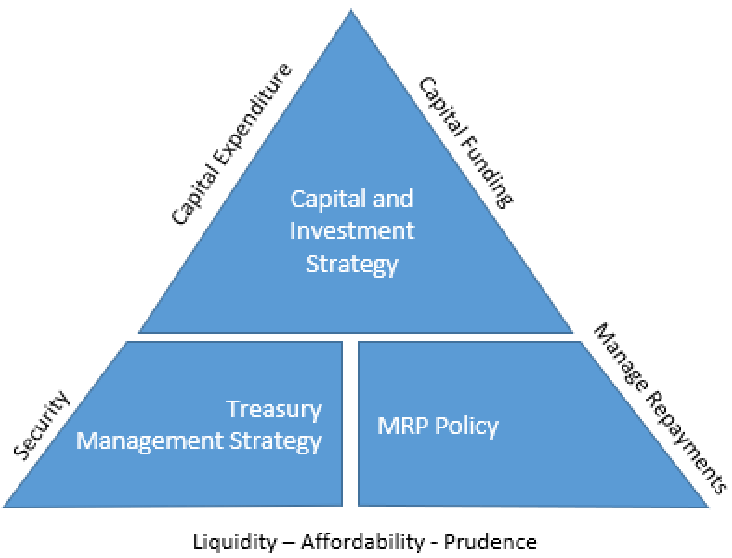
APPENDIX 1

Capital, Investment and Treasury Management Strategy 2025/26

1. **Introduction**

1.1 The Capital, Investment and Treasury Management Strategy (the strategy) provides an overview of the three main components of capital planning;

- **Capital expenditure and investments**: the Capital Programme; supporting the Council's priorities and the Investment Property Strategy; generating income and supporting economic growth and regeneration;
- **Financing our capital plans, and maintaining liquidity**: the Treasury Management Strategy; setting out how the capital programme will be financed and how cash investments will be managed; and
- **Repaying our debt in a prudent way**: the Minimum Revenue Provision (MRP) Policy; setting out how we use the revenue budget to repay debt.



This report sets out a high-level overview of how capital expenditure, capital financing and treasury management activity contributes to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

1.2 The strategy sets out a clear picture of the plans of the Council for financing capital expenditure, and investment plans within the financial constraints, risk appetite and regulatory framework that the Council operates.

1.3 The strategy can be broken down into separate key elements that set out the Council's approach to capital, investment and treasury management:

- **Capital Overview** - asset management, capital expenditure planning, risk management and long-term sustainability of capital expenditure plans (**Section 2**)
- **Investment Overview** – setting out investment plans focusing on the approach to service and commercially led investment (**Section 3**);
- **The Treasury Management Strategy Statement (TMSS)** – setting out how we borrow and invest to support our capital financing requirement (**Section 4**)
- **The Minimum Revenue Provision (MRP) Policy** – setting out how we repay capital borrowing (**Included as Appendix A**).

1.4 Decisions made this year on capital, investment and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

1.5 The strategy will:

- Set out how we ensure that capital expenditure contributes to the achievement of corporate priorities;
- Explain how the Capital Programme is financed and demonstrates that it is affordable and sustainable;
- Explains the Council's approach to investments; and;
- Set out and fulfil the Council's regulatory requirements in respect of Borrowing, Treasury Management and Investment.

2 Capital Overview

Capital Expenditure and Financing:

2.1 The Council's intention in relation to capital investment is to ensure it can make a real and demonstrable impact on the economy and infrastructure of Tandridge by:

- **Investing in the District**, by attracting and securing significant amounts of external investment to supplement Council resources and deliver an enhanced district-wide infrastructure offer, and;
- **Prioritising regeneration investment** to develop the local economy, infrastructure and housing and to support job creation and promote local employment within the District.

2.2 The Council's capital expenditure and financing plans over the medium-term include an overview of the governance arrangements for approval and monitoring of expenditure and, in relation to commercial investment activities, sets out the due diligence process and the Council's risk appetite in respect of these, including proportionality in respect of overall resources.

2.3 The section includes a projection of the Council's capital financing requirement and how this will be funded and repaid. It links to the Council's borrowing plans and sets out the Council's statutory duty to make an annual revenue provision for the repayment of debt, detailed in the MRP Policy.

Capital Expenditure

2.4 Capital expenditure refers to Local Authority spending on assets such as infrastructure, property or vehicles that will be used for more than one year. In Local Government this includes spending on assets owned by other bodies and loans and grants to other bodies, enabling them to buy assets.

2.5 In the 2025/26 Budget and 3-year Capital Programme to 2027/28, the Council has a total capital expenditure requirement of £85.2m (2025/26 - 2027/28) as summarised in Table 1.

Table 1 - Estimates of Capital Expenditure

	2023/24 Actual £m	**2024/25 Forecast* £m**	**2025/26 Budget £m**	**2026/27 Budget £m**	**2027/28 Budget £m**	**Total 2025/26 to 2027/28 £m**
General Fund services	1.5	5.3	4.8	1.4	1.4	7.6
Community Infrastructure Levy (CIL) Funded	0.3	1.5	3.6	0	0	3.6
Council Housing (HRA)	13.7	21.7	26.6	27.5	19.9	74.0
TOTAL	**15.5**	**28.5**	**35.0**	**28.9**	**21.3**	**85.2**

* Month 6 Forecast

2.6 Our medium-term approach to financial planning means we can commit to a Capital Programme of c£85m over the next 3 years. The revenue implications of this proposed programme are integrated and factored into the financial planning over the Medium-Term Financial Strategy (MTFS) period.

2.7 In developing the capital expenditure estimates, we have ensured that borrowing costs remain in line with the revenue budget envelopes set out in the 2025/26 Budget and MTFS.

2.8 The main General Fund capital projects include Queen's Park flood alleviation & enhancement (£1.8m), Disabled Facilities Grant (£1.3m), delivery of the Council's Open Spaces Strategy from the UK Shared Prosperity Fund (£0.8m), IT Hardware and Infrastructure Projects (£0.7m), Garden waste, recycling, food waste and refuse bins (£0.4m), public conveniences (£0.7m), Children's Playground improvements (£0.6m) and Parks, Pavilions and Open spaces (£0.4m) and Vehicle Replacement (£0.5m).

2.9 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that Council Housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately.

2.10 The Council has specific arrangements for the management of capital expenditure to ensure they are aligned with the Council's priorities. The principles for governance of the capital programme are detailed in Appendix B. The separate approval process for the acquisition of investments in property is contained within the Investment Property Strategy (Appendix C).

2.11 Fundamentally, they are approved on the principles of value for money, affordability and deliverability. Projects need to demonstrate value for money and that they are capable of being delivered within expected timescales.

Capital Funding

2.12 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing). The planned financing of the above expenditure is as follows:

Table 2 - Capital Financing

	2023/24 Actual £m	2024/25 Estimate £m	2025/26 Budget £m	2026/27 Budget £m	2027/28 Budget £m	Total 2025/26 to 2027/28 £m
General Fund						
Grants & contributions	0.8	1.8	1.6	0.4	0.4	2.4
CIL	0.3	2.5	5.0	0	0	5.0
Internal resources	0.3	0	0	0	0	0
Borrowing	0.4	2.5	1.8	1.0	1.0	3.8
Total General Fund and CIL	**1.8**	**6.8**	**8.4**	**1.4**	**1.4**	**11.2**
HRA						
Grants & contributions	4.9	3.2	7.8	4.4	2.2	14.4
Internal resources	8.4	8.5	8.5	8.5	8.4	25.4

Borrowing	0.4	10.0	10.3	14.6	9.3	34.2
Total HRA	**13.7**	**21.7**	**26.6**	**27.5**	**19.9**	**74.0**
TOTAL	**15.5**	**28.5**	**35.0**	**28.9**	**21.3**	**85.2**

2.13 Borrowing is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). No MRP is charged in respect of assets held within the Housing Revenue Account – this is a feature of the HRA accounting rather than a choice by the Council.

2.14 Alternatively, proceeds from selling capital assets (known as capital receipts) may currently be used to replace debt finance. No use of receipts is currently assumed to repay existing debt.

2.15 Planned MRP is set out in the following table:

Table 3 - Repayment of Debt through Minimum Revenue Provision

	2023/24 Actual £m	**2024/25 Estimate £m**	**2025/26 Budget £m**	**2026/27 Budget £m**	**2027/28 Budget £m**
Minimum Revenue Provision	1.2	1.0	1.3	1.5	1.6

2.16 The Council's cumulative underlying requirement for debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure on service delivery and on investments and reduces with MRP and capital receipts used to replace debt.

2.17 The CFR is expected to increase by £10.8m during 2025/26, related primarily to the HRA. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4 - Prudential Indicator: Estimates of Capital Financing Requirement

	31/03/2024 Actual £m	**31/03/2025 Estimate £m**	**31/03/2026 Estimate £m**	**31/03/2027 Estimate £m**	**31/03/2028 Estimate £m**
General Fund services	25.3	27.1	27.8	27.6	27.1
Council housing (HRA)	62.0	72.5	82.8	97.4	106.7
Commercial activities/non- financial investments*	20.8	20.6	20.4	20.2	19.9
TOTAL CFR	**108.1**	**120.2**	**131.0**	**145.2**	**153.7**

** Commercial activities/non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.*

2.18 Our capital plans lead to an increase in the estimated CFR of £33.5m over the three-year period. The General Fund and Commercial CFR falls by £0.7m with the HRA CFR increasing by £34.2m. The revenue implications of this are set out below and the TMSS (Appendix D, section 6).

2.19 **Asset management and disposals:** The Council does not currently have a land disposal programme for the General Fund, although it is in the process of reviewing all of its assets to determine whether they should be retained, and, if so, for the optimum use. The current policy is to use any surplus land and property which is identified for housing purposes where feasible. If it is not feasible then general fund capital receipts will be realised. When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayment of capital grants, loans and investment also generate capital receipts. The Council is also permitted to spend capital receipts "flexibly" on service transformation projects. In 2025/26 the Council plans to use £0.5m of capital receipts flexibly for planning and finance transformation purposes.

2.20 The Council plans to receive £1.8m of capital receipts in 2025/26. Expectations for future years are set out in the table below:

Table 5 - Capital Receipts Receivable

	2023/24 Actual £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
HRA Disposals	1.8	1.8	1.8	1.8	1.8
GF Disposals	0	0	0	0	0
Loans repaid	0.3	0.3	0	0	0
TOTAL	**2.1**	**2.1**	**1.8**	**1.8**	**1.8**

Revenue Budget Implications

2.21 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. This is referred to as net financing costs.

2.22 Current projections show that the net financing cost will be contained within budget projections over the MTFS, rising from -£0.2m net in 2024/25 to £1.6m net in 2027/28. The net costs of financing our capital plans are set out in the table below.

Table 6 – Net Finance Cost Budget

	2023/24 Actual £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
MRP	1.2	1.0	1.3	1.5	1.6
Interest Payable (GF)	1.1	1.2	1.3	1.3	1.4
Investment Income and property income	(2.2)	(2.3)	(2.2)	(2.1)	(2.0)
Net Finance Cost	**0.1**	**(0.2)**	**0.4**	**0.7**	**1.0**

2.23 The proportion of net finance cost to net revenue budget is a key indicator of direction of travel relative to medium term revenue resources and provides insight into the affordability of finance costs (see TMSS Appendix D, Annex 1, Table 2).

Financial Sustainability

2.24 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred over the MTFS will extend for up to 50 years into the future. The Section 151 Officer is satisfied that the proposed Capital Programme is prudent, affordable and sustainable because it remains proportional to the Council's overall revenue budget.

Environmental Sustainability

2.25 Capital expenditure over the planning period includes schemes that will contribute to carbon reduction, action on climate change. The Council will continue to take direct action on environmental sustainability for future generations as part of the Carbon Net Zero targets set for 2050. All new council properties aim to be net carbon zero (operational) and the council is engaging with a specialist energy consultant at the design and planning stage of new schemes to make sure the use of renewable energy is maximised, as well as energy saving measures to reduce emissions. The first net zero carbon homes were completed in July 2024.

3 Investment Overview

3.1 In addition to service-led capital expenditure, the Council has invested its money for a further two broad purposes:

- To support local public services by setting up, lending to or buying shares in other organisations (service investments) such as to its Leisure Service Provider and in its Property subsidiary, Gryllus Property Ltd, to generate revenue income;
- As a result of surplus cash from its day-to day activities, for example when income is received in advance of expenditure (known as treasury management investments)

3.2 This investment strategy meets the requirements of the statutory guidance issued by the Government in January 2018.

3.3 The statutory guidance defines investments as “all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios.” The Council interprets this to exclude (a) trade receivables which meet the accounting definition of financial assets but are not investments in the everyday sense of the word and (b) property held partially to generate a profit but primarily for the provision of local public services. This aligns the Council’s definition of an investment with that in the 2021 edition of the CIPFA Prudential Code.

Service and Property Investments: Loans

3.4 **Overview:** The Council invests money in its subsidiary, Gryllus Property Limited and other organisations to support local public services and stimulate local economic growth, for example Freedom Leisure.

3.5 **Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk and ensure that total exposure to service loans remains prudent, decisions on service loans are made in the context of their value, the stability of the counterparty and an assessment of the risk of default. The current value of service loans is set out as follows:

Table 7 - Loans

Category of borrower	**31.3.2024 actual**		
	Balance owing	**Loss allowance**	**Net figure in accounts**
Subsidiaries	15.1	0	15.1
Suppliers	0.3	0	0.3
TOTAL	**15.4**	**0**	**15.4**

3.6 The strategy does not propose an approved limit for these investments since any increase should be subject to further Member approval.

3.7 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council’s Statement of Accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum advanced and has appropriate credit control arrangements in place to recover overdue repayments.

3.8 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding service loans by reference to their financial position, past experience and other factors. We wholly own our subsidiaries for service purposes and so their financial position is subject to the same rigour and control as that of the Council.

Service and Property Investments: Shares

3.9 **Security**: One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. To limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 8 – Shares held for service purposes

Category of company	**31.3.2024 actual**		
	Amounts invested £m	**Gains or losses £m**	**Value in accounts £m**
Subsidiaries	5.3	0	5.3
TOTAL	**5.3**	**0**	**5.3**

3.10 The strategy does not propose an approved limit for these investments since any increase should be subject to further Member approval.

3.11 **Risk Assessment:** The investment in shares totalling £5.3m is within the Council's subsidiary Gryllus Property Limited. The Authority assesses the risk of loss before entering into and whilst holding shares by assessing the current and future return achievable and the level of security provided by the assets of the company, and the level of control which the Council can exert over the strategy of the company. The Council has created an Income Equalisation Reserve, with a current balance of c£0.3m to finance any diminution in value and income volatility. The Income Equalisations Reserves will help mitigate the risk of any loss of income from the Council's investments allowing time to formulate plans to address any longer-term reductions in income.

3.12 **Liquidity:** The funding of long-term investments in the Council's subsidiary are financed by fixed long term borrowing, so that there is no short or medium-term risk to the liquidity of the Council, which would require the Council to be forced to liquidate its assets in the company.

3.13 **Non-specified Investments:** Shares are the only investment type that the Authority has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Authority's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

3.14 **Governance:** Decisions on service investments are agreed by Management Team, led by the Chief Executive in consultation with the Director of Resources and must meet the criteria and limits laid down in the Investment Property Strategy. Loans and shares are capital expenditure and their purchase will therefore also be approved by Members as part of the capital programme.

Property Investments

3.15 **Overview:** The Council holds investments in local commercial property; office space and leisure, with the intention of supporting Tandridge's economy and generating a surplus that will be spent on local public services. The table below shows the value of our investments by main category, including those under construction where the ultimate use is to be determined.

Table 9 – General Fund Property held for socio economic and/or development purposes

Property Type	**Actual**	**31/03/2024 Actual**	
	Purchase cost £m	**Gains or (losses) £m**	**Value in accounts £m**
Offices	20.0	(4.3)	15.7
Leisure	0.9	0.0	0.9
TOTAL	**20.9**	**(4.3)**	**16.6**

3.16 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

3.17 A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. The Council holds these properties for socio economic and/or development purposes, short-term fluctuation in investment values can be expected. Should the 2024/25 year-end Accounts preparation and audit process value these properties below their purchase cost, we will take mitigating actions to protect the capital invested, such as exploring alternate uses where appropriate, in consultation with Committee.

Proportionality

3.18 The Council's revenue budget includes an element of profit generating investment activity to support services. The table below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the MTFS. Investment activity is forecast to remain at approximately 6% of the Council's net revenue stream over the medium-term. Should we fail to achieve the expected net profit, the Council would manage the impact on budget through use of the income equalisation reserve in the current financial year and a re-assessment of efficiency plans for the remainder of the medium-term.

Table 10: Proportionality of Investments

	2023/24 Actual £m	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**	**2027/28 Estimate £m**
Net Revenue Stream (£m)	11.9	12.8	13.8	13.4	13.4
Investment rental income (£m)	0.8	0.8	0.8	0.8	0.8
Proportion (%)	7%	6%	6%	6%	6%

Investment Indicators

3.19 The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

3.20 **Total risk exposure:** The first indicator shows the Council's total exposure to potential investment losses. This would include amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans. No such commitments exist.

Table 11: Total investment exposure

Total investment exposure	**31/03/2024 Actual £m**	**31/03/2025 Estimate £m**	**31/03/2026 Estimate £m**
Treasury management investments	15.0	15.0	15.0
Service investments: loans	15.4	15.1	15.1
Service investments: shares	5.3	5.3	5.3
Commercial investments: Property	17.2	17.2	17.2
TOTAL INVESTMENTS	68.3	60.8	50.6

3.21 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Councils, including TDC, do not generally associate borrowing with individual assets, since we borrow as required to fund the whole portfolio of capital spend. However, the following investments could be described as being funded from capital sources, including borrowing and receipts. The remainder of the Council's investments are funded by Usable Reserves and income received in advance of expenditure.

Table 12: Investments funded by borrowing

Investments funded by borrowing	**31/03/2024 Actual £m**	**31/03/2025 Estimate £m**	**31/03/2026 Estimate £m**
Service investments: loans	15.4	15.1	15.1
Service investments: shares	5.3	5.3	5.3
Commercial investments: Property	17.2	17.2	17.2
TOTAL FUNDED BY BORROWING	33.9	33.6	33.3

3.22 **Rate of return received:** This indicator shows the investment income received as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Investments net rate of return	**2023/24 Actual £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2025/26 Estimate %**
Treasury management investments	1.2	1.0	1.0	5%
Service investments: loans	0.9	0.9	0.9	5%
Service investments: shares	0	0	0	0%
Commercial investments: Property	0.5	0.7	0.7	4%
ALL INVESTMENTS	2.6	2.6	2.6	

4. Treasury Management Strategy Statement 2025/26

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

4.2 Treasury risk management at the Authority 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 Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

4.3 The Council's Treasury Management Strategy Statement and associated annexes can be found at Appendix D.

APPENDIX A

Annual Minimum Revenue Provision (MRP) Policy Statement 2025/26

When the Council finances capital expenditure by debt (borrowing), it must put aside resources to repay that debt in future years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP). The Council is required by statute to make a prudent provision for the repayment of its debt. It is also required to 'have regard' to guidance on how to calculate this provision, issued by the Ministry of Housing, Communities and Local Government, most recently in 2024.

The broad aim of the DLUHC Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by revenue grant, reasonably commensurate with the period implicit in the determination of that grant.

MHCLG regulations have been issued which require the Full Council to approve an Annual MRP Statement in advance of each year. A variety of options for the calculation of MRP are provided to councils, so long as there is a prudent provision.

General Fund Capital expenditure incurred during 2025/26 will be fully subject to a MRP charge from 2026/27 onwards, or in the financial year after the asset becomes operational.

For **all** General Fund unsupported borrowing, MRP will be calculated using the Asset Life – Annuity Method, as the principal repayment on an annuity starting in the year after the asset becomes operational.

For the following types of capital expenditure, the Council has determined that an alternative methodology for determining the annual MRP charge should be adopted:

- Where loans are made to other bodies for their capital expenditure, e.g. subsidiaries of the Council, MRP is charged as with any other asset.
- For capital loans made on or after 7th May 2024 where an expected credit loss is recognised during the year, the MRP charge in respect of the loan will be no lower than the loss recognised. Where expected credit losses are reversed, for example on the eventual repayment of the loan, this will be treated as an overpayment.
- For capital loans made before 7th May 2024 and for loans where expected credit losses are not applicable, where a shortfall in capital receipts is anticipated, MRP will be charged to cover that shortfall over the remaining life of the assets funded by the loan.

Capital receipts - proceeds from the sale of capital assets are classed as capital receipts and are typically used to finance new capital expenditure. Where the Authority decides instead to use capital receipts to repay debt and hence reduce the CFR, the calculation of MRP will be adjusted as follows:

- Capital receipts arising on the repayment of principal on capital loans to third parties will be used to lower the MRP charge in respect of the same loans in the year of receipt, if any.

- Capital receipts arising on the repayment of principal on finance lease receivables will be used to lower the MRP charge in respect of the acquisition of the asset subject to the lease in the year of receipt, if any.

- Capital receipts arising from other assets which form an identified part of the Authority's MRP calculations will be used to reduce the MRP charge in respect of the same assets over their remaining useful lives, starting in the year after the receipt is applied.

- Any other capital receipts applied to repay debt will be used to reduce MRP in 10 equal instalments starting in the year after receipt is applied.

No MRP will be charged in respect of assets held within the Housing Revenue Account. This is in accordance with proper accounting practice where the HRA is instead charged for depreciation of assets.

APPENDIX B

CORPORATE GOVERNANCE

<u>Extended Management Team</u>

Extended Management Team (EMT), which comprises the Heads of each Service led by the Chief Executive, is the officer body for Capital Investment development and planning and is charged with bringing forward funded capital expenditure plans for approval by the Strategy and Resources Committee. The Committee considers capital expenditure and funding plans, monitors performance through a series of regular capital monitoring reports and recommends the annual Capital Programme to Council for approval.

All capital investment will be commissioned on the recommendation of the EMT which will enable any expenditure and its funding to be aligned with the Council's Capital Priorities and funding sources.

<u>Approval of Capital Investment</u>

Fundamentally, capital projects are approved on the principles of strategic fit, value for money, affordability and deliverability. Projects need to demonstrate value for money and that they are capable of being delivered within expected timescales.

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (largely borrowing and leasing)

Within the Council, a concept for a potential capital project will originate from, or at least be 'owned' by the Head of Service. The 'owner' should prepare or direct the preparation of a Strategic Business Case (SBC) for the proposed project. The Strategic Business Case outlining the initial idea or 'concept' for a project should be submitted to EMT for consideration.

If EMT is satisfied that the proposal meets investment criteria, it will be given approval to progress to Stage 2 of the process – the completion of an Outline Business Case (OBC).

The OBC builds on the SBC providing more detailed information including the benefits that could be realised focusing on the links to the Council's Capital Investment Priorities and the proposed outcomes and may include several options to deliver the proposed benefits. The OBC will be submitted to the EMT for consideration, and if it is satisfied with the proposal will give guidance for the development of a preferred option.

Stage 3 of the process entails the completion of a Final Business Case (FBC) which will then be submitted to EMT for final consideration. Again, building on the OBC, the FBC will contain evidence of a:

- Full option appraisal;
- Detailed financial analysis of all costs/income including how the project is financially sustainable and that any adverse revenue implications can be dealt with within existing budgets;

- Robust delivery plan including how the chosen option delivers the highest impact in achieving the required outcomes with identified key project milestones enabling progress review. Included within the delivery plan should be proposed consultation arrangements, value for money assessment equality and environmental impact assessments;
- Risk assessment and that appropriate actions to negate these risks have been identified;
- Full exit strategy where the project involves a disposal; and
- Method of procurement that represents value for money.

Depending on the circumstances of the bid for resources, EMT has the discretion to vary the three-stage review process and omit one or more of the stages. Once Final Business Cases have been agreed, these bids will be prioritised against agreed criteria. The business case will be subject to peer review.

The results of this process will be presented to Members for approval each year as part of the capital budget setting process, or during the year if projects come forward outside the normal timeframe.

Service Challenge & Review, Efficient Use of Assets

With regard to the review of operational assets, the Asset Management Team and services continue to work closely with service managers alongside wider public and third sector partners to ensure that portfolios are best fit for purpose and efficient usage is maximised.

The Chief Executive and EMT will oversee any acquisition and disposal of land and property assets and monitors the progress of any corporate disposals and performance of the investment portfolio.

In terms of acquisition of property there is a specific process for this under Financial Regulation 17 to enable proposals to progress in year, with appropriate Member approval. Details of this are set out in the Investment Property Strategy.

Performance Monitoring of Capital Programme

The capital expenditure investment approach above is supported by a strong programme management process to ensure a coordinated corporate approach. This will ensure that investments are planned, managed and delivered prudently.

EMT has a remit to review the financial performance of the capital programme and it receives a monthly monitoring report. In addition, financial monitoring reports will be considered by Service Committees periodically throughout the year, together with a capital outturn report. Issues that have been considered and agreed at EMT can be reported to Service Committees as necessary via the regular financial monitoring reports.

Budget managers are responsible for monitoring expenditure throughout the financial year and provide forecasts against budget, commentary on variances and an assessment of deliverability and risk as part of the monthly capital monitoring process. Finance support budget holders to provide robust information that can be relied upon to take actions to mitigate overspends and make best use of Council resources to deliver intended outcomes.

The undertaking of the detailed annual review of the capital programme provides the opportunity to review all schemes or focus on specific areas of concern.

Where a potential cost overrun has been identified, EMT will explore possible solutions in detail. It will also consider any underspending or identified surplus resources which can be added to the central pool of resources. EMT may also suggest a reallocation of resources to other projects.

Where there is a delay in the commitment of programme/project resources, the EMT will require project managers to report the reasons for the delay and consider whether it would be appropriate to recommend the decommissioning of the project and the reallocation of un-ring-fenced resources to other projects.

APPENDIX C

INVESTMENT PROPERTY STRATEGY 2025/26

Introduction

1. The Investment Property Strategy forms part of the Council's overall Capital Investment & Treasury Management Strategy and is included with the performance monitoring and reporting procedures.

2. The returns from property investment will contribute positively towards the achievement of savings targets and budgets to enable the continued delivery and investment in key frontline services and/or the bolstering of financial reserves whilst achieving a balanced budget.

3. The Investment Property Strategy aims to provide a robust and viable framework for the acquisition of property towards the pursuance of redevelopment and regeneration opportunities that can deliver positive returns and significant benefits to our residents, businesses and communities.

4. The strategy is to set out how the Investment Property Portfolio will be managed and covers the following matters:

    - Objectives and strategic priorities for Investment Property;
    - Governance and performance reporting arrangements;
    - Risks;
    - Portfolio Mix;
    - Funding, Performance monitoring and Financial Indicators for Investment; Property
    - Investment evaluation criteria;
    - Acquisition procedure; and
    - Disposal Procedure

Background

5. The Local Government Act 2003 (the Act) and supporting regulations requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and MHCLG Investment Guidance (the Guidance) to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

6. The Local Government Act 1972 – Section 120 of the Local Government Act 1972 empowers local authorities to acquire by agreement "any land whether situated inside or outside their area for the purpose of any of their functions under this or any other enactment, or for the benefit, improvement or development of their area".

7. The Localism Act 2011 – Part 1, Section 1 of the Localism Act 2011. Local Authorities are allowed to confer powers for a commercial purpose or for the benefit of the Authority, its area or residents.

Government Guidance

8. In February 2018 the Secretary of State issued new guidance on Local Government Investments (the Guidance) which widened the definition of an investment to include all the financial assets of a Local Authority as well as non-financial assets held primarily or partially to generate a profit.

9. The Guidance requires the Investment Property Strategy to be approved by Full Council on an annual basis and sets out the disclosure and reporting requirements. Any mid-year material changes will also be subject to Full Council approval. Further CIPFA guidance issued in November 2019 reinforces the need for a comprehensive Investment Property Strategy.

10. In November 2020 HM Treasury published their conclusions from the consultation regarding the use of monies lent by the Public Works Loan Board (PWLB). "In recent years a minority of local authorities have borrowed substantial sums from the PWLB to buy investment property with the primary aim of generating yield".

11. New guidelines were introduced for PWLB borrowing which excludes local authorities from all future PWLB borrowing (whatever the purpose) if any projects within an Authority's three year capital programme were for the primary purpose of generating yield. Losing access to PWLB borrowing would cause significant problems and increase costs, in particular for the funding of affordable housing development and essential works through the Housing Revenue Account. Other sources of finance are unlikely to be at such competitive levels.

12. The latest edition of the Prudential Code for Capital Finance was released in December 2021. The main elements of the Code in relation to commercial property are as follows.

    The Prudential Code determines that certain acts or practices are not prudent activity for a Local Authority and incur risk to the affordability of Local Authority investment:

    - 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.

    - The UK Government's rules for access to PWLB lending at the date of this publication require statutory Chief Finance Officers to certify that their Local Authority's capital spending plans do not include the acquisition of assets primarily for yield, reflecting a view that Local Authority borrowing papers are granted to finance direct investment in local service delivery (including housing, regeneration and local infrastructure) and for cash flow management, rather than to add debt leverage to return-seeking investment activity.

Since access to the PWLB is important to ensure Local Authorities' liquidity in the long term, and leveraged investment always increases downside risks, local authorities must not borrow to fund acquisitions where obtaining financial returns is the primary aim. Authorities with existing commercial investments (including property) are not required by this Code to immediately sell these investments. However, Authorities which have an expected need to borrow should review options for exiting financial investments for commercial purposes in their annual treasury management or investment strategies. The options should include using the sale proceeds to repay debt or reduce new borrowing requirements. They should not take new borrowing if financial investments for commercial purposes can reasonably be realised instead, based on a financial appraisal which takes account of financial implications and risk reduction benefits. Authorities with commercial property may also invest in the repair, renewal and update of their existing commercial properties.

Objectives and Strategic priorities for the Property Investment Portfolio

13. The objective of the Investment Property Strategy is to establish a framework for the identification of property investments which, if acquired, would either provide economic, social and environmental benefits to residents and businesses and/or development opportunities for the District.

14. The Council has moved away from acquisitions of commercial property for yield. Nevertheless, the Investment Evaluation Criteria (Annexe A) and the Acquisition and Disposal Procedure (Annexe B) remain applicable as they cover good practice of all property purchase circumstances.

15. In delivering the strategy over the next year the following main priorities are to be used to guide the growth of the investment property portfolio:
    a) A major driver for acquisition of new investment property will be economic benefit for the residents of the Council either through protection of commercial space or employment generation/protection.
    b) Properties that have a development potential will also be considered for their long-term benefits.

    Investments will be mainly focused within the District boundary. It is not considered that there will be many opportunities for properties outside the District over the next three years of the Strategy which will align with the Council's priorities

16. Investment relating to the Strategy will be directed towards:-

Regeneration and Development Opportunities

17. Investment which can facilitate/generate regeneration or economic development benefits as well as positive financial returns for the Council. Financial returns for the Council may come in the form of increased business rates or New Homes Bonus where the investment is within the District.

18. The Contributions from Regeneration and Development Investments will include positive financial returns for the Council and may also include the following:
    - Regeneration benefits for the area including employment opportunities;
    - Economic benefits for the area;
    - Social value improvements e.g. place-making, public realm space, pride in one's local area and surroundings; and
    - Environmental improvements e.g. demolition or refurbishment of old, inefficient and/or vacant/unsightly properties.

19. Economic, social and environmental benefits collectively make up the strategic value of an asset, and collectively, they can drive inward private investment and prosperity for an area.

Governance and Performance

20. The Strategy and Resources Committee will be responsible for approving the strategic priorities and the arrangements set out in this policy. There will be an annual report to the Committee that will set out performance over the previous year and plans for the next.

21. Operational management, including acquisitions is to be delegated to officers acting within Financial Regulation 17 of the Council Constitution.

22. The Council recognises that investing in land and properties is a specialist and potentially complex area. The Council will require the services of professional property, legal and financial advisers, where appropriate, in order to access specialist skills and resources to inform the decision-making process associated with the strategy.

23. The lead officer for Asset Management shall lead on potential purchases and development opportunities that meet the pre-determined selection criteria contained within the strategy. The criteria to evaluate potential acquisitions is attached as **Annexe A**. The Asset Management team will identify opportunities based on the selection criteria, will co-ordinate all necessary due diligence in accordance with the Acquisition Procedure (**Annexe B**), and will present a business case for challenge and scrutiny to the relevant Committee or Chief Executive as required under Financial Regulation 17.

24. CIPFA Guidance requires that elected members and officers involved in the investment decision-making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment. In addition, it places a duty on the council to ensure that advisors negotiating deals on behalf of the Council are

aware of the core principles of the prudential framework and the regulatory regime in which the Council operates.

25. The Council recognises that it is responsible for property investment decisions at all times and will ensure that undue reliance is not placed upon our external service providers.

26. The lead officer for Asset Management is to be accountable for the performance of the Investment Property Portfolio and will be charged with making recommendations to the Chief Executive for acquisitions.

27. Disposal of Investment Property assets are to be undertaken in accordance with the Council's Financial Regulations and delegated Authorities. The lead officer for Asset Management will make recommendations to the Strategy & Resources Committee and in accordance with officer delegated powers.

28. The Council's Constitution sets out delegations to Officers in respect of the acquisition and disposal of assets.

Risk Assessment

29. Property investment has its own specific risks, set out below:

    a) **Property Risks** – the property market is cyclical and is affected by the wider economic environment. There are also property risks that are specific to a building due to its location, condition and quality of the tenants. Mitigation proposed in this policy for these risks include diversifying the portfolio (portfolio mix) to include investments that perform during different cycles of the economic cycle. The evaluation criteria, diversity of location, due diligence tests, approval processes and accountability for implementation are also proposed to address property specific risks;

    b) **Financial Risks** – the primary financial risks are borrowing levels, interest rate movement, ongoing ability to service debts, the general investment market conditions and its effect on rental income. Proposals have included the creation of a fully owned subsidiary property investment company, Gryllus Property Ltd and a funding strategy that allocates debt and all associated costs to the investment property portfolio so that the net revenue benefits to the Council is transparent and can be benchmarked; and

    c) **Corporate Risks** – effective delivery of the Strategy requires staff with the requisite expertise, effective arrangements for asset management and the recognition of the reputational risks that can come from inappropriate tenants and from legal and environmental breaches. In accordance with the Statement of Investment beliefs as we are investing public money we will be sensitive to the ethical considerations of local residents.

30. The Council assesses the risk of loss before entering into and whilst holding property. The approach is laid out in **Annexe A** – Investment Evaluation Criteria.

Liquidity

31. Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. The funding of long-term investments is financed by fixed long term borrowing, so that there is no short or medium-term risk to the liquidity of the Council, which would require the Council to be forced to liquidate its asset and suffer a loss nor impact upon the Council's provision of services. As these long-term investments are matched by long term borrowing, it will not be necessary to access the invested funds in an emergency. Investments in property are not undertaken unless they are secure over the medium term, have additional socio- economic benefits and the target rate of return significantly exceeds the annual cost of borrowing.

Portfolio Mix

32. The medium and long term aims of the Strategy have been adjusted following the publication of the HM Treasury consultation to:

    a) Acquire properties within the District in areas with strong sustainable economic activity i.e. areas with the environmental and business activities capable of providing an economy whereby capital and rental growth over the mid to long term was possible;
    b) When making investments the Strategy and Resources Committee will have regard to other economic and social benefits for the residents of Tandridge; and
    c) Achieve a balanced portfolio where after 6 (was 4) years[1] no single class of property, ie retail, industrial, office and leisure is larger than 60% and none smaller than 10%, other than retail or leisure.

Contribution

33. The Council has previously invested in commercial property with the intention of making a surplus that will be spent on local services and for socio- economic benefits. The portfolio is at an early stage of development.

34. Table 1 shows the properties currently held by Tandridge District Council for Investment Purposes, by type:

Property by Type	**Value in Draft Accounts 31st March 2023**	**Value in Draft Accounts 31st March 2024**
Offices & Mixed/other	£16,236,300	£15,704,900
Leisure	£972,800	£944,900
Total	**£17,209,100**	**£16,649,800**

[1] Change made in 2020/21 Investment Property Strategy

Values taken from external annual valuations by Wilkes, Head & Eve

35. Investments held under Gryllus Holdings are reported separately.

36. Income from Investment Property

	2023/24 Actual	**2024/25 Forecast**
Income	£905,506	£905,000

Funding and Financial Performance of the portfolio

37. The Council will fund investment property acquisitions by utilising the most appropriate and efficient funding strategy available at the time of purchase. The Council has the option of utilising long term prudential borrowing, capital receipts or reserves. Financing decisions will link to the Council's Capital & Investment Strategy and Treasury Management Strategy.

38. All new acquisitions are to achieve an appropriate positive return net of borrowing and other costs associated with the acquisition. Properties purchased for redevelopment, refurbishment or regeneration may not provide an immediate positive return. These will be assessed through a business case and considered by Strategy & Resources Committee

39. Separate accounts are to be kept for income and expenditure in connection with investment property and are to be included in the annual report to the Strategy & Resources Committee.

40. Key Indicators have been adopted to monitor performance of the portfolio. Performance will be reported against the following indicators along with a property market narrative:

- **Total Return** – the annual increase in capital value plus income expressed as a percentage of the previous year's capital value (adjusted to include purchases);
- **Effective Return** – total return receivable less costs expressed as a percentage of the previous year's capital value;
- **Growth in Asset Value** – Percentage increase per year;
- **Income Growth** – Percentage increase in gross income per year; and
- **Vacancy Rate** – Expressed as a percentage and number of vacant units compared with total number of units. This will also be expressed in terms of lost rental. Void periods are factored into financial appraisals as part of the assessment criteria.

	2021/22	2022/23	2023/24
A) Total Return	-2.20%	0.2%	2.52%
B) Effective Return	-5.9%	-3.6%	-3.7%
C) Growth in Asset Value	-6.3%	-3.4%	-3.25%
D) Income Growth*	n/a	-21.8%	19.4%

E) Vacancy Rate	Redstone House was sold. Quadrant House is 31% vacant by floor area	Quadrant House vacancy was 31%	Quadrant House vacancy was 22%

* Net income reduced by 36.3% from 2020/21 (£746,000) to 2021/22 (£475,429).

Due to a lease renewal and associated incentive in 2022/23, rental income against the portfolio dropped by c.£232k. This is expected to be recovered in 2023/24.

41. In addition to property specific performance indicators are quantitative indicators that will be reported within the Council's Capital & Investment Strategy and Treasury Management Strategy to allow Councillors and the Public to assess a local authority's total risk exposure as a result of property investment decisions.

42. The operating cost of the Council's internal Strategic Asset Management Team excluding the Housing Development Specialists is projected to be £237k (£152k in 2023/24). The increased budget allocated to the service reflect changes in the management structure and the latest estimate of the proportion of costs within the team charged to the capital programme. Overall, the team is unchanged in staffing numbers and the changes are part of a wider saving against the management structure delivered in 2022/23 and 2023/24. The costs reflect the cost of managing the Council's entire property portfolio and *functions*, not just the assets acquired under this Property Investment Strategy. Additional costs may be incurred if new commercial activity takes place. Any such costs will be factored into the financial appraisals as part of the assessment to ensure that anticipated net rates of return are achieved.

Investment Property Strategy – Annexe A

Investment Evaluation Criteria

41. As with other forms of investment at the most basic level, property investment is a trade-off between risk and return. A traditional well diversified property portfolio (spread across different property sectors and geographical areas) will deliver long-term rental and capital growth with relatively low risk.

42. Prime property in the target region covered by this strategy will typically provide an initial yield of between 5 –7% with the additional prospect of capital growth leading to a higher total return to the Council. Equivalent /Income yields over longer periods will also be reported.

43. The four main commercial property sectors will be included (industrial, office, retail and leisure) and in turn, these will be additionally diversified on criteria including location, the lease term and lot size. This will assist in protecting the Council's overall risk return profile should an individual property investment cease to be income producing (for example, it is undergoing refurbishment or awaiting a new tenant). Residential and mixed used sites will be considered using similar criteria albeit for residential investments lease terms and repairing obligations are likely to be very different. Regeneration opportunities and potential development sites will be considered using additional criteria, including if a development appraisal shows strong potential or if there is strong asset management potential.

44. The following Criteria are to be used to make decisions on acquiring new property investment properties:

    a. **Location** – Property is categorised as prime, secondary or tertiary in terms of its location desirability. For example, a shop located in the best trading position in the town would be prime, where as a unit on a peripheral neighbourhood shopping parade would be considered tertiary;
    b. **Tenant covenant** – the financial strength of a tenant determines the security of the property is rental income. A financially weak tenant increases the likelihood that the property will fall vacant. The minimum acceptable financial strength for any given tenant will be determined through financial appraisal of company accounts and the use of appropriate methods of risk assessment and credit scoring. To minimise management and risk, the preference will be for single occupancy investments wherever possible;
    c. **Lease terms** – the lease is to be free from unencumbered/onerous terms. The lease must have mechanisms for the rent to be periodically reviewed to take into account inflation and upward market movement;
    d. **Occupational lease length** – the lease term will determine the duration of the tenant's contractual obligation to pay rent. The most attractive investments offer a long lease with a strong tenant covenant. The lease term will reflect any tenant break clause;
    e. **Building quality** – a brand-new or recently refurbished building will not usually require capital expenditure for at least 15 years. This is attractive for income

investors requiring long-term rental income with a minimum of ongoing capital expenditure;

f. **Tenure and Title** anything less than a freehold acquisition will need to be appropriately reflected in the price. The legal title is required to be clean and free from any onerous conditions;
g. **Tenant repairing obligations**. – Under a full repairing and insuring lease (FRI), the tenant is responsible for the building's interior and exterior maintenance/repair. The obligation is limited to the building's interior under an internal repairing and insuring lease (IRI). The preference will be to favour FRI terms (or FRI by way of service charge i.e. all costs relating to occupation repairs are born by the tenants administered through a service charge; and
h. **Lot size** – to maintain portfolio balance the preference will be for no single property to exceed £25 million for a single let property.

In addition, it must -

a. Have passed a **building and plant survey;**
b. Show a **positive return** after making allowance for financing costs, borrowing repayments and other associated costs;
c. Be supported by an Independent **RICS Red Book Valuation;** and
d. Be accompanied by a **full business case report** prepared by the Executive Head of Communities and other officers where relevant.

Each potential property investment will undergo a quantitative and qualitative appraisal and risk assessment to establish portfolio suitability and the legal and financial implications of the purchase.

All due diligence findings will be included in the reporting procedure. The business case is to include reference to all areas above, the financial modelling, a risk assessment matrix and Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis.

An investment opportunity that does not meet the minimum criteria and investment criteria may have separate investment or regeneration benefits and therefore may be considered separately under the regeneration and development stream of the strategy.

For a regeneration or development opportunity to be considered by the Council it must:

a. Deliver a rate of return commensurate with the deemed level of risk associated with the investment. The financial returns from regeneration activities may be capital rather than revenue. If the returns are capital all the full costs will be capitalised; and
b. Be accompanied by a full business case prepared by officers.

45. Some of the above criteria may be reconsidered if the property is of strategic value to the Council and has gained Strategy & Resources Committee Approval. Strategic Value may be seen where a property is close to significant Council land ownership, a property gives economic benefits through Council ownership and or there are opportunities to change the use in accordance with Council priorities.

Investment Property Strategy - Annexe B

Acquisition Procedure

46. Acquisition of new investment properties is to follow the following process:

<table>
<tr><th>Activity</th><th>Acquisition Stage and Timeline Guide</th></tr>
<tr><td>a) Property identified as a potential investment by Asset Management or by Agents
b) Property to be discussed with in house Legal team for initial review
c) Lead officer for Asset Management to notify Chief Executive and the Statutory Officers (includes Head of Legal & Chief Finance Officer) of potentially suitable property and summarise to seek views
d) If possible, obtain desktop valuation from suitably qualified and experienced Valuer
e) Review the valuation against the cost of Borrowing with Finance
f) Finance to undertake search of tenant to ascertain the tenant’s current financial status
g) Finance to produce initial financial appraisal</td><td>Initial Review
2 to 3 weeks</td></tr>
<tr><td>h) Make offer for property, subject where appropriate to any of the following:
Contract
Approval by Chief Executive, or relevant Committee
RICS Red Book valuation carried out by external Registered Valuer (independent of introducing Agent)
Searches
Legal due diligence to include receipt and analysis of all leases to determine landlord’s financial obligations
Disclosure of freehold title and review to ensure clear of any onerous restrictions.
Pre-acquisition survey by chartered building surveyor to include, if appropriate, structural, mechanical and electrical survey
Internal inspection
Valid Energy Performance Certificate
Disability Discrimination Assessment if appropriate
Environmental desktop study if search suggests one is appropriate</td><td>Under Offer
3 to 4 weeks</td></tr>
</table>

• Asbestos or other contamination survey if appropriate • Resolution of any TUPE transfer implications • VAT • Insurance requirements • Tax implications If offer accepted: i) Instruct legal services to deal with contract documentation, searches and legal due diligence j) Instruct valuation k) Instruct surveys l) If appropriate based on any of the above, propose adjustment to purchase price to reflect the monetary value of any issues discovered.	
m) Complete any outstanding surveys/ M&E reports and resolve all contractual matters before exchange n) Complete TDC Strategic Asset Management Acquisition Checklist o) Complete full Business Case for approval in accordance with Financial Regulation 17. p) Following agreement of terms and before instructing exchange of contract prepare Record of Officer Delegated Decision Notice and advise Leader of the Opposition and Ward Councillors if located in the District prior to publication date q) Arrange for transfer of funds r) Arrange Insurance Cover s) Exchange Contracts, if not simultaneous with Completion	Exchange 1-2 weeks
t) Complete purchase. All Documents and Management handed over to Asset Management to take forward as appropriate.	Completion 1 day

47. Newly purchased property acquired under this strategy would be added to the existing portfolio. The Asset Management Team would undertake management to maintain and improve the performance of an investment property; or additional specialist resources may need to be brought in as required.

Disposal Procedure

48. Properties will be considered for sale based on their performance and fit for the portfolio.

49. Any property considered for sale should be appropriately marketed. If an off-market approach is made and considered the property would not be sold unless the price offered is in excess of an independent Red Book Valuation to support such a decision

50. A property will be disposed of in accordance with the Financial Regulations of the Council's Constitution and in line with the Delegated Authority provisions in place. The lead officer for Asset Management will make recommendations to the Strategy & Resources Committee and in accordance with officer delegated powers.

APPENDIX D

Treasury Management Strategy Statement 2025/26

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 typically sees cash surpluses 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 Managing the cost of the Council's borrowing is at the heart of the Treasury Management Strategy (TMS) and we work proactively with our Treasury Management advisor, Arlingclose on a continual basis, to ensure that our approach represents the best balance between minimising cost and managing the risk of interest rate changes. Regular meetings with Arlingclose coincide with Bank of England Monetary Policy Committee meetings, however our strategy is under constant review throughout the year, and we can call on Arlingclose's expertise whenever required.

1.6 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 2024 – to highlight the range of debt and investments from the prior year accounts.
- Glossary of Terms

2. **External Context**

Economic background (provided by Arlingclose).

The impact on the UK from the government's Autumn Budget, slower interest rate cuts, modestly weaker economic growth over the medium term, together with the impact from President-elect Trump's second term in office and uncertainties around US domestic and foreign policy, will be major influences on the Authority's treasury management strategy for 2025/26.

The Bank of England's (BoE) Monetary Policy Committee (MPC) reduced Bank Rate to 4.75% at its meeting in November 2024, having previously cut by 25bp from the 5.25% peak at the August MPC meeting. At the November meeting, eight Committee members voted for the cut while one member preferred to keep Bank Rate on hold at 5%.

The November quarterly Monetary Policy Report (MPR) is forecasting Gross Domestic Product (GDP) growth to pick up to around 1.75% (four-quarter GDP) in the early period of the BoE's forecast horizon before falling back. The impact from the Budget pushes GDP higher in 2025 than was expected in the previous MPR, before becoming weaker. Current GDP growth was shown to be 0.5% between April and June 2024, a downward revision from the 0.6% rate previously reported by the Office for National Statistics (ONS).

Office for National Statistics (ONS) figures reported the annual Consumer Price Index (CPI) inflation rate at 1.7% in September 2024, down from 2.2% in the previous month and lower than the 1.9% expected. Core CPI also declined further than expected to 3.2% against a forecast of 3.4% and the previous month's 3.6%. The outlook for CPI inflation in the November MPR showed it rising above the MPC's 2% target from 2024 into 2025 and reaching around 2.75% by the middle of calendar 2025. This represents a modest near-term increase due to the ongoing impacts from higher interest rates, the Autumn Budget, and a projected margin of economic slack. Over the medium-term, once these pressures ease, inflation is expected to stabilise around the 2% target.

The labour market appears to be easing slowly however, but the data still requires treating with some caution. The latest figures reported the unemployment rate fell to 4.0% in the three months to August 2024, while economic inactivity also declined. Pay growth for the same period was reported at 4.9% for regular earnings (excluding bonuses) and 3.8% for total earnings. Looking ahead, the BoE MPR showed the unemployment rate is expected to increase modestly, rising to around 4.5%, the assumed medium-term equilibrium unemployment rate, by the end of the forecast horizon.

The US Federal Reserve has also been cutting interest rates, bringing down the Fed Funds Rate by 0.25% at its November 2024 monetary policy meeting to a range of 4.5%-4.75%. Further interest rate cuts are expected, but uncertainties around the potential inflationary impact of incoming President Trump's policies may muddy the waters in terms of the pace and magnitude of further rate reductions. Moreover, the US economy continues to expand at a decent pace, rising at an annual rate of 2.8% in the third quarter of 2024, and inflation remains elevated suggesting that monetary policy may need to remain more restrictive in the coming months than had previously been anticipated.

Euro zone inflation fell below the European Central Bank (ECB) 2% target in September 2024, the first time in over three years. This allowed the ECB to continue its rate cutting cycle and reduce its three key policy rates by 0.25% in October. Inflation is expected to rise again in the short term, but then fall back towards the 2% target during 2025, with the ECB remaining committed to maintaining rates at levels consistent with bringing inflation to target, but without suggesting a specific path.

Credit outlook

Credit Default Swap (CDS) prices have typically followed a general trend downwards during 2024, reflecting a relatively more stable financial period compared to the previous year. Improved credit conditions in 2024 have also led to greater convergence in CDS prices between ringfenced (retail) and non-ringfenced (investment) banking entities again.

High interest rates can lead to a deterioration in banks' asset quality through increased loan defaults and volatility in the value of capital investments. Fortunately, the rapid interest rate hikes during this monetary tightening cycle, while putting some strain on households and corporate borrowers, has not caused a rise in defaults, and banks have fared better than expected to date, buoyed by strong capital positions. Low unemployment and robust wage growth have also limited the number of problem loans, all of which are positive in terms of creditworthiness.

Moreover, while a potential easing of US financial regulations under a Donald Trump Presidency may aid their banks' competitiveness compared to institutions in the UK and other regions, it is unlikely there will be any material impact on the underlying creditworthiness of the institutions on the counterparty list maintained by Arlingclose, the authority's treasury adviser.

Overall, 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 (November 2024)

The Authority's treasury management adviser Arlingclose forecasts that The Bank of England's Monetary Policy Committee will continue reducing rates during 2024 and through 2025, taking Bank Rate to around 3.75% by the end of the 2025/26 financial year. The effect from the Autumn Budget on economic growth and inflation has reduced previous expectations in terms of the pace of rate cuts as well as pushing up the rate at the end of the loosening cycle.

Arlingclose expects long-term gilt yields to remain broadly at current levels on average (amid continued volatility), but to end the forecast period modestly lower compared to now. Yields will continue remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will be short-term volatility due to economic and (geo)political uncertainty and events.

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

3. **Local Context:**

3.1 On 31 March 2024 the Council held £96.2m borrowing (£89.4m of long-term borrowing and £6.9m of short-term borrowing), £10.9m of long-term treasury investment and £4.1m of cash investments. By 31st December 2024, there had been no change to the borrowing position, with an increase in cash investments of £13.1m (due to regular fluctuations in the cash position).

3.2 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.

3.3 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

	31.3.2024 Actual £m	**31.3.2025 Estimate £m**	**31.3.2026 Estimate £m**	**31.3.2027 Estimate £m**	**31.3.2028 Estimate £m**
HRA Debt	52.8	63.3	73.6	88.3	97.5
General Fund External Debt	43.4	46.0	47.8	48.7	49.7
Total Debt	**96.2**	**109.3**	**121.4**	**137.0**	**147.3**
Capital Financing Requirement	108.1	120.2	131.0	145.2	153.8
CFR not funded by Borrowing	11.9	10.9	9.6	8.2	6.5

3.4 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.

3.5 **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.

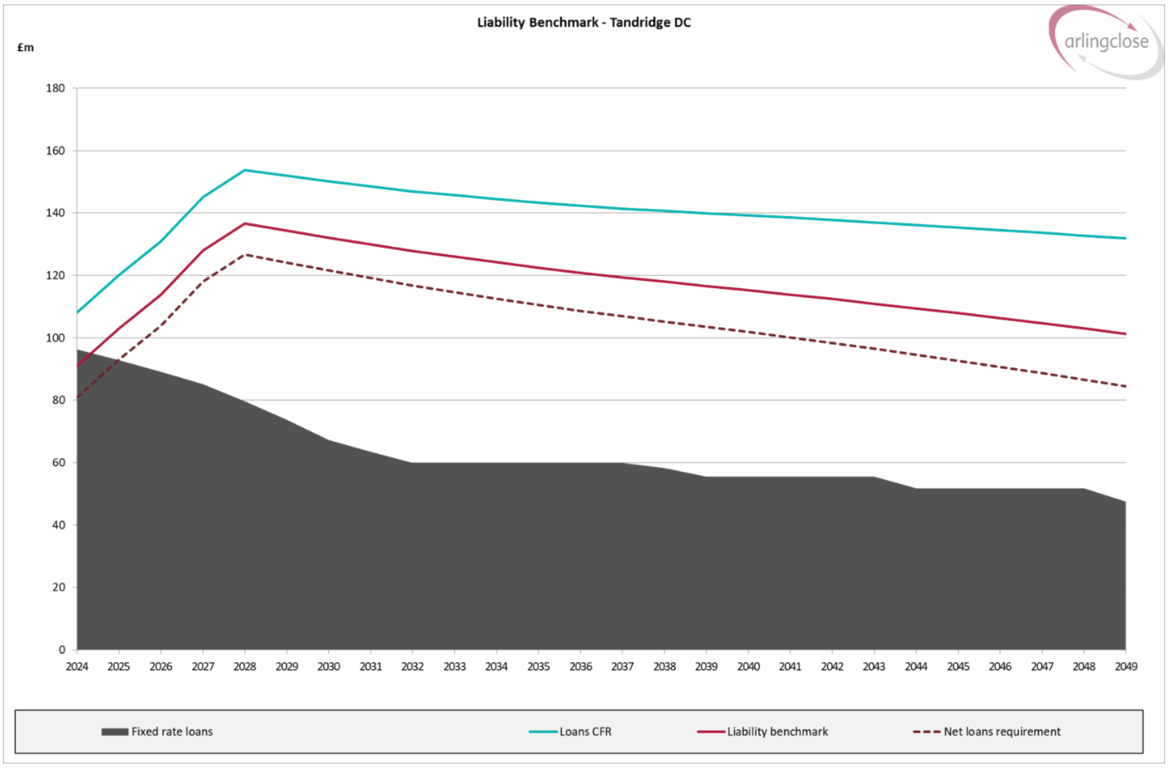
This assumes the same forecasts as table 14 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

3.6 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	**2023/24 Actual £m**	**2024/25 Projected £m**	**2025/26 Estimated £m**	**2026/27 Estimated £m**	**2027/28 Estimated £m**
Loans CFR	108.1	120.2	131.0	145.1	153.7
External borrowing	(96.3)	(92.8)	(89.2)	(85.2)	(79.7)
Internal (over) borrowing	11.8	27.4	41.8	59.9	74.1
Balance sheet resources	(27.1)	(27.1)	(27.1)	(27.1)	(27.1)
Investments/ (new borrowing)	15.3	(0.2)	(14.7)	(32.8)	(47.0)
Treasury investments	15.3	10.0	10.0	10.0	10.0
New borrowing	0.0	10.2	24.7	42.8	57.0
Net loans requirement	80.9	93.1	103.9	118.0	126.6
Liquidity allowance	10.0	10.0	10.0	10.0	10.0
Liability benchmark	90.9	103.1	113.9	128.0	136.6

Graph 1: Liability Benchmark



3.7 The long-term liability benchmark assumes:

- Capital expenditure funded by borrowing as per the 2025-2028 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.

3.8 Overall, the liability benchmark shows that the Council is currently marginally over-borrowed, because the amount of external debt (grey shaded area) is slightly above 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.

3.9 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 currently holds £96.2m of loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £12.1m in 2025/26. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £160 million

4.2 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.

4.3 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.

4.4 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.

4.5 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.

4.6 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.

4.7 **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.

4.8 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.

4.9 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.

4.10 **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.

4.11 **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.

4.12 Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

4.13 **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

4.14 Gross borrowing costs include interest payable and the statutory charge on the general fund for MRP. The borrowing costs associated with the 2025/26 to 2027/28 General Fund capital Programme start at £2.6m in 2025/26 and increase to £2.8m in 2026/27, before increasing again to £3.0m in 2027/28.

4.15 Net borrowing costs are calculated after offsetting interest and investment income and over the same period, net borrowing costs grow from £0.4m in 2025/26 to £1.0m in 2027/28. This change predominantly reflects the Council setting aside £0.1m each year to reflect the potential risk on income associated with the Castlefield House property.

5. **Treasury Investment Strategy**

5.1 The Council holds invested funds representing income received in advance of expenditure plus reserves. For the first half of 2024/25, the Council held average balances of £7.1m, compared with £9.4m for the equivalent period in 2023/24. The average return for the first half of 2024/25 was 5.01%. Cash balances are expected to reduce during the remainder of 2024/25 and over the MTFS.

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

5.4 Money Market Funds (MMFs) and short-term bank deposits will be utilised, with a cash limit per counterparty/fund of £5m per MMF. 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.

5.5 **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.

5.6 **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 / ST: N/a	LT:A / ST: F1
Overseas Banks (subject to Sovereign Rating AA-)	£2m each	£8m	LT:A / ST: F1
UK building societies with an asset base > £1bn	£2m each		LT: BBB+ / ST:F1
UK building societies with an asset base < £1bn	£1m each		LT:A / 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	N/a
Property Funds without credit ratings	£4m each	£4m	N/a
Multi Asset Funds	£4m each	£8m	N/a

[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.

5.7 **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.

5.8 **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. See below for arrangements relating to operational bank accounts.

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

5.10 **Government:** Sterling-denominated investments with or explicitly guaranteed by the UK Government, including the Debt Management Account Deposit Facility, treasury bills and gilts. These are deemed to be zero credit risk due to the government's ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

5.11 **Pooled funds:** Bond, equity and property funds, including exchange traded funds, that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority 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 can be either withdrawn after a notice period or sold on an exchange, their performance and continued suitability in meeting the Authority'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, even though it may otherwise meet the above criteria.

5.16 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority 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 Authority’s cash balances, then the surplus will be deposited with the UK Government or other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

5.17 **Reputational aspects:** The Authority is aware that investment with certain counterparties, while considered secure from a purely financial perspective, may leave it open to criticism, valid or otherwise, that may affect its public reputation, and this risk will therefore be taken into account when making investment decisions, in consultation with Members.

5.18 **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

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

5.20 **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 31/03/24	Upper Limit 2025/25	Lower Limit 2024/25
	%	%	%
Under 1 year	3.6	15	0
1 to 2 years	3.8	15	0
2 to 5 years	16.0	25	0
5 years to 10 years	14.3	50	0
10 years to 20 years	8.3	50	0
Over 20 years	51.7	60	0
Total	**100%**		

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:

	2025/26 £m	2026/27 £m	2027/28 £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 majority of the current treasury investment portfolio is held in investments at a variable rate, with two investments in fixed rate bonds. 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 2024 (which is a particularly high point in terms of investment balances), a 1% change in interest rate would have a £0.220m 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 The CIPFA Code requires the Authority to include the following in its treasury management strategy.

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

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

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

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

5.29 **Housing Revenue Account:** The Authority has split each of its existing long-term loans into General Fund and HRA portfolios. New long-term loans borrowed will be assigned in their entirety to one portfolio or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Where the value of the HRA loans pool is below the HRA capital financing requirement, interest on this "under-borrowing" will be charged to the HRA at the Authority's average rate of borrowing. Interest on any "over-borrowing" above the HRA capital financing requirement, and on balances in the HRA, its earmarked reserves and the major repairs reserve will be credited to the HRA at the Authority's average interest rate on treasury investments excluding strategic pooled funds and subsidiary investments (e.g. Gryllus), adjusted for credit risk

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

5.31 **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:

5.32 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.

5.33 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.

5.34 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.

5.35 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 2025/26 is £2.2m. The budget for debt interest paid in 2025/26 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

Prudential Indicators 2025/26 – 2027/28

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.

<u>Estimates of capital expenditure</u>

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.

<u>The Council's borrowing need (the capital financing requirement)</u>

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.

<u>Gross borrowing and the capital financing requirement</u>

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.

<u>The Council's authorised limit and operational boundary for external debt</u>

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

	2024/25 limit £m	**2025/26 limit £m**	**2026/27 limit £m**	**2027/28 limit £m**
Authorised limit – borrowing	150	160	176	188
Authorised limit – leases	0	0	0	0
Authorised limit – total external debt	150	160	176	188
Operational boundary – borrowing	140	150	166	178
Operational boundary – leases	0	0	0	0
Operational boundary – total external debt	140	150	166	178

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

	2023/24 Actual £m	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**	**2028/29 Estimate £m**
Net revenue stream	11.4	11.9	13.8	13.4	13.4
General Fund – Gross Financing costs	1.1	1.0	1.3	1.5	1.6
Proportion of GF Gross financing costs to net revenue stream	10%	8%	9%	11%	12%

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.

	2023/24 Actual £m	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**	**2027/28 Estimate £m**
Net revenue stream	11.4	11.9	13.8	13.4	13.4
Total net income from service and commercial investments	1.5	1.6	1.5	1.4	1.3
Proportion of net income to net revenue stream	13%	13%	11%	10%	10%

APPENDIX D - Annex 2

Arlingclose Economic & Interest Rate Forecast – November 2024

Underlying assumptions:

1.1 As expected, the Bank of England Monetary Policy Committee (MPC) cut Bank Rate to 4.75% in November in an 8-1 vote. However, the outlook for monetary policy has changed following the new government's fiscal plans, as delivered in the recent Budget.

1.2 The Budget contained measures that will boost demand, in a constrained supply environment, while pushing up direct costs for employers. The short to medium-term inflationary effects of the Budget require a change to our Interest Rate Forecast.

1.3 UK GDP recovered well in H1 2024 from technical recession, but underlying growth appears relatively subdued. However, the Budget will significantly boost government spending over the short-term, with few offsetting measures to subdue household demand, so GDP growth is likely to rise relatively steeply.

1.4 Private sector wage growth has eased to 4.8% yet remains high, while services inflation continues to hold above pre-pandemic levels. The increase in employers' NICs, minimum and public sector wage levels could have wide ranging impacts on private sector employment demand and costs, but the near-term impact will likely be inflationary as these additional costs get passed to consumers.

1.5 CPI inflation was below the 2% target in September but will rise a little by year-end as energy price declines from the previous year fall out of the annual comparison. The Bank of England (BoE) estimates the Budget impact will see the CPI rate at 2.7% by year end 2025 and remain over target in 2026, as opposed to the prior projection of inflation easing back to and then below target by this point.

1.6 The MPC re-emphasised the gradual move to easing monetary policy, and we now believe the Budget measures have both reduced the pace of Bank Rate cuts and increased the low for this loosening cycle (although downside risks remain in the medium term).

1.7 The increase in borrowing, rise in inflation and shallower path for Bank Rate projected by the Office for Budget Responsibility (OBR) raised gilt yields. The material change in rate expectations means that yields will be generally higher in the post-Budget world.

1.8 US government yields have risen following Donald Trump's and Republican victories in the US elections. Trump has run on a platform of policies that appear inflationary, calling into question the extent of policy loosening required from the Federal Reserve (which was already uncertain given continued solid US growth data). Higher US yields could also support higher UK yields.

Forecast:

1.9 The Bank Rate was cut to 4.75% in November 2024.

1.10 The MPC will continue to lower Bank Rate to reduce the restrictiveness of monetary policy, but more slowly and to a higher level. We see another rate cut in February 2025, followed by one cut per quarter, in line with Monetary Policy Report publication, to a low of 3.75%.

1.11 Long-term gilt yields have risen to reflect both UK and US economic, monetary and fiscal policy expectations, and increases in bond supply. Volatility is likely to remain elevated as the market digests incoming data for clues around the impact of policy changes.

1.12 This uncertainty may also necessitate more frequent changes to our forecast than has been the case recently.

1.13 Upside risks to inflation over the next 12 months could limit the extent of monetary easing, but we see the risks as broadly balanced over the medium term.

	Current	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Central Case	4.75	4.75	4.50	4.25	4.00	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Downside risk	0.00	0.00	-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
3-month money market rate													
Upside risk	0.00	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Central Case	4.95	4.80	4.60	4.35	4.10	3.90	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	0.00	-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
5yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.30	4.20	4.10	4.05	3.95	3.90	3.90	3.90	3.95	4.00	4.05	4.05	4.05
Downside risk	0.00	-0.40	-0.50	-0.60	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65
10yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.41	4.40	4.35	4.35	4.35	4.30	4.30	4.30	4.35	4.35	4.35	4.35	4.35
Downside risk	0.00	-0.40	-0.50	-0.60	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65
20yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.84	4.80	4.75	4.70	4.65	4.65	4.65	4.65	4.65	4.65	4.65	4.65	4.65
Downside risk	0.00	-0.40	-0.50	-0.60	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65
50yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.35	4.50	4.45	4.40	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
Downside risk	0.00	-0.40	-0.50	-0.60	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65

PWLB Standard Rate = Gilt yield + 1.00%
PWLB Certainty Rate = Gilt yield + 0.80%
PWLB HRA Rate = Gilt yield + 0.40%
National Wealth Fund (NWF) Rate = Gilt yield + 0.40%

Investment & Debt Portfolio Position as at 31 March 2024

	2023/24 Actual 31/03/2024 £m	2023/24 Actual 31/03/2024 %
Money Market Funds	4.1	5.1
CCLA Property Fund	3.9	2.3
Funding Circle	0.2	-
Schroders Bond Fund	2.7	4.5
UBS Multi-Asset Fund	2.2	5.0
CCLA Diversification Fund	2.0	4.5
Total Treasury Investments	**15.1**	**3.8**
Long-term PWLB loans (HRA)	52.8	2.7
Long-term PWLB loans (GF)	43.4	2.6
Total Borrowing	**96.2**	**2.7**
Net Borrowing	**81.1**	

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