%
Market Loans	16,886	2.68%	16,221	2.68%
Salix Loans	235	0.00%	70	0.00%
Total Loans	**321,754**	**3.00%**	**320,871**	**3.00%**

Deposit Type	31 March 2023 Principal Outstanding £000's	31 March 2023 Weighted Average Rate	17 January 2024 Principal Outstanding £000's	17 January 2024 Weighted Average Rate
Bank Call Accounts	2	3.80%	7,343	5.09%
Money Market Funds	15,980	3.96%	35,073	5.32%
Bank Fixed Term Deposits	86,000	3.93%	30,000	4.98%
Bank Certificates of Deposit	10,000	2.85%	-	0.00%
Other Local Authorities	2,000	1.60%	-	0.00%
Total Deposits	**113,982**	**3.80%**	**72,416**	**5.15%**

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

Table 7: Net Borrowing Requirement

	2022/23 Actual £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
External Debt						
Debt at 1 April	£ 323,271	£ 321,753	£ 384,346	£ 520,674	£ 688,547	£ 782,969
Actual/Expected change in Debt	£ (1,518)	£ 62,593	£ 136,328	£ 167,873	£ 94,423	£ 13,168
Other long-term liabilities (OLTL) at 1 April	£ 95,914	£ 92,433	£ 88,739	£ 84,815	£ 80,661	£ 76,277
Actual/Expected change in OLTL	£ (3,481)	£ (3,694)	£ (3,924)	£ (4,154)	£ (4,384)	£ (4,614)
Actual/Expected Gross Debt at 31 March	**£ 414,186**	**£ 473,085**	**£ 605,489**	**£ 769,208**	**£ 859,246**	**£ 867,800**
The Capital Financing Requirement	**£ 440,094**	**£ 498,085**	**£ 630,488**	**£ 794,207**	**£ 884,246**	**£ 892,800**
Under / (over) borrowing	**£ 25,908**	**£ 25,000**	**£ 25,000**	**£ 25,000**	**£ 25,000**	**£ 25,000**
Deposits						
Cash & Cash Equivalents	£ 15,982	£ 25,000	£ 25,000	£ 25,000	£ 25,000	£ 25,000
Short-Term Investments	£ 98,000	£ 70,000	£ 57,000	£ 57,000	£ 57,000	£ 57,000
Total Deposits	**£ 113,982**	**£ 95,000**	**£ 82,000**	**£ 82,000**	**£ 82,000**	**£ 82,000**

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2024/25.

The Chief Financial Officer & Section 95 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

For this Council:-

- the Operational Boundary for Borrowing has been calculated to equate directly to the in-year value of the CFR over the current and following 4 financial years (2023/24 to 2027/28); and
- the Operational Boundary for Other Long-Term Liabilities has been calculated to equate directly to the in-year CFR for Other Long-Term Liabilities, given the known contractual provisions for the repayment of debt within the Council's two PPP agreements.

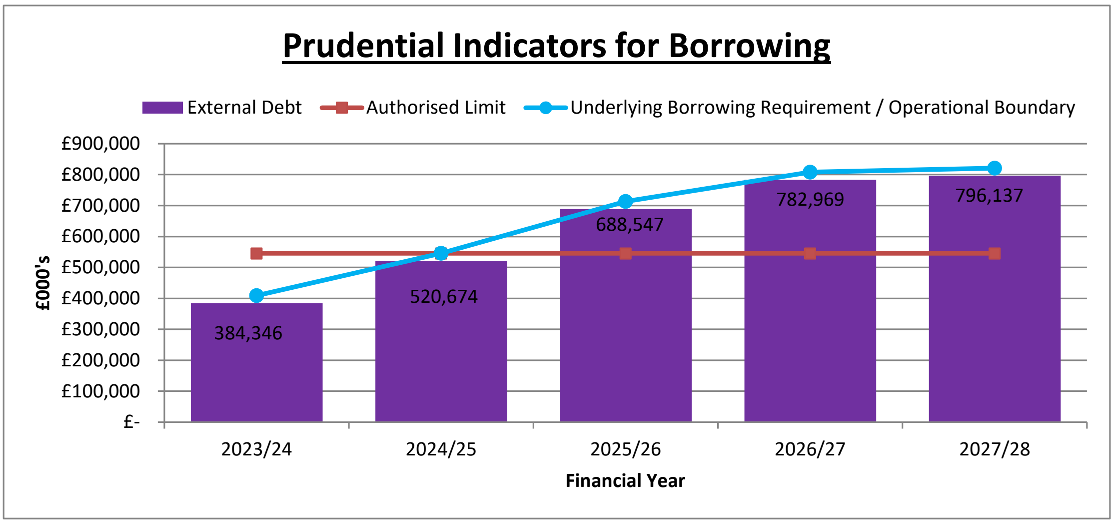
Table 8: Operational Boundary					
	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
Operational Boundary - Borrowing	£ 409,346	£ 545,673	£ 713,546	£ 807,969	£ 821,137
Operational Boundary - Other long term liabilities	£ 88,739	£ 84,815	£ 80,661	£ 76,277	£ 71,663
Total	**£ 498,085**	**£ 630,488**	**£ 794,207**	**£ 884,246**	**£ 892,800**

The authorised limit for external debt

This indicator sets the limit for total external debt.

The Authorised Limit for Borrowing for the 2024/25 financial year has been calculated to equate to the maximum value of the Underlying Borrowing Requirement in 2024/25. This equates to £545.673 million as outlined below.

Table 9: Authorised Limit for Borrowing	
	£000's
CFR - General Services at 31 March 2025	£ 228,109
CFR - HRA at 31 March 2025	£ 317,564
Authorised Limit for Borrowing	**£ 545,673**



3.3 Prospects for interest rates

The Council has appointed Link Group, Link Treasury Services Limited as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts for certainty rates, gilt yields plus 80 bps on 8 January 2024.

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

At its 14th December meeting, the Bank of England's Monetary Policy Committee (MPC) kept rates on hold for the third time in a row, pushing back against the prospect of near-term interest rate cuts. The vote in favour of keeping rates on hold was 6-3.

However, recent softer wage and inflation data (annual CPI is currently 3.9%) mean that markets have moved significantly in the direction of Link's November interest rate forecast, pricing in a first rate cut in Q2 2024. Link now expects Bank Rate to be cut to 4.25% by the end of 2024 and 3% by the end of 2025. The low point of the interest rate cycle is also expected to be 3%.

Regarding the Bank of England, it continued to sound hawkish last month. Indeed, the evidence of subsiding price pressures did not dissuade the more hawkish members of the Monetary Policy Committee (MPC) – Catherine Mann, Megan Greene and Jonathan Haskel – from again voting to raise interest rates by 25 basis points (bps). The MPC maintained its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it reiterated that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time".

At the time of the meeting, the Bank did not appear to have taken any comfort from subsiding price pressures in the US and the Eurozone either, saying that measures of inflation persistence are higher in the UK than in other major advanced economies. And its statement that relative to developments in the US and the Eurozone "measures of wage inflation were considerably higher in the UK and services price inflation had fallen back by less so far". Nonetheless, even if the Bank would prefer to cut interest rates after the Fed and the ECB, Capital Economics' forecast for the CPI measure of inflation to drop below 2% by April, and for core inflation to drop below 2% only three months later, adds further grist to the mill that rates will be cut sharply in the second half of 2024 if not before.

Since the December rate decision, the Bank's hawkish bias has also not prevented the markets from forming a view that rates will be falling soon. Accordingly, swap rates and gilt yields have reduced significantly over the past month despite a partial rebound upwards since the turn of the year. This will have the effect of ensuring upcoming mortgage rate resets (c400k per quarter) will be somewhat lower than they were through the second half of 2023. Indeed, it is noteworthy that the Halifax house price index has recently moved into positive territory after registering only a slight fall in house prices from their peak in the summer of 2022.

Looking further afield, we suspect the wider economy may only endure the lightest of recessions or, possibly, not at all. The Bank's November Quarterly Monetary Policy Report saw it revise down its Q3 and Q4 GDP forecasts for 2023 and its annual forecast for 2024 from 0.4% to 0.0% (2023 stayed at 0.5%). But it could be this outlook underestimates the robustness and resilience of the UK economy, particularly considering upward revisions to GDP stemming from the pandemic years.

There are, of course, significant risks to Link's central forecast. First, it is likely still the early days of the Gaza-Israel conflict, and a meaningful and prolonged shift up in oil prices from $75 per barrel to something closer to $120 would keep inflation higher for longer. Furthermore, the UK domestic labour market is still having to contend with very low unemployment (4.2%) and the total number of job vacancies is only a little below one million. It is unlikely that a fundamental overhaul of immigration policy, with a view to addressing staff shortages in various sectors of the economy, is going to be a priority regardless of the current/future government, so keeping a lid on wages is going to be a tough challenge even if some of the more recent signs are that wage growth is moderating (still c7% y/y).

Regarding PWLB rates, movement in the short part of the curve has reflected the revised Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, but by the market's appetite for significant gilt issuance. Indeed, although Link have a slightly lower starting point for the envisaged reduction in short and medium dated gilts, they now forecast the 10, 25 and 50 years part of the curve to stay a bit higher than earlier forecasts from 2023/24.

Furthermore, a General Election is expected in the next year, so Government fiscal policy may potentially loosen at the same time as the Bank's monetary policy is still trying to take momentum out of the economy. That may mean that Bank Rate stays elevated for a little longer than Link's central forecast.

Of course, what happens outside of the UK remains critical to movement in gilt yields as well. The ECB has made it clear that policy tightening is at, or close to, the terminal rate (currently 4%), whilst the US FOMC has held its Bank Rate equivalent in the range of 5.25% - 5.5%.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

Link's current central forecast for interest rates expects rate cuts to start when both the CPI inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent GDP releases have surprised with their on-going robustness).

Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

In the upcoming months, Link's forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

PWLB RATES

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

The balance of risks to the UK economy: -

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

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

- Labour and supply shortages prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).
- The Bank of England has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.
- Geopolitical risks, for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

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

- Despite the tightening in Bank Rate to 5.25%, the Bank of England allows inflationary pressures to remain elevated for a long period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.
- The pound weakens because of a lack of confidence in the UK Government's pre-election fiscal policies, which may prove inflationary, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Projected gilt issuance, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields compensating.

LINK GROUP FORECASTS

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

A more detailed interest rate view and economic commentary is provided at appendix 5.1.

3.4 Borrowing strategy

Borrowing is undertaken to finance the Council's approved Capital plans and to do so in the most cost-effective way. As can been noted from Table 4 above the Council has a significant borrowing requirement across the current and forthcoming four financial years (2023/24 to 2027/28).

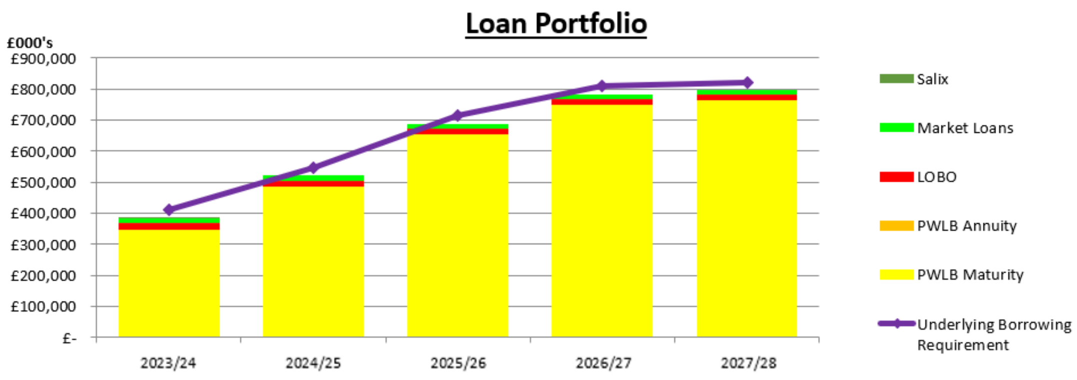
This TMIS provides for this capital investment to be underpinned by long-term borrowing, recognising the current interest rate environment, the significant borrowing requirement arising from the Council's capital plans, and the long term benefits of de risking the delivery and affordability of these capital plans by locking into the certainty brought by PWLB fixed rate loans.

The Council's **external loan debt** at 31 March 2024 is projected to be **£384.346 million**. Based on the Council's historic and current approved Capital Plans, the **Underlying Borrowing Requirement (UBR) –** which is the Council's underlying need to borrow for capital purposes (excluding the long-term liability arising from PFI/DBFM projects) – at 31 March 2024 is expected to equate to **£409.346 million**.

This means that the Council is expected to be £25.000 million (6%) under-borrowed at the end of the 2023/24 financial year i.e. the Council has funded the majority (94%) of its underlying borrowing requirement as at 31 March 2024. In the current economic climate, this is a prudent approach which balances (a) de-risking the longer term borrowing requirement at current longer term borrowing rates; against (b) the current year and forthcoming financial year budget projections. The Council has an extremely low short-medium term exposure to refinancing risk and is therefore in a strong position to plan its new borrowing requirements in advance, taking advantage of any dips in longer-term borrowing rates from PWLB and other sources, and maintain a low weighted average coupon rate on external debt.

The **Underlying Borrowing Requirement** is projected to rise to **£821.137 million** by 31 March 2028 – more than double the current Underlying Borrowing Requirement. The profile of this, and the projected external loan portfolio to fund the Underlying Borrowing Requirement over the period 2023/24 to 2027/28, is shown in graphical format below.

Figure 3: Loan Portfolio & Underlying Borrowing Requirement



Interest Rates

The current PWLB yield curve is bell shaped with the low point in the curve is at the 5 year mark (4.40%) with rates trending upwards towards the 20-30 year tenor (5.25%) before easing back slightly to sit at c. 5.10% in the 50 year duration. Current rates have generally eased off 30-40bps from levels reported at the time of the 2023/24 Treasury Management Mid-Year Review Report to Council, with no material change to the medium term forecast for rates.

The yield curve is expected to remain bell shaped over the short-medium term, with a gradual shift downwards of the entire curve by c. 40-60bps over the next 12 months and a further 40-50bps over the subsequent 12 months. This is forecast to bring longer-term borrowing rates down to between 4.10-4.60% by March 2025 and between 3.70%-4.20% by March 2026. Further commentary on this is provided in Appendix 3 Section 3.3.

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

The funding of the Council's in-year and forward CFR is typically for infrastructure with long asset lives (50-60 years), and the tenor of PWLB and market loans are typically drawn with this in mind.

Consideration for any new borrowing in the remainder of the 2023/24 financial year and during the 2024/25 financial year, to fund the Council's in-year CFR, will seek to balance:-

a) the security/certainty of current relatively high longer-term borrowing rates of upwards of 5.25% in the 30-50 year duration (which are forecast to drop by 60bps within one year and 100bps within 24 months) and the potential additional budgetary pressure that this brings in both the short/medium and longer term; with

b) the option to borrow initially for a shorter-term duration from PWLB or other markets, for 3 to 5 years (at say c. 4.40%), to allow the Council to fund the immediate in-year borrowing requirement. Based on current interest rate forecasts (see Appendix 3 Section 3.3), this would then allow the Council the option to refinance this borrowing at initial 3-5 year maturity with less expensive, longer term borrowing, e.g. a 45 to 47 year tenor in, say, 36 months at a forecast rate of c. 3.90%.

As noted in Section 3.1, the Council's proactive Treasury Management over the last decade has put the Council in a strong refinancing position for its external debt portfolio which allows the Council to slot in shorter dated external borrowing into the current debt maturity profile to fund the current & forthcoming in-year borrowing requirements, to allow the Council to navigate past the current expected hump in longer-term borrowing rates.

It is expected that any further long-term borrowing that is undertaken during 2023/24 and 2024/25 to finance the current & future year capital plans will be sourced by drawing new PWLB loans at the Certainty Rate (which has been available to the Council since 2012 and is priced at Gilts+80bps), and/or the HRA rate. The HRA rate is available to all Councils to fund HRA capital expenditure, at a rate that is priced at Gilts+60bps. On 22 November 2023, the availability over which Councils can draw HRA rate borrowing from PWLB was extended to 30 June 2025.

Both the General Services and HRA capital programmes are being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour, and the ratios of financing costs to the net revenue streams. The Council's borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, to achieve optimum value and risk exposure in the medium-long-term. The impact particularly of the General Services Capital Plan Prioritisation – which will be reported to Council in February 2024 – will have a significant bearing on this.

Council officers, in conjunction with Link, will continue to monitor daily long-term borrowing rates in order to take advantage of any dips in the market or to de-risk any change in the medium-longer term forecast for gilt yields.

Forward Borrowing

The opportunity also continues to exist to consider further loans on a 'forward dealing' basis, and officers will continue to explore the viability of these loans as part of securing the long term borrowing required to meet the Council's Underlying Borrowing Requirement.

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates for borrowing based upon the gross debt position, and variable interest rates for investments based upon the total investment position;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates for both borrowing and investments;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

Upper Limits on Exposure to Fixed and Variable Interest Rates 2024/25	
Interest rate exposures	**Upper Limit**
Limits on fixed interest rates based on gross debt	100.00%
Limits on variable interest rates based on gross debt	30.00%
Limits on fixed interest rates based on investments	100.00%
Limits on variable interest rates based on investments	100.00%

Maturity Structure of Borrowing 2024/25		
Maturity structure of fixed interest rate borrowing 2024/25	**Lower**	**Upper**
Under 12 months	0.00%	50.00%
12 months to 2 years	0.00%	50.00%
2 years to 5 years	0.00%	50.00%
5 years to 10 years	0.00%	50.00%
10 years to 20 years	0.00%	50.00%
20 years to 30 years	0.00%	50.00%
30 years to 40 years	0.00%	50.00%
40 years to 50 years	0.00%	50.00%
50 years and above	0.00%	50.00%
Maturity structure of variable interest rate borrowing 2024/25	**Lower**	**Upper**
Under 12 months	0.00%	30.00%
12 months to 2 years	0.00%	30.00%
2 years to 5 years	0.00%	30.00%
5 years to 10 years	0.00%	30.00%
10 years to 20 years	0.00%	30.00%
20 years to 30 years	0.00%	30.00%
30 years to 40 years	0.00%	30.00%
40 years to 50 years	0.00%	30.00%
50 years and above	0.00%	30.00%

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sum borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates (as detailed in Section 3.2) and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

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

3.6 Debt rescheduling

As noted in the Mid-Year Review Report, now that the whole of the yield curve has shifted higher there may be opportunities for debt rescheduling in the remainder of the financial year.

This would involve the Council repaying loans prematurely (both market and PWLB) whilst high discount rates on premature repayment prevail.

Any debt rescheduling will be considered when the difference between the refinancing rate and the redemption rate is most advantageous and the situation will be continually monitored in order to take advantage of any perceived anomalies in the yield curve. The reasons for any rescheduling taking place would include:

- the generation of cash savings at minimum risk;
- to reduce the average interest rate;
- to amend the maturity profile and/or the balance of volatility of the debt portfolio.

Council officers will explore debt rescheduling opportunities with Link Group, Link Treasury Services Limited; with only prudent and affordable debt rescheduling that considers both the short and medium-longer term impact being considered.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

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

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

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

In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs but to also consider "laddering" investments for periods up to 12 months with high credit rated financial institutions, whilst investment rates remain elevated, as well as wider range fund options.

The above regulations and guidance place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

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

2. 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 environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.

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

4. This authority has defined the list of **types of investment instruments** that are permitted investments authorised for use in appendix 5.2. Appendix 5.3 expands on the risks involved in each type of investment and the mitigating controls.

5. **Lending limits**, (maturity tenors), for each counterparty will be set through applying the matrix table in Section 4.2 (maturity durations).

6. Investments will only placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).

7. Lending per **Country** and **Institution** will be set through the application of the criteria in Section 4.3 (amounts).

8. **Transaction limits** are set for each type of investment in appendix 5.2.

9. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.4).

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

11. All investments will be denominated in sterling.

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

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Link Group, Link Treasury Services Limited. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:-

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:-

Table 14: Recommended Maximum Durations for Investments

Link Asset Services Colour Code	Maximum Suggested Duration for Investment
Yellow	6 years*
Dark Pink	6 years**
Light Pink	6 years**
Purple	2.5 years
Blue	1.25 years***
Orange	1.25 years
Red	7 months
Green	120 days
No colour	Not to be used

* *Note the yellow colour category is for:- UK Government Debt, or its equivalent, Money Market Funds (MMF's), and collateralised deposits where the collateral is UK Government Debt*

** *Dark Pink for Ultra Short Dated Bond Funds with a credit score of 1.25*
Light Pink for Ultra Short Dated Bond Funds with a credit score of 1.5

*** *Applies only to nationalised or semi-nationalised UK Banks*

Note that the maximum suggested durations listed above have been extended by 1 year (when compared to the suggested maximum durations provided by Link) for the Yellow, Dark Pink, Light Pink, Purple, Blue and Orange categories, to allow flexibility around these durations on the margins e.g. the placement of a 13 month fixed term deposit for a counterparty rated Orange or Blue. Equally, the maximum suggested duration for the Red category has been extended by a month to 8 months, on the same basis. A thorough appraisal of the additional risk involved in extending the duration of any deposit (marginally) beyond the maximum suggested by Capita, against any enhanced value to the portfolio, will be undertaken prior to the placement of any deposit.

The Link Group, Link Treasury Services Limited creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be (Fitch or equivalents):-

- Short term rating F1;
- Long term rating A-.

There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Group, Link Treasury Services Limited creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately;
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to the Council by Link Group, Link Treasury Services Limited. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on sovereign support for banks and the credit ratings of that supporting government.

UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Country and sector limits

The Council has determined that it will only use approved counterparties from the UK, or approved counterparties from other countries with a minimum sovereign credit rating of AA- from Fitch.

The list of countries that qualify using the above criteria as at the date of this report are shown in Appendix 5.4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

The Council will avoid a concentration of investments in too few counterparties or countries by adopting a spreading approach to investing whereby no more than £30 million will be invested in Lloyds Banking Group and the NatWest (Royal Bank of Scotland) Group, £15 million in any other UK counterparty, and £15 million in any one counterparty, group or country outwith the UK.

4.4 Investment strategy

Current Deposits

As at 17 January 2024, the Council's deposits were as follows:-

Counterparty	Amount £000's	Security *Long/Short Term Rating** *(Colour)***	Liquidity	Yield	UK Local Authority Investment*** £000's
MMF Aberdeen	5,279	AAAmmf *(Yellow)*	Instant Access	5.28%	516,393
MMF Federated	14,951	AAAmmf *(Yellow)*	Instant Access	5.32%	1,059,536
MMF LGIM	14,843	AAAmmf *(Yellow)*	Instant Access	5.33%	291,934
Handelsbanken AB Call Account	7,343	AA/F1+ *(Orange)*	Instant Access	5.09%	142,698
National Westminster Bank plc	15,000	A+/F1 *(Blue)*	Start: 08 Mar 2023 End: 08 Mar 2024	4.80%	578,003
National Westminster Bank plc	15,000		Start: 01 Jun 2023 End: 28 Feb 2024	5.15%	
Total	**72,416**				**2,588,564**

** Credit Rating from Fitch*
*** Colour represents maximum recommended duration for investment per Link Group, Link Treasury Services Limited Credit Scoring methodology – see Appendix 2.*
**** As at 31 December 2023*

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e., rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate having peaked in the second half of 2023 and possibly reducing as early as the second half of 2024 so an agile investment strategy would be appropriate to optimise returns.

While an element of cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable;
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

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

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

Average earnings in each year	
2023/24 (residual)	5.30%
2024/25	4.70%
2025/26	3.20%
2026/27	3.00%
2027/28	3.25%
Long term later years	3.25%

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

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and expected usable reserve forecasts, and are based on the availability of funds after each year-end.

The Council is asked to retain the following treasury indicator and limit: -

Principal Sums Invested for > 365 Days		
Limit		£70m

The current strategy as outlined in the body of these reports is to continue to cash-back the Council's balance sheet reserves. It is expected that the majority of this will be in the form of fixed term deposits and/or certificates of deposit. Given expected reserve forecasts and the current interest rate environment, in particular the short-medium term forecast for the Council's Capital Fund and HRA Reserve, the limit for prinicipal sums invested for > 365 days has been retained at £70m.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access accounts and money market funds.

4.5 Investment risk benchmarking

The Council will use an investment benchmark to assess the investment performance of its investment portfolio of 6 month SONIA compounded. The Council also participates in Investment Benchmarking groups with Link Group, Link Treasury Services Limited whereby performance with other Benchmarking club members and the wider Scottish and UK Local Authority Investment benchmarking is compared.

4.6 End of year investment report

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

5 Appendices

1. Economic background
2. Treasury Management Practice 1 – Permitted Investments
3. Treasury Management Practice 1 – Credit and Counterparty Risk Management
4. Approved countries for investments
5. Treasury management scheme of delegation
6. The treasury management role of the section 95 officer

5.1 APPENDIX: Economic Background

The first half of 2023/24 saw:

- Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- CPI inflation falling from 8.7% in April to 6.7% in September, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.1% in September from 7.1% in April and May, a then 31 years high.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose by 7.8% for the period June to August, excluding bonuses).

The registering of 0% GDP for Q3 suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.

The fall in the composite Purchasing Managers Index from 48.6 in August to 46.7 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0% q/q rise in real GDP in the period July to September, being followed by a contraction in the next couple of quarters.

The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.

As the growing drag from higher interest rates intensifies over the next six monthsthe economy is expected to continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government financial support packages have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

But the cooling in labour market conditions still has not fed through to an easing in wage growth. The headline 3myy rate rose 7.8% for the period June to August, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular annual average total pay growth for the private sector was 7.1% in June to August 2023, for the public sector this was 12.5% and is the highest total pay annual growth rate since comparable records began in 2001. However, this is affected by the NHS and civil service one-off non-consolidated payments made in June, July and August 2023. The Bank of England's prediction was for private sector wage growth to fall to 6.9% in September.

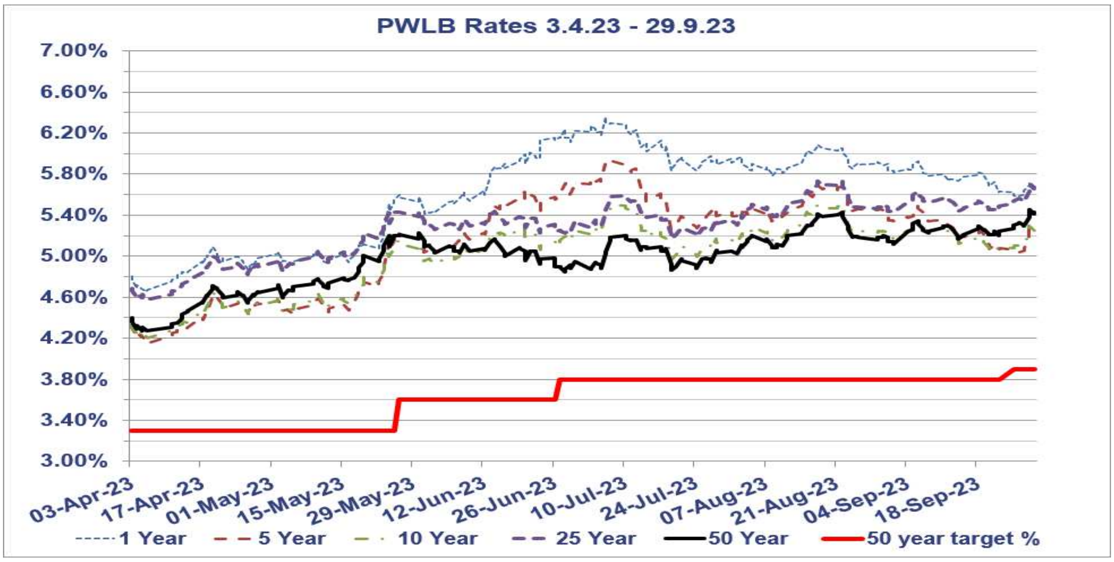
CPI inflation declined from 6.8% in July to 6.7% in August and September, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.1%. That reverses all the rise since March.

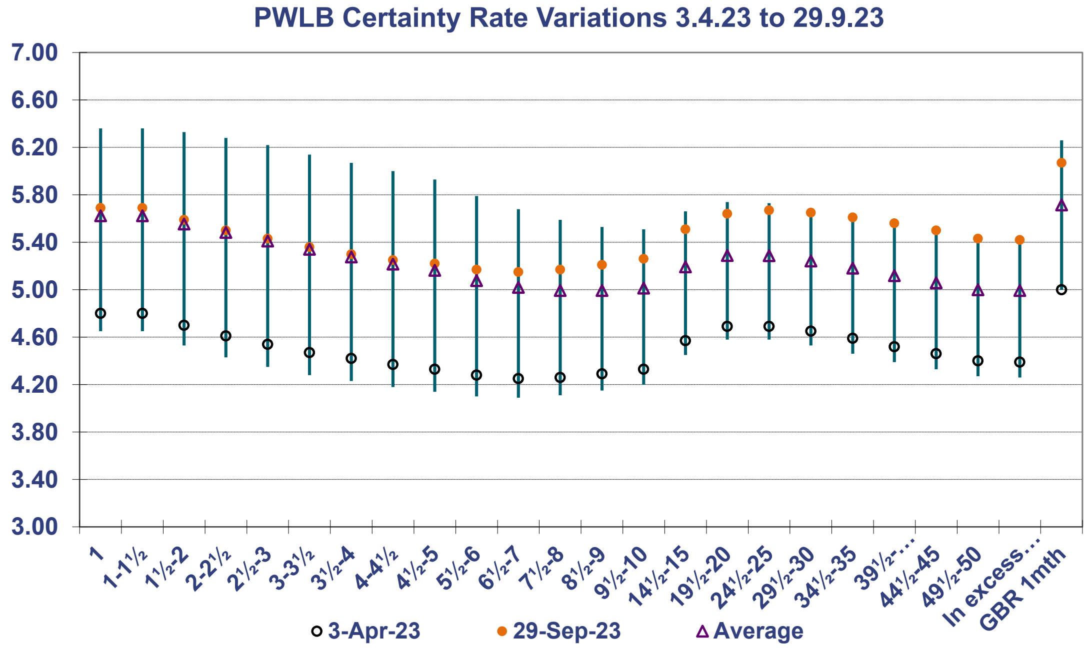
In its latest monetary policy meeting on 13 December 2023, the Bank of England left interest rates unchanged at 5.25%. The vote to keep rates on hold was a split vote, 6-3. It is clear that some members of the MPC are still concerned about the stickiness of inflation.

Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. In terms of messaging, the Bank once again said that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures", citing the rise in global bond yields and the upside risks to inflation from "energy prices given events in the Middle East". So, like the Fed, the Bank is keeping the door open to the possibility of further rate hikes. However, it also repeated the phrase that policy will be "sufficiently restrictive for sufficiently long" and that the "MPC's projections indicate that monetary policy is likely to need to be restrictive for an extended period of time". Indeed, Governor Bailey was at pains in his press conference to drum home to markets that the Bank means business in squeezing inflation out of the economy.

This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates in the future.

In the table below, the rise in gilt yields across the curve as a whole in 2023/24, and therein PWLB rates, is clear to see.





HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.23 – 29.09.23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.14%	4.20%	4.58%	4.27%
Date	06/04/2023	06/04/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.51%	5.73%	5.45%
Date	06/07/2023	07/07/2023	22/08/2023	17/08/2023	28/09/2023
Average	5.62%	5.16%	5.01%	5.29%	5.00%
Spread	1.71%	1.79%	1.31%	1.15%	1.18%

The peak in medium to longer dated rates has generally arisen in August and September and has been primarily driven by continuing high UK inflation, concerns that gilt issuance may be too much for the market to absorb comfortably, and unfavourable movements in US Treasuries.

The S&P 500 and FTSE 100 have struggled to make much ground through 2023.

CENTRAL BANK CONCERNS

Currently, the Fed has pushed up US rates to a range of 5.25% to 5.5%, whilst the MPC followed by raising Bank Rate to 5.25%. EZ rates have also increased to 4% with further tightening a possibility.

Ultimately, however, from a UK perspective it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

5.2 APPENDIX: Treasury Management Practice (TMP1): Permitted Investments

This Council is asked to approve the following forms of investment instrument for use as permitted investments as set out in tables 1.1-1.4.

Treasury risks

All the investment instruments in tables 1.1-1.4 are subject to the following risks:-

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

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. However, it has to be pointed out that while some forms of investment e.g. gilts, CDs, corporate bonds can usually be sold immediately if the need arises, there are two caveats: - a. cash may not be available until a settlement date up to three days after the sale b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer. The column in tables 1.1-1.4 headed as 'market risk' will show each investment instrument as being instant access, sale T+3 = transaction date plus 3 business days before you get cash, or term i.e. money is locked in until an agreed maturity date.

3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately. However, some cash rich local authorities may positively want exposure to market risk e.g. those investing in investment instruments with a view to obtaining a long term increase in value.

4. **Interest rate risk**: this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report (see Section 3.4).

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

Controls on treasury risks

1. **Credit and counter-party risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes. See Sections 4.2 and 4.3.

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

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

4. **Interest rate risk**: this authority manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing. See Section 4.4.

5. **Legal and regulatory risk:** this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Unlimited investments

Regulation 24 states that an investment can be shown in tables 1 / 2 as being 'unlimited' in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category. The authority has given the following types of investment an unlimited category: -

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

2. **High credit worthiness banks and building societies**. See paragraph 4.2 for an explanation of this authority's definition of high credit worthiness. While an unlimited amount of the investment portfolio may be put into banks and building societies with high credit worthiness, the authority will ensure diversification of its portfolio ensuring that no more than £15 million can be placed with any one institution or group at any one time, other than the Bank of Scotland or Royal Bank of Scotland where the limit is £30 million.

Objectives of each type of investment instrument

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

1. DEPOSITS

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

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

b) **Term Deposits – Local Authorities.** They are quasi-Government bodies with low counterparty and value risk. Typical deposit terms vary from 1 month to 2 years, with longer term deposits offering an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and typically higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date other than with agreement of the counterparty, at which point penalties would typically apply.

c) **Call accounts with high credit worthiness banks and building societies.** See Section 4.2 for an explanation of this authority's definition of high credit worthiness. These typically offer a much higher rate of return than the DMADF and now that measures have been put in place to avoid over reliance on credit ratings, the authority feels much more confident that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. There is instant access to recalling cash deposited (or short-dated notice e.g. 15-30 days). This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit (see 1d below). However, there are a number of call accounts which at the time of writing, offer rates 2 – 3 times more than term deposits with the DMADF. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

d) **Term deposits with high credit worthiness banks and building societies.** The objectives are as for 1c. These offer a much higher rate of return than the DMADF and deposits made with other Local Authorities (dependent upon term) and, similar to 1c, now that measures have been put in place to avoid over reliance on credit ratings, the authority feels much more confident that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. This is the most widely used form of investing used by local authorities. The authority will ensure diversification of its portfolio of deposits ensuring that no more than £15 million is invested with any (non-nationalised) UK counterparty, and no more than £15 million is invested with any other non-UK counterparty, group or country. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

e) Fixed term deposits with variable rate and variable maturities (structured deposits). This encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market. This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide greater flexibility to adopt new instruments as and when they are brought to the market.

2. DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF UK GOVERNMENT SUPPORT / OWNERSHIP

These banks offer another dimension of creditworthiness in terms of UK Government backing through either direct (partial or full) ownership. The view of this authority is that such backing makes these banks attractive institutions with whom to place deposits, and that will remain our view if the UK sovereign rating were to be downgraded in the coming year.

a. **Call accounts.** As for 1c. but UK Government stated support implies that the UK Government stands behind these banks and building societies and will be deeply committed to providing whatever support that may be required to ensure the continuity of such institutions. This authority feels this indicates a low and acceptable level of residual risk.

b. **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for 1d. but Government ownership partial or full implies that the UK Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers this indicates a low and acceptable level of residual risk.

c. **Fixed term deposits with variable rate and variable maturities (structured deposits).** As for 1e but UK Government stated support implies that the UK Government stands behind eligible banks and building societies and will be deeply committed to providing whatever support that may be required to ensure the continuity of such institutions. This authority feels this indicates a low and acceptable level of residual risk. This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide greater flexibility to adopt new instruments as and when they are brought to the market.

3. COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

a. **Government liquidity funds.** These are the same as money market funds (see below) but only invest in government debt issuance with highly rated governments. Due to the higher quality of underlying investments, they offer a lower rate of return than MMFs. However, their net return is typically on a par with the DMADF, but with instant access.

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

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

d. **Gilt funds.** These are funds which invest only in U.K. Government gilts. They offer a lower rate of return than bond funds but are highly rated both as a fund and through investing only in highly rated government securities. They offer a higher rate of return than investing in the DMADF but they do have an exposure to movements in market prices of assets held.

e. **Bond funds.** These can invest in both government and corporate bonds. This therefore entails a higher level of risk exposure than gilt funds and the aim is to achieve a higher rate of return than normally available from gilt funds by trading in non-government bonds.

4. SECURITIES ISSUED OR GUARANTEED BY GOVERNMENTS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it matures or is sold. The annual earnings on a security is called a yield i.e. it is normally the interest paid by the issuer divided by the price you paid to purchase the security unless a security is initially issued at a discount e.g. treasury bills..

a. **Treasury bills.** These are short term bills (up to 12 months, although none have ever been issued for this maturity) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.

b. **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. Market movements that occur between purchase and sale may also have an adverse impact on proceeds. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.

c. **Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government** e.g. National Rail. This is similar to a gilt due to the explicit Government guarantee.

d. **Sovereign bond issues (other than the UK govt) denominated in Sterling.** As for gilts but issued by other nations. Use limited to issues of nations with at least the same sovereign rating as for the UK.

e. **Bonds issued by Multi Lateral Development Banks (MLDBs).** These are similar to c. and e. above but are issued by MLDBs which are typically guaranteed by a group of sovereign states e.g. European Bank for Reconstruction and Development.

5. SECURITIES ISSUED BY CORPORATE ORGANISATIONS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it is sold. The annual earnings on a security is called a yield i.e. is the interest paid by the issuer divided by the price you paid to purchase the security. These are similar to the previous category but corporate organisations can have a wide variety of credit worthiness so it is essential for local authorities to only select the organisations with the highest levels of credit worthiness. Corporate securities are generally a higher risk than government debt issuance and so earn higher yields.

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

b. **Commercial paper.** This is similar to CDs but is issued by commercial organisations or other entities. Maturity periods are up to 365 days but commonly 90 days.

c. **Corporate bonds.** These are (long term) bonds (usually bearing a fixed rate of interest) issued by a financial institution, company or other non-government issuer in order to raise capital for the institution as an alternative to issuing shares or borrowing from banks. They are generally seen to be of a lower creditworthiness than government issued debt and so usually offer higher rates of yield.

d. **Floating rate notes.** These are bonds on which the rate of interest is established periodically with reference to short-term interest rates.

6. OTHER

a. Local Authority Mortgage Scheme. Authorities who are participating in the Local Authority Mortgage Guarantee Scheme (LAMS) may be required to place a deposit with the mortgage provider(s) up to the full value of the guarantee. The deposit will be in place for the term of the guarantee i.e. 5 years (with the possibility of a further 2 year extension if the account is 90+ days in arrears at the end of the initial 5 years) - and may have conditions / structures attached. The mortgage provider will not hold a legal charge over the deposit.

b. Loans to third parties – This would involve the Council borrowing from the PWLB/markets and onward lending to Registered Social Landlords to enable them to access lower cost loans and kickstart developments of affordable mid-market homes. The risk associated with such an investment would be mitigated by an assessment of the counterparty in advance of any loan being granted and through the application of a premium on the loan rate. Interest would be paid by the RSL over the term of the loan, with repayment of principal upon the earlier of 10/20 years or at the point of house sales. The Council will also request that a standard security is taken over the property which would allow the Council to require the sale of the homes to another landlord, providing greater risk mitigation.

c. **Subordinated Debt Subscription to the SPV set up to deliver the Newbattle Centre project –** this involved the Council subscribing £332,806 of subordinated debt to the SPV that was set up to deliver the Newbattle Centre project (2 year construction and 25 year operational contract length). The length of the investment is 25 years with the subscription made at operation commencement of the contract. The repayment profile will comprise 81% of the principal remaining invested until the final two years of the contract. The risk associated with this type of investment will be mitigated through an annual assessment as a minimum to review the holding of such debt, and whether the exposure to risk arising from the investment has changed over the period.

d. **ESCO:** Midlothian Energy Limited (MEL) Joint Venture between Midlothian Council and Vattenfall to deliver energy supply to Shawfair using heat supplied from the Millerhill Energy from Waste plant and related projects.

Table 1: Permitted Investments

1.1 Deposits

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period	Max Transaction Value
Debt Management Agency Deposit Facility	UK Government	Term	No	**100%**	**6 months**	**n/a**
Term deposits – local authorities	Quasi-UK Government	Term	No	**100%**	**5 years**	**£15m**
Call accounts – banks and building societies	Green	Instant	No	**100%**	**1 day**	**£15m**
Term deposits / Notice Accounts – banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**	**£15m**
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**	**£15m**

1.2 Deposits with counterparties currently in receipt of government support / ownership

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period	Max Transaction Value
UK nationalised banks – Call accounts	Blue	Instant	No	**100%**	**1 day**	**£30m**
UK nationalised banks – Term Deposits / Notice Accounts	Blue	Term	No	**100%**	**2 years**	**£30m**
UK nationalised banks – Fixed term deposits with variable rate and variable maturities: - Structured deposits	Blue	Term	No	**100%**	**2 years**	**£30m**
Non-UK (high sovereign rated country) nationalised banks – Call accounts	Green	Instant	No	**100%**	**1 day**	**£15m**
Non-UK (high sovereign rated country) nationalised banks:- Term Deposits / Notice Accounts	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**	**£15m**
Non-UK (high sovereign rated country) nationalised banks:- Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**	**£15m**

If forward deposits are made, the forward period plus the deal period equate to the maximum maturity period.

1.3 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period	Max Transaction Value
Government Liquidity Funds	AAA	Instant	No	**100%**	**1 day**	**£15m**
Money Market Funds CNAV	AAA	Instant	No	**100%**	**1 day**	**£15m**
Money Market Funds LVNAV	AAA	Instant	No	**100%**	**1 day**	**£15m**
Money Market Funds VNAV	AAA	Instant	No	**100%**	**1 day**	**£15m**
Ultra Short Dated Bond Funds with a credit score of 1.25	AAA	T+1 to T+5	Yes	**100%**	**1 week**	**£15m**
Ultra Short Dated Bond Funds with a credit score of 1.5	AAA	T+1 to T+5	Yes	**100%**	**1 week**	**£15m**
Bond Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**	**£15m**
Gilt Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**	**£15m**

1.4 Securities issued or guaranteed by governments

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max %?£m of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	Yes	**100%**	**6 months**
UK Government Gilts	UK sovereign rating	Sale T+1	Yes	**100%**	**50 years**
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	Sale T+3	Yes	**100%**	**50 years**
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**

1.5 Securities issued by corporate organisations

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period	Max Transaction Value
Certificates of deposit issued by banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Sale T+1	Yes	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**
Commercial paper other	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**
Floating rate notes	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**
Corporate Bonds other	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**

1.6 Other

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Local authority mortgage guarantee scheme.	Blue	Term	No	**50%**	**5 years**
Loans to Third Parties	n/a	Term	No	**£25m**	**20 years**
Subordinated Debt Subscription to Newbattle Centre SPV	n/a	Term	No	**£0.326m**	**22 years**
ESCO	n/a	Term	No	**£10.2m**	**n/a**

5.3 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

Midlothian Council Permitted Investments, Associated Controls and Limits

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
Cash type instruments			
a. Deposits with the Debt Management Account Facility (UK Government) **(Very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.	As shown in Appendix 5.2.
b. Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non- local authority deposits will follow the approved credit rating criteria.	As shown in Appendix 5.2.
c. CNAV, LVNAV and VNAV Money Market Funds (MMFs) **(Low to very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMF has a “AAA” rated status from either Fitch, Moody’s or Standard & Poors.	As shown in Appendix 5.2.
d. Ultra Short Dated Bond Funds **(low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the Ultra Short Dated Bond Fund has a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	As shown in Appendix 5.2.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
e. Call account deposit accounts with financial institutions (banks and building societies) **(Low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's, with the credit scoring methodology by Link Group, Link Treasury Services Limited overlaid. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.
f. Term deposits with financial institutions (banks and building societies) **(Low to medium risk depending on period & credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b), (c) and (d) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's, with the credit scoring methodology by Link Group, Link Treasury Services Limited overlaid. On day to day investment dealing, this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
g. Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity.	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures	As shown in Appendix 5.2.
h. Certificates of deposits with financial institutions **(Low risk)**	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates (no loss if these are held to maturity). Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available colour band / credit rating to provide additional risk control measures. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.
i. Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) (Low to medium risk depending on period & credit rating)	These tend to be medium to low risk investments, but will exhibit higher risks than categories (a), (b), (c) and (d) above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement of the counterparty (penalties may apply).	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's, with the credit scoring methodology by Link Group, Link Treasury Services Limited overlaid. On day to day investment dealing, this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
j. Corporate bonds **(Medium to high risk depending on period & credit rating)**	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available colour band / credit rating to provide additional risk control measures. Corporate bonds will be restricted to those meeting the base criteria. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
Other types of investments			
k. Loans to third parties	Using the example of a loan to a RSL, these would be medium risk investments, exhibiting higher risks than categories (a)-(f) above. They are also highly illiquid and are only repaid at the end of a defined period of time (up to 20 years) or on the sale of a property, whichever is the earlier.	The risk associated with such an investment would be mitigated through the application of a premium on the loan rate. The Council will also request that a standard security is taken over the property which would allow the Council to require the sale of the homes to another landlord, providing greater risk mitigation.	£25m
l. Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	Per Existing
m. Local Authority Mortgage Scheme (LAMS)	These are service investments at market rates of interest plus a premium.		As shown in Appendix 5.2.
n. Subordinated Debt Subscription to Newbattle Centre SPV	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council and Scottish Government (via the SFT) are participants in and party to the governance and controls within the project structure. As such they are well placed to influence and ensure the successful completion of the project's term.	As shown in Appendix 5.2.
o. ESCO	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council is in a joint venture partnership and therefore party to the governance and controls within the project structure. As such the Council is	As shown in Appendix 5.2.

		well placed to influence and ensure the successful completion of the project's term	

The Monitoring of Deposit Counterparties - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Link Group, Link Treasury Services Limited, including when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Financial Officer & Section 95 Officer, and if required new counterparties which meet the criteria will be added to the list.

5.4 APPENDIX: Approved countries for investments

Based on the lowest available rating as at 17.01.2024

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)

AA-

- Belgium
- France
- U.K.

5.5 APPENDIX: Treasury management scheme of delegation

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit Committee

- reviewing treasury management reports, the treasury management policy and procedures, and making recommendations to the responsible body.

5.6 APPENDIX: The treasury management role of the section 95 officer

The S95 (responsible) officer

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

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

Follow-Up Review of Completed Internal Audit Recommendations

Duncan Stainbank, Chief Internal Auditor

Report for Decision

1 Recommendations

The Audit Committee is asked to:

a) Note the results from the sample check of Internal Audit recommendations that have been marked as completed by Management in the period April 2022 to March 2023 to improve internal controls and governance, and mitigate risks;

b) Acknowledge the progress made by Management in implementing Internal Audit recommendations to improve internal controls and governance, to mitigate risks, and consider whether it is satisfied with the progress made by Management;

c) Considers whether it is satisfied with the outcomes or whether any further action is required;

d) Endorse the proposal to extend the due dates for the overdue recommendations; and

e) Note that Internal Audit will continue to monitor for completion the outstanding recommendations and will provide update reports to the Audit Committee.

2 Purpose of Report/Executive Summary

The purpose of this report is to provide an update to members of the Audit Committee on the results of the Internal Audit Follow-up review which included a sample check on the adequacy of new internal controls for Internal Audit recommendations marked as completed by Management in the period April 2022 to March 2023.

This report also provides an update to members of the Audit Committee on the status of the implementation by Management of audit recommendations made and agreed in Internal Audit reports.

Internal Audit is an independent appraisal function established for the review of the internal control system as a service to Midlothian Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources and the management of risk.

The Internal Audit activity adds value to the organisation (and its stakeholders) when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management and control processes (by way of making audit recommendations); and objectively provides relevant assurance.

The remit of the Audit Committee includes “To consider reports on the effectiveness of internal controls and monitor the implementation of agreed actions”, as part of its high-level oversight of the Council’s governance, risk management and control framework.

Date 17 January 2024

Report Contact:
Duncan Stainbank
Chief Internal Auditor
duncan.stainbank@midlothian.gov.uk

3 Background

3.1 Internal Audit is an independent appraisal function established for the review of the internal control system as a service to Midlothian Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources and the management of risk.

3.2 The Internal Audit activity adds value to the organisation (and its stakeholders) when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management and control processes (by way of making audit recommendations); and objectively provides relevant assurance.

3.3 Management has the responsibility for ensuring that agreed audit actions are implemented to improve internal controls, risk management and governance. At Internal Audit final report stage, the audit recommendations are input to the Pentana Performance system, the Council's corporate performance management system. This is designed to assist with Management tracking of implementation, link with relevant risks and evidence improvement.

3.4 Each year, Internal Audit undertakes two follow up reviews on the recommendations it has raised. The first checks a sample of Internal Audit recommendations which have been reported as complete and reviews the adequacy of the actions taken and improvements made. The second reports on the progress Management have made in implementing the recommendations by the expected date. This year we have combined the two follow up reviews into one report.

3.5 The remit of the Audit Committee includes "To consider reports on the effectiveness of internal controls and monitor the implementation of agreed actions", as part of its high-level oversight of the Council's governance, risk management and control framework.

4 Review of Completion of Internal Audit Recommendations

4.1 The objective of this follow-up audit was to review a sample of Internal Audit recommendations that have been signed off by Management as complete during the period 1 April 2022 to 31 March 2023 to assess the evidence that recommendations have been implemented satisfactorily and to ensure that the new controls had the desired effect on improving internal control and governance and reducing risk.

4.2 A sample of 41 audit recommendations (plus 1 sub-action) which were at the 'completed' status on the Pentana Performance system were selected and evidence was obtained to support the satisfactory completion of each recommendation. Recommendations from the following Internal Audit reports were selected:

Financial Year	Internal Audit Report	No.	High Rated	Medium Rated	Low Rated
2018/19	Sales to Cash	1		1	
2019/20	Electronic Payment Systems	2			2
2019/20	Information Governance - Records Management	1		1	
2019/20	Leisure Management System	1		1	
2020/21	Social Housing Rents	1		1	
2021/22	Digital Learning Strategy and Equipped for Learning Project	2		2	
2021/22	Early Years Childcare (ELC) Expansion	5	1	3	1
2021/22	Housing Allocations	4	1	1	2
2021/22	ICT and Cyber Security	1		1	
2021/22	Learning Disabilities and Physical Disabilities (sub-action)	Sub action			Sub action
2021/22	Risk Management	4		4	
2021/22	Roads Maintenance Service	1			1
2021/22	Sustainable Environment	1		1	
2021/21	Waste Management and Recycling	1		1	
2022/22	Accounts Receivable	3		1	2
2022/23	Care at Home	1		1	
2022/23	Freedom of Information and Environmental Information Regulations	4		2	2
2022/23	PPP Schools Contract Management and Payment Mechanism	5		2	3
2022/23	Street Lighting	3		2	1
	Total	**41**	**2**	**25**	**14**

4.3 From the 41 recommendations tested, 27 (66%) plus the sub-action, were found to have been completed satisfactorily, 8 (20%) were identified as partially satisfactory requiring further work, and 6 (14%) were not satisfactory.

4.4 For the audit recommendations that had been completed satisfactorily the evidence that was provided by Management indicated that the action taken had the desired effect on improving internal control and governance and reducing risk.

4.5 For the 8 audit recommendations identified as partially satisfactory requiring further work: 2 were Low-rated and 6 were Medium-rated. Further work required for the 8 recommendations is detailed in the table below:

	Audit	Further Work required	Rating
1	2019/20 – Electronic Payments	There should be up to date documentation mapping out the flow of transactions for all relevant payment systems.	Low
2	2019/20 – Electronic Payments	Authorisation types in the Payment Guidelines need to be clarified.	Low
3	2019/20 – Leisure Management System	The outstanding debt recorded on the Legend system should be reviewed and updated.	Medium
4	2021/22 Digital Learning Strategy and Equipped for Learning Project	The Digital Learning Strategy should be updated to reflect the impact of the Equipped for Learning Project and provide a framework for future developments.	Medium
5	2021/22 – Early Years Children (ELC) Expansion	Undertake early years child roll projections.	Medium
6	2021/22 – Early Years Children (ELC) Expansion	Undertake appropriate lessons learned processes for ELC expansion projects when completed.	Medium
7	2021/22 – Risk Management	Risk management processes needs to be consistently applied across Council Services, and then maintain standards at this level.	Medium
8	2022/23 - PPP Schools Contract Management and Payment Mechanism	PPP2 MD forms should be provided. A reconciliation of the lifecycle element of all variations should be undertaken.	Medium

4.6 Of the 6 audit actions identified as not satisfied: 2 were Low-rated and 4 were medium related which are summarised in the table below:

	Audit	Recommendation	Rating
1	2021/22 – Risk Management	Arrangements for monitoring and reporting of risks requires improvement in some areas: • The CMT and Audit Committee should receive, on an annual basis, assurances of compliance with the Risk Management Policy. • Operational risk level information in respect of high or critical risks should be considered at DMTs for potential escalation to CMT. • Quality assurance checks on the application of risk management process should be undertaken and reported to DMTs as required in the Risk Management Policy.	Medium
2	2021/22 - Waste Management and Recycling	The benefits of having performance data on various aspects of the waste collection process should be considered and if judged to be beneficial, performance targets should be set and monitored through the use of appropriate performance indicators.	Medium

3	2022/22 - PPP Schools Contract Management and Payment Mechanism	A risk register, in line with the Council's Risk Management Policy, should be created for PPP Services.	Low
4	2022/23 – Street Lighting	An effective lighting inspection programme should be developed and maintained.	Medium
5	2022/23 – Street Lighting	When calculating Performance Indicators, the following should be implemented: • retain an audit trail of source documentation for reported PIs; • create procedure notes to enable indicators to be produced in the absence of key individuals; • undertake quality assurance checks; and • consider benchmarking information with other councils to identify areas of improvements.	Medium
6	2022/23 – Street Lighting	The service risk register requires to be reviewed and updated	Low

4.7 Discussions have been held with the action owners to highlight what is required to ensure the remaining elements of the audit actions are fully completed or a sustained control is established. A number of recommendations have not been completed as they are dependent on new systems being implemented. 14 audit actions have been re-opened on the Pentana Performance system to enable the recommendation to be completed by the new agreed action date with evidence of the improvement action undertaken.

5 Progress Update

5.1 The objective of the second review is to assess Management's reported performance in closing actions raised by Internal Audit by the agreed due date. It is Management's responsibility to design and maintain adequate risk management, governance and internal control processes and checking that the arrangements and controls are operating effectively which are also known as the first and second lines. The quarterly performance monitoring process provides an opportunity for Management to have a discussion on all of the open audit actions, including those that are overdue, the reasons why they were not completed by the original due date, risk mitigations in place in the interim and requests to Internal Audit for extensions to due dates.

5.2 An Internal Audit action report was generated from the Pentana Performance system on 18 December 2023 which reflected the Quarter 2 updates 2022/23. 3 actions were overdue and 129 actions (including sub-actions) were in progress which are summarised as follows:

Financial Year	Action Status	High	Medium	Low	Total
2018/19	In Progress	2	1	1	**4**
2019/20	In Progress	1	2	5	**8**
2020/21	In Progress	2	7	4	**13**
2021/22	In Progress	3	20	18	**41**
2022/23	In Progress	0	20	25	**45**
	Overdue	0	0	1	**1**
2023/24	In Progress	1	3	14	**18**
	Overdue	0	0	2	**2**
Total		**9**	**53**	**70**	**132**

5.3 The 3 overdue actions are summarised in Appendix B. The due dates for these are now to be extended to 31 January 2024 in the Pentana system, following further updates from management, which will ensure the actions are completed within a reasonable time (1 of the actions will be superseded by an action raised in the Risk Management internal audit report). CMT are in support of this proposal and the Audit Committee are asked to endorse this proposal.

5.4 In addition to our normal review a requested follow up review of all of the outstanding recommendations that an update is provided on the progress of the audit recommendations from the Construction Projects audit completed in May 2023. 7 of the 9 recommendations made have been marked as fully complete by management the one overdue recommendation in relation to risk management will be superseded by recommendations to be made in the Risk Management Audit that will be completed by March 2024, and the final recommendation will be fully implemented when draft procedures are finalised in the first quarter of 2024. Further work will now be completed by internal audit that will confirm the impact of the implementation of these recommendations and will be confirmed by June 2024 if there is complete evidence of implementation.

5.5 This report was prepared for presentation to the Audit Committee on 29 January 2024. As this report was produced from the Pentana system as of 18 December 2023, it should be noted that some actions will have been updated as completed during the Quarter 3 updates and some actions will have moved from ‘In Progress’ to ‘Overdue’ as they’ve gone beyond their due date. The progress on implementation of Internal Audit recommendations has been discussed with the Corporate Management Team on 17 January 2024.

5.6 A further update on progress with the implementation of Internal Audit recommendations will be included within the Internal Audit Annual Assurance Report 2023/24 for Midlothian Council which is scheduled for presentation to the Audit Committee in May 2024.

6 Report Implications (Resource, Digital, Risk and Equalities)

6.1 Resource

Resource implications of implementing Internal Audit recommendations are considered as part of the audit process to ensure these are reasonable and proportionate to the risks.

6.2 Digital

There are no digital implications arising from this report.

6.3 Risk

The recommendations made by Internal Audit are designed to reduce the level of risk to which the Council is exposed through the strengthening of the control environment and management of risks.

It is anticipated that improvements in the management and mitigation of risks will arise as a direct result of Management implementing the Internal Audit recommendations made. If audit recommendations are not implemented, there is a greater risk of financial loss and/or reduced operational efficiency and effectiveness, and Management may not be able to demonstrate improvement in internal control and governance arrangements, and effective management of risks.

6.4 Ensuring Equalities

This report does not relate to a new or revised policy, service or budget change, which affects people (the public or staff), so an Integrated Impact Assessment (IIA) is not an applicable consideration.

The Internal Audit work is carried out in accordance with the appropriate legislation and professional standards. The latter includes compliance by those within the Internal Audit function with the Code of Ethics set out in the PSIAS which is appropriate for the profession of Internal Audit founded as it is on trust placed in its independent and objective assurance about risk management, internal control and governance.

6.5 Additional Report Implications (See Appendix A)

APPENDIX A – Additional Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Although this report does not relate directly to the key priorities within the Single Midlothian Plan to which Midlothian Council and its Community Planning Partners have made a commitment (Reducing the gap in economic circumstances; Reducing the gap in learning outcomes; Reducing the gap in health outcomes; and Reducing the impact of climate change), good governance is important to enable Midlothian Council to deliver its key priorities in support of achieving the Council's objectives.

A.2 Key Drivers for Change

Key drivers addressed in this report:

☒ Holistic Working
☒ Hub and Spoke
☒ Modern
☒ Sustainable
☒ Transformational
☒ Preventative
☒ Asset-based
☒ Continuous Improvement
☒ One size fits one
☐ None of the above

Midlothian Council is committed to creating a great place to grow supported by the 9 drivers for change. Implementing the 9 drivers for change in practice is applicable to the Council's Internal Audit service provision to assist the Council in achieving its objectives.

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

☒ One Council Working with you, for you
☒ Preventative and Sustainable
☒ Efficient and Modern
☒ Innovative and Ambitious

A.4 Delivering Best Value

The definition of Internal Auditing within the Public Sector Internal Audit Standards (PSIAS) is "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Implementation by Management of the actions associated with Internal Audit recommendations, that are designed to improve internal control and governance arrangements and management of risks, underpins the Council's own continuous improvement arrangements to enhance its effectiveness, thus supporting the delivery of the Council's best value duties.

A.5 Involving Communities and Other Stakeholders

The Chief Internal Auditor is accountable to the Audit Committee which, in fulfilling its governance role, acts as a bridge between the Council and other stakeholders. This report is presented to the Audit Committee to fulfil its remit "monitor the implementation of agreed actions", as part of its high-level oversight of the Council's governance, risk management and control framework.

This report has been presented to the Corporate Management Team to outline the key messages of assurance and areas of improvement. The implementation of Audit recommendations will continue to be tracked by Management using the Pentana Performance system and followed-up by Internal Audit. Any further matters of concern will be raised to CMT and the Audit Committee as appropriate.

A.6 Impact on Performance and Outcomes

The Findings and Recommendations from Internal Audit work during the year are designed to assist the Council in improving its performance and outcomes.

A.7 Adopting a Preventative Approach

Internal Audit assurance work includes assessments on when a preventative approach can be adopted.

A.8 Supporting Sustainable Development

This report does not relate directly to supporting sustainable development. Good governance is important to enable Midlothian Council to achieve its objectives.

Appendix 1 Internal Audit Recommendations – Overdue Actions

As at 18 December 2023

Midlothian

Audit Recommendation (Risk Rating)	Rating	Due Date	Progress	Service
2022/23 - Construction Projects - Substantial Assurance				
Appropriate service risk registers should be established in the Pentana Performance System for the Development Team.	Low	30-Sep-2023	0%	Place
2023/24 - Licensing - substantial for the processing of applications and evidence compilation. Assurance is limited for the governance arrangements in place to support the licensing activity and the ongoing risk-based monitoring arrangements.				
There is a need to clarify some aspects of the roles and responsibilities for Protective Services and the Clerk of the Licensing Board.	Low	31-Oct-2023	10%	Place
Application forms should be updated with the Council’s Privacy Policy and should be available online for all licences.	Low	31-Oct-2023	25%	Place

Audit Committee
Monday 29 January 2024
Item 5.3

Internal Audit Mid-Term Performance Report 2023/24

Report by Chief Internal Auditor

Report for Decision

1 Recommendations

The Audit Committee is asked to:

a) Note the progress Internal Audit has made with activity in the Internal Audit Annual Plan 2023/24 to the end of December 2023;

b) Confirm that it is satisfied with the performance of the Internal Audit service provision.

2 Purpose of Report/Executive Summary

The purpose of this report is to inform the Audit Committee of the progress Internal Audit has made in the first 9 months of the year to 31 December 2023, towards completing the Internal Audit Annual Plan 2023/24. It also summarises the statutory obligations for Internal Audit and requirements of the Public Sector Internal Audit Standards.

Internal Audit provides assurance to Management and the Audit Committee on the effectiveness of internal controls and governance within the Council.

The Internal Audit Annual Plan 2023/24 that was approved by the Audit Committee on 7 March 2023 sets out the audit coverage for the year utilising the expected available Internal Audit staff resources to enable the Chief Internal Auditor, as the Council's Chief Audit Executive (CAE), to provide the statutory annual internal audit opinion regarding the adequacy and effectiveness of internal control within the Council.

The report provides details of the progress to date by Internal Audit with its programme of work and highlights changes that require approval to reflect the changes in resourcing available throughout the year.

Date 12 January 2024

Report Contact:
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3 Background

3.1 As part of Midlothian Council's system of corporate governance, Internal Audit's purpose is to support the Council in its activities designed to achieve its declared objectives and to do so:

- In support of the Council's vision, values and priorities.
- As a contribution to the Council's corporate management of risk, including assisting Management to improve the risk identification and management process in particular where there is exposure to significant financial, strategic, reputational and operational risk to the achievement of the Council's objectives.
- As an aid to ensuring that the Council and its elected members, employees and contracted third parties are operating within the law and relevant regulations, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.
- As a contribution towards establishing and maintaining a culture of honesty, integrity, openness, accountability and transparency throughout the Council in all its activities and transactions.
- As a contribution towards ensuring that financial statements and other published performance information are accurate and reliable.

3.2 Internal Audit provides assurance to Management and the Audit Committee on the effectiveness of internal controls, risk management and governance within the Council.

3.3 The Internal Audit Annual Plan 2023/24 that was approved by the Audit Committee on 7 March 2023 set out the audit coverage for the year utilising anticipated available Internal Audit staff resources to enable the Chief Internal Auditor, as the Council's Chief Audit Executive (CAE), to provide the statutory annual internal audit opinion regarding the adequacy and effectiveness of internal control within the Council.

3.4 Internal Audit assurance services are also provided during the year to the Midlothian Health and Social Care Integration Joint Board, and a statutory annual Internal Audit opinion is provided to its respective Management and Board/Audit and Risk Committee to meet its obligations.

4 Mid-Year Results Against Internal Audit Plan 2023/24

4.1 The Internal Audit programme of work led by the Principal Internal Auditor takes account of the availability of auditor resources and consultation with Management to consider operational service delivery demands and timing of the Council's transformation programmes.

4.2 The Appendix B to this report provides details of the progress by Internal Audit with its programme of work. Those audits which are complete are highlighted in dark shading, those underway to reflect their continuous audit approach are highlighted in light shading, and those scheduled for the final quarter of the year are not shaded.

4.3 In addition, 2 audits: Workforce Planning and Property Assets and Property Strategy (shaded in grey) have now been removed from the audit plan as this is not the appropriate time to complete these audits given current risk and other external assurance.

4.4 The Internal Audit plan had, in addition to regularly required review processes, 13 audits scheduled for completion in 2023/24. 2 assignments are being substituted for other risk work which has been identified during the year. The team has completed 5 assignments (39%), 2 further assignments will be complete for the March Audit Committee (15%). 6 further assignments (46%) are scheduled with current team capacity to be substantially complete prior to the annual governance reports in June 2024. Substantial completion of the plan will allow for an appropriate assessment of the Councils governance, risk and control environment.

4.5 The continuous audit approach, in accordance with the Internal Audit Strategy approved by Audit Committee on 7 March 2023, enables Internal Audit to provide added value advice on internal controls and governance and 'critical friend' consultancy services. For example, Capital Planning and Asset Management Board, and Information Management Group.

5 Continued Reporting on the Internal Audit Plan for 2023/24

5.1 The Internal Audit work will continue to be reported to the Corporate Management Team and to the Audit Committee. The Internal Audit reports will include: an Executive Summary of the audit objective, findings, good practice, recommendations (where appropriate) and audit opinion of assurance for each Final Internal Audit Report issued to relevant Management; a summary of Internal Audit Assurance Work in Progress; and an outline of Internal Audit Consultancy and Other Work carried out in accordance with the approved Internal Audit Charter.

5.2 Internal Audit's compliance with its Strategy and delivery of its risk-based Annual Plan will be communicated within the Internal Audit Annual Assurance Report which will also provide the statutory annual Internal Audit opinion based on audit findings over the year.

6 The Local Authority Accounts (Scotland) Regulations 2014

6.1 The Local Authority Accounts (Scotland) Regulations 2014 which came into force on 10 October 2014 require a local authority to operate a professional and objective internal auditing service. This service must be provided in accordance with recognised standards and practices in relation to internal auditing. Recognised standards and practices are those set out in the *Public Sector Internal Audit Standards: Applying the IIA International Standards to the UK Public Sector* (PSIAS). The standards require internal audit to have suitable operational independence from the authority.

6.2 The regulations require a local authority to assess the efficiency and effectiveness of internal auditing activity from time to time in accordance with recognised internal auditing standards and practices.

7 Public Sector Internal Audit Standards (PSIAS) and Quality Assurance & Improvement Plan (QAIP)

7.1 The Internal Audit function follows the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) effective April 2013 (updated April 2017) which includes:

- Definition of Internal Auditing;
- Code of Ethics;
- Attribute Standards (responsibility, independence, proficiency, quality);
- Professional Standards (managing activity, nature of work, engagement planning, performing the engagement, communicating results, monitoring progress, risk management).

7.2 The PSIAS requires the Chief Audit Executive (CAE), the Council's Chief Internal Auditor, to carry out an annual internal self-assessment against the PSIAS, develop a quality assurance and improvement plan (QAIP) based on the outcome, and report the results of the QAIP to senior management and elected members.

7.3 An annual internal self-assessment against the PSIAS of the Internal Audit function will be completed prior to the end of 2023/24. The results and any associated improvement actions will continue to be reported to the Corporate Management Team and the Audit Committee within the Internal Audit Annual Assurance Report. This will enable the Council to meet the requirements of the Local Authority Accounts (Scotland) Regulations 2014 to consider the findings of assessments as part of the consideration of the system of internal control required by regulation 5.

7.4 The PSIAS also requires the self-assessment to be subject to an External Quality Assessment (EQA) each five years, by appropriately qualified and independent reviewers. This EQA was carried out by Highland Council in March 2018 and the results were outlined in the Internal Audit Annual Assurance Report 2017/18 reported to the Audit Committee in June 2018. The schedule for the second cycle of EQAs, with other participating Scottish Councils as peer reviewers, indicates that Midlothian will be reviewed by East Renfrewshire Council in 2024.

8 Report Implications (Resource, Digital, Risk and Equalities)

8.1 Resource

The Internal Audit function reports directly to the Chief Executive (operationally) and the Audit Committee (functionally). There is currently a staff resource of 3.22 FTE, comprising Chief Internal Auditor (0.5 FTE – shared with East Lothian Council), Principal Internal Auditor (0.72 FTE), and Internal Auditor (2.0 FTE). Each member of the Internal Audit team has a professional internal audit or accountancy qualification, and has suitable experience, knowledge, skills and competencies (such as the Code of Ethics set out in PSIAS and the Seven Principles of Public Life) needed to perform the plan.

Budget monitoring of the Service is discussed by the Chief Internal Auditor and the Principal Internal Auditor with the Financial Services Manager on a quarterly basis to address any budgetary pressures.

There is a commitment to provide resource to the Midlothian Health and Social Care Integration Joint Board (MIJB) as part of the Council's commitment to partnership working. Separate plans and reports are presented to MIJB Audit and Risk Committee to fulfil this role.

8.2 Digital

There are no digital implications arising from this report.

8.3 Risk

The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process.

Key components of the audit planning process include a clear understanding of the Council's functions, associated risks, and potential range and breadth of audit areas for inclusion. During the development of the Internal Audit Annual Plan 2023/24, at the start of each audit engagement, and during the re-assessment of the plan, to capture potential areas of risk and uncertainty more fully, key stakeholders have been consulted and risk registers have been considered, to ensure the plan is formulated on a risk-based approach.

If Internal Audit staffing levels fall below that assumed for the remaining three-month period or if there is an unexpected and unplanned level of contingency audit work, there is a high level of risk that the remaining elements of the Annual Plan 2023/24 will not be delivered in full. This could only be mitigated by use of external resource. Regular monitoring will be undertaken to ensure that a sufficient range and breadth of assurance audit work will be carried out during 2023/24 to underpin, a 'not limited' statutory Internal Audit opinion to Management and the Audit Committee on the effectiveness of internal controls and governance within the Council.

8.4 Ensuring Equalities

This report does not relate to a new or revised policy, service or budget change, which affects people (the public or staff), so an Integrated Impact Assessment (IIA) is not an applicable consideration.

The Internal Audit work is carried out in accordance with the appropriate legislation and professional standards. The latter includes compliance by those within the Internal Audit function with the Code of Ethics set out in the PSIAS which is appropriate for the profession of Internal Audit founded as it is on trust placed in its independent and objective assurance about risk management, internal control and governance.

8.5 Additional Report Implications (See Appendix A)

APPENDIX A – Additional Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Although this report does not relate directly to the key priorities within the Single Midlothian Plan to which Midlothian Council and its Community Planning Partners have made a commitment (Reducing the gap in economic circumstances; Reducing the gap in learning outcomes; Reducing the gap in health outcomes; and Reducing the impact of climate change), by providing an independent and objective annual assessment of the adequacy of the entire control environment, Internal Audit supports the Council to achieve its objectives.

A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☒ Holistic Working
- ☒ Hub and Spoke
- ☒ Modern
- ☒ Sustainable
- ☒ Transformational
- ☒ Preventative
- ☒ Asset-based
- ☒ Continuous Improvement
- ☒ One size fits one
- ☐ None of the above

Midlothian Council is committed to creating a great place to grow supported by the 9 drivers for change. Implementing the 9 drivers for change in practice is applicable to the Council's Internal Audit service provision to assist the Council in achieving its objectives.

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☒ One Council Working with you, for you
- ☒ Preventative and Sustainable
- ☒ Efficient and Modern
- ☒ Innovative and Ambitious

A.4 Delivering Best Value

The definition of Internal Auditing within the Public Sector Internal Audit Standards (PSIAS) is "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Implementation by Management of the actions associated with Internal Audit recommendations, that are designed to improve internal control and governance arrangements and management of risks, underpins the Council's own continuous improvement arrangements to enhance its effectiveness, thus supporting the delivery of the Council's best value duties.

A.5 Involving Communities and Other Stakeholders

Internal Audit's purpose is to support the Council in its activities designed to achieve its declared objectives for the benefit of Midlothian's communities and other stakeholders.

The Chief Internal Auditor is accountable to the Audit Committee which, in fulfilling its governance role, acts as a bridge between the Council and other stakeholders.

This report has been presented to the Corporate Management Team to outline the key messages of assurance plans.

A.6 Impact on Performance and Outcomes

The Findings and Recommendations from Internal Audit work during the year, which are designed to maintain and / or enhance internal controls, governance arrangements and risk management, assists the Council in improving its performance and outcomes.

A.7 Adopting a Preventative Approach

Having robust internal controls, governance arrangements and risk management in place contributes to safeguarding the Council's resources for delivery of services, as part of protecting the public purse. Internal Audit assurance and consultancy activity is designed to improve operations and assist the Council in accomplishing its objectives.

A.8 Supporting Sustainable Development

This report does not relate directly to supporting sustainable development. Good governance, including the provision of an Internal Audit service, is important to enable Midlothian Council to achieve its objectives.

AUDIT	DAYS	COMMENTARY	STATUS
Assurance - Cyclical			
MLC Annual Assessment of Internal Control and Governance	20	Prepare an annual assurance report for Management and the Audit Committee summarising the work undertaken by Internal Audit during the year and forming an opinion on adequacy of the Council's arrangements for risk management, governance and internal control. Continuous audit approach on progress with areas of improvement. Annual evaluation of compliance with the Local Code of Corporate Governance covering the corporate whole and individual Directorates / Services.	Continuous audit approach to follow-up on implementation of actions on Areas of Improvement set out in the Annual Governance Statement 2022/23. Annual evaluation of compliance with the Local Code of Corporate Governance scheduled 4th Qtr. Internal Audit opinion, work undertaken and compliance with PSIAS will be outlined in Internal Audit Annual Assurance Report 2023/24.
Care Homes, Council and Private	20	Review of the arrangements in place to manage the process of utilising appropriate bed spaces within care homes and the monitoring and control mechanisms in place to ensure quality care and best value.	Complete: Final Report issued January 2024. Executive Summary to Audit Committee 29 January 2024.
Council Tax Discounts and Exemptions	20	Review the processes in place to ensure that the Council is providing the appropriate Council Tax discounts and exemptions to those households with an entitlement to these discounts and exemptions whilst preventing any error or fraud.	Complete: Final Report issued 21 September 2023. Executive Summary to Audit Committee 26 October 2023.
Licensing	20	Review the policies, processes and procedures in place to ensure the effective licensing services are in place and subject to effective governance.	Complete: Final Report issued 6 September 2023. Executive Summary to Audit Committee 26 October 2023.
Payroll	20	Review the processes in place to ensure complete, accurate and timely payment of Council staff (including Teachers payroll) in accordance with the Contractual terms and Conditions of the employees.	Audit Testing currently underway with the Executive Summary of the report due to be submitted to the 18 March 2024 Audit Committee.

AUDIT	DAYS	COMMENTARY	STATUS

Assurance – Risk Based

Absence & Performance Management	30	Review the operation of the systems in place for monitoring of absence to ensure maintenance of staff wellbeing in new working environments and capacity for service delivery. Review the operation of performance management processes across the Council following COVID recovery.	This audit is scheduled to commence in the 4th quarter of the financial year with reporting of the Executive Summary to the Audit Committee on 14 May 2024.
Children's Services Continued Care	30	Review the processes around continuation of care for looked after children.	This audit is scheduled to commence in the 4th quarter of the financial year with reporting of the Executive Summary to the Audit Committee on 24 June 2024.
IT Audit	30	Review Core IT controls following a more detailed review of the current control environment with the IT teams to establish best use assurance resources between Internal and External Audit.	This audit is scheduled to commence in the 4th quarter of the financial year with reporting of the Executive Summary to the Audit Committee on 24 June 2024.
Property Assets and Property Strategy	20	Review the processes of developing a property asset management strategy and the governance of the implementation.	This audit has been delayed until 2024/25 as a result of additional work being completed on the review of Hillend project post delays.
Risk Management	20	Review the Risk Management governance and control arrangements across the Council to ensure that they are providing good quality, timely, complete and accurate reporting to all senior management, council members and other stakeholders.	The draft report has been issued to management on 18 December 2023. The Executive Summary will be reported to the Audit Committee on 18 March 2024.
Attainment Scotland Funding	30	Review the governance and internal control arrangements in place to support the effective utilisation of Attainment Scotland Funding (Pupil Equity, Strategic Equity and Care Experienced Children and Young People Funding).	Planning has commenced on this audit with reporting of the Executive Summary to the Audit Committee on 24 June 2024.
Growing Council, Budgeting for Growth	30	Review the approach to including population and infrastructure growth into future budget requirements across Council services.	This audit is scheduled to commence in the 4th quarter of the financial year with reporting of the Executive Summary to the Audit Committee on 24 June 2024.

Workforce Planning	30	Review of the strategy for recruitment, retention and training of employees across the Council, including a review of changes made in relation to new ways of working.	This audit has been delayed until 2024/25 as a result of additional work being completed on the review of leases reported to the 29 January 2023 Audit Committee.
Developer Contributions	30	Review the processes in place to ensure that appropriate contributions are received for infrastructure as a result of housing development and the governance, control and risk management processes in place to ensure that the calculations for the value of contributions to be received are based on accurate and complete information.	Complete: Final Report issued December 2023. Executive Summary to Audit Committee 29 January 2024.

AUDIT	DAYS	COMMENTARY	STATUS
Consultancy			
Consultancy	30	In its 'critical friend' role provide: an independent view and challenge of a sample of programmes and projects (including Learning Estate Strategy, Business Transformation Board, Information Management Group); and an objective assessment of self-evaluation arrangements.	In its critical friend role provided an independent view and challenge at various forums including Business Transformation Board, Capital Plan and Asset Management Board, and Information Management Group.

AUDIT	DAYS	COMMENTARY	STATUS
Other			
PSIAS Self-Assessment	10	Undertake annual self-assessment of the Internal Audit function against the Public Sector Internal Audit Standards (PSIAS) and report findings to the Audit Committee.	Scheduled 4th Qtr. Findings will be outlined in Internal Audit Annual Assurance Report 2023/24.
MLC Audit Committee Self-Assessment	5	Provide assistance to Chair in undertaking a self-assessment of the Audit Committee against the CIPFA best practice guidance.	The Chair presented the Audit Committee Annual Report 2022/23 to Council in October 2023. 2023/24 self-assessment is scheduled 4th Qtr.
MLC Recommendation Follow Up Reviews	30	Undertake 2 reviews: the first includes a sample check on the adequacy of new internal controls for audit actions flagged as closed, and the second assesses performance against closing audit actions by the agreed due date.	Follow-up Review of Completed and In Progress Internal Audit Recommendations reported to Audit

			Committee 29 January 2024.
Contingency	20	Support / undertake any investigations and other reactive work to ensure high risk issues and concerns identified by management or Audit Committee during the year are appropriately addressed.	Contingency days are being used to support completion of Internal Audit plan due to resource constraints and investigation/reactive work.
Help Desk Enquiry system	20	Provide guidance and advice to management on internal controls.	Ongoing
MLC Administration of Audit Scotland Reports	2	Monitor publication of Audit Scotland reports and co-ordinate submission by management of Audit Scotland reports to the relevant Committee.	Ongoing
Management Groups	4	Attend and provide support to Risk Management and Integrity Groups.	Ongoing
MLC Attendance at Boards / Committees	10	Prepare for and attend Audit Committee meetings and other Boards/Committees.	Ongoing
MLC Audit Planning for 2024/25	10	Update the Audit Universe, check risk registers and other sources of assurance, and develop and consult on proposed coverage within the Internal Audit Annual Plan 2024/25.	Scheduled 4 Qtr. Internal Audit Annual Plan 2024/25 will be presented to Audit Committee for approval in March 2024.

AUDIT	DAYS	COMMENTARY	STATUS
Non MLC			
Midlothian Health and Social Care Integration Joint Board	30	Audit reviews and support to be determined and agreed by the MIJB Audit and Risk Committee for review of the adequacy of the MIJB's arrangements for risk management, governance and internal control for delegated resources.	MIJB Internal Audit Annual Plan 2023/24 approved by MIJB Audit and Risk Committee in March 2023. Audit work ongoing. Reports will be presented to MIJB Audit and Risk Committee.

Midlothian

Audit Committee
Monday 29 January 2024
Item 5.4

Internal Audit Work to December 2023

Report by Chief Internal Auditor

Report for Decision

1 Recommendations

The Audit Committee is asked to:

a) Consider the Executive Summaries of the final Internal Audit assurance reports issued associated with the delivery of the approved Internal Audit Annual Plan 2023/24;

b) Note the Internal Audit Consultancy and Other Work carried out in accordance with the approved Internal audit Charter; and

c) Acknowledge the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work.

2 Purpose of Report/Executive Summary

The purpose of this report is to provide members of the Audit Committee with details of the recent work carried out by Internal Audit and the findings and recommended audit actions agreed by Management to improve internal controls and governance arrangements.

The Internal Audit Annual Plan 2023/24 was approved by the Audit Committee on 7 March 2023. Internal Audit has carried out work associated with the delivery of the plan to meet its objective of providing an opinion on the efficacy of the Council's risk management, internal control and governance.

An Executive Summary of the final Internal Audit assurance reports issued, including audit objective, findings, good practice and recommendations (where appropriate), and the Chief Internal Auditor's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, is shown in Appendix 1.

The Internal Audit function conforms to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017) including the production of this report to communicate the results of the reviews.

Date 17 January 2024

Report Contact:
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3 Progress Report

3.1 The Internal Audit Annual Plan 2023/24 was approved by the Audit Committee on 7 March 2023. Internal Audit has completed the following work in the period from 1 September to 31 December 2023 associated with the delivery of the plan to meet its objective of providing an opinion on the efficacy of the Council's risk management, internal control and governance.

3.2 The Internal Audit function conforms to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017), including the production of this report to communicate the results.

3.3 Internal Audit issued final assurance reports on the following subjects:

- Developer Contributions; and
- Care Homes Public and Private.

3.4 An Executive Summary of the final Internal Audit assurance report issued, including audit objective, findings, good practice and recommendations (where appropriate), and the Chief Internal Auditor's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, is shown in Appendix 1.

The definitions for Internal Audit assurance categories are as follows:

Level	Definition
Comprehensive assurance	Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required.
Substantial assurance	Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement as current arrangements could undermine the achievement of objectives or leave them vulnerable to error or misuse.
Limited assurance	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or misuse.
No assurance	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or misuse is unacceptable. Significant improvements are required.

Internal Audit Consultancy and Other Work

3.5 Internal Audit staff have been involved in the following for the Council to meet its aims and objectives, and its roles and responsibilities in accordance with the approved Internal Audit Charter and Strategy:

a) In its critical friend role provided an independent view and challenge at various forums including: Capital Plan Management Group, Chief Officers Risk & Resilience Group, Integrity Group, UKSPF Oversight Board and Information Management Group.

b) Learning and development during the research stage of new audit areas for all Internal Audit team members and through joining virtual audit forums (Computer Audit Sub-group) and meetings; and

c) Monitored publication of Audit Scotland reports.

Recommendations

3.6 Recommendations in reports are suggested changes to existing procedures or processes to improve the controls or to introduce controls where none exist. The grading of each recommendation reflects the risk assessment of non-implementation, being the product of the likelihood of the risk materialising and its impact:

High: Significant weaknesses in existing controls, leaving the Council or Service open to error, fraud, financial or reputational damage, where the risk is sufficiently high to require immediate action within one month of formally raising the issue. Added to the relevant Risk Register and included in the relevant Assurance Statement.
Medium: Substantial weaknesses in existing controls, leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage requiring reasonably urgent action within three months of formally raising the issue.
Low: Moderate weaknesses in existing controls, leaving the Council or Service open to low risk of error, fraud, financial loss or reputational damage requiring action within six months of formally raising the issue to improve efficiency, effectiveness and economy of operations or which otherwise require to be brought to attention of senior management.
Outwith the report, Internal Audit informs operational managers about other matters as part of continuous improvement.

3.7 The table below summarises the number of Internal Audit recommendations made during 2023/24:

Recs Rating	2023/24 Number of Recs
High	0
Medium	5
Low	7
Sub-total reported this period	**12**
Previously reported	33
Total	**45**

Recommendations agreed with action plan	45
Not agreed; risk accepted	0
Total	**45**

4 Report Implications (Resource, Digital, Risk and Equalities)

4.1 Resource

Resource implications of implementing Internal Audit recommendations are considered as part of the audit process to ensure these are reasonable and proportionate to the risks.

4.2 Digital

There are no digital implications arising from this report.

4.3 Risk

The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process. At the start of each audit engagement, to capture potential areas of risk and uncertainty more fully, key stakeholders have been consulted and risk registers have been considered. During each audit engagement the management of risk has been tested.

It is anticipated that improvements in the management and mitigation of risks will arise as a direct result of Management implementing the Internal Audit recommendations made. If audit recommendations are not implemented, there is a greater risk of financial loss and/or reduced operational efficiency and effectiveness, and Management may not be able to demonstrate improvement in internal control and governance arrangements, and effective management of risks.

4.4 Ensuring Equalities

This report does not relate to a new or revised policy, service or budget change, which affects people (the public or staff), so an Integrated Impact Assessment (IIA) is not an applicable consideration.

The Internal Audit work is carried out in accordance with the appropriate legislation and professional standards. The latter includes compliance by those within the Internal Audit function with the Code of Ethics set out in the PSIAS which is appropriate for the profession of Internal Audit founded as it is on trust placed in its independent and objective assurance about risk management, internal control and governance.

4.5 Additional Report Implications (See Appendix A)

APPENDIX A – Additional Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Although this report does not relate directly to the key priorities within the Single Midlothian Plan to which Midlothian Council and its Community Planning Partners have made a commitment (Reducing the gap in economic circumstances; Reducing the gap in learning outcomes; Reducing the gap in health outcomes; and Reducing the impact of climate change), good governance is important to enable Midlothian Council to deliver its key priorities in support of achieving the Council's objectives.

A.2 Key Drivers for Change

Key drivers addressed in this report:

☒ Holistic Working
☒ Hub and Spoke
☒ Modern
☒ Sustainable
☒ Transformational
☒ Preventative
☒ Asset-based
☒ Continuous Improvement
☒ One size fits one
☐ None of the above

Midlothian Council is committed to creating a great place to grow supported by the 9 drivers for change. Implementing the 9 drivers for change in practice is applicable to the Council's Internal Audit service provision to assist the Council in achieving its objectives.

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

☒ One Council Working with you, for you
☒ Preventative and Sustainable
☒ Efficient and Modern
☒ Innovative and Ambitious

A.4 Delivering Best Value

The definition of Internal Auditing within the Public Sector Internal Audit Standards (PSIAS) is "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Implementation by Management of the actions associated with Internal Audit recommendations, that are designed to improve internal control and governance arrangements and management of risks, underpins the Council's own continuous improvement arrangements to enhance its effectiveness, thus supporting the delivery of the Council's best value duties.

A.5 Involving Communities and Other Stakeholders

The Chief Internal Auditor is accountable to the Audit Committee which, in fulfilling its governance role, acts as a bridge between the Council and other stakeholders.

This report has been presented to the Corporate Management Team to outline the key messages of assurance and areas of improvement. Senior Management relevant to the areas audited have agreed the final Internal Audit assurance reports as set out in the relevant Executive Summary within Appendix 1.

A.6 Impact on Performance and Outcomes

The Findings and Recommendations from Internal Audit work during the year are designed to assist the Council in improving its performance and outcomes.

A.7 Adopting a Preventative Approach

Internal Audit assurance work includes assessments on when a preventative approach can be adopted.

A.8 Supporting Sustainable Development

This report does not relate directly to supporting sustainable development. Good governance is important to enable Midlothian Council to achieve its objectives.

Report	Summary of key findings and recommendations	Recommendations H	M	L	Status
Subject: Care Homes Council and Private Category: Assurance – Cyclical Date issued: 12 December 2023 Draft 18 January 2023 Final Level of Assurance: Substantial for governance arrangements, procurement of care home contracts and assessments for funding. Limited for service capacity, checking compliance with the National Care Home Contract, periodic care plan reviews for residential care, and assurance over business continuity arrangements within external care homes**.**	The purpose of the audit was to review of the arrangements in place to manage the process of utilising appropriate bed spaces within care homes and the monitoring and control mechanisms in place to ensure quality care and best value. The Health and Social Care Partnership (HSCP) is required under statute to provide care and support services to those who are assessed as being in need. Care homes for older people are provided by the Council and external providers in Midlothian. The Council currently runs 1 care home and 1 intermediate care service. A National Care Home Contract (NCHC) is in place which is negotiated by COSLA on behalf of all Scottish local authorities. The Care Home Support Team (CHST) undertakes quality monitoring audits at each care home. The Chief Nurse provides clinical support to care homes and liaises with the CHST. A multidisciplinary Rapid Run Down group was established early in the pandemic to provide a responsive reporting structure for the CHST. Periodic care plan reviews for residential care are set on Mosaic and are undertaken by the Social Work team. In August 2023, it was reported to the MIJB that the Social Care overall forecast is projecting a £4.4m overspend. Areas reporting an overspend were the resource panel budget (particularly learning disabilities) and Newbyres Care Home and Highbank Intermediate care home. Following challenges in securing workforce, there has been a temporary pause to admissions (61 to 48 bed spaces) at Newbyres Care Home. The temporary decision to reduce bed space was not related to budget but about ensuring the safe care of residents. The HSCP were unable to ensure that there were sufficient care workers available to work, due to both a local and national issue around the workforce in this line of work. Safety of both residents and staff is the prime focus. As at end of Q2, 2023/24, the forecasted overspend for care homes (including clients with learning disabilities placed in external care homes) was £2.6m. In the Council owned care home, there has been a reliance on agency staff to support resident complexity and the increasing complexity of care needs is contributing to the significant financial pressures on the Learning Disability budget.	0	2	3	Management have accepted the factual accuracy of the report and its findings, and agreed to implement the recommendations.

	Internal Audit considers that the level of assurance is substantial for governance arrangements, procurement of care home contracts and assessments for funding. Assurance is limited for service capacity (based on increasing demographic demands in Midlothian), checking compliance with the National Care Home Contract, periodic care plan reviews for residential care, and assurance over business continuity arrangements within external care homes. Although budget management processes and recovery plans are in place, there are significant financial pressures over funding of internal care homes and external care home placements. There are currently insufficient care home placements within Midlothian with only 474 beds (both self-funding and standard funded beds). This number of beds is below the national average against age demographic and means vacancies within Midlothian are limited and require families to think of placements out with Midlothian. In addition, there are currently clients who have been resident in Highbank Intermediate Care Home for longer than the planned 6 weeks. Management have advised that a commissioned review of all beds across Midlothian will be undertaken, and the outcome of this review is expected to be reported in early 2024. Whilst it has been advised that there are service plans in place for care homes, Internal Audit made the following recommendations: • Overarching guidance should be in place for managing Newbyres and Highbank care homes. The guidance should explain the roles and responsibilities of services, legislative requirements and monitoring arrangements. (Low) • The Rapid Run Down group should have a formal terms of reference describing the purpose of the group; the frequency of meetings and the responsibilities of the group members. (Low) • Care plan reviews for residential care should be undertaken on a timely basis and the community care home review policy should be reviewed and updated. (Medium) • Care Home Service risks should be recorded within an Adult Social Care Risk Register in line with the Council's Risk Management Policy. (Low) • Monitoring of care homes should be undertaken to ensure they are complying with the National Care Home contract (eg. ensuring relevant policies and procedures are in place and reviewing the residency agreements used by the provider). Building and contents insurance for care home providers should be				

	checked annually and maintained by the Council. Management should ensure that all external care home providers have adequate business continuity plans in place. (Medium)				

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
Subject: Developer Contributions Category: Assurance – Risk-based Date issued: 30 November 2023 Draft 20 December 2023 Final Level of Assurance: Substantial	Midlothian has been experiencing significant growth and investment for a number of years. The 2022 census highlighted that Midlothian's percentage population growth has been almost six times higher than the national average over the last decade (16.1% in Midlothian compared to a Scottish national average of 2.7%). Developer Contributions are a means of mitigating against the impact of growth by providing the Council with a financial contribution towards the cost of new capital infrastructure. Midlothian's development plan is comprised of National Planning Framework 4 (which superseded the Edinburgh and South East Scotland Strategic Development Plan June 2013 in February 2023) and the Midlothian Local Development Plan 2017 (MLDP), adopted in November 2017 following consultation. Policies set out within the MLDP require the developer to deliver, or contribute to, the required infrastructure or mitigate the impact of the development. The MLDP sets out the following topic areas for developer contributions: education provision; transport infrastructure (including towards Borders Rail, the A7 urbanisation scheme, Sheriffhall Roundabout upgrade and the A701 realignment and A702 spur); affordable housing provision (which could include a financial contribution); community facilities; sport and leisure facilities; town centre improvements; and open space and play provision/upgrades. Developer Contributions towards these areas generally only cover the capital cost of the development, not the ongoing revenue costs. However, new housing should in theory increase the ongoing revenue for the Council through additional Council tax and increases in the block grant to reflect the increase in population. Local Authorities are required to set out their plans in Supplementary Guidance (SG) (Circular 1/2009, Scottish Government, 2009). The purpose of this guidance is to detail the Council's requirements in respect of planning obligations to be secured from new developments and provide further detail in support of the development plan. The Council's Supplementary Guidance was published in 2012.	0	3	4	Management have accepted the factual accuracy of the report and its findings, and agreed to implement the recommendations.

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
	As at 31 March 2023, the Council held £43.092m of Developer Contributions with contribution receipts in the year of £9.029m and contributions applied of £6.074m. £1.598m of planning obligations were entered into in 2022/23 and £2.139m were entered into in 2021/22. The Council's Planning team, as part of the planning application process, assess whether Developer Contributions are required, and the decision is logged in the Idox Uniform system. Applications are assessed against the Council's Local Development Plans and Supplementary Guidance to determine whether contributions are relevant. If the application is not covered by the Local Development Plans (windfall housing), the Planning team will engage with service areas as required to establish the necessary contributions and follow the process set out in the MLDP and SG. The Lead Officer Planning Obligations is responsible for the majority of negotiations with developers. Following negotiation, a Heads of Terms document is prepared setting out the contributions required for the development, and this is submitted to the Executive Director, Place, for review and approval under the Council's delegated authority. Following approval, the Legal Services team produce a legal agreement in conjunction with the developer's solicitors. Developer Contributions are logged on the Exacom Planning Obligations Suite system which records documentation relevant to the agreement, the financial details of each agreement, the trigger points when contributions are due (e.g. when a specific number of houses are completed), the receipt of contributions from developers, the projects contributions are to be allocated to, and the subsequent application of contributions to these projects. The majority of the update and maintenance of the system is undertaken by the Lead Officer Planning Obligations. Financial Services coordinate with the Lead Officer Planning Obligations to monitor the contributions received and their subsequent application to projects. The allocation of contributions to projects is initially on approval from Council, and this is administered by Financial Services in the financial ledger and annually updated on the Exacom system. Unutilised				

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	contributions are allocated to interest bearing accounts in line with the Council's Treasury Management Strategy. The Capital Plan and Asset Management Board (CP&AMB) has responsibility for monitoring the Council's Developer Contributions and receives twice yearly update reports which includes reporting on the expiry dates of contributions. Additionally, an annual report is submitted to Council providing an update on planning obligations (The Planning (Scotland) Act 2019 will make this a mandatory requirement, but the Council has implemented this in advance of it coming into force). A previous internal audit in 2016 reported that there was not an adequate database to manage the Council's developer contributions resulting in no central repository to hold details of all agreements and modifications and a significant reliance on developers to advise the Council when contributions were due. This issue has been resolved with the implementation of the Exacom system. Similarly, reporting on expiry dates of contributions to an appropriate governance body is now in place - this was not in place in 2016. Internal Audit considers that the level of assurance is substantial for Developer Contributions. Since the last full audit review in 2016 there has been a significant improvement in this area. Internal Audit made the following recommendations: • Written procedures should be developed for the Developer Contributions calculation process and creation of the Heads of Term document. The service risk register should be updated to take into account the risk of contributions not utilised used in time and completeness of the MLDP. An annual declaration process should be introduced for declaring conflicts of interest for those involved in negotiating with developers. (Low) • Procedures should be prepared covering the invoicing, ongoing monitoring and reconciliation processes within Financial Services. (Low) • Sufficient resource should be in place to support the Developer Contributions process, ensure that the database is kept up to date, all relevant documents are uploaded to the system and demand notices are generated promptly.				

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	Additionally, an appropriate audit trail should be retained of the calculation workings supporting the Heads of Terms. (Medium) • The Supplementary Guidance for Developer Contributions should be updated and include adequate detail as to how contributions should be calculated. (Medium) • For the next LDP, management should liaise with NHS Lothian and other stakeholders to establish if there is a need or basis for contributions in their respective areas. (Medium) • The reconciliation between the Financial Ledger and the Exacom system should be undertaken annually, and any differences promptly investigated. (Low) • Reporting to the Capital Plan and Asset Management Board should highlight developer contributions that are due to expire but do not have an assigned project. Additionally, consideration should be given to reporting 3 times a year instead of two given the importance of this area. (Low)				

Lease of Premises: Burnbrae Road, Bonnyrigg

Report by: Chief Internal Auditor

Report for Information

1 Recommendations

The Audit Committee is asked to note the work undertaken by Internal Audit in response to the instruction, from the Council on 29 August 2023 to review the lease of the retail premises at Burnbrae Road Bonnyrigg.

2 Purpose of Report/Executive Summary

The purpose of this report is to provide members of the Audit Committee with details of the recent work carried out by Internal Audit following an instruction from the Council meeting on 29 August 2023.

The instruction in the minute was that the Council had agreed:

- That Internal Auditors investigate the position of the retail unit at Burnbrae Road and that the Council are at no undue risk.
- That an update is provided ‘in private’ on the retail unit currently being constructed adjacent to this building, in Buccleuch Street.

Internal Audit has reviewed the situation of the retail unit at Burnbrae Road which was subject to the inherent commercial risks of developing retail unit space as part of any place making development. The risk of leasing retail space to commercial partners materialised as an issue in relation to this development as a result of an identified partner potentially not being able to take on the lease of the building when complete. However, on identification of this issue, Council Officers acted in an appropriate manner to reduce the risks to the Council. Processes were undertaken to identify a new preferred partner and an appropriate organisation was identified who will be taking on the lease for this premises.

Internal Audit found that whilst commercial risk has been identified in relation to the development of this retail unit, this risk is being appropriately managed.

The retail units in Buccleuch Street are in the process of being let and have interactions with the Dalkeith Town Centre regeneration plans. Internal Audit have no concerns over the processes being undertaken in relation to these units that they would bring to the attention of the Audit Committee, although the process remains ongoing.

Date 17 January 2024

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3 Background

3.1 The 29 August 2023 Council meeting was presented with report 8.4 for noting in relation to the Chief Executive in consultation with the Leader of the Council using Standing Order 19.2 powers to secure lease arrangements with a supermarket provider to occupy the retail unit being developed by the Council at Burnbrae Road, Bonnyrigg. The minute of the 29 August 2023 Council meeting instructed that the Council had agreed:

- That Internal Auditors investigate the position of the retail unit at Burnbrae Road and that the Council are at no undue risk.
- That an update is provided 'in private' on the retail unit currently being constructed adjacent to this building, in Buccleuch Street.

3.2 Internal Audit, having been advised of this instruction on 5 October 2023, met with officers from the Property and Facilities team who provided further documentation in relation to these properties through to December 2023. A final report is now being provided to the Audit Committee identifying the agreed conclusions of this Internal Audit work.

3.3 The Internal Audit work completed as instructed has focused on the leasing of the retail unit at Burnbrae Road which was being developed as part of a development to deliver 20 housing units in addition to the retail unit. A review of the processes being undertaken to let the retail units in Buccleuch Street has been completed at a high level.

Findings

3.4 As part of the development of the retail unit at Burnbrae Road, Bonnyrigg a documented preferred client had been identified for the retail unit who had signed a pre-lease agreement to conclude a lease when the unit had been completed. Towards the end of 2022 and beginning of 2023, as a result of multiple contacts with this client, the Property and Facilities Management Service had ascertained that due to a change of circumstances with this client, they would not be in a position to enter a lease agreement when the building was completed.

3.5 The Property and Facilities Management Service undertook an open market exercise for this property (with a closing date in June 2023) and 4 offers were received to be the preferred lease client. In July 2023, the Council decided (as described in paper 8.4 to the Council on 29 August 2023) to progress with the offer that provided the highest rental value and largest retailer who had offered to take on the lease.

3.6 The retail unit at Burnbrae Road was completed and passed over to the Council in December 2023. The major supermarket retailer who agreed to take over the lease has been confirming the lease terms and conditions with the Council appointed legal firm and a final lease is now available for signature during January 2024 (with a commencement date of the lease shortly after this).

3.7 The risk of potential clients being unable to continue with a lease are understood by the Property and Facilities Management Service and has been monitored and mitigated and on that basis no undue risk has been taken.

3.8 The retail units in Buccleuch Street are in the process of being let by the Council. They have interactions with the wider Dalkeith Town Centre regeneration plans and are not being let directly through the market. However, when required, independent advice on rent levels is being sought to ensure rates are in line with the market. At the time of writing, no leases have yet been finalised for the units.

4 Report Implications (Resource, Digital, Risk and Equalities)

4.1 Resource

Resource implications are considered as part of the audit process to ensure these are reasonable and proportionate to the risks.

4.2 Digital

There are no digital implications arising from this report.

4.3 Risk

This review identifies the risks associated with retail development and how they are managed.

4.4 Ensuring Equalities

This report does not relate to a new or revised policy, service or budget change, which affects people (the public or staff), so an Integrated Impact Assessment (IIA) is not an applicable consideration.

The Internal Audit work is carried out in accordance with the appropriate legislation and professional standards. The latter includes compliance by those within the Internal Audit function with the Code of Ethics set out in the PSIAS which is appropriate for the profession of Internal Audit founded as it is on trust placed in its independent and objective assurance about risk management, internal control and governance.

4.5 Additional Report Implications (See Appendix A)

APPENDIX A – Additional Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Although this report does not relate directly to the key priorities within the Single Midlothian Plan to which Midlothian Council and its Community Planning Partners have made a commitment (Reducing the gap in economic circumstances; Reducing the gap in learning outcomes; Reducing the gap in health outcomes; and Reducing the impact of climate change), good governance is important to enable Midlothian Council to deliver its key priorities in support of achieving the Council's objectives.

A.2 Key Drivers for Change

Key drivers addressed in this report:

☒ Holistic Working
☒ Hub and Spoke
☒ Modern
☒ Sustainable
☒ Transformational
☒ Preventative
☒ Asset-based
☒ Continuous Improvement
☒ One size fits one
☐ None of the above

Midlothian Council is committed to creating a great place to grow supported by the 9 drivers for change. Implementing the 9 drivers for change in practice is applicable to the Council's Internal Audit service provision to assist the Council in achieving its objectives.

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

☒ One Council Working with you, for you
☒ Preventative and Sustainable
☒ Efficient and Modern
☒ Innovative and Ambitious

A.4 Delivering Best Value

The definition of Internal Auditing within the Public Sector Internal Audit Standards (PSIAS) is "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Implementation by Management of the actions associated with Internal Audit recommendations, that are designed to improve internal control and governance arrangements and management of risks, underpins the Council's own continuous improvement arrangements to enhance its effectiveness, thus supporting the delivery of the Council's best value duties.

A.5 Involving Communities and Other Stakeholders

The Chief Internal Auditor is accountable to the Audit Committee which, in fulfilling its governance role, acts as a bridge between the Council and other stakeholders.

This report has been presented to the Corporate Management Team to outline the key messages of assurance.

A.6 Impact on Performance and Outcomes

The Findings and Recommendations from Internal Audit work during the year are designed to assist the Council in improving its performance and outcomes.

A.7 Adopting a Preventative Approach

Internal Audit assurance work includes assessments on when a preventative approach can be adopted.

A.8 Supporting Sustainable Development

This report does not relate directly to supporting sustainable development. Good governance is important to enable Midlothian Council to achieve its objectives.