Annex O

Milton Keynes City Council

Treasury Management Strategy

2023/24 to 2027/28

Contents

1 Introduction

1.1 Background

1.1.1 Under the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice, the Council is required to approve a treasury management strategy before the start of each financial year. In addition, the Department for Levelling Up, Housing & Communities (DLUHC) has issued Guidance on Local Authority Investments that requires the Council to approve an investment strategy before the start of each financial year. This report fulfils the legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and DLUHC Guidance.

1.1.2 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. 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 invested in low-risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

1.1.3 The second 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, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.1.4 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.

1.1.5 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."

1.1.6 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities – typically arising from capital expenditure – so are considered separate from day-to-day treasury management activities.

1.2 Reporting requirements

1.2.1 The Council is required to receive and approve quarterly reports on Treasury Management activity, including three main reports (outlined below) which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by Cabinet.

a) Treasury Management Strategy (this report) – which covers:

- capital spending plans;
- a Minimum Revenue Provision (MRP) Policy outlining how residual capital expenditure is charged to revenue over time;
- the strategic approach detailing how treasury investment and borrowing portfolios are to be organised; and
- an investment strategy showing the parameters on how investments are to be managed.

b) A Mid-year Treasury Management Report – which updates members on progress against the strategy, the latest capital position, an update of the performance of the treasury, or whether any policies require revision.

c) An Annual Treasury Report – this backward-looking review provides details of actual prudential and treasury indicators and actual treasury operations compared to the estimates within this strategy.

2 Prudential Indicators

2.1 Capital Strategy

2.1.1 The Council's capital expenditure plans are the key driver of treasury management activity, the outputs of which are reflected in prudential indicators designed to assist decisions making.

2.1.2 CIPFA’s Prudential and Treasury Management Codes require local authorities to prepare a Capital Strategy report that sets out capital long-term policy objectives, governance procedures and risk appetite. This includes:

- 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 associated risks are managed;
- the consequential implications to the Council’s financial sustainability.

2.1.3 Capital Prudential Indicators are set within the Capital Strategy so that the context from which those indicators have been derived is transparent. Once approved, these indicators are considered against all treasury management decisions. These indicators are:

- **estimates of capital expenditure**; both those previously agreed and those forming part of the latest budget setting cycle.
- details of **how these capital expenditure plans are to be financed**; from capital or revenue resources with any shortfall resulting in a funding/borrowing need.
- 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 indebtedness and so its underlying borrowing need. Any capital expenditure not immediately funded from a revenue or capital resource increases the CFR.
- the Council’s **gross debt against the CFR**; a key indicator of prudence, to ensure that over the medium-term debt will only be for a capital purpose, gross debt should not, (except for in the short term), exceed the CFR in the preceding year plus the estimates for the next two financial years.
- the **Authorised Limit and Operational Boundary for external debt**; authorities are legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. It reflects the level of borrowing which, while not desired, could be afforded in the short-term but is not sustainable. It is the Council's anticipated maximum borrowing need plus scope for borrowing in advance of need (where worthwhile) and headroom for the potential of unplanned cashflow anomalies. A lower operational boundary is also set which acts as a warning indicator should debt approach the authorised limit.
- the **ratio of financing costs to net revenue stream**; a key indicator of affordability, this shows the proportional cost of capital (borrowing and other

long-term obligation costs, net of investment income), measured against net revenue stream. The net revenue stream is defined as the amount required to be funded from Government Grants and local taxpayers (in effect the annual budget requirement).

2.1.4 Non-treasury management investments are reported through the Capital Strategy. This ensures the separation of treasury management investments that follow the core principles of security, liquidity, and yield, from investments driven by policy, service and commercialism agendas that typically result in capital expenditure on assets.

2.1.5 The Capital Strategy also considers the proportionality between the treasury investments (shown throughout this report) and non-treasury investments.

2.2 Treasury Prudential Indicators

2.2.1 There are three treasury management prudential indicators, they are:

1. Liability Benchmark

2.2.2 The 2021 Treasury Management Code introduced a new indicator to apply from 2023/24 – the liability benchmark – as a measure of how the existing loans portfolio matches the Council's planned borrowing needs over the long-term. In its simplest form, the liability benchmark is intended to highlight whether external borrowing is required and if so when, how much and for how long:

- If existing external loans are less than the indicated liability benchmark, this indicates a new borrowing requirement, and the Council would need to take on new loans to meet the shortfall.
- If existing external loans exceed the indicated liability benchmark, this indicates more debt is being carried than necessarily needed, and so the surplus increases investment balances.

2.2.3 CIPFA recognises that managing debt on a net-book basis using this analysis tool will require ongoing transition towards matching the external loans portfolio to a profile close to the liability benchmark over time.

2.2.4 The three primary components of the liability benchmark are:

1. Existing external loans; note that LOBO loan maturities at their most probable option call date (which may not be their next option or final maturity date).

2. Loans Capital Financing Requirement (CFR); this represents the unfinanced element of the capital programme yet to be paid for by a cash resource and excludes any part of the

CFR related to other long-term liabilities (typically leases). The loans CFR starts from the last year-end actual loans CFR. Added to this is the prudential borrowing in the Council's current capital programme with **no assumption for unknown future prudential borrowing not yet approved**. Deducted from this is the annual Minimum Revenue Provision (MRP) set aside to repay this liability and any material capital receipts to be applied towards repaying debt.

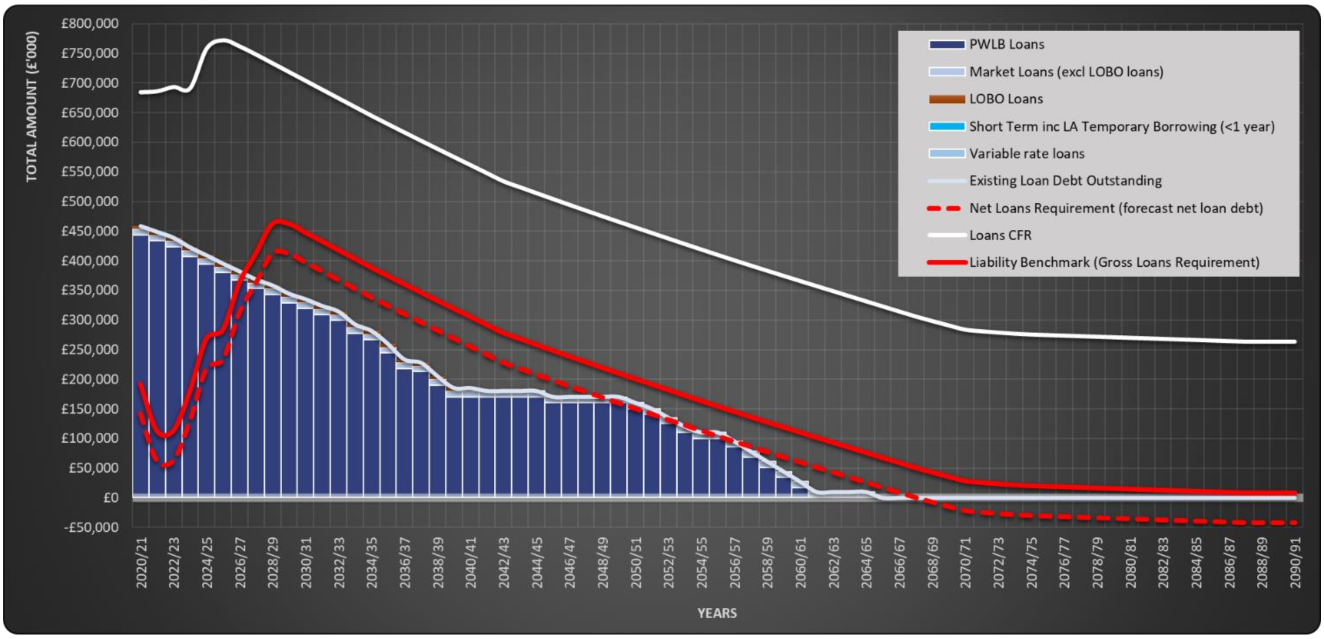
3. Investment balances; for treasury management purposes starting from the confirmed position at the last year-end. This will change in accordance with the Council's annual cash flow forecast – plus or minus the increase or reduction in the CFR, plus or minus any material cash flows that are not considered in setting the balanced revenue budget. Forward cash flow forecasts are likely to broadly perpetuate any existing gap between the Council's actual net loan debt and its CFR. This is a reasonable baseline planning assumption as unless Government implements a structural change in the basis of local government finance, the Council is likely to continue to benefit from a working capital surplus (owes less to its creditors than it is owed by its debtors) which means we are unlikely to need to borrow as much as our Loans CFR.

2.2.5 From these components we calculate two outputs, the:

- **Net loans requirement:** Existing external loans less investments balances; and
- **Liability Benchmark (or gross loans requirement):** This is a forecast of the level of gross loan debt the Council will require in accordance with its budget plans. It starts from the Net loans requirement then adds a liquidity allowance (to provide an adequate, but not excessive, level of liquidity for daily cash flow management) to indicate the amount of gross loan debt required.

2.2.6 The liability benchmark is derived from data but should be presented in chart format. The combined (GF & HRA) liability benchmark is shown in Chart 1 below.

Chart 1: Liability Benchmark – January 2023 – General Fund and HRA combined



2.2.7 A detailed commentary can be found in Appendix C. Authorities with a HRA with borrowing are encouraged to produce separate liability benchmarks for the HRA and the General Fund; this breakdown can also be found in Appendix C.

2. Maturity structure of borrowing portfolio

2.2.8 There is one treasury borrowing related prudential indicator against the maturity structure of the Council's borrowing portfolio. Gross upper and lower percentage limits for both the General Fund and HRA are set to limit exposure to large sums falling due for refinancing. The HRA borrowing amounts include internal loans from the General Fund (further details can be found in Section 5.4). The limits are shown compared against the existing borrowing portfolio maturity profile at 1st April 2023 in Table 1 below:

Table 1: Maturity Structure of Borrowing 2023/24

	General Fund				HRA					
	Lower Limit	Upper Limit	Borrowing		Lower Limit	Upper Limit	Borrowing			
							Total		*External*	*Internal*
	%	%	%	£m	%	%	%	£m	*£m*	*£m*
< 12 months	0	15	2.8	6.215	0	15	3.5	10.000	*10.000*	*0.000*
1-2 years	0	15	3.0	6.587	0	15	5.1	14.750	*6.750*	*8.000*
2-5 years	0	50	10.3	22.796	0	50	17.7	51.000	*18.000*	*33.000*
5-10 years	0	50	18.6	40.920	0	50	14.6	42.000	*13.000*	*29.000*

0-10 years Total			**34.7**	**76.518**			**40.9**	**117.750**	***47.750***	***70.000***
10-20 years			22.2	48.914			29.5	85.000	*85.000*	*0.000*
20-30 years			20.4	45.000			0.0	0.000	*0.000*	*0.000*
30-40 years			18.2	40.000			29.6	85.360	*85.360*	*0.000*
40-50 years			4.5	10.000			0.0	0.000	*0.000*	*0.000*
10-50 years Total	**50**	**100**	**65.3**	**143.914**	**50**	**100**	**59.1**	**170.360**	***170.360***	***0.000***
Grand Total			**100.0**	**220.432**			**100.0**	**288.110**	***218.110***	***70.000***

Note 1: LOBO loan classified at maturity date as highly unlikely lenders call option will be exercised in current economic climate (£5m classified as 10-20 years).

3. Longer term treasury investments

2.2.9 There is one treasury investment related prudential indicator applied to cap the amount of funds invested for longer than one year. Set to restrictively, opportunities to improve return will be impaired. Set to loosely, there is a risk that funds maybe tied up for too long and not readily available to meet expenditure commitments when they fall due, either forcing the unplanned early redemption of investments where able or the need to raise further borrowing that would otherwise have been unnecessary.

2.2.10 Table 2 below sets out the proposed limits over the next five years:

Table 2: Upper limits on investments for longer than 365 days

	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m	2027/28 £m
Upper Limit	75.000	75.000	75.000	75.000	75.000

2.3 Local Indicators

2.3.1 The Council has chosen to implement an additional local indicator that sets an upper limit to borrowing against the Housing Revenue Account (HRA).

2.3.2 In October 2018, the Government announced that it was scrapping the restrictive HRA debt cap. Whilst its removal gives rise to the possibility of significant additional borrowing by the HRA to support housing regeneration and new housing stock build programmes, and although currently accompanied by low borrowing interest rates, it is not a panacea for unconstrained borrowing. The revenue financing costs of servicing new debt need to be sustainable over the long-term and the schemes delivered able to clearly demonstrate value for money.

2.3.3 The Council has chosen to set HRA borrowing limits based on an Interest Rate Cover (ICR) ratio. The ICR is calculated on HRA revenue operating surpluses (income less management, maintenance, and depreciation expenses) available to service borrowing interest and repayment costs. The Council will apply a minimum ICR of 1.25, which effectively provides 100% cover for expected debt financing costs with an additional 25% contingency buffer to protect against the risk of reductions in the operating surplus. This level is consistent with similar local authorities housing providers and registered social landlords, the latter of which uses the strength of this ratio to raise borrowing from market lenders.

2.3.4 Table 3 below sets out the HRA borrowing limits – based upon the HRA Business Plan financial model updated for the 2023/24 budget cycle – over the next five years:

Table 3: HRA Borrowing Limit

	2023/24 £m	**2024/25 £m**	**2025/26 £m**	**2026/27 £m**	**2027/28 £m**
Upper Limit	290.000	405.000	405.000	410.000	440.000

2.3.5 The HRA business plan model is a live document that is updated in-year as new capital schemes are approved, and as such the ICR is subject to ongoing movement. HRA borrowing limits are set over the medium-term five-year planning period but reviewed annually as part of the budget setting process to take account of changes in the operating environment, legislation, and approved capital and revenue expenditure and income.

3 Minimum Revenue Provision (MRP)

3.1 Background

3.1.1 The Capital Financing Requirement (CFR) represents the total of 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 indebtedness and so its underlying borrowing need. The CFR does not increase indefinitely, as a statutory annual revenue charge is applied known as a minimum revenue provision (MRP), which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets to revenue as they are used. This applies to the General Fund only, there is no statutory requirement to charge MRP against the HRA.

3.1.2 Local authorities may choose to pay more MRP than the minimum prudent amount in any given year. If they do so they should separately disclose the in-year and cumulative amount of MRP overpaid in the Statement presented to Council.

3.1.3 To reduce the burden of future debt financing costs, the Council has previously made £20.150m voluntary overpayments between 2016/17 and 2021/22 against GF spend on capital assets that would otherwise have incurred MRP charges in 2023/24 and beyond. Over the same period an additional £0.230m of voluntary overpayments have been made against HRA capital spend and £4.820m from retained right-to-buy receipts used to repay attributable debt against those disposed properties. Further voluntary overpayments may be made during 2022/23 but this remains subject to final outturn position. The Council could choose to reinstate some or all of this overpayment sum in the future to release funds to support the budget position, but this must be weighed against the reinstatement of long-term annual MRP charges.

3.2 Regulations

3.2.1 DLUHC regulations have been issued which require full Council to approve an MRP policy in advance of each year. A variety of options are provided to Councils, but this does not preclude other approaches so long as there is a prudent provision. The Council's MRP policy is set out in Appendix B.

3.2.2 In November 2021 DLUHC published a consultation paper proposing changes to the capital framework for MRP. These changes principally include a requirement to charge MRP on all unfinanced borrowing liability regardless of any future earmarked resource intended to repay it (for example the eventual principal repayment of a capital loan or future capital receipts). Draft regulations were published in June 2022 that were intended to apply from 2023/24 but the final version is yet to be published, with latest information indicating that any changes may now not take effect until 2024/25 at the earliest.

4 Economic context

4.1 Background

4.1.1 Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, UK interest rates have been volatile, from Bank Rate through to long-term gilt yields, for all of 2022.

4.1.2 Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year gilt yields all rising by over 200bps since the turn of the year.

4.1.3 Central banks are facing a conundrum; inflation is elevated yet labour markets are extra-ordinarily tight (UK unemployment rate fell to a 48-year low of 3.6%), making it an issue of fine judgment as to how far monetary policy needs to tighten. Throughout Q3 2022 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 2022 has seen Bank Rate rise to 3% in November and the market expects Bank Rate to peak within a lower range of 4.5% - 4.75% by May 2023.

4.2 Interest rate forecast

4.2.1 Table 4 below shows the forecast (December 2022) for bank rate. The Council can readily access loans from the Public Works Loan Board (PWLB) and so these interest rates are used to show borrowing rates. A list of significant risks to this forecast by the Council's treasury management advisors is attached at Appendix E.

Table 4: Summary interest rate forecast – December 2022 (%)

	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24	Mar 25	Jun 25	Sep 25	Dec 25
Bank Rate	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
5yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

Note: PWLB rates, these are forecasts for certainty rates (gilt yields plus 80bps)

4.2.2 As shown in Table 4 above, the forecast for Bank Rate shows an expected peak at 4.50% in June 2023 through to February 2024 to combat inflation, before reducing to a stabilised 2.50% long term level. With high level of uncertainty prevailing on several different fronts, inevitably this forecast will be superseded, with updates reported throughout the year.

4.3 Borrowing rates

4.3.1 The interest rate forecasts at Table 4 above for PWLB (certainty rates) shows a near-term peak before a gradually and sustained reduction. The current margins applied over gilt yields are as follows:

- PWLB Certainty Rate for General Fund and HRA loans is gilts plus 80 basis points (G+80bps)
- Local Infrastructure Rate is gilts plus 60bps (G+60bps)

4.4 Investment rates

4.4.1 Investment returns are expected to continue to peak during 2023/24. Financial markets are pricing-in further Bank Rate rises in line with the forecast at Table 4 above and so locking into higher rates ahead of a tailing off would optimise returns.

5 Borrowing Strategy

5.1 Background

5.1.1 The capital expenditure plans within the Capital Strategy provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with relevant professional codes, so that sufficient cash is available to meet this service activity and the capital plans. This involves both the organisation of cash flow and the organisation of appropriate borrowing facilities where capital plans require.

5.2 Context

5.2.1 The Council is currently maintaining an internal borrowing position. This means that the underlying capital borrowing need (the CFR) has not yet been fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains prudent despite low borrowing rates, as investment returns are low and counterparty risk is high.

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

5.2.3 The Council maintains two separate loan pools, one supporting capital activity for General Fund and one supporting the HRA.

5.2.4 In October 2018 the Government scrapped a restrictive cap on HRA debt. Whilst its removal gives rise to the possibility of significant additional borrowing by the HRA to support housing regeneration and new housing stock build programmes, and although currently accompanied by low market interest rates, it is not a panacea for unconstrained borrowing. The revenue financing costs of servicing new debt need to be sustainable over the long-term and the schemes delivered able to clearly demonstrate value for money. The HRA Business Plan Model (HRA BPM) includes integrated metrics to manage HRA debt, which influences the HRA borrowing limits in Table 3 above.

5.3 Current external loans portfolio position

5.3.1 The forecast external borrowing portfolio at 1st April 2023 per fund type is shown in Table 5 below:

Table 5: External borrowing portfolio per fund type

Tenor Bucket	General Fund		HRA		Total	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
< 1 Year	£6,214,716.41	2.8%	£10,000,000.00	4.6%	£16,214,716.41	3.7%
1 - 2 Years	£6,587,381.06	3.0%	£6,750,000.00	3.1%	£13,337,381.06	3.0%
2 - 5 Years	£22,795,836.10	10.3%	£18,000,000.00	8.3%	£40,795,836.10	9.3%
5 - 10 Years	£40,920,081.68	18.6%	£13,000,000.00	6.0%	£53,920,081.68	12.3%
10 - 20 Years	£48,914,247.99	22.3%	£85,000,000.00	38.9%	£133,914,247.99	30.5%
20 - 30 Years	£45,000,000.00	20.4%	£0.00	0.0%	£45,000,000.00	10.3%
30 - 40 Years	£40,000,000.00	18.1%	£85,360,000.00	39.1%	£125,360,000.00	28.6%
40 - 50 Years	£10,000,000.00	4.5%	£0.00	0.0%	£10,000,000.00	2.3%
Total	**£220,432,263.24**	**100.0%**	**£218,110,000.00**	**100.0%**	**£438,542,263.24**	**100.0%**

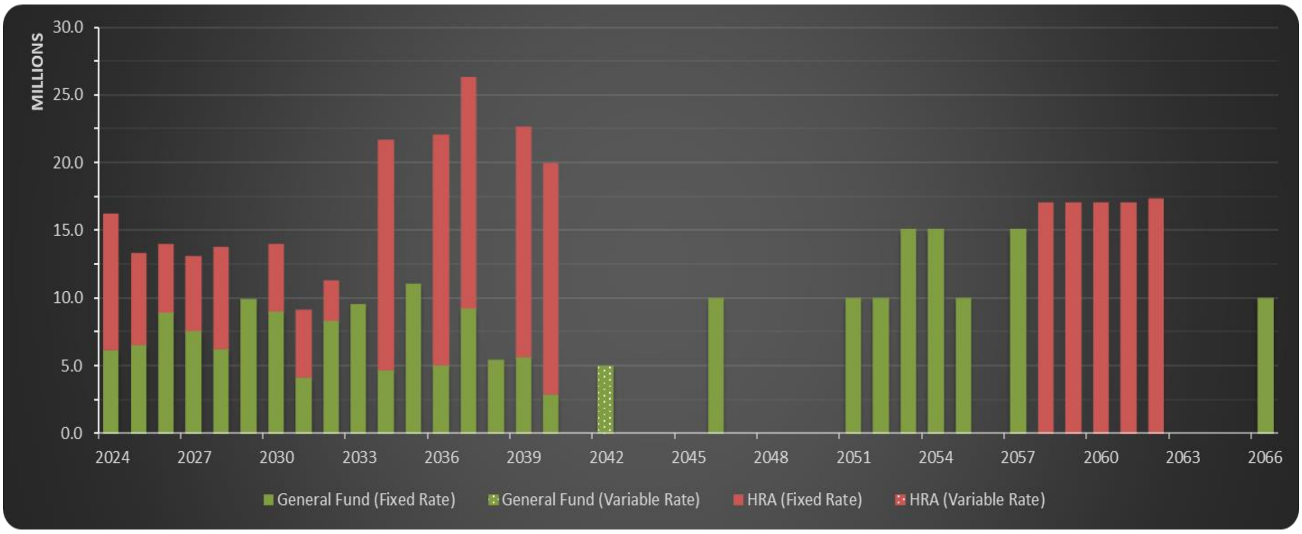
5.3.1.1 Table 6 below sets out the profile of the Council's forecast opening external borrowing portfolio by loan source per fund type**:**

Table 6: External borrowing portfolio by loan source per fund type

Tenor Bucket	Market Loans				PWLB Loans			
	General Fund		HRA		General Fund		HRA	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
< 1 Year	£0.00	0.0%	£0.00	0.0%	£6,214,716.41	3.0%	£10,000,000.00	4.6%
1 - 2 Years	£0.00	0.0%	£0.00	0.0%	£6,587,381.06	3.2%	£6,750,000.00	3.1%
2 - 5 Years	£0.00	0.0%	£0.00	0.0%	£22,795,836.10	11.1%	£18,000,000.00	8.3%
5 - 10 Years	£0.00	0.0%	£0.00	0.0%	£40,920,081.68	19.9%	£13,000,000.00	6.0%
10 - 20 Years	£5,000,000.00	33.3%	£0.00	0.0%	£43,914,247.99	21.4%	£85,000,000.00	38.9%
20 - 30 Years	£0.00	0.0%	£0.00	0.0%	£45,000,000.00	21.9%	£0.00	0.0%
30 - 40 Years	£0.00	0.0%	£0.00	0.0%	£40,000,000.00	19.5%	£85,360,000.00	39.1%
40 - 50 Years	£10,000,000.00	66.7%	£0.00	0.0%	£0.00	0.0%	£0.00	0.0%
Total	**£15,000,000.00**	**100.0%**	**£0.00**	**0.0%**	**£205,432,263.24**	**100.0%**	**£218,110,000.00**	**100.0%**

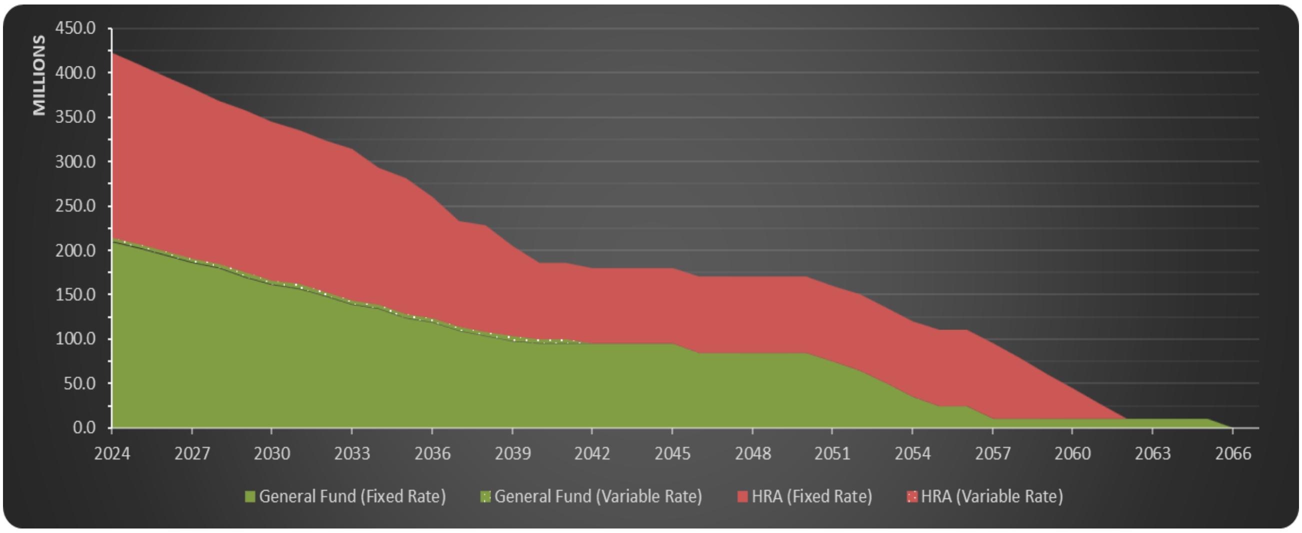
5.3.2 Chart 2 below shows the maturity profile of the Council's external borrowing portfolio:

Chart 2: External borrowing profile by annual maturities per fund



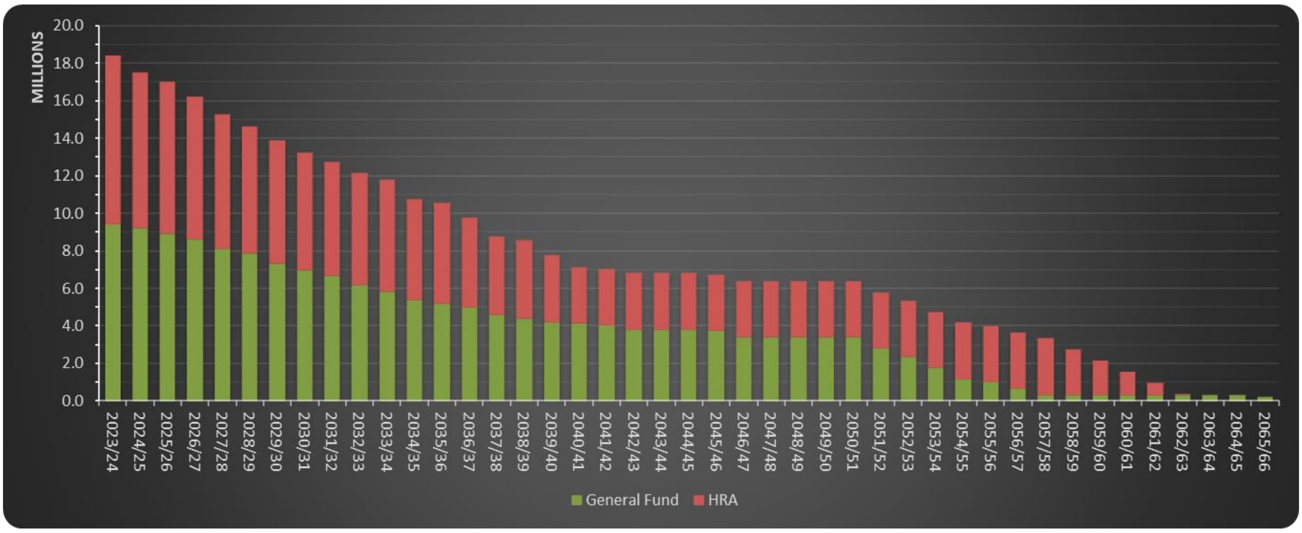
5.3.3 Chart 3 below shows the fallout structure of the Council's external borrowing portfolio:

Chart 3: External borrowing profile by cumulative annual maturities per fund



5.3.4 Chart 4 below shows the interest cost commitments associated with these external loans:

Chart 4: External borrowing portfolio loan interest cost commitments per fund



5.3.5 The Council holds a single General Fund loan that carries a variable interest rate. This Lender's Option Borrower's Option (LOBO) loan to the principal value of £5m has terms whereby the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost.

5.3.6 This LOBO loan has option dates during 2023/24 (rolling six monthly options) and, although it is highly unlikely the lenders call option will be exercised in current economic climate, there remains a small element of refinancing risk. Given that this risk is so low, the loan has been presented throughout this strategy as maturing in 10-20 years tenor band on its eventual maturity date. The Council will consider the option to repay this LOBO loan at no cost if the opportunity presents.

5.4 Internal loans

5.4.1 As mentioned in paragraph 5.2.3 above, the Council operates a two-pool approach to borrowing, maintaining separate loan pools for the General Fund and HRA.

5.4.2 The Council has not fully funded its GF CFR with external loans, which is achievable due to the existence of GF usable reserves and positive working capital resources that make up most of our investment balances. The HRA, being a smaller component of the Council's Balance Sheet, is expected to be virtually fully funded to its HRA CFR, with any shortfall representing a borrowing requirement. This HRA funding requirement could be met with external loans or by internal loans from the GF, which would generate for the GF a return on its cash resources above that it could achieve in traditional treasury management investments in the current economic climate as well as reduce exposure to credit risk.

5.4.3 The timing, rate, and other practical considerations of loans between the GF and HRA will be subject to review with our treasury management advisors.

5.4.4 To provide the HRA with cost certainty against its immediate short term capital financing requirement (committed capital spending and maturing debt), a series of fixed rate internal loans from the General Fund totalling £70m were agreed, commencing on 1st March 2022 and priced at the prevailing PWLB rate on that day. These loans varied in principal amount and were spread over different durations, taking account of existing external debt maturities that the HRA is due to refinance, to ensure that refinancing risk can be managed, and that the GF has sufficient cash balances.

5.4.5 Table 7 below sets out the forecast opening position of HRA internal loans:

Table 7: HRA internal loans maturity profile

Tenor	Principal	Interest Rate
1 - 2 Years	£8,000,000.00	1.69%
2 - 3 Years	£12,000,000.00	1.72%
3 - 4 Years	£11,500,000.00	1.75%
4 - 5 Years	£9,500,000.00	1.79%
5 - 6 Years	£17,000,000.00	1.84%
6 - 7 Years	£12,000,000.00	1.91%
Total	**£70,000,000.00**	

5.4.6 For residual amounts of HRA capital debt liability and approach to risk sharing, the Council's HRA internal recharge policy is included at Appendix D.

5.5 Approach to new external borrowing

5.5.1 The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

5.5.2 Deferring new borrowing allows the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short-term borrowing however needs to be carefully balanced against the potential for incurring additional costs when new borrowing becomes unavoidable in future years.

5.5.3 The Council may borrow on a short-term basis to cover unplanned cash flow shortage where appropriate, although this need is not expected to materialise.

5.5.4 Against the context above and the risks within the economic forecast, caution will be adopted with the 2023/24 borrowing strategy. The Director of Finance and Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- Where intelligence suggests that there was a significant risk of a sharp **FALL** in long and short-term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- Where intelligence suggests that there was a significant risk of a much sharper **RISE** in long and short-term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

5.6 Other sources of external borrowing

5.6.1 The Council could look to borrow long-term funding from sources other than PWLB including banks, pensions and local authorities, and may investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding. Unlike the PWLB, market lenders can also offer forward start loans, where the interest rate is fixed in advance, but the cash is received in later months or years, which would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

5.7 Borrowing rate risk

5.7.1 In addition to refinancing risk of existing loans, the Council is exposed to three further forms of borrowing interest rate risk:

1. **Existing loans that carry a variable interest rate;** Only 1% of the Council's existing borrowing portfolio carries a variable interest rate. Furthermore, that exposure is in the form of a single LOBO loan (see paragraphs 5.3.5 and 5.3.6 above) and should the market lender propose an alteration to the interest rate, the Council could repay the loan without penalty.

2. **Short-term borrowing;** the Council could choose to finance long term commitments with a proportion of rolling short-term borrowing to take advantage of cheaper borrowing rates. This would however introduce uncertainty for budget planning purposes and risks adverse movements in interest rates when longer term borrowing

becomes unavoidable. The Council has historically chosen to take long term loans, so has no exposure to short-term borrowing for capital purposes at this time.

3. **Internal borrowing;** the Council is currently maintaining an internal borrowing position. This means that the underlying capital borrowing need (the CFR) has not yet been fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. A strong grasp of the Council's balance sheet resources is required to manage this position, with cashflows monitored daily and annual reviews with the Council's treasury advisors to analyse cash movements and trends.

5.7.2 The benefits of both internal and/or short-term borrowing always need to be carefully balanced against the potential for incurring additional costs when new borrowing becomes unavoidable in future years. The Council will monitor the 'cost of carry' to determine whether the Council borrows at long-term fixed rates in 2023/24 with a view to keeping future interest costs low, even if this means incurring additional cost in the short-term.

5.8 Borrowing in advance of need

5.8.1 The Council will not borrow more than or in advance of its needs purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates 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.

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

5.9 Debt rescheduling

5.9.1 The PWLB allows authorities to repay loans before maturity at either a payment premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

5.9.2 Primary reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- amending the balance of the portfolio (i.e. amend the maturity profile and/or the balance of volatility).

5.9.3 Details of any rescheduling undertaken will be reported to Cabinet at the earliest meeting following its action.

6 Annual investment strategy (AIS)

6.1 Context

6.1.1 The Council's investment policy has regard to the following current guidance:

- DLUHC's Guidance on Local Government Investments ("the Guidance");
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code");
- CIPFA Treasury Management Code Guidance Notes 2021.

6.1.2 DLUHC and CIPFA have extended the meaning of 'investments' to cover both treasury and non-treasury investments. This report deals solely with treasury investments with non-treasury investments (commercial assets and service derived investments) are contained within the Capital Strategy.

6.1.3 Both the CIPFA Code and DLUHC guidance requires the 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 objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults as well as the risk of receiving unsuitably low investment income.

6.1.4 The Councils prudent approach to managing its investment risk will be framed by:

- **Minimum acceptable credit criteria**; from this, an outline list of highly creditworthy potential counterparties will be derived. The key credit ratings used to monitor counterparties are the short-term and long-term credit ratings.
- **Credit Default Swaps (CDS)**; a tradeable contract that insures the holder of a bond against default. The cost of a CDS indicates the price investors must pay to insure against a default; as default risk rises, so does the cost. As with credit ratings, CDS measures are an imperfect barometer, but sudden and/or sustained rises can act as a near real-time early warning indicator of financial stress. Price movements are overlaid on top of the credit ratings.
- **Other information sources**; this will include the financial press, share price and other such information pertaining to the financial sector in order to establish the

most robust scrutiny process on the suitability of potential investment counterparties.

- **Duration**; time duration limits commensurate to the relative creditworthiness of counterparties.

- **Diversification**; sector and/or counterparty limits will be set to limit concentration risk.

6.2 Counterparty selection

6.2.1 The Council applies the creditworthiness service provided by its treasury management advisors Link Group. This modelling approach combines credit ratings, and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The result of this is a scale of relative creditworthiness of counterparties used to determine suggested maximum durations for investment, which currently fall into the following bands (these bands may be amended to reflect prevailing market conditions):

- Up to 100 days;
- Up to 6 months;
- Up to 12 months;
- Up to 2 years;
- Up to 5 years.

6.2.2 The Council is alerted to changes to ratings of all three agencies and if a downgrade results in the counterparty/investment no longer meeting the Council’s minimum criteria, its further use as a new investment will be withdrawn immediately. Furthermore, extreme market movements in CDS prices may result in downgrade of an institution or removal from the Council’s lending list.

6.2.3 Typically, the minimum credit ratings criteria the Council will apply will be a long-term rating of **A- / A3**. 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.

6.2.4 The Council recognises that the responsibility for treasury management decisions always remains with the Council. The Director of Finance and Resources is authorised under delegated powers to further restrict or relax the investment names, limits, and durations to safeguard the Council’s resources. Any use of these powers will be explained in the next treasury management report due.

6.3 Investment instruments

6.3.1 Table 8 below sets out the types of investment instruments that the Council may choose to invest in. In accordance with Government guidance these instruments are categories as either 'specified' and 'non-specified' investments:

- **Specified investments** are those;
    - denominated in sterling and any payments or repayments in the respect of the investment are payable only in sterling;
    - is not a long term investment (contractual right to repayment within 12 months either because that is the expiry term of the investment or through a non-conditional option);
    - the making of the investment is not defined as capital expenditure by virtue of Regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended];
    - with a body or in an investment scheme described as high quality; or
    - with one of the following bodies:
        i. UK Government;
        ii. a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; or
        iii. a parish council or community council.

- **Non-specified investments;** any other type of investment which does not meet the criteria to be classified as specified, and/or more complex instruments which require greater consideration before being use.

Table 8: Approved investment instruments

Specified Investments (up to 1 year)	Non-specified Investments (over 1 year)
Debt Management Agency Deposit Facility	Term deposits – local authorities, parish or community councils, and housing associations/registered social landlords
Call / Notice accounts - banks & building societies	Term deposits – banks and building societies
Term deposits – local authorities, parish or community councils, and housing associations/registered social landlords	Certificates of deposits – banks & building societies
Term deposits – banks & building societies	Fixed term deposits with variable rate and variable maturities: - Structured deposits
Certificates of deposits – banks & building societies	UK Government Gilts
UK Government Gilts	Commercial Papers/Corporate Bonds
Reverse Repurchase Agreements (REPOs)	Reverse Repurchase Agreements (REPOs)

Specified Investments (up to 1 year)	Non-specified Investments (over 1 year)
Covered Bonds	Covered Bonds
Collective Investment Schemes structured as Open-Ended Investment Companies (OEICs): -	
1. Government Liquidity Funds	1. Bond Funds / Gilt Funds
2. Money Market Funds	2. Property Funds
3. Enhanced cash funds	3. Enhanced cash funds
4. Bond Funds / Ultra-Short Dated Bond Funds / Gilt Funds	4. Bond Funds / Ultra-Short Dated Bond Funds / Gilt Funds
Collective Investment Schemes structured as Closed-End Investment Companies (CICs): -	
	1. Property Funds

6.3.2 If an investment trade is agreed in advance of the dealing date, this forward dealing period plus the deal period itself should not exceed 12 months in aggregate to classify as a specified investment, or the investment will otherwise automatically classify as non-specified until such time as only 12 months remain to maturity.

6.4 Investment principal limits

6.4.1 Portfolio limits are set to manage potential exposure to loss of investment principal. Were losses to be incurred, this would present an immediate pressure against revenue reserves. The Council has determined that for any single organisation exposure other than Government entities:

- no more than **£12.5m** will be placed as unsecured investments – **this is an increase of +£2.5m from the 2022/23 limit of £10.0m** due to the sustained high level of overall cash under management and increased market rates available consummate to the Council's low-risk approach to investments;

- no more than **£20m** will be placed as secured investments – **this limit remains unchanged from 2022/23**. The sum of both secured and unsecured deposits held with any single organisation will not exceed this limit in total;

- For diversified investments such as Money Market Funds, no more than **£15m** will be placed as unsecured investments per fund – **this limit remains unchanged from 2022/23**.

6.4.2 A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts.

6.5 Investment portfolio limits

6.5.1 Table 9 below sets out the investment portfolio limits to control concentration of funds held in certain sectors:

Table 9: Investment Portfolio Limits

	Limit
UK Central Government (including local authorities)	Unlimited
Investments with Building Societies	Max. £80m in sector
Registered Providers	Max. £40m in total
Any group of pooled funds under the same management	Max. £20m each
Loans to unrated corporates	£10m in total
Loans to own wholly owned subsidiaries	Case-by-case basis
Negotiable instruments held in a broker's nominee account	Max. £150m each
Money Market Funds	£150m in total

6.5.2 Secured investments may include covered (collateralised) bonds, reverse repurchase agreements (REPO) and other collateralised arrangements. These investments are secured against assets, which limits the potential losses in the unlikely event of insolvency and means that they are exempt from bail-in risk. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

6.5.3 Deposits placed with Governments includes loans, bonds and bills issued or guaranteed by national, 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.

6.5.4 Pooled Funds include shares or units in diversified investment vehicles which may invest in bonds, deposits, and bills, and also equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short term Money Market Funds that offer same-day liquidity and very low or no risk of price fluctuation will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period may be used for longer investment periods.

6.5.5 Bond, equity, and property funds offer enhanced returns over the longer term but are more volatile in the short term. The funds themselves may not be credit rated, however the assets within the fund will follow a strict selection criterion including the assignment of appropriate minimum credit ratings. These funds would allow the Council to diversify into asset classes other than cash without the need to own and directly manage the underlying investments. Because these funds have no defined maturity date but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

6.6 Performance benchmarking

6.6.1 The Council will use the 3-month Sterling Overnight Index Average (SONIA) market investment rate as a benchmark to compare returns. SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

6.6.2 This benchmark serves simply as a guide to market performance and the Council's actual performance will depend on cash availability, market risk, movements in interest rates and counterparty criteria. Officers will monitor the current and trend position and may alter operational activity (strictly within the boundaries of this approved strategy) to manage risk as conditions change.

6.7 Extreme market conditions

6.7.1 When deteriorating financial market conditions affect the creditworthiness of all organisations, this may not be immediately reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions.

6.8 Council's bankers

6.8.1 Should the long-term credit rating of the Council's incumbent bankers fall below our investment criteria, the Council may continue to place up to a maximum of £10m on an instant-access overnight basis only given the real-time visibility and immediate access to these funds on the online banking platform. If enacted, this practice will be kept under daily review.

6.9 Use of external advisors

6.9.1 Following competitive tender in August 2020, the Council appointed Link Group as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions always remains with the Council and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services to acquire access to specialist skills and resources.

6.9.2 The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed, documented, and subjected to regular review.

6.10 Local Authority Managed (LAM) Schools interest on surplus balances

6.10.1 68 LAM schools operate under the Council's group banking contract. By special arrangement, school's surplus cash is pooled and forms part of the Council's investment portfolio. Schools are then paid a quarterly share of interest earned on those sums proportionate to cash balances they individually held during each period.

6.10.2 Since 2009, in response to the financial crisis and tumbling interest rates, the Council has paid school's interest on their cash balances at a fixed interest rate of 0.30%. However, with market investment rates significantly improved in 2022/23 and into 2023/24 and beyond, officers have been considering an interest rate calculation basis that is fair, equitable and transparent to LAM schools which best reflects:

a) school's investment through the Council is completely automated;

b) counterparty failure risk sits with the Council, so school's investment is effectively risk-free;

c) school's retain immediate access to these funds and the Council imposes no requirement to provide cashflow information; and

d) the expertise of the Council's treasury officers.

6.10.3 After considering several options, interest will be calculated based upon the Bank of England (BoE) base rate minus 1%, calculated daily. For 2022/23 this approach will be backdated to 4th August 2022, being the first date that BoE base rate minus 1% rose above the previous fixed rate of 0.30%.

6.10.4 Further details on the practical application of this approach will be included within the next update to the Scheme for Financing LAM Schools.

6.10.5 To ensure a consistent approach, the same rate will be applied to other 3rd party funds held, where interest is paid but a rate has not been specified.

Appendix A: Treasury Management Policy Statement

Treasury Management activity within this Council will be undertaken in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services (The TM Code).

1. This organisation defines its treasury management activities as:

    - The management of the organisation's investment 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.

2. This organisation regards the successful identification, monitoring, and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments used to manage these risks.

3. This organisation acknowledges that effective treasury management will provide support towards the achievements of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risks management.

In adopting the TM code, this Council shall apply the following four key principles:

1. This organisation will create and maintain, as the cornerstone for effective treasury management:

    i. A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities (this document);

    ii. Suitable treasury management practices (TMPs), setting out the way the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

Appendix A: Treasury Management Policy Statement cont.

The content of this policy statement and TMPs will follow the recommendations contained in Section 6 and 7 of the Code, subject only to amendment where necessary to reflect the circumstances of the organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. Cabinet will receive reports on its treasury management policies, practices, and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in the TMPs.

3. This Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury decisions to the Director of Finance and Resources who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard Professional Practice on Treasury Management.

4. The Council nominates Budget and Resources Scrutiny Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and Policies.

Summary of approach to Borrowing and Investments

Full details of the Council's approach to Borrowing and Investment are contained within the main Treasury Management Strategy report. In summary, these are:

Borrowing; The Council will maintain a cautious approach to borrowing and market circumstances but ensuring cashflow requirements and capital financing needs are met. The Council will not borrow in advance purely to profit from the investment of the extra sums borrowed. Loan rescheduling opportunities shall be kept under review.

Investments; The Council's investment priorities will be **security, liquidity,** and **yield – strictly in that order.** Investment activity shall be conducted in accordance the adopted Annual Investment Strategy (AIS). The Council will manage investment balances with reference to core funds, cash flow requirements and the outlook for interest rates.

Appendix B: MRP Policy

The Council is required to repay an element of the accumulated General Fund borrowing requirement used to fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP). It is also permitted to undertake additional overpayments if considered prudent.

DLUHC regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. Four primary options are set out to Councils, but this does not preclude other options so long as there is a prudent provision.

Capital Expenditure incurred before 1st April 2008 or future SCE

From 2015/16, for capital expenditure incurred before 1st April 2008 or which in the future will be Supported Capital Expenditure, MRP will be charged on a 2% straight line basis. This ensures that this debt will be repaid within 50 years. Previously, the Council charged MRP in line with former DCLG Option 1. This option provided for an approximate 4% reduction in the supported borrowing need (CFR) each year.

Capital Expenditure incurred after 1st April 2008

From 1st April 2008 for all unsupported borrowing except those separately listed in this Policy (including PFI and leases) the MRP policy will be either:

- Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (known as Option 3);

- Depreciation method – MRP will follow standard depreciation accounting procedures (known as Option 4);

These options provide for a reduction in the borrowing need over the approximate asset's life.

Appendix B: MRP Policy cont.

Estimated life periods will be determined under delegated powers, subject the MRP guidance tables.

To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure.

Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

Housing Revenue Account (HRA)

There is no statutory requirement to charge MRP on HRA debt liability but by not doing so, no prudent provision is made for its eventual repayment. Charging MRP ensures that lifecycle provision is made for the replacement of assets by cleared the debts used to fund them. Authorities are free to make voluntary overpayments to reduce debt liability quicker if they so wish (see MRP Overpayments section below).

For historic HRA debt liability, the Council will only charges voluntary overpayments of MRP where sufficient surpluses are identified within the HRA business plan to support repayments.

For new HRA unsupported borrowing, straight line voluntary MRP will be applied reflecting the consumption period of those assets as:

- Land acquisitions; Nil, its value to the HRA is not expected to diminish;
- Regeneration schemes; 2% per annum / write down over 50 years;

Appendix B: MRP Policy cont.

- New HRA house build schemes; 1% per annum / write down over 100 years;
- Build of houses to be sold on open market; Nil, the debt liability will be repaid from eventual sale proceeds;
- HRA house open market acquisitions; on an estimated remaining asset life basis set under delegated authority by the Section 151 officer.

This policy ensures a more commercial financial approach to HRA borrowing plans by requiring cash provision to be set aside for eventual debt repayment where appropriate, but also allows the HRA flexibility to use its surplus funds to repay its debt liability or invest in further housing provision.

MRP Overpayments

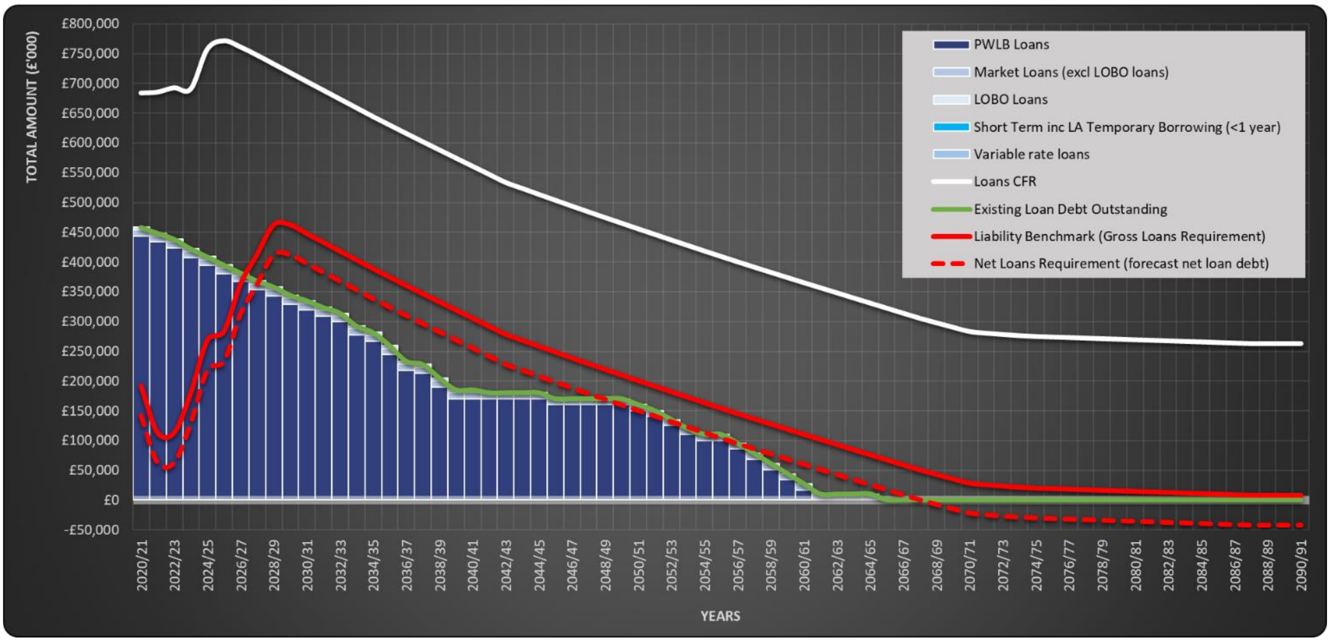
MRP charges made over the statutory minimum – that is voluntary revenue provision or overpayments – can be reclaimed in later years so far as to offset the current year's statutory provision (an MRP must be charged so cannot be nil) if deemed necessary or prudent. For these sums to be reclaimed for use in the budget, this policy must disclose the in-year and cumulative overpayments made each year. Details can be found in Section 3 of the main Strategy report above.

To adopt a more commercial-style financial approach to unconstrainted self-financing HRA borrowing plans, the Section 151 Officer may instruct that a voluntary cash provision be set aside for eventual debt repayment. This will ensure borrowing decisions remain prudent and affordable which gives the HRA flexibility to use these accumulating surpluses funds to repay its debts or invest in further housing provision. As there is no statutory requirement to charge MRP against the HRA, there is no provision to offset a current year's statutory provision to nil to reclaim these sums.

Appendix C: Liability benchmark

1. Chart 1 below shows the liability benchmark at January 2023 combined for both the General Fund and HRA.

Chart 1: Liability Benchmark – January 2023 – General Fund and HRA combined



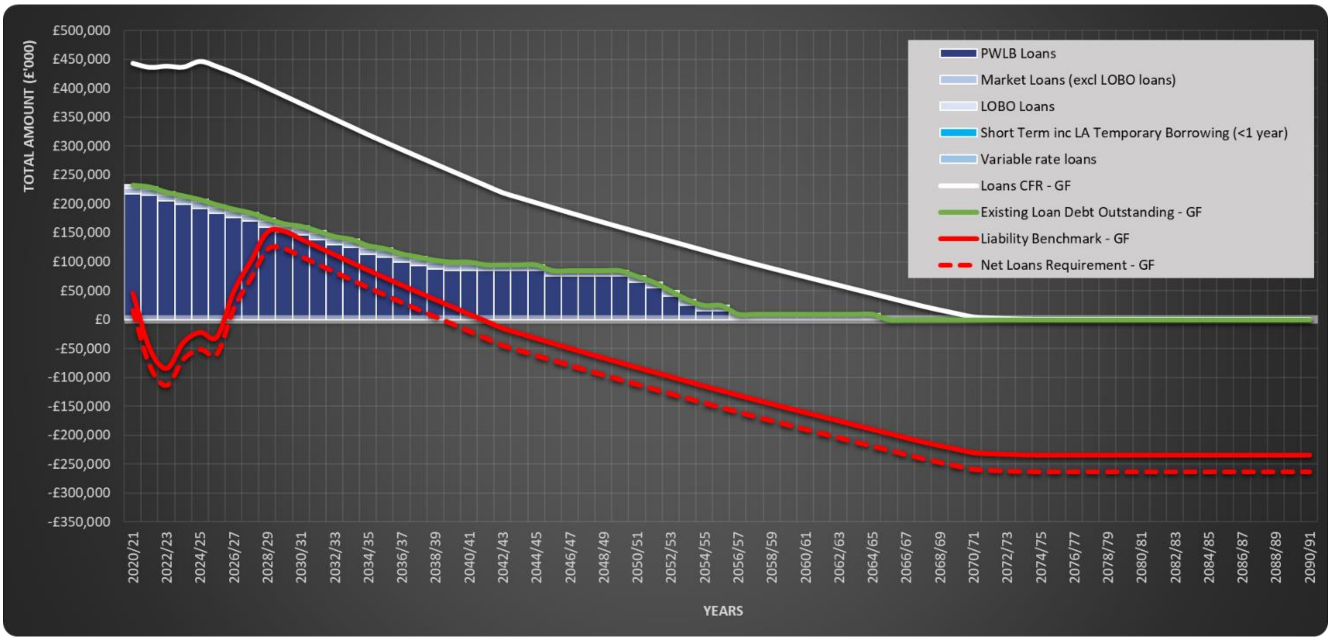
2. The solid white line shows the expected path of the CFR, reducing in time as MRP is applied. The solid green line, made up of the dark blue (PWLB loans) and various light blue (other Market loans) bars, remains significantly below the CFR borrowing requirement. The solid red line depicts the liability benchmark unadjusted for liquidity allowance. The dashed red line shows the net loans requirement (the liability benchmark adjusted for liquidity allowance) – it represents CIPFA's view of the optimum borrowing position. The Council's current strong cash investment position means that we hold excess borrowing and will continue to do so until 2028/29 as these cash resources are applied. Penalty costs (premium charge) attached to early repayment of loans make this exercise largely unviable. From 2028/29 onwards the net loans requirement (dashed red line) rises above the existing loans pool (green line/blue bars), indicating a relatively modest borrowing requirement on current assumptions. If no further prudential borrowing is undertaken to fund future capital schemes and the optimum path for borrowing followed, the Council would no longer have an overall external borrowing requirement from 2068/69.

Appendix C: Liability benchmark cont.

3. Up until 2020/21, the Council operated a single loans pool and allocated notional borrowing costs between the General Fund and HRA. The legacy loans portfolio has taken its form on this basis. Since 2021/22 the Council equitably separated its loans into two pools – one for the General Fund and one for the HRA – and so borrowing decisions are now taken independently.

4. When we present the General Fund and HRA separately, we see a stark difference between the two respective funds. Chart 2 below shows the liability benchmark at January 2023 for the General Fund only.

Chart 2: Liability Benchmark – January 2023 – General Fund



5. Investment balances predominately belong to the General Fund, other than those reserves and balances specifically identified as belonging to the HRA.

6. The chart indicates that General Fund cash investment balances are set to begin reducing in 2023/24 as the intended spending purpose of those cash-backed resources arises, reaching a minimum level by 2028/29 before building against progressively thereafter as the cash-backed MRP charge accumulates and no further prudential borrowing beyond the approved capital programme is assumed to occur. This would imply that on current projection and should the optimum path for borrowing be followed, the General Fund would not have a borrowing

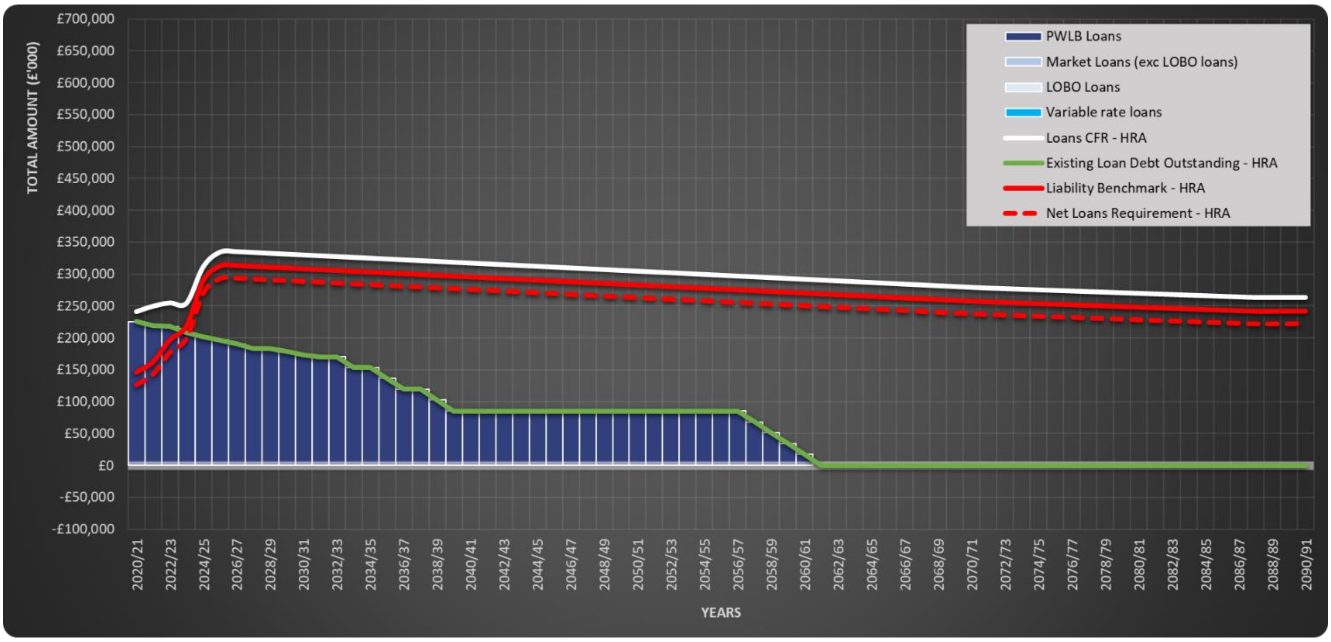
Appendix C: Liability benchmark cont.

requirement from 2039/40 but, in the absence of debt restructuring opportunities arising in the meantime, would continue to hold loan debt until 2064/65.

7. The ‘cash-rich’ position for the General Fund gives rise to opportunity to continue internally lending surplus cash to the HRA, avoiding counterparty credit risk as well as reducing the HRA’s external loans requirement and keeping the interest-cost benefit within the Council.

8. In contrast, Chart 3 below shows the liability benchmark at January 2023 for the HRA only.

Chart 3: Liability Benchmark – January 2023 – HRA



9. The HRA’s cash-backed resources are programmed to be applied to fund capital schemes between 2022/23 and 2025/26 before remaining at a constant optimum operating level. The HRA loans CFR increases in 2024/25 and 2025/26 with additional prudential borrowing funding the residual capital programme balance. With no further prudential borrowing beyond the approved capital programme assumed to occur, the HRA loans CFR reduces gradually as voluntary MRP is applied on certain debt liability. The existing loans portfolio (green line/blue bars) reduces as loans fall due for repayment, leading to a rising and continued borrowing requirement from 2023/24 onwards (gap between green and dashed red line). However, the Council’s latest HRA Business Plan assumes that future HRA operating surpluses beyond those needed to sustain stock standards are applied to repay debt liability. This would see the HRA

Appendix C: Liability benchmark cont.

loans CFR significantly reduce in later years before eventually becoming debt-free. Any future HRA borrowing will be undertaken with reference to the HRA Business Plan funding model. As mentioned in the General Fund commentary, the 'cash-rich' position for the General Fund gives rise to opportunity to continue internally lending surplus cash to the HRA, reducing the quantum of additional external loans needed.

Conclusion

10. The liability benchmark is intended to identify how much and for how long new external loans are drawn, in theory avoiding borrowing for too long or too short but matching future liabilities. But as cautioned above, the liability benchmark projects forward fifty years and beyond but does not make assumption about the level of future prudential borrowing beyond the five-year capital programme – effectively assuming no further capital borrowing ever occurs. This is intended to avoid making long-term financing decisions today based upon speculative future capital spend and resourcing assumptions, but also means that it is somewhat unlikely that the path projected for the loans CFR and external borrowing will accurately materialise.

11. The TM Code does not expect authorities to follow a compulsory path of matching external loan debt closely to the liability benchmark. Each authority may have a view of interest rates or other external or internal factors that leads it to a prudent alternative conclusion. This may include, for example, an external loans portfolio with more one-to-two-year debt and less five-to-ten-year debt than the benchmark suggests, which may save on immediate interest costs but introduces greater refinancing risk. Alternatively, an authority may wish to borrow now in advance of the cash flow needs of the next two years to secure affordable interest costs where intel suggests rising interest rates. The profile of the actual/planned debt and investments versus the benchmark will identify the maturities where the authority has borrowed more or less than its current plans require and highlight the associated risks. While the projections may show that some authorities may have existing commitments that exceed their liability benchmark, there is no requirement for loans to be repaid to meet the benchmark, although opportunities to do so to align the loans portfolio more closely to the benchmark should be kept under continual review.

Appendix D: HRA Debt Charges; Internal recharge basis

Under a two-pool approach to allocating debt costs between the HRA and General Fund, the HRA is expected to be fully funded to its Capital Financing Requirement (CFR) where possible. Where this is not possible, any residual differences are charged based on:

HRA Loans CFR: short term loans payable (under-funded CFR; HRA borrowing internally from GF)	Average rate on GF external debt, or a pre-arranged formally agreed borrowing rate referenced to a PWLB equivalent rate.
HRA Loans CFR: short term loans receivable (over-funded CFR; HRA lending internally to GF)	Average rate on external investments excluding any earmarked GF investments, or for earmarked HRA reserves an actual external investment rate.
HRA Cash balances: short term loans payable (cash balances overdrawn; HRA borrowing internally from GF)	Average rate on external investments + 5.0%, or a pre-arranged formally agreed borrowing rate referenced to a market equivalent rate.
HRA Cash balances: short term loans receivable (cash balances in hand; HRA lending internally to GF)	Average rate on external investments excluding any earmarked GF investments, or for earmarked HRA reserves an actual external investment rate.

Additional considerations include:

1. Debt management expenses are charged on an apportioned basis that considers the weighting of time spent on managing debt and investments respectively.
2. Risk associated with external loans sit with either the GF or HRA depending on which of these the loan has been earmarked to.
3. Similarly, risk associated with any external investment of earmarked HRA reserves sits with the HRA. This includes impairment risk.
4. Where risk cannot be identified specifically to either the GF or HRA, it is apportioned fairly between the two using relevant available data.

Appendix E: Interest rate forecast – Link Group

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

- 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, rising gilt yields).
- The Bank of England acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in resolving remaining issues.
- Geopolitical risks, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.
- The Government acts too quickly to cut taxes and/or increases expenditure considering the cost-of-living squeeze.
- The pound weakens because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer term US treasury yields rise strongly and pull gilt yields up higher than forecast.
- Projected gilt issuance, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields consequently.

The balance of risks to the UK economy:

- Considering the upside and downside risks outlined above, the overall balance of risks to economic growth in the UK is now to the downside.

Carl Oliver, Treasury Manager
carl.oliver@milton-keynes.gov.uk or treasury@milton-keynes.gov.uk

Anna Rulton, Head of Finance
anna.rulton@milton-keynes.gov.uk

Steve Richardson, Director of Finance and Resources
steve.richardson@milton-keynes.gov.uk