

**Treasury Management Strategy Statement  
and Annual Investment Strategy**

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Midlothian Council  
2024/25

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# 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
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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 policies, 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.

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### 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 responsible for scrutiny.

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

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

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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.

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## 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:-

	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
<b>General Services</b>						
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)
<b>Total General Services</b>	<b>£ 23,322</b>	<b>£ 64,921</b>	<b>£ 108,857</b>	<b>£ 121,975</b>	<b>£ 89,765</b>	<b>£ 12,128</b>
<b>Total HRA</b>	<b>£ 51,710</b>	<b>£ 52,125</b>	<b>£ 99,585</b>	<b>£ 91,901</b>	<b>£ 36,647</b>	<b>£ 26,128</b>
<b>Combined Total</b>	<b>£ 75,032</b>	<b>£ 117,046</b>	<b>£ 208,442</b>	<b>£ 213,876</b>	<b>£ 126,412</b>	<b>£ 38,256</b>

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.

	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
<b>Capital Expenditure</b>						
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
<b>Total</b>	<b>£ 75,032</b>	<b>£ 117,046</b>	<b>£ 208,442</b>	<b>£ 213,876</b>	<b>£ 126,412</b>	<b>£ 38,256</b>
<b>Financed by:</b>						
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
<b>Net financing need for the year</b>	<b>£ 46,473</b>	<b>£ 70,181</b>	<b>£ 143,528</b>	<b>£ 179,543</b>	<b>£ 106,980</b>	<b>£ 27,363</b>

*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 1<sup>st</sup> 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:

	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
<b>Capital Financing Requirement</b>						
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
<b>Total CFR</b>	<b>£ 440,094</b>	<b>£ 498,085</b>	<b>£ 630,488</b>	<b>£ 794,207</b>	<b>£ 884,246</b>	<b>£ 892,800</b>
<b>Movement in CFR</b>	<b>£ 37,230</b>	<b>£ 57,991</b>	<b>£ 132,404</b>	<b>£ 163,719</b>	<b>£ 90,039</b>	<b>£ 8,554</b>
<b>Movement in CFR represented by</b>						
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)
<b>Movement in CFR</b>	<b>£ 37,230</b>	<b>£ 57,991</b>	<b>£ 132,404</b>	<b>£ 163,719</b>	<b>£ 90,039</b>	<b>£ 8,554</b>

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: -

- Existing loan debt outstanding:** the Council's existing loans that are still outstanding in future years.
- 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.
- 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.



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

<b>Infrastructure</b>	<b>Current Loans Fund Advance Period</b>
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 appropriate 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		17 January 2024	
	Principal Outstanding £000's	Weighted Average Rate	Principal Outstanding £000's	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%
<b>Total Loans</b>	<b>321,754</b>	<b>3.00%</b>	<b>320,871</b>	<b>3.00%</b>

Deposit Type	31 March 2023		17 January 2024	
	Principal Outstanding £000's	Weighted Average Rate	Principal Outstanding £000's	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%
<b>Total Deposits</b>	<b>113,982</b>	<b>3.80%</b>	<b>72,416</b>	<b>5.15%</b>

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
<b>External Debt</b>						
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)
<b>Actual/Expected Gross Debt at 31 March</b>	<b>£ 414,186</b>	<b>£ 473,085</b>	<b>£ 605,489</b>	<b>£ 769,208</b>	<b>£ 859,246</b>	<b>£ 867,800</b>
<b>The Capital Financing Requirement</b>	<b>£ 440,094</b>	<b>£ 498,085</b>	<b>£ 630,488</b>	<b>£ 794,207</b>	<b>£ 884,246</b>	<b>£ 892,800</b>
<b>Under / (over) borrowing</b>	<b>£ 25,908</b>	<b>£ 25,000</b>				
<b>Deposits</b>						
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
<b>Total Deposits</b>	<b>£ 113,982</b>	<b>£ 95,000</b>	<b>£ 82,000</b>	<b>£ 82,000</b>	<b>£ 82,000</b>	<b>£ 82,000</b>

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.

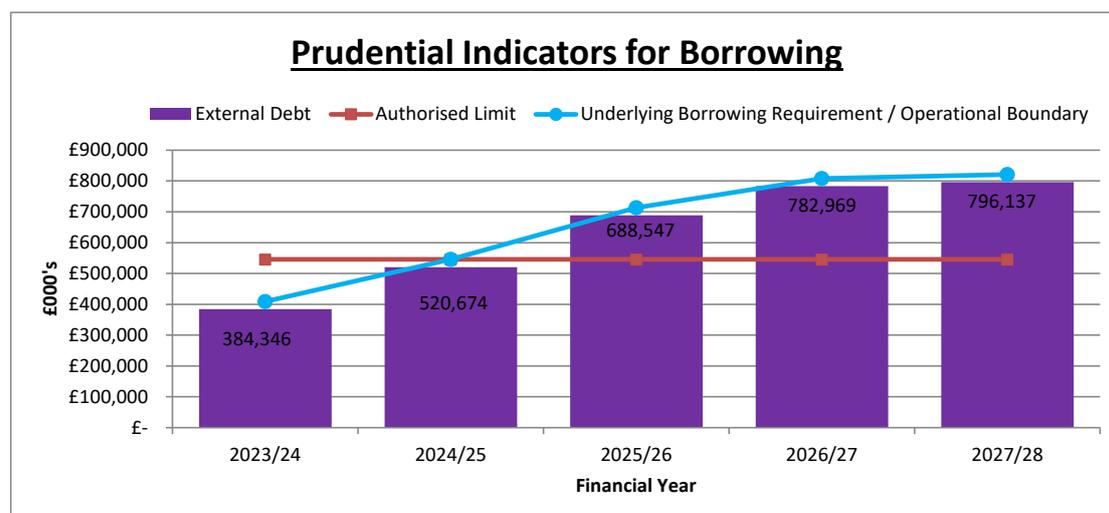
	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's	2027/28 Estimate £000's
Operational Boundary - Borrowing	£ 409,346	£ 545,673	£ 713,546	£ 807,969	£ 821,137
Operational Boundary - Other long term liabilities	£ 88,739	£ 84,815	£ 80,661	£ 76,277	£ 71,663
<b>Total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

#### 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.

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



### 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
<b>BANK RATE</b>	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.

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**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.](#)*

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### 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 be 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:

<b>Upper Limits on Exposure to Fixed and Variable Interest Rates 2024/25</b>			
<b>Interest rate exposures</b>			<b>Upper Limit</b>
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%

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

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## 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 be 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.

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## 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:-

<b>Link Asset Services Colour Code</b>	<b>Maximum Suggested Duration for Investment</b>
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.

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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	AAAmf (Yellow)	Instant Access	5.28%	516,393
MMF Federated	14,951	AAAmf (Yellow)	Instant Access	5.32%	1,059,536
MMF LGIM	14,843	AAAmf (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%	
<b>Total</b>	<b>72,416</b>				<b>2,588,564</b>

\* 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: -

<b>Principal Sums Invested for &gt; 365 Days</b>	
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 principal 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 months the 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.

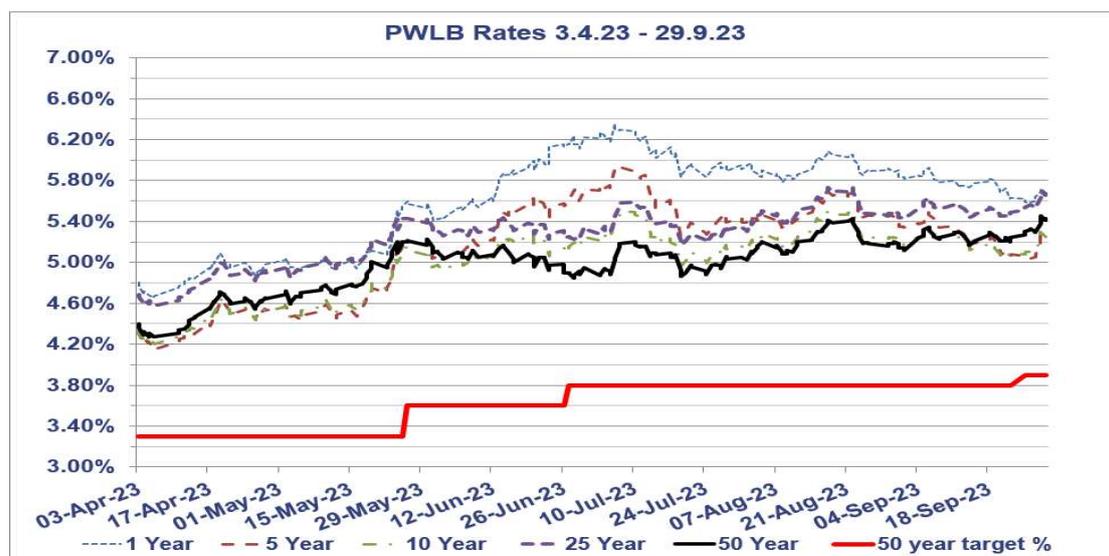
CPI inflation declined from 6.8% in July to 6.7% in August and September, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.1%. That reverses all the rise since March.

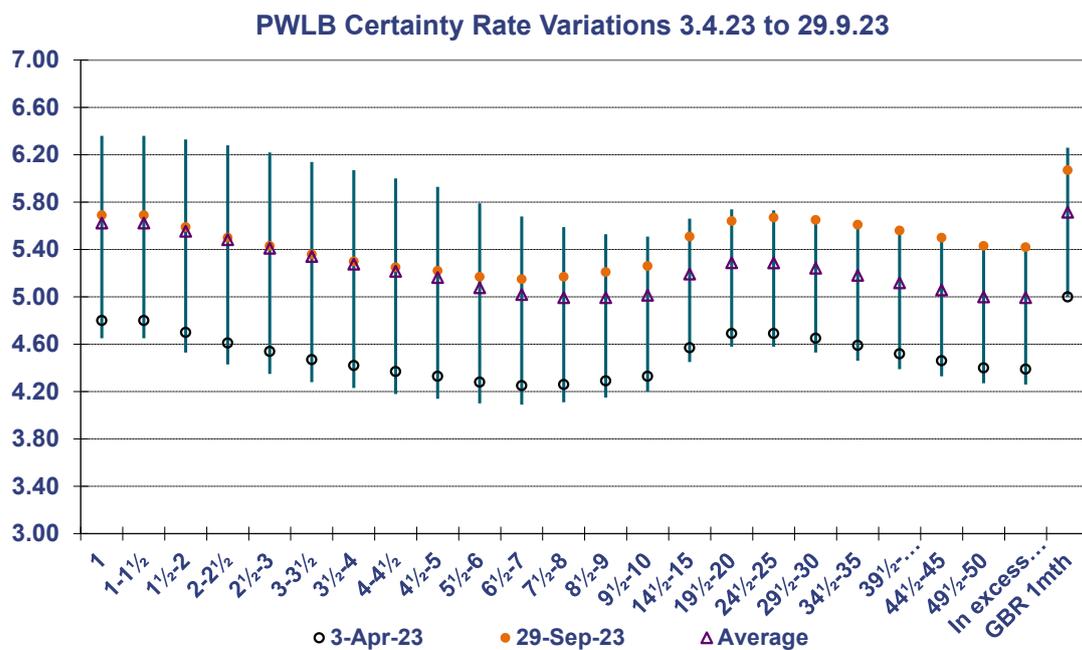
In its latest monetary policy meeting on 13 December 2023, the Bank of England left interest rates unchanged at 5.25%. The vote to keep rates on hold was a split vote, 6-3. It is clear that some members of the MPC are still concerned about the stickiness of inflation.

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
<b>Low</b>	4.65%	4.14%	4.20%	4.58%	4.27%
<b>Date</b>	06/04/2023	06/04/2023	06/04/2023	06/04/2023	05/04/2023
<b>High</b>	6.36%	5.93%	5.51%	5.73%	5.45%
<b>Date</b>	06/07/2023	07/07/2023	22/08/2023	17/08/2023	28/09/2023
<b>Average</b>	5.62%	5.16%	5.01%	5.29%	5.00%
<b>Spread</b>	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**

<b>Investment Category</b>	<b>Minimum Credit Criteria</b>	<b>Liquidity risk</b>	<b>Market risk</b>	<b>Max %/£m of total investments</b>	<b>Max. maturity period</b>	<b>Max Transaction Value</b>
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**

<b>Investment Category</b>	<b>Minimum Credit Criteria</b>	<b>Liquidity risk</b>	<b>Market risk</b>	<b>Max %/£m of total investments</b>	<b>Max. maturity period</b>	<b>Max Transaction Value</b>
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
<b>Cash type instruments</b>			
a. Deposits with the Debt Management Account Facility (UK Government) ( <b>Very low risk</b> )	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 ( <b>Very low risk</b> )	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) ( <b>Low to very low risk</b> )	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 ( <b>low risk</b> )	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
<p>e. Call account deposit accounts with financial institutions (banks and building societies) <b>(Low risk depending on credit rating)</b></p>	<p>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.</p>	<p>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.</p> <p>On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.</p>	<p>As shown in Appendix 5.2.</p>
<p>f. Term deposits with financial institutions (banks and building societies) <b>(Low to medium risk depending on period &amp; credit rating)</b></p>	<p>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.</p>	<p>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.</p> <p>On day to day investment dealing, this criteria will be further strengthened by the use of additional market intelligence.</p>	<p>As shown in Appendix 5.2.</p>

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
g. Government Gilts and Treasury Bills ( <b>Very low risk</b> )	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 ( <b>Low risk</b> )	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
<p>j. Corporate bonds (<b>Medium to high risk depending on period &amp; credit rating</b>)</p>	<p>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.</p>	<p>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.</p> <p>Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.</p>	<p>As shown in Appendix 5.2.</p>

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
<b>Other types of investments</b>			
k. Loans to third parties	<p>Using the example of a loan to a RSL, these would be medium risk investments, exhibiting higher risks than categories (a)-(f) above.</p> <p>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.</p>	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	
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**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.