Treasury Management Strategy 2024/25

Introduction

1. In 2018 the Ministry of Housing, Communities & Local Government (MHCLG) produced new Investment Guidance including the requirement to produce an Investment Strategy.

2. The County Council's Capital and Investment Strategy sets out the Council's broad approach to investment, including its capital programme, how this is funded, and investments held for service purposes or for commercial profit.

3. This Treasury Management Strategy Statement (TMSS) supports the Capital and Investment Strategy in setting out the arrangements for the management of the County Council's cash flows, borrowing and investments, and the associated risks.

4. The County Council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the County Council's prudent financial management.

5. Treasury risk management at the County Council is conducted within the framework of the CIPFA Code which requires the County Council to approve a Treasury Management Strategy Statement (TMSS) before the start of each financial year. This Strategy fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

6. Investments held for service purposes or for commercial profit are considered separately in the Capital and Investment Strategy.

External Context

7. The following paragraphs explain the economic and financial background against which the TMSS is being set.

Economic background

8. The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be

major influences on the County Council's treasury management strategy for 2024/25.

9. The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level for the rest of 2023. The November 2023 quarterly Monetary Policy Report (MPR) forecast a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with near-term risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

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

Credit outlook

11. Credit Default Swap (CDS) prices are used as an indicator of credit risk, where higher premiums indicate higher perceived risks. CDS prices were volatile during 2023, spiking in March on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in Quarter 2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.

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

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

14. Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same

update the long-term ratings of those five local authorities were downgraded.

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

16. However, the institutions on the County Council's treasury adviser, Arlingclose's, counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast (December 2023)

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

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

19. A more detailed economic and interest rate forecast provided by Arlingclose is in Annex A.

Balance Sheet Summary and Forecast

20. On 31 December 2023, the County Council held £174m of treasury borrowing and £496m of investments. This is set out in further detail at Annex B. Forecast changes in these sums are shown in the balance sheet analysis in Table 1.

Table 1: Balance sheet summary and forecast

	31/03/23 Actual £m	31/03/24 Estimate £m	31/03/25 Forecast £m	31/03/26 Forecast £m	31/03/27 Forecast £m
Capital Financing Requirement	**750**	**731**	**721**	**735**	**819**
Less: Other debt liabilities*:					
- Leases**	0	0	(15)	(13)	(12)
- Street Lighting PFI	(83)	(79)	(75)	(70)	(65)
- Waste Management Contract	(38)	(34)	(30)	(25)	(20)
Loans CFR	**629**	**618**	**601**	**627**	**707**
Less: External borrowing***:					
- Public Works Loans Board	(188)	(160)	(150)	(141)	(131)
- Other Loans (incl. LOBOs)	(12)	(12)	(12)	(12)	(12)
- Other short-term borrowing	(50)	(50)	(50)	(50)	(50)
Total external borrowing	**(250)**	**(222)**	**(212)**	**(203)**	**(193)**
Internal borrowing	**379**	**396**	**389**	**424**	**529**
Less: Balance sheet resources	(1,078)	(704)	(566)	(504)	(335)
New borrowing or (Treasury investments)	**(699)**	**(308)**	**(177)**	**(80)**	**194**

* Leases and PFI liabilities that form part of the County Council's debt

** IFRS 16 requires the County Council to change how it recognises its leases from 1 April 2024.

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

21. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The County Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

22. It is forecast that the County Council will continue to take advantage of internal borrowing, which will increase through until 2024/25, whilst paying off Public Works Loan Board (PWLB) debt as maturities arise.

23. Reserves and balances are due to reduce significantly over the forecast period due to the anticipated funding of the Capital Programme and use of the Budget Bridging Reserve (BBR) to balance the budget pending further

savings to be planned and delivered, whilst the Dedicated Schools Grant deficit unusable reserve is forecast to continue to grow, reaching over £370m by 2026/27. These factors are culminating in reducing treasury investment balances with a forecast requirement to borrow in 2026/27 if reserves and capital expenditure are fully delivered as planned, which would have further financial implications for the Council's revenue budget.

24. Since 2018 the County Council has (publicly and consistently) said that without fundamental changes to the way in which local government is funded, it will not be financially sustainable. The balance sheet forecast starkly presents the scale of the challenge facing the Council over the coming years in the absence of such a change.

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

Liability benchmark

26. To compare the County Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

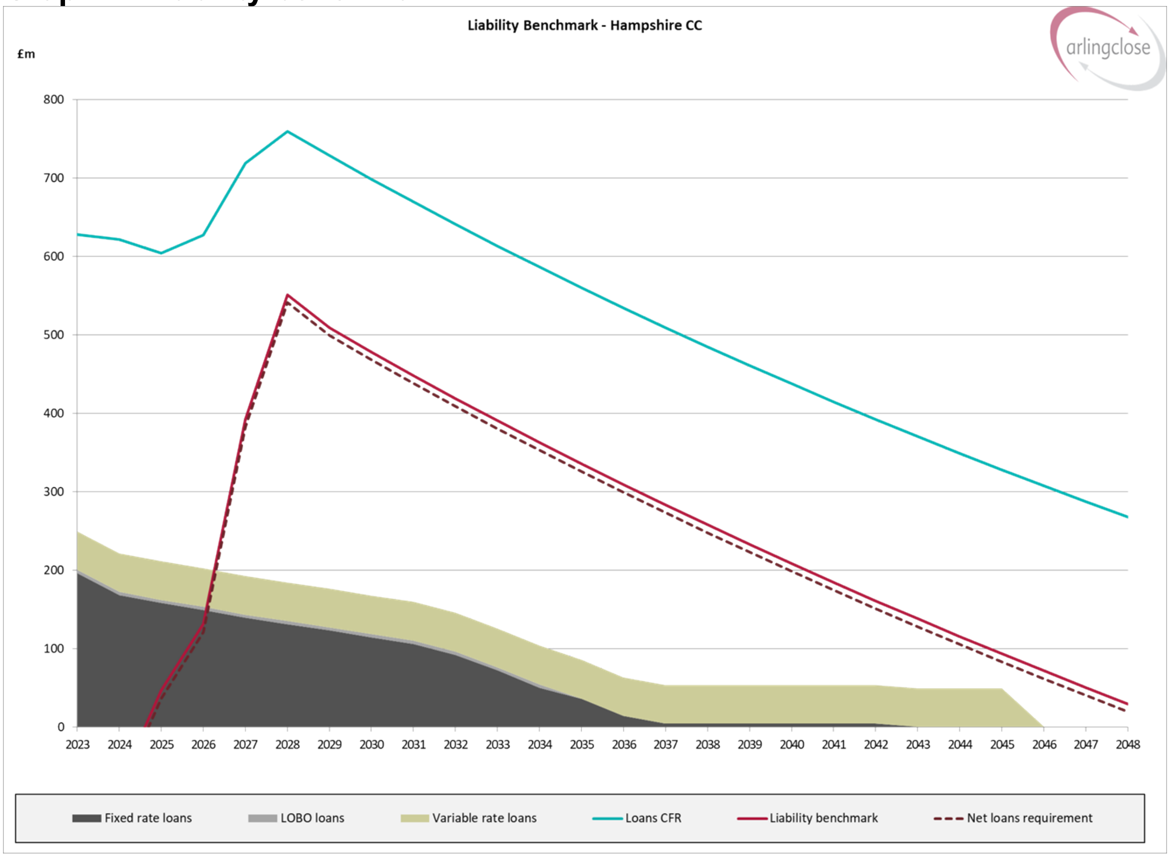
27. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external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

Table 2: Prudential Indicator: Liability benchmark

	31/03/23 Actual £m	**31/03/24 Estimate £m**	**31/03/25 Forecast £m**	**31/03/26 Forecast £m**	**31/03/27 Forecast £m**
Loans CFR	629	618	601	627	722
Less: Balance sheet resources	(1,078)	(704)	(566)	(504)	(335)
Net loans requirement	**(449)**	**(86)**	**35**	**123**	**387**
Plus: Liquidity allowance	10	10	10	10	10
Liability benchmark	**(439)**	**(76)**	**45**	**133**	**397**

28. At the start of the period, 31 March 2023, the County Council had a Loans CFR of £629m, external borrowing of £250m, balance sheet resources of £1,078m and a liability benchmark of -£439m. The difference of £379m between the CFR and external borrowing is internal borrowing which is where the County Council has used its own resources to fund its borrowing requirement.

Graph 1: Liability benchmark



29. The liability benchmark is the lowest level of debt the County Council could hold if it used all of its balances, reserves and cash flow surpluses to fund its CFR. The liability benchmark graph is created based on five years of data, which explains why the Loans CFR line reduces past the initial five year period – the diagram assumes that no new capital projects will begin after 2026/27, which is a very unlikely scenario but a reflection of the current horizon for capital expenditure forecasts.

30. The County Council expects a negative liability benchmark at the beginning of the forecast period (which cannot be seen on Graph 1) which then moves to a positive liability benchmark in 2025, reflecting the forecast balance sheet resources position mapped out in Tables 1 and 2. A positive liability benchmark that extends above the loans lines shows a need to take additional borrowing as the balance sheet resources and current external

borrowing combined are not sufficient to meet the CFR. Therefore Table 2 and Graph 1 illustrate that from 2027 the Council's existing borrowing is forecast to no longer be sufficient to meet the liability benchmark and the Council will need to source external borrowing if it is to meet the full delivery of its capital programme. The Council will keep the position under review and continue to take advice from Arlingclose on the most appropriate time to borrow when it is required.

Borrowing Strategy

31. The County Council held £174m of treasury management loans as at 31 December 2023, a decrease of £30m from 12 months previous, as part of its strategy for funding previous years' capital programmes, but also includes amounts held on behalf of others for governance or administration purposes. As interest rates have risen the opportunity was taken in June 2023 to repay £20m of PWLB loans (in addition to the early repayment of £12m of PWLB debt and £29m of other loans (including some Lenders Option Borrowers Option (LOBO) loans) in 2022/23). This has locked-in a future rate of return for the Council on the use of resources used to repay debt and reduced overall treasury risk by reducing overall cash balances.

32. The balance sheet forecast in Table 1 shows that the County Council has a high level of internal borrowing in comparison to its CFR but currently does not expect to need to take on new external borrowing in 2024/25. Tables 1 and 2 of this strategy do however indicate that the Council may need to borrow in future years. The County Council has the option to borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £760m. The Deputy Chief Executive and Director of Corporate Operations will explore all options to ensure the financial stability of the County Council in future years.

Objectives

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

Strategy

34. Given the significant cuts to public expenditure and in particular to local government funding, the County Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Short-term interest rates are currently at a 15-year high but are expected to fall in the coming years and it is therefore

likely to be more cost effective over the medium term to either use internal resources, or to borrow short-term loans instead.

35. By internally borrowing, the County Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Arlingclose will assist the County Council in regularly monitoring the benefits of this approach against taking on short term external borrowing and the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

36. The County Council has previously raised the majority of its long-term borrowing from the PWLB. The County Council does not expect to take on any new long-term borrowing in 2024/25 due to the forecast level of reserves, however should the County Council need to borrow any long-term amounts it will consider long-term loans from other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield, however the County Council's investment strategy does not support this activity and so will retain its access to PWLB loans.

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

38. In addition, the County Council may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

Sources of borrowing

39. The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- UK Infrastructure Bank Ltd
- Any institution approved for investments
- Any other bank or building society authorised to operate in the UK.
- Any other UK public sector body.
- UK public and private sector pension funds (except Hampshire Pension Fund).

- Capital market bond investors.
- retail investors via a regulated peer-to-peer platform
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

Other sources of debt finance

40. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative (PFI)
- sale and leaseback
- similar asset based finance

LOBOs

41. The County Council holds £4.0m of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost.

42. This loan has options during 2024/25, and with interest rates having risen recently, there is now a reasonable chance that lenders will exercise their options. If they do, the County Council will take the option to repay LOBO loans to reduce refinancing risk in later years. Total borrowing via LOBO loans will be limited to the current level of £4m.

Short-term and variable rate loans

43. These loans leave the County Council exposed to the risk of short-term interest rate rises. This risk is monitored through the indicator on interest rate exposure in the treasury management indicators in this report.

Debt rescheduling

44. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The County Council may take advantage of

this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

Treasury Investment Strategy

45. The County Council holds invested funds representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the County Council's treasury investment balance has ranged between £454m and £800m.

46. Over the last 12 months the investment balance has fallen by £225m which is largely due to the combination of the County Council's decision to pay employer's LGPS pension contributions in advance on 1 April 2023 for the three-year period to March 2026 at a cost of just over £264m, and the early repayment of £61m of external borrowing between October 2022 and June 2023. These decisions have been made to take advantage of savings, whilst also reducing the level of external borrowing.

Objectives

47. The CIPFA Code requires the County Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The County Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. The County Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy

48. The County Council aims to continue to hold a diversified investment portfolio, including investments in more secure and/or higher yielding asset classes. This is especially the case for the estimated funds that are available for longer-term investment.

49. The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the County Council may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises

with inflation; and to manage price risk by adding diversification to the strategic pooled fund portfolio.

50. At 31 December 2023 approximately 77% of the County Council's investment balances were invested so that they were not subject to bail-in risk (that investors funds are taken to sure a failing bank), as they were invested in Government investments, secured bank bonds and pooled funds.

51. Of the 23% of investment balances that were subject to bail-in risk at 31 December 2023, 93% were held in overnight money market funds and cash plus funds which are subject to a reduced risk of bail-in due to the high level of diversification within these investments, and the remainder was held in overnight bank call accounts for liquidity purposes.

52. Further detail is provided at Annex B. This diversification is a continuation of the strategy adopted in 2015/16.

Business models

53. Under the IFRS 9 standard, the accounting for certain investments depends on the 'business model' for managing them. The County Council aims to achieve value from its internally managed treasury investments through a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Environmental, social and governance factors

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

Investments targeting higher returns

55. In previous years the County Council earmarked an amount of its cash balances for investments targeting higher yields; these were made from its most stable core balances with the intention that they would be held for at least the medium term, and it was targeted that these investments would

achieve a return of at least 4%. This was a successful approach through the period of very low interest rates, as this portfolio achieved higher interest rates than what was being achieved by cash investments and significantly increased the annualised average income return for the total investment portfolio.

56. Following the increases in UK Bank Rate the decision was made to subsume the investments targeting higher returns within the long-term investment portfolio as there was no longer a significant difference between the interest rates being achieved by those investments and cash, as short-term interest rates are now comparable with longer term interest rates.

57. The County Council will however continue to make use of long-term balances, making investments in longer term investments including local authorities, other asset classes and regions, fixed capital value and pooled funds to mitigate the risk of low interest rates which will affect cash investments when UK Bank Rate is reduced. This diversification also helps to mitigate the risk of overexposure to a single event affecting a specific asset class.

58. The County Council continues to invest in pooled funds (although this allocation has reduced over the last 12 months) which enables the County Council to achieve a greater degree of diversification than could effectively be achieved by directly owning individual assets. Pooled funds are managed by specialist external fund managers who are best placed to select and manage investments, for example with property investments in selecting appropriate buildings and then managing the relationship with tenants and the maintenance of those buildings.

59. Diversification in itself does not guarantee positive outcomes. The selection of pooled funds is carefully managed to target funds with a strong performance track record and objectives that are well aligned to the County Council's income returns aims without putting its initial investment at undue risk over the longer term. The County Council is therefore currently invested in pooled funds that specialise in providing income returns to support the revenue budget. As a result of their income focus these funds may not achieve the same capital growth and therefore total return, as other more general investment funds, however they are likely to deliver good income returns for the longer term.

60. The investible universe for pooled funds is vast and part of the service provided by Arlingclose as treasury advisers is to conduct research and suitable due diligence on pooled funds prior to making recommendations to their clients.

61. Past performance does not guarantee that funds can replicate successful outcomes in future and knowing which funds will perform well is not an exact science. The County Council will therefore continue to conduct its own ongoing review and scrutiny of the performance of its pooled fund investments. The County Council will also discuss these investments regularly with Arlingclose, who provide advice based on regular meetings with representatives from the pooled funds and their own ongoing due diligence on areas such as performance and investment style, strategy and process.

62. At the current time, given the medium to long term nature of the investments, it is unlikely that a capital loss would ever be realised, since the County Council would avoid selling investments that realised a capital loss. In addition to the risk of realising a capital loss, changes to IFRS 9 mean that capital gains and losses on investments need to be reflected in the revenue account on an annual basis, although there is currently a statutory override in place for local authorities that exempts them from complying with this requirement.

63. The County Council is aware of the risks involved with investing in pooled funds that hold underlying investments in equities and property. When the County Council began to specifically target higher returns from a proportion of its investments, it also established an Investment Risk Reserve to mitigate the risk of an irrecoverable fall in the value of these investments. The balance held in this reserve is currently £10.15m.

Investment Limits

64. The maximum that will be lent to any one organisation (other than the UK Government) will be £80m, which although is a reduction in comparison to the previous TMSS, this is a return to more normal limits. The limits had been temporarily increased in the 2023/24 TMSS due to increased investment balances.

65. Table 1 indicates that treasury balances are forecast to reduce over the longer term, however this investment strategy needs to contain investment limits that allow flexibility to manage higher mid-year investment balances as well as to ensure that all of the County Council's cash can be invested in accordance with this TMSS in the eventuality that the capital programme doesn't proceed as planned, and increased investment balances become available.

66. A group of entities under the same ownership will be treated as a single organisation for limit purposes. Limits are also placed on fund managers as shown in Table 3.

Table 3: Investment Limits

	Cash Limit
Any single organisation, except the UK Central Government	£80m each
UK Central Government	Unlimited
Any group of pooled funds under the same management	£200m per manager

Approved Counterparties

67. The County Council may invest its surplus funds with any of the counterparty types in Table 4, subject to the limits shown:

Table 4: Sector and counterparty limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	30 years	Unlimited	n/a
Local authorities & other government entities	25 years	£80m	Unlimited
Secured investments *	25 years	£80m	Unlimited
Banks (unsecured) *	13 months	£40m	Unlimited
Building societies (unsecured) *	13 months	£40m	£80m
Registered providers (unsecured) *	5 years	£40m	£80m
Money market funds *	n/a	£80m	Unlimited
Strategic pooled funds	n/a	£80m	£400m
Real estate investment trusts	n/a	£40m	£80m
Other investments *	5 years	£40m	£80m

This table must be read in conjunction with the notes below

*** Minimum credit rating**

68. Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-/A3. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant known factors including external advice will be taken into account.

69. For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

Government

70. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 30 years.

Secured investments

71. Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and building societies (unsecured)

72. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Registered providers (unsecured)

73. Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money market funds

74. Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the

advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the County Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds

75. Shares or units in diversified investment vehicles consisting of bond, equity and property investments. These funds offer enhanced returns over the longer term but are more volatile in the short term and allow the County Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. This sector also includes cash plus funds which are also a type of pooled fund, but are used for short-term funds, with a lower risk appetite. Because strategic pooled funds have no defined maturity date, but are available for withdrawal after a notice period; their performance and continued suitability in meeting the County Council's investment objectives will be monitored regularly.

Real estate investment trusts (REITs)

76. Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Other investments

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

78. The Council's Strategy had previously allowed for investment in unrated corporate entities where the Council owned an interest in the company and had participation in its governance. Having received further advice these investments will now be classified as 'Investments for Service Purposes', following the approval of this policy, and are reported on in the Capital and Investment Strategy.

Operational bank accounts

79. The County Council may incur operational exposures, for example through current accounts, to any UK bank with credit ratings no lower than BBB-/Baa3 and with total assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and

balances will therefore be kept low. The County Council's operational bank account is with National Westminster – NatWest (currently with a lowest long-term credit rating of A+) and aims to keep the overnight balances held in current accounts positive, and as close to zero as possible. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion (such as NatWest) are more likely to be bailed-in than made insolvent, increasing the chance of the County Council maintaining operational continuity.

Risk assessment and credit ratings

80. Credit ratings are obtained and monitored by the County Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

81. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the security of investments

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

83. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings, but can be seen in other market

measures. In these circumstances, the County Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the County Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office, or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Reputational aspects

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

Liquidity management

85. The County Council has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the County Council's medium term financial position (summarised in Table 1) and forecast short-term balances.

86. The County Council will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider, except in cases of extreme market stress whereby the County Council will be able to invest all of its liquid cash in one provider only, being the Debt Management Office.

Treasury Management Prudential Indicators

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

Interest rate exposures

88. The following indicator shows the sensitivity of the County Council's current investments and borrowing to a change in interest rates. Fixed rate investments maturing during the year are assumed to be variable for the remainder of the year.

Table 5: Interest rate risk indicator

	31/12/2023 Actual	**Impact of +/- 1% interest rate change**
	£m	**£m**
Sums subject to variable interest rates:		
Investment	379	+/- 3.8
Borrowing	(6)	+/- 0.1

Maturity structure of borrowing

89. This indicator is set to control the County Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 6: Refinancing rate risk indicator

	Upper	**Lower**
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and above	100%	0%

90. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Long-term treasury management investments

91. The purpose of this indicator is to control the County Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments will be:

Table 7: Price risk indicator

	2024/25	**2025/26**	**2026/27**
Limit on principal invested beyond year end	£400m	£350m	£300m

92. Long-term investments with no fixed maturity date include strategic pooled funds but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Related Matters

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

Financial derivatives

94. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

95. The County Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the County Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

96. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit.

97. In line with the CIPFA Code, the County Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

External Funds

98. The County Council manages cash on behalf of Thames Basin Heaths as the County Council is the Administrative Body which effectively means acting as the banker. As part of this role the County Council invests the monies held in accordance with instructions from Thames Basin Heaths. Investment decisions are made by the Thames Basin Heath Joint Strategic Partnership Board (JSPB) and they are advised by the County Council's Treasury Management Advisers, Arlingclose. The JSPB assumes all risks associated with these investments. All interest earned on those cash balances is allocated to Thames Basin Heaths using the County Council's accounting software system.

Investment training

99. The needs of the County Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

100. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, and other appropriate organisations.

101. CIPFA's Code of Practice requires that the County Council ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

Investment advisers

102. The County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with the Director of Corporate Operations, his staff and Arlingclose.

Markets in Financial Instruments Directive

103. The County Council has opted up to professional client status with its providers of financial services, including advisers, brokers, and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the County Council's treasury management

activities, the Section 151 Officer believes this to be the most appropriate status.

Other Options Considered

104. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Corporate Operations believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed in Table 8.

Table 8: Alternative strategies and their implications

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain