## APPENDIX D

**Treasury Management Strategy Statement 2024/25**

1. **Introduction**

1.1 Treasury management at Tandridge District Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

1.2 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code. Prudential Indicators and Treasury Indicators are set out in Annex 1 and a number of treasury limits and indicators are set out below.

1.3 Treasury management is the management of the Council's cash flows, borrowing, investments, and the associated risks. The Council has borrowed and invested substantial 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 Council's prudent financial management.

1.4 The Council is typically cash rich in the short-term as revenue income is received before it is spent, but will have less cash in the long-term as capital expenditure is incurred before being financed. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

1.5 The Treasury Management Strategy is supported by four annexes:

- Prudential indicators – a Code requirement which supports our approach to borrowing, managing risk and highlighting our capital financing requirement.
- Detailed external context – a detailed summary from Arlingclose (the Council's Treasury advisors) of the current and future economic climate, risks and opportunities along with detailed interest rate forecasts.
- Investment & Debt Portfolio Position as at 31 March 2023 – to highlight the range of debt and investments from the prior year accounts.
- Glossary of Terms

2. **External Context**

Economic background (provided by Arlingclose).

2.1 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 Council's treasury management strategy for 2024/25.

2.2 The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level for the rest of 2023. In December 2023, members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25%. The three dissenters wanted to increase rates by another 0.25%.

2.3 The November 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 upside risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

2.4 Office for National Statistics (ONS) figures showed CPI inflation was 3.9% in November 2023, down from a 4.6% rate in the previous month and, in line with the recent trend, lower than expected. The core CPI inflation rate declined to 5.1% from the previous month's 5.7%, again 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 before dropping below target during the second half 2025 and into 2026.

2.5 ONS figures showed the UK economy contracted by 0.1% between July and September 2023. The BoE forecasts GDP will likely stagnate through 2024. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.

2.6 The labour market appears to be loosening, but only very slowly. The unemployment rate rose slightly to 4.2% between June and August 2023, from 4.0% in the previous 3-month period, but the lack of consistency in the data between the two periods made comparisons difficult. Earnings growth has remained strong, but has showed some signs of easing; regular pay (excluding bonuses) was up 7.3% over the period and total pay (including bonuses) up 7.2%. Adjusted for inflation, regular pay was 1.4% and total pay 1.3%. Looking forward, the MPR showed the unemployment rate is expected to be around 4.25% in the second half of calendar 2023, but then rising steadily over the forecast horizon to around 5% in late 2025/early 2026.

2.7 Having increased its key interest rate to a target range of 5.25-5.50% in August 2023, the US Federal Reserve appears now to have concluded the hiking cycle. It is likely this level represents the peak in US rates following a more dovish meeting outcome in December 2023. US GDP grew at an annualised rate of 4.9% between July and September 2023, ahead of expectations for a 4.3% expansion and the 2.1% reading for Q2. But the impact from higher rates has started to feed into economic activity and growth will weaken in 2024. Annual CPI inflation was 3.1% in November.

Credit outlook

2.8 Credit Default Swap (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 Q2 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.

2.9 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.

2.10 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.

2.11 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.

2.12 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.

2.13 However, the institutions on our 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)

2.14 Although UK inflation and wage growth remain elevated, the Council's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25%. The Bank of England's Monetary Policy Committee will start reducing rates in 2024 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 Q3 2024 to a low of around 3% by early-mid 2026.

2.15 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.

2.16 A more detailed economic and interest rate forecast provided by Arlingclose is in the Appendix D TMS Annex 2.

## 3. Local Context:

3.1 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 Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.2 Internal borrowing allows the Council to utilise its internal cash balances (i.e. working capital and reserves) which are not required in the short to medium-term in order to reduce risk and keep interest costs low. Forecast gross external debt and capital financing requirement are shown in the table 1 below.

***Table 1: Prudential Indicator: Forecast Gross External Debt and the Capital Financing Requirement***

| | 31.3.2023 Actual £m | 31.3.2024 Estimate £m | 31.3.2025 Estimate £m | 31.3.2026 Estimate £m | 31.3.2027 Estimate £m |
|---|---|---|---|---|---|
| HRA Debt | 56.0 | 66.0 | 73.6 | 86.9 | 94.1 |
| General Fund External Debt | 43.4 | 43.4 | 43.4 | 43.4 | 43.4 |
| Other Long-Term Liabilities | 0 | 0 | 0 | 0 | 0 |
| **Total Debt** | **99.4** | **109.4** | **117.0** | **130.3** | **137.5** |
| Capital Financing Requirement | 108.4 | 114.0 | 122.1 | 135.0 | 141.7 |
| CFR not funded by Borrowing | 9.0 | 4.6 | 5.1 | 4.7 | 4.2 |

3.3 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation across the medium-term.

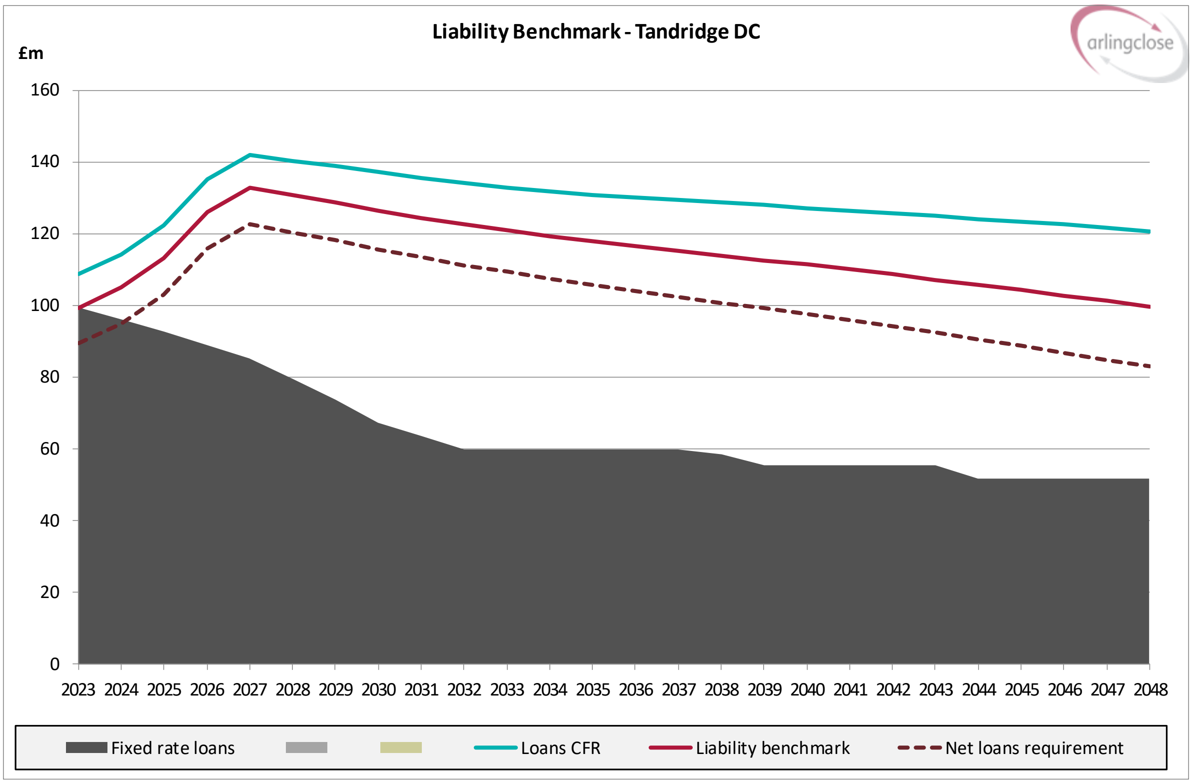
3.4 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 14 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

3.5 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**

| **Position at 31 March** | **2022/23 Actual £m** | **2023/24 Projected £m** | **2024/25 Estimated £m** | **2025/26 Estimated £m** | **2026/27 Estimated £m** |
|---|---|---|---|---|---|
| Loans CFR | 108.8 | 114.0 | 122.1 | 135.0 | 141.7 |
| External borrowing | -99.4 | -96.3 | -92.8 | -89.2 | -85.2 |
| Internal (over) borrowing | 9.3 | 17.7 | 29.3 | 45.8 | 56.5 |
| Balance sheet resources | -19.3 | -19.3 | -19.3 | -19.3 | -19.3 |
| Investments/ (new borrowing) | -10 | -1.6 | 10 | 26.5 | 37.2 |
| | | | | | |
| Treasury investments | 9.9 | 10 | 10 | 10 | 10 |
| New borrowing | -0.1 | 8.4 | 20 | 36.5 | 47.2 |
| | | | | | |
| Net loans requirement | 89.4 | 94.7 | 102.8 | 115.7 | 122.4 |
| Liquidity allowance | 10 | 10 | 10 | 10 | 10 |
| **Liability benchmark** | 99.4 | 104.7 | 112.8 | 125.7 | 132.4 |

**Graph 1: Liability Benchmark**




3.6 The long-term liability benchmark assumes:

- Capital expenditure funded by borrowing as per the 2024-2027 Capital Programme, with no further assumed expenditure factored in beyond this period;
- Minimum Revenue Provision (MRP) on new capital expenditure is based on the MRP Policy in Appendix A;
- Reserves and Balances are based on proposed and approved use over the life of the Medium-term Financial Plan (MTFS) and increase by inflation thereafter; and
- The benchmark is based on our assumptions on capital expenditure and the external loans requirement may not ultimately reduce to zero as future capital expenditure is approved.

3.7 Overall, the liability benchmark shows that we are currently borrowing exactly what we need, because the amount of external debt (grey shaded area) matches the liability benchmark (red line). As we progress over the medium term, the gap between total external debt and the liability benchmark grows, meaning that we need to borrow more money to meet our financing requirement. We aim to avoid a scenario where our external debt exceeds our liability benchmark, as it indicates that we are borrowing more than we need – i.e borrowing to invest, carrying with it an increased risk of investment returns.

3.8 In the short term, the difference between the CFR (underlying need to borrow – represented by the blue line) and actual external borrowing is funded from Reserves and Balances (internal borrowing).

4. **Borrowing Strategy**

4.1 The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. To achieve this, the key aim is to maximise internal borrowing and use cash surpluses to avoid the need to borrow externally until needed. The Council does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

4.2 By maximising internal borrowing, the Council is able to supress net borrowing costs (despite foregone investment income) and limit market and credit risk in the investment portfolio.

4.3 The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing are uncertain. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. 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.

4.4 The Council could consider short-term low rate borrowing from counterparties such as other local authorities if it had a temporary cash shortfall that needed to be addressed, rather than committing unnecessarily to long-term lending before it is needed.

4.5 Alternatively, the Council may 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 without suffering a cost of carry in the intervening period.

4.6 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- HM Treasury's Public Works Loan Board (PWLB);
- any institution approved for investments (see below);
- banks or building societies authorised to operate in the UK;
- UK Local Authorities;
- UK public and private sector pension funds (except the Surrey Pension Fund);
- capital market bond investors;
- retail investors via a regulated peer-to-peer platform; and
- UK Municipal Bonds Agency plc and other special purpose companies created to enable Local Authority bond issues.

4.7 The Council has previously raised its long-term borrowing from the PWLB. For short-term borrowing if it was considered necessary in the future the Council could use other sources of finance, such as loans from other Local Authorities, pension funds and other public bodies as these are often available at more favourable rates. These short-term loans leave the Council exposed to the risk of interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

4.8 Under the Prudential Code, an authority must not borrow to invest primarily for financial return. It is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose. Authorities with commercial land and property may invest in maximising its value, including repair, renewal and updating of the properties. This Strategy certifies that the Council's capital spending plans do not include the acquisition of assets primarily for yield.

4.9 **Other sources of debt finance:** 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
- sale and leaseback
- similar asset based finance

All such sources of finance are subject to a robust options appraisal.

4.10 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report.

4.11 **Debt rescheduling:** The PWLB allows Local 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 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 efficiency or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

**Borrowing Costs**

4.12 Gross borrowing costs include interest payable and the statutory charge on the general fund for MRP. The borrowing costs associated with the 2024/25 to 2026/27 General Fund capital Programme start at £2.4m in 2024/25 and increase to £2.7m in 2025/26, before increasing again to £2.9m in 2026/27.

4.13 Net borrowing costs are calculated after offsetting interest and investment income and over the same period, net borrowing costs grow from £0.2m in 2024/25 to £0.6m in 2026/27.

5. **Treasury Investment Strategy**

5.1 **Objectives:** The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The 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. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Fund Manager Selection report on this Investment Sub Committee agenda sets out a proposed approach. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

5.2 **Strategy:** As demonstrated by the liability benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments. Existing investments will be reviewed on a regular basis for appropriateness of size, length of investment and counterparty, referring to the Government's policy on statutory overrides and the current performance of each investment.

5.3 Money Market Funds (MMFs) and short-term bank deposits will be utilised, with a cash limit per counterparty/fund of £4m per bank and £5m per MMF. The limits for MMFs have been increased from £4m to ensure sufficient capacity for cash management in the short term. If the economic situation changes, which results in a decision to undertake additional borrowing, resulting in higher cash balances, other investment counterparties may be considered and the counterparty limits set out below would apply.

5.4 **Business models**: Under the new International Financial Reporting Standard (IFRS 9) standard, the accounting for certain investments depends on the Council's "business model" for managing them. The new standard requires entities to account for expected credit losses in a timely manner; from the moment when financial instruments are first identified. These investments will continue to be accounted for at amortised cost.

5.5 **Approved counterparties**: The Council may invest its surplus funds with any of the counterparty types in Table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

**Table 3 - Approved investment counterparties and limits**

| High Credit Quality | Individual Monetary limit for initial investment(1) | Aggregate Monetary Limit | Fitch Credit rating(3) |
|---|---|---|---|
| UK Central Government | No Limit | No Limit | Not applicable |
| UK Local Authorities including PCC's | £2m each | LT: £8m | Not applicable |
| Banks(1) operating in the UK(2) | £2m each | LT: £8m<br>ST: None | LT:A-<br>ST: F1 |
| Overseas Banks (subject to Sovereign Rating AA-) | £2m each | £8m | LT:A-<br>ST: F1 |
| UK building societies with an asset base > £1bn | £2m each | | LT: BBB+<br>ST:F1 |
| UK building societies with an asset base < £1bn | £1m each | | LT: A-<br>ST:F1 |
| Money Market Funds | £5m each | | ST: AAA |
| Ultra Short Dated Bond Fund | £4m each | | ST: AAA |
| | | | |
| **Pooled Funds**(4) | | | |
| Bond Funds without credit ratings | £4m each | £8m | Not applicable |
| Property Funds without credit ratings | £4m each | £4m | Not applicable |
| Multi Asset Funds | £4m each | £8m | Not applicable |

[1]Banks within the same group ownership are treated as one bank for limit purposes

[2]Where the bank is used as a reserve account the criteria will exclude consideration of the long-term credit rating

[3] Minimum Credit rating required, is expressed as a Fitch rating or the equivalent S&P or Moodys ratings etc

[4] The Council has placed an overall limit on pooled funds of £16m

The majority of the Council's investments activity will be made for relatively short periods and in highly credit rated investments, giving priority to security and liquidity ahead of yield. In order that the Council is not at risk of a large single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £2 million or £5 million per pooled fund. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

5.6 **Minimum credit rating:** Treasury investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's. 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 factors including external advice will be taken into account.

5.7 **Banks unsecured:** 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.

5.8 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they 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 to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

5.9 **Government:** 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 Central Government may be made in unlimited amounts for up to 50 years.

5.10 **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus 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 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 Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

5.11 **Bond, equity and property funds** offer enhanced returns over the longer term but are more volatile in the short-term. These allow the Council to diversify into asset classes other than cash without the need to own and 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.

5.12 **Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB - and with 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, where practical, be kept below £1m. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. The Council's bank, HSBC, has a credit rating of AA-.

5.13 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the 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.

5.14 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") 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.

5.15 **Other information on the security of investments**: The 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, reports in the quality financial press and analysis. No investments will be made with an organisation if there are substantive doubts about its credit quality.

5.16 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally 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. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the 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 or with other Local Authorities.

5.17 **Liquidity management:** The Council uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

**Treasury Management Prudential Indicators**

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

5.19 **Maturity structure of borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

| **Debt Maturity Profile Limits** | **Actual as at 31/03/23** | **Upper Limit 2025/25** | **Lower Limit 2024/25** |
|---|---|---|---|
| | % | % | % |
| Under 1 year | 3 | 15 | 0 |
| 1 to 2 years | 7 | 15 | 0 |
| 2 to 5 years | 16 | 25 | 0 |
| 5 years to 10 years | 14 | 50 | 0 |
| 10 years to 20 years | 8 | 50 | 0 |
| Over 20 years | 52 | 60 | 0 |
| **Total** | **100%** | | |

5.20 Time periods start on the first day of each financial year. The maturity date of borrowing is the date of the loans are due to be repaid.

5.21 **Interest rate exposure:** This indicator is set to control the Council's exposure to interest rate risk. The indicator sets an upper limit to the impact on revenue if there were a 1% change in interest rates:

| | 2024/25 £m | 2025/26 £m | 2026/27 £m |
|---|---|---|---|
| Upper limit on impact on revenue for a 1% change in interest rates | 0.4 | 0.4 | 0.4 |

5.22 The Council's borrowing is all held at a fixed rate, and the current treasury investment portfolio is all held in investments at a variable rate. There is currently a reserve set aside of £0.4m, which is reflected in the above indicator. Assessing the treasury investment portfolio as at 31 December 2023 (which is a particularly high point in terms of investment balances), a 1% change in interest rate would have a £0.31m impact on revenue.

5.23 **Long-term treasury management investments:** The purpose of this indicator is to control the 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:

| Price risk indicator | 2022/23 | 2023/24 | 2024/25 | No fixed date |
|---|---|---|---|---|
| Limit on principal invested beyond year end | £16m | £16m | £16m | £16m |

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

**Related matters**

5.24 There are a number of additional items that the Council is obliged by CIPFA and DLUHC to include in its treasury management strategy.

5.25 **Treasury Management Advice:** Tandridge District Council has appointed Arlingclose as Treasury management advisers and receives specific advice on investments, debt and capital finance matters.

5.26 **Treasury Management Training**: Member and Officer training needs are assessed regularly as part of the staff appraisal process. Additional training will be provided as and when there is a change in roles and responsibilities. The Council also benefits from the Orbis partnership Centre of Expertise as part of the Joint Working Arrangement with Surrey County Council, which provides a robust Treasury team providing day to day treasury management operational activities to Tandridge District Council, Surrey County Council, Brighton & Hove City Council and East Sussex County Council.

**Knowledge and Skills**

As part of the Joint Working arrangement with Surrey County Council:

5.27 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council pays for officers to study towards relevant professional qualifications including CIPFA.

5.28 All officers involved in the treasury and investment management function have access to relevant technical guidance and training to enable them to acquire and maintain the appropriate level of expertise, knowledge and skills to undertake the duties and responsibilities allocated to them. The Council currently employs treasury management advisors through Arlingclose, who provide support and guidance relating to Council's Treasury Management and borrowing strategies, providing proactive advice in response to emerging market trends.

5.29 The Orbis partnership enables the creation and development of specialist resources. Centres of Expertise have been established for key areas of finance, and central teams of pooled expertise have been created to provide robust services which are resilient to meet the changing service needs of partners.

5.30 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. This approach is more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

## 6. Financial Implications

6.1 The budget for investment income in 2024/25 is £2.3m. The budget for debt interest paid in 2024/25 is £1.2m (GF) and £2.2m (HRA), which is based on the existing long-term fixed rate debt portfolio and the HRA borrowing internally from the GF to finance its capital programme.

6.2 The budget for investment income is set prudently and is below the forecasts stated elsewhere in this report. Surplus investment income may be added to an investment income equalisation reserve to ensure that any fluctuation in capital value or return can be offset in the longer-term.

6.3 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund.

6.4 The CIPFA Code does not prescribe any particular treasury management strategy for Local Authorities to adopt. The Section 151 Officer 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 below.

| 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 will 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 |

**APPENDIX D – Annex 1**

**Prudential Indicators 2024/25 – 2026/27**

1.1 The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of Local Authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

1.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice.

**Estimates of capital expenditure**

1.3 The Council's planned capital expenditure and financing is summarised in table 1 (para 2.5) and table 2 (para 2.12) of the main strategy. This prudential indicator is a summary of the Council's annual capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

**The Council's borrowing need (the capital financing requirement)**

1.4 Table 4 (para 2.17) of the main strategy sets out the Council's estimated capital financing requirement (CFR). The CFR represents capital expenditure funded by external debt and internal borrowing and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR therefore measures a Council's underlying need to borrow for a capital purpose. Any capital expenditure which has not been funded from locally determined resources will increase the CFR. The CFR will reduce by the Minimum Revenue Provision (MRP).

1.5 The MRP is a statutory annual revenue charge which reduces the borrowing need in a similar way to paying principal off a household mortgage.

1.6 The CFR would include any other long-term liabilities, e.g. finance leases. Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes and they therefore do not form part of the Council's underlying need to borrow.

**Gross borrowing and the capital financing requirement**

1.7 In order to ensure that over the medium-term borrowing will only be for a capital purpose, the Council should ensure that its debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next 2 financial years. This allows some flexibility for early borrowing in advance of need, but ensures that borrowing is not undertaken for revenue purposes. This is a key indicator of prudence, see Table 1, para 3.2 TMSS. Total debt is expected to remain below the CFR during the forecast period.

**The Council's authorised limit and operational boundary for external debt**

1.8 Table 1 sets out the Council's authorised limit and operational boundary for external debt.

1.9 The authorised limit represents a control on the maximum level of borrowing. It is a statutory limit determined under section 3(1) of the Local Government Act 2003 and represents a limit beyond which external debt is prohibited. It is the maximum amount of debt that the Council can legally owe.

1.10 The operational boundary is an indicator against which to monitor its external debt position. It is based on the Council's estimate of the most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the CFR and cash flow requirements and is a key management to for in-year monitoring.

1.11 Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. Other long-term liabilities comprise finance lease, PFIs and other liabilities that are not borrowing but form part of the Council's debt position.

1.12 The operational boundary is not a limit and actual borrowing could vary around this boundary for short periods during the year. It should act as an indicator to ensure the authorised limit is not breached. The operational boundary increases over the MTFS period to reflect an increasing underlying need to borrow linked to the Capital Programme. We monitor against the indicator throughout the year.

1.13 The Authorised limit provides headroom over and above the operational boundary for unusual cash movements and potential additional borrowing to meet the ambitions of the Council in respect of its investment strategy.

***Table 1: Prudential Indicators: Authorised limit and operational boundary for external debt***

| | **2023/24 limit £m** | **2024/25 limit £m** | **2025/26 limit £m** | **2026/27 limit £m** |
|---|---|---|---|---|
| Authorised limit – borrowing | 150 | 150 | 155 | 162 |
| Authorised limit – leases | 0 | 0 | 0 | 0 |
| Authorised limit – total external debt | 150 | 150 | 155 | 162 |
| Operational boundary – borrowing | 140 | 140 | 145 | 152 |
| Operational boundary – leases | 0 | 0 | 0 | 0 |
| Operational boundary – total external debt | 140 | 140 | 145 | 152 |

**Estimated ratio of gross financing costs to net revenue stream**

1.14 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs.

***Table 2: Prudential Indicator: Proportion of financing costs to net revenue stream***

| | **2022/23 Actual £m** | **2023/24 Estimate £m** | **2024/25 Estimate £m** | **2025/26 Estimate £m** | **2026/27 Estimate £m** |
|---|---|---|---|---|---|
| Net revenue stream | 11.4 | 11.9 | 12.8 | 12.8 | 12.4 |
| General Fund – Gross Financing costs | 1.1 | 1.2 | 1.3 | 1.3 | 1.4 |
| Proportion of GF Gross financing costs to net revenue stream | 10% | 10% | 10% | 10% | 11% |

**Net income from commercial and service investments to net revenue stream**

1.15 This is an indicator of affordability and highlights the net financial impact on the authority of its entire non-treasury investment income.

| | **2022/23 Actual £m** | **2023/24 Estimate £m** | **2024/25 Estimate £m** | **2025/26 Estimate £m** | **2026/27 Estimate £m** |
|---|---|---|---|---|---|
| Net revenue stream | 11.4 | 11.9 | 12.8 | 12.8 | 12.4 |
| Total net income from service and commercial investments | 1.5 | 1.6 | 1.6 | 1.6 | 1.6 |
| Proportion of net income to net revenue stream | 13% | 14% | 13% | 13% | 13% |

APPENDIX D - Annex 2

## Arlingclose Economic & Interest Rate Forecast – December 2023

### Underlying assumptions:

- UK inflation and wage growth remain elevated but have eased over the past two months fuelling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.
- The MPC's message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.
- Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the more timely PMI figures suggest that the services sector is recovering from a weak Q3. Tighter policy will however bear down on domestic and external activity as interest rates bite.
- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.
- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.
- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant loosening in the future to boost activity.
- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium- term level for Bank Rate.
- There is a heightened risk of fiscal policy and/or geo-political events causing substantial volatility in yields.

### Forecast:

- The MPC held Bank Rate at 5.25% in December. Arlingclose believes this is the peak for Bank Rate.
- The MPC 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. We see rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.
- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.
- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

| | Current | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 | Mar-26 | Jun-26 | Sep-26 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | 1.00 | 1.00 |
| Central Case | 5.25 | 5.25 | 5.25 | 5.25 | 5.00 | 4.75 | 4.25 | 4.00 | 3.75 | 3.50 | 3.25 | 3.00 | 3.00 |
| Downside risk | 0.00 | 0.00 | -0.25 | -0.50 | -0.75 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 |
| 3-month money market rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | 1.00 | 1.00 |
| Central Case | 5.40 | 5.40 | 5.40 | 5.30 | 5.15 | 4.80 | 4.30 | 4.10 | 3.80 | 3.50 | 3.25 | 3.05 | 3.05 |
| Downside risk | 0.00 | 0.00 | -0.25 | -0.50 | -0.75 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 |
| 5yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.25 | 0.75 | 0.85 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Central Case | 3.77 | 3.75 | 3.75 | 3.75 | 3.70 | 3.60 | 3.50 | 3.50 | 3.40 | 3.30 | 3.30 | 3.30 | 3.35 |
| Downside risk | 0.00 | -0.25 | -0.75 | -0.85 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 |
| 10yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.25 | 0.75 | 0.85 | 0.85 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Central Case | 3.72 | 3.75 | 3.80 | 3.80 | 3.80 | 3.80 | 3.80 | 3.80 | 3.75 | 3.65 | 3.60 | 3.65 | 3.70 |
| Downside risk | 0.00 | -0.25 | -0.75 | -0.85 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 |
| 20yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.25 | 0.75 | 0.85 | 0.85 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Central Case | 4.16 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 | 4.20 | 4.25 |
| Downside risk | 0.00 | -0.25 | -0.75 | -0.85 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 |
| 50yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.25 | 0.75 | 0.85 | 0.85 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Central Case | 3.76 | 3.80 | 3.85 | 3.90 | 3.90 | 3.90 | 3.90 | 3.90 | 3.90 | 3.90 | 3.95 | 3.95 | 3.95 |
| Downside risk | 0.00 | -0.25 | -0.75 | -0.85 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 | -1.00 |

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB HRA Rate (Maturity Loans) = Gilt yield + 0.40%
UK Infrastructure Bank Rate (Maturity Loans) = Gilt yield + 0.40%

**Investment & Debt Portfolio Position as at 31 March 2023**

| | 2022/23 Actual 31/03/2023 £m | 2022/23 Actual 31/03/2023 % |
|---|---|---|
| Notice Accounts & Cash Plus Funds | 2.0 | 1.9 |
| Money Market Funds | 4.0 | 2.2 |
| Short-term Deposits | 0 | 0 |
| CCLA Property Fund | 4.1 | 4.3 |
| Funding Circle | 0.1 | - |
| Schroders Bond Fund | 2.6 | 5.9 |
| UBS Multi-Asset Fund | 2.2 | 6.6 |
| CCLA Diversification Fund | 1.9 | 3.0 |
| | | |
| **Total Treasury Investments** | **16.9** | **3.1** |
| | | |
| Long-term PWLB loans (HRA) | 56.0 | 2.9 |
| Long-term PWLB loans (GF) | 43.4 | 2.6 |
| | | |
| **Total Borrowing** | **99.4** | **2.7** |
| | | |
| **Net Borrowing** | **82.5** | |

**Glossary of Terms**

**CCLA – Churches, Charities and Local Authorities**

**CFR – Capital Financing Requirement**

**CIPFA – Chartered Institute of Public Finance Accountancy**

**CPI – Consumer Price Index**

**DMO – Debt Management Office**

**DMADF – Debt Management Account Deposit Facility**

**ECB – European Central Bank**

**GDP – Gross Domestic Product**

**DLUHC – Department for Levelling Up, Housing and Communities**

**MiFID - Markets in Financial Instruments Directive**

**MMF – Money Market Fund**

**MPC – Monetary Policy Committee**

**MRP – Minimum Revenue Provision**

**PWLB – Public Works Loan Board**

**TMSS – Treasury Management Strategy Statement**