# Strategy & Treasury Management Strategy 2025/26

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## 1. Executive Summary

### Capital Strategy

1.1. The requirement for Local Councils to produce an annual Capital Strategy is outlined in the most recent update of the CIPFA Prudential Code, published in 2021.

1.2. In order to demonstrate that the Council takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, Councils should have in place a capital strategy that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

1.3. As local Councils become increasingly complex and diverse it is vital that those charged with governance understand the long-term context in which investment decisions are made and the financial risks to which the Council is exposed.

1.4. With local Councils having increasingly wide powers around commercialisation, more being subject to group arrangements and the increase in combined Council arrangements it is no longer sufficient to consider only the individual local Council; the residual risks and liabilities to which it is subject should also be considered.

1.5. The Capital strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. The development of a capital strategy allows flexibility to engage with full council to ensure that the overall strategy, governance procedures and risk appetite are fully understood by all elected members.

1.6. Decisions made now on capital 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.

### Treasury Strategy

1.7. Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council borrows and invests 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 risks are therefore central to the Council's prudent financial management.

1.8. Treasury risk management at the 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 (the TM Code) which requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Council Investments that requires the Council to approve an investment strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the WG Guidance.

1.9. The TM Code identifies three key Treasury management principles:

1.10. **KEY PRINCIPLE 1**
Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

**KEY PRINCIPLE 2**
Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

**KEY PRINCIPLE 3**
They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

The TM Code is clear that throughout public services, the priority for treasury management is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate nor possible. However, a balance must be struck with a keen responsibility for public money.

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

**Appendix 1**

# 2025/26 Capital Strategy

## 1. Introduction

1.1. This Capital Strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services, along with an overview of how associated risk is managed and a summary of the implications for future financial sustainability.

1.2. Capital expenditure is where the Council spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this also includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

1.3. Current Welsh Government legislation on the flexible use of capital receipts permits them to be used to fund revenue expenditure that will generate ongoing savings or reduce revenue costs or pressures over the longer term to a Council, or several Councils, and/or to another public body.

1.4. In the current economic climate of financial constraints and a continued Medium Term Financial Projection (MTFP) revenue budget gap, expenditure on capital needs to remain within affordable limits. Demand for capital resources remains high and therefore inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners remain key to meeting this demand.

1.5. The strategy highlights the key risks and considerations:

- The Council's medium term capital programme contains a substantial amount of borrowing, in particular until the end of 2025/26 as part of the financing package of the new King Henry school in Abergavenny. Whilst this is affordable and included in the medium term revenue budget considerations, it would be unsustainable to continue at a such a heightened borrowing level thereafter, especially given the current economic climate and ongoing pressures upon the Council's revenue budget.

- Within the context of significant demands for capital resources and limited availability, there is the need to develop and link our use of the various strategic plans across the organisation which drive the need for capital investment and develop alternative strategies to meet demand so the Councils own capital programme is prioritised within an affordable framework. This will include clearer visibility and assessment of demand for maintenance of assets such as property, highways and other operational assets, as well as focussing on asset rationalisation.

- Useable capital receipts have been used successfully to provide a limited one-off resource to support financing of the capital programme. In recent years the Council has made use of Welsh Government's guidance allowing flexible use of capital receipts to meet one-off revenue costs associated with service reform. The Council has called upon this flexibility since 2019/20 and plans to do similarly over the medium term.

- With the pool of useable capital receipts forecast to be at minimal levels at the end of the medium term financial plan period, the continued use of capital receipts for this purpose is recognised as necessary but will be required to be tapered down.

- Approval of capital expenditure funded through borrowing locks the Council into committing revenue funding over a very long period (as long as 60 years). With Minimum Revenue Provision (MRP) budgets increasing over the medium-term, the Council needs to ensure its capital plans remain affordable and sustainable.

- The prudential indicators, including borrowing limits, are in line with the final budget proposals presented to Cabinet and Council in February 2024.

1.6. The strategy will be reviewed and updated on an annual basis alongside the Treasury Management Strategy given that both strategies are intrinsically linked.

1.7. The strategy sets out:

- The key objectives outlined in the Prudential Code and the governance arrangements for the Capital Strategy and programme (Section 2)
- The medium term capital programme, its financing, and the revenue implications arising from capital investment (Sections 3 to 5)
- Long term projections for the capital financing costs of the Council and where future demands arise from the various strategic plans across the Council for further capital investment. (Section 6)
- Capital disposals & receipts (Section 7)
- Links between the Capital Strategy and Treasury Management strategy, and treasury decision making. (Sections 8 to 10)
- Consideration of investment for service purposes and commercial activity of the Council and the strategy going forward. (Section 11 and 12)
- Summary of the skills and knowledge the Council holds in order for it to carry out its capital investment and treasury functions. (Section 13)

## 2. The Prudential Code

2.1. The objective of the Prudential Code is to ensure, within a clear framework, that the capital expenditure plans of local Councils are:

- **AFFORDABLE -** It is important that the Council's capital investment remains within sustainable limits. The Code requires Councils to consider the resources currently available to them and those estimated to be available in the future, together with the totality of the capital plans and income and expenditure forecasts. As well as capital expenditure plans, Councils should consider the cost of past borrowing, ongoing and future maintenance requirements, planned asset disposals and the MRP policy, which all impact upon affordability.

- **PRUDENT –** All external borrowing and other long-term liabilities are within prudent levels. The full Council set an authorised limit and operational boundary for external debt, these need to be consistent with the Council's plans for affordable capital expenditure and financing, and with its treasury management policy statement and practices.

- **SUSTAINABLE –** taking into account the arrangements for repayment of debt (including through MRP) and consideration of risk and the potential impact on the Council's overall financial sustainability in the medium to longer term.

2.2. The risks associated with investments for commercial purposes should be proportionate to the Council's financial capacity and standing.

2.3. Treasury management decisions should be taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.

2.4. The Prudential Code requires Councils to look at capital expenditure plans, investments and debt in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long-term financing implications and potential risks to the Council.

2.5. In order to demonstrate that local Councils have fulfilled these objectives, the Prudential Code sets out the prudential indicators that must be used, and the factors that must be taken into account. These indicators are presented alongside the final budget presented to Council.

2.6. **Governance & reporting**

2.7. The responsibility for decision making in respect of capital investment, investment and borrowing, and prudential indicators lies with full Council.

2.8. Council will approve the Capital strategy and the annual Treasury management strategy (including the investment strategy and MRP policy statement).

2.9. Council delegates responsibility for the detailed implementation, monitoring and scrutiny of capital investment consequences, including treasury management policy, strategy and practices to the Governance & Audit Committee.

2.10. The execution and administration of treasury management decisions is delegated the Section 151 officer or deputy, who will act in accordance with the policy and strategy and follow CIPFA's Standard of Professional Practice on Treasury Management.

2.11. The Council recognises the value in the use of treasury advisors to support the management of risk and to access specialist skills and resources. Support provided by its current advisors Arlingclose Limited includes advice on timing of decision making, training, credit updates, economic forecasts, research, articles and advice on capital finance.

2.12. ***Revised strategy:*** Full Council would be asked to approve a revised Treasury Management Strategy should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, a significant change in the Council's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

## 3. Setting capital budgets

Over the next four years the Council is planning capital expenditure of £66.8m as summarised below:

***Table 1: Capital Medium Term Financial Plan***

| Scheme Type | Indicative Budget 2025/26 | Indicative Budget 2026/27 | Indicative Budget 2027/28 | Indicative Budget 2028/29 |
|---|---|---|---|---|
| Asset Management Schemes | 2,449,049 | 2,230,049 | 2,230,049 | 2,230,049 |
| School Development Schemes | 12,232,076 | 0 | 0 | 0 |
| Infrastructure & Transport Schemes | 6,075,740 | 4,204,740 | 4,204,740 | 4,204,740 |
| Regeneration Schemes | 1,017,724 | 730,200 | 730,200 | 730,200 |
| Inclusion Schemes | 1,200,000 | 1,200,000 | 1,200,000 | 1,200,000 |
| ICT Schemes | 462,500 | 413,000 | 413,000 | 413,000 |
| Vehicles Leasing | 1,500,000 | 1,500,000 | 1,500,000 | 1,500,000 |
| Capitalisation Directive | 3,707,500 | 2,357,500 | 1.357,500 | 0 |
| Other Schemes | 550,000 | 1,110,000 | 1,110,000 | 1,110,000 |
| **Total Expenditure** | **29,194,590** | **13,745,490** | **12,745,490** | **11,387,990** |

3.1. Member responsibility for assets rests with the Cabinet member for Resources. The main governance and approval process for capital investment is summarised as follows:

- Council approve the overall revenue and capital budgets following recommendations from Cabinet. They also approve the borrowing limits of which the capital programme will need to remain within (***the Authorised limit***). This limit is a key performance indicator for treasury management and ensures that capital expenditure is limited and borrowing remains within an affordable limit.
- Any variation of the Authorised borrowing limit can only be approved by Council.
- Council approve the Treasury Management, Investment & Borrowing strategies, which are intrinsically linked to capital expenditure and the capital strategy.
- Service managers put forward proposals for any change or additional capital investment annually which are collated and scrutinised by senior finance teams, who consider the

financing cost of the proposals. These are initially screened against the approved priority investment matrix, and a recommendation made to the strategic leadership team (SLT).

- SLT further consider the recommendations against the approved priority matrix and wider Council plans and strategies in place. Following review, SLT will make recommendation to Cabinet for inclusion in the capital budget and to be considered further by Cabinet and Council at final budget setting stage.
- Monitoring of capital expenditure is reported to Cabinet and includes updates on capital receipts and any consequential impact on the revenue budget of the scheme progress made.
- The 2025/26 and forward capital budgets include investment in schemes which attract significant match funding from external bodies which services will be responsible for bidding for. The agreed priority investment matrix listed below plays a key role in ensuring investment is properly aligned with the overall Community and Corporate Plan and wider strategic principles of the Council.

| Ref | Aspect | Indicative Rank |
|---|---|---|
| **H&S** | Health & safety works (life & limb works) | 1 |
| **Legal** | Legal & regulatory obligations | 1 |
| **Rev** | Allow a balanced revenue budget to be set, or a net deficit in revenue spending to be positively addressed | 2 |
| **Corp** | Deliver Community & corporate plan priorities | 2 |
| **Third** | Attract significant 3rd party or private match funding to the County | 3 |
| **S2S** | Spend to save transformational works (including flexible use of capital receipts) | 3 |
| **INC** | Spend to earn net income – rents, interest and dividends | 3 |
| **Sust** | Create sustainable income streams – business rates and council tax | 3 |
| **AMP** | Asset management plan outcomes | 4 |
| **INF** | Addresses major infrastructure investment | 4 |

3.2. The current capital MTFP does not cover all the capital budget pressures that have been identified. This shows that there is more demand for capital spending than the Council

considers it can reasonably afford. This means that capital schemes will have to be ranked or the capital available has to be divided more widely than is ideal.

3.3. All stakeholders must understand that paying for capital spending by borrowing only pushes the cost to revenue budgets over future years, but at the same time if capital maintenance works are put off then the total lifetime costs of keeping an asset are likely to go up. This effect is often hidden in medium term financial planning as asset lives are much longer than four years.

3.4. The capital programme includes yearly investment for property maintenance, highways maintenance, relevant specific capital grants and the future schools programme. This will help to deal with the most urgent backlog issues, focussing on worst condition first and related risk. However, estate rationalisation programs, closure/disposal of assets, asset transfers and other capital projects to refurbish or replace operational properties will also be used to reduce the backlog funding needed. This will not solve the specific total backlog but is a way of targeting the main issues in a reasonable way.

3.5. There might be other calls for capital funding for schemes that are not yet included in the overall programme. Any new schemes that come forward during the year will either need to be paid for by specific funding sources or represent a call upon any available programme under spends. It is important that capital spending stays at a reasonable level within the framework agreed and, therefore, ranking of capital spending is essential and needs to be affordable and sustainable in the long-term.

3.6. Frequent reviews of previously approved schemes that have been delayed will be carried out to ensure that they are still affordable within set budgets. This is especially important in the current economic situation of high inflation and supply chain disruption.

## 4. Capital financing requirement

4.1. 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, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

***Table 2: Capital financing***

| Financing source | Final Budget 2025/26 | Indicative Budget 2026/27 | Indicative Budget 2027/28 | Indicative Budget 2028/29 |
|---|---|---|---|---|
| Debt | 22,000,566 | 8,188,990 | 8,188,990 | 8,188,990 |
| External sources | 3,333,524 | 3,046,000 | 3,046,000 | 3,046,000 |
| Capital Receipts | 3,757,500 | 2,407,500 | 1,407,500 | 50,000 |
| Reserves | 103,000 | 103,000 | 103,000 | 103,000 |
| **Total Funding** | **29,194,590** | **13,745,490** | **12,745,490** | **11,387,990** |

4.2. Debt 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). Alternatively, proceeds from selling capital assets (capital receipts) may be used to replace debt finance.

4.3. The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace the debt.

4.4. The table below provides the medium-term outlook for the Council's CFR, inclusive of the impact of PFI arrangements. This is based on the indicative medium term capital programme and, therefore, does not reflect any potential additional borrowing beyond that already approved.

***Table 3: CFR and related MRP charges in £m***

| | 2024/25 Forecast £m's | 2025/26 Estimate £m's | 2026/27 Estimate £m's | 2027/28 Estimate £m's | 2028/29 Estimate £m's |
|---|---|---|---|---|---|
| Capital Financing Requirement | 220.0 | 234.4 | 234.4 | 234.5 | 238.0 |
| Minimum Revenue Provision | 6.4 | 6.1 | 6.7 | 6.6 | 6.9 |

4.5. The increase in capital expenditure, including that funded via other sources, will be a considerable operational challenge to achieve, as evidenced by the significant levels of slippage incurred over recent financial years. Therefore, it is important to recognise the possibility that the actual CFR may be lower than estimated by the end of the 2024/25 financial year, and in turn reducing the actual need to undertake external borrowing.

4.6. It is important that capital expenditure plans are realistic, as otherwise this can result in unnecessarily committing revenue resources towards capital financing budgets, which in turn restricts alternative investment in achieving service delivery aspirations.

## 5. Revenue budget implications

5.1. 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. These net annual charges are known as financing costs. The table below compares these financing costs to the net revenue stream i.e. the amount of income from Council Tax (MCC element), business rates and general government grants.

***Table 4: Proportion of financing costs to net revenue stream***

| Proportion of financing Costs to net revenue stream | 2024/25 Estimate £m's | 2025/26 Estimate £m's | 2026/27 Estimate £m's | 2027/28 Estimate £m's | 2028/29 Estimate £m's |
|---|---|---|---|---|---|
| Net Interest payable | 6.6 | 6.8 | 7.3 | 7.4 | 7.4 |
| MRP | 6.4 | 6.1 | 6.7 | 6.7 | 6.9 |
| Total Financing costs | 13.0 | 12.9 | 14.0 | 14.1 | 14.3 |
| Net Revenue Stream | 199.3 | 215.8 | 227.1 | 238.6 | 250.4 |
| Proportion of net revenue stream % | 6.52% | 5.98% | 6.16% | 5.91% | 5.71% |

5.2. The overall proportion of financing costs remains fairly stable over the MTFP window which is reflective of the total revenue stream increasing in line with expected inflationary impacts whilst the financing costs increase moderately in line further capital investment made.

5.3. **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years afterwards. The Section 151 officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because the financing costs have been spread over no more than, the lower of 50 years and the expected life of the resultant asset, so the assets will be paid for by the Council tax payers benefitting from them over the life of the assets. The financing costs for assets funded by debt are included in each annual revenue budget which is balanced before approval by Council.

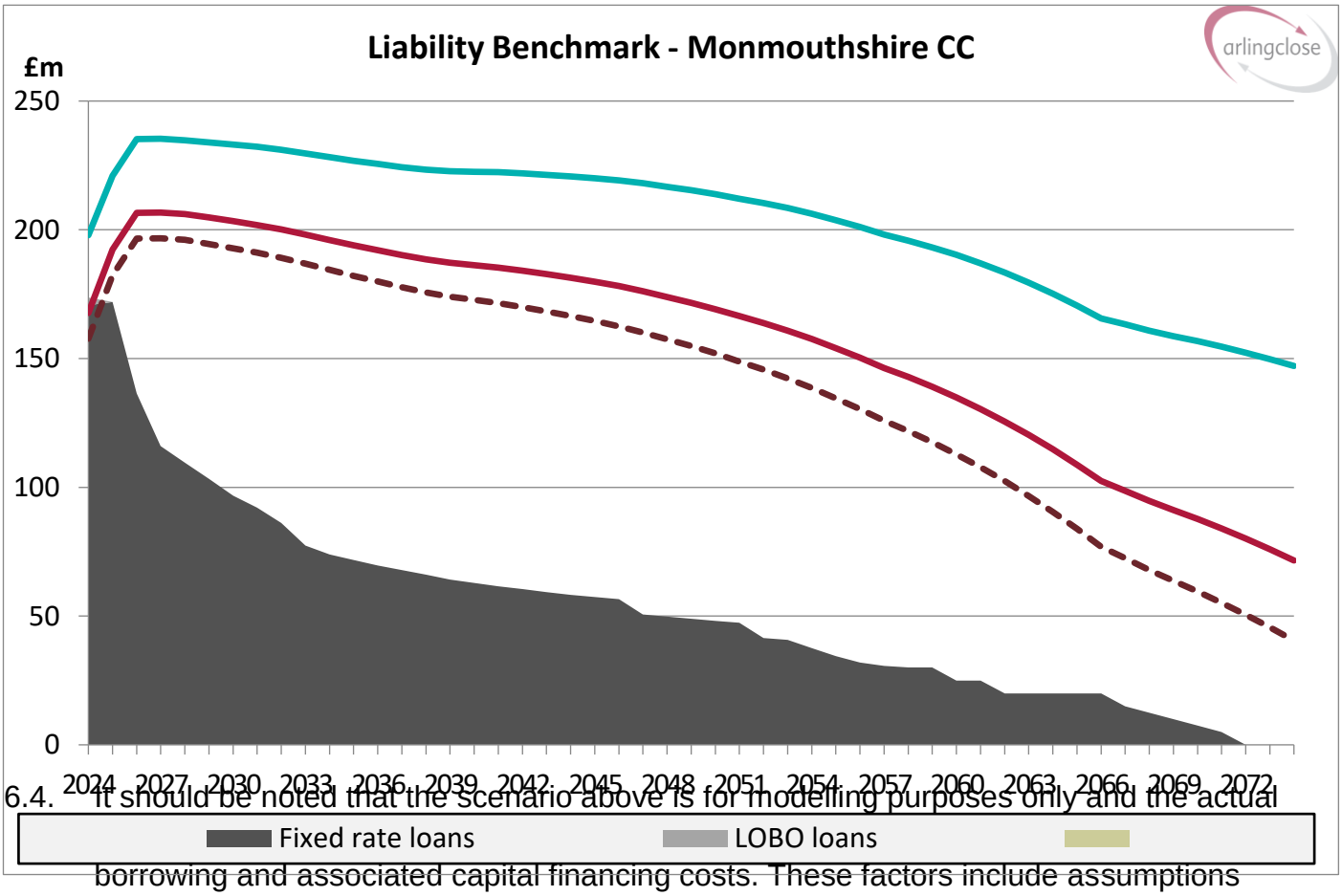
## 6. Long term capital financing projections

6.1. Capital investment is often for assets which have a long-term life i.e. buildings and road infrastructure may have an asset life in excess of 50 years. The financing of these assets could also be over a long-term period. Therefore, it is important to take a long-term view of capital expenditure plans and the impact that may have on the affordability and sustainability of capital expenditure. Once capital expenditure has been financed from borrowing the Council is committed to the revenue implications arising from that decision (i.e. the annual cost of MRP) for a long-term period.

6.2. Due to the financial constraints that the Council continues to operate under, it is anticipated that the ability to finance capital expenditure from borrowing will remain incredibly restricted over the long-term. This means that the Council will face a significant challenge in being able to finance its medium to longer term capital aspirations in terms of maintenance backlogs, as well as the need to invest in new and existing assets.

6.3. The Liability benchmark shown below demonstrates the following, in terms of the impact of the current capital programme and projected capital investment financed from borrowing over the next 50 years:

- The impact the current capital programme has in terms of the increasing the CFR (blue line) in the short term and the consequent need for external borrowing, denoted by the steepness of the solid and dashed red curves over the initial years;
- A longer-term gradual reduction in the overall level of CFR, as shown by the trajectory of the solid blue line which is a result of indicative annual borrowing being below the level of annual MRP;
- A longer-term reduction in the need to undertake actual external borrowing, as shown by the trajectory of the dashed red line;
- A requirement for further external borrowing in the medium to long-term, despite lower capital expenditure levels, resulting from the need to refinance maturing loans.




6.4. It should be noted that the scenario above is for modelling purposes only and the actual borrowing and associated capital financing costs. These factors include assumptions included on the level and deliverability of capital investment; the level of external financing for the programme; internal Council resources; and future MRP policy and treasury strategy.

**Ongoing Capital Programme Development**

6.5. In light of continuing funding constraints, it is important that the Council understands the key risks and future aspirations for capital investment. These are captured through various plans and strategies across the Council. There will be a range of priorities originating from these plans which will look to deliver on aspirational long term objectives such as the decarbonisation agenda and affordable housing.

6.6. Alongside this, it is important to consider the requirement to maintain the Councils current asset base. As noted previously, this is something that has been severely impacted by constrained funding levels in previous years and has resulted in a maintenance backlog developing, which gives rise to the potential for major asset failures to occur where issues have developed over time. Although the risks associated are captured through ongoing condition surveys and monitoring, it is inevitable that as time progresses that more significant sums of investment will be required to maintain or substantially refurbish ageing assets.

6.7. The level of annual investment included in the capital programme for maintenance and refurbishment of assets assists in addressing the highest priority backlog issues, focussing on worst condition first and associated risk. However, estate rationalisation programmes, closure/disposal of assets, asset transfers and other capital projects to refurbish or replace operational properties will also be utilised to offset the backlog funding required. This will not address the specific total backlog but is a way of targeting the main issues in an affordable manner.

6.8. There will inevitably be other priorities to be considered for inclusion within the capital programme over the medium to longer term, with the next phase of WG's Sustainable Communities for Learning Programme and further regeneration schemes that will require substantial match funding commitments. The consideration to support such priorities will need to be carefully balanced against other competing demands.

## 7. Capital disposals & receipts

7.1. The Council's Asset Management Strategy (AMS) sets out the strategic objectives for our land and property. The strategy sets out the way property will be managed and contribute to the policy objectives of the council. The Asset Management Strategy provides a clear vision of the future of property assets and management of their strategic performance.

7.2. Asset Management Strategy objectives:

- **A fit for purpose and collaborative estate** – providing assets necessary to deliver council services, in the right location, compliant and co-located where possible.
- **Be good role models for climate and nature practices** – manage our assets well, lowering our carbon footprint and promoting more sustainable practices.
- **Maximised and commercialised asset base** – generate more revenue and higher value outcomes (financial and non-financial) from sales of surplus assets.
- **Strengthen the enablement role of Landlord Services** – continue to support service objectives including job creation, tackling homelessness, constructing affordable homes, driving value for money.
- **Optimise social value from community assets** – support community assets equitably, transparently, and consistently.

7.3. MCC benefits from a diverse land and property portfolio that has delivered a commercial return over a number of years. There are over 1500 assets in MCC ownership which support different services and public needs.

7.4. In circumstances where property is deemed surplus to requirements and can be sold, the Disposal Strategy within the AMS provides the process by which this happens and considerations for doing so. To enable a consistent approach to the disposal of surplus land and property, the Disposal policy clarifies the circumstances within which the council will achieve its requirements for best consideration, whilst supporting the Council's objectives as per the Community & Corporate Plan and AMS.

7.5. The AMS acknowledges a need for assets to align to its five core objectives. In circumstances where properties are considered to not meet this criteria, have alternative development potential or can be rationalised to unlock capital receipts, the Council's Disposal Policy can be exercised to support the disposal of surplus assets.

7.6. When capital receipts are generated these can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts "flexibly" on service transformation projects under the Welsh Government flexible use of capital receipts policy. Repayments of capital grants, loans and investments also generate capital receipts.

7.7. The Council anticipates the following capital receipts in the forthcoming financial years:

***Table 5: Forecast Capital receipts***

| | **2024/25** | **2025/26** | **2026/27** | **2027/28** | **2028/29** |
|---|---|---|---|---|---|
| | **£000** | **£000** | **£000** | **£000** | **£000** |
| Balance as at 1st April | 9,984 | 5,052 | 3,332 | 1,116 | 635 |
| *Less:* capital receipts used for financing | (1,381) | (640) | (460) | (460) | (460) |
| *Less:* capital receipts used to support capitalisation directive | (3,744) | (3,358) | (2,358) | (324) | 0 |
| Capital receipts for Redundancies | 0 | 0 | 0 | 0 | 0 |
| Capital receipts Received | 91 | 0 | 0 | 0 | 0 |
| Capital receipts Forecast | 103 | 2,278 | 603 | 303 | 0 |
| **Forecast Balance as at 31st March** | **5,052** | **3,332** | **1,116** | **635** | **175** |

7.8. Further specific details of planned asset disposals are reported regularly to Cabinet Members.

7.9. The value of Capital receipts forecast after 2025/26 drops off quite considerably which is reflective of the replacement local development plan (RDLP) not proceeding as quickly as envisaged in the original delivery agreement. This will have an impact on the balance of receipts available to fund future capital investment demands in the near term.

7.10. Traditionally receipts have been earmarked to finance the Councils future schools investment. Whilst the Council has further future schools aspirations, it is not proposed to advocate a similar approach to members in respect of futures tranches of investment. Schools based assets commonly have a useful life of 50 years+, and as such traditional long term loan funding can be sourced at competitive rates with limited annual revenue volatility. The Council derives greater revenue benefit by using capital receipts in affording replacement of short life assets, given the avoidance of proportionately more significant minimum revenue provision.

## 8. Treasury management

8.1. The Treasury management strategy (TMS) is considered alongside the Capital strategy at Council and the figures within it the link directly to the impact of the debt resulting from the Capital strategy and the subsequent capital investment.

8.2. Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. 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. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

## 9. Borrowing strategy

9.1. Whilst the Council has significant long term borrowing requirements, the Council's current strategy of funding capital expenditure is through utilising internal resources such as reserves (called 'internal borrowing') rather than undertaking new borrowing i.e. we defer taking out new long term borrowing and fund capital expenditure from day to day positive cash-flows for as long as we can.

9.2. By using this strategy, the Council can also minimise cash holding at a time when counterparty risk remains high. The interest rates achievable on the Council's investments are also significantly lower than the current rates payable on long term borrowing and this remains a primary driver for our current 'internally borrowed' strategy.

9.3. Whilst this strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.

9.4. The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher.

9.5. **Authorised limit:** The Council is legally obliged to approve an affordable borrowing limit (also termed the 'authorised limit' for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

***Table 6: Authorised limit and operational boundary for external debt in £m***

| Operational boundary and Authorised limit | 2025/26 Estimate £m's | 2026/27 Estimate £m's | 2027/28 Estimate £m's | 2028/29 Estimate £m's |
|---|---|---|---|---|
| Operational Boundary - borrowing | 248.2 | 264.1 | 265.6 | 267.2 |
| PFI, leases & right of use assets/Headroom | 17.8 | 17.8 | 17.8 | 17.8 |
| **Operational Boundary - total external debt** | **266.0** | **281.9** | **283.4** | **285.0** |
| | | | | |
| Authorised Limit - borrowing | 263.6 | 279.5 | 281.0 | 282.6 |
| PFI, leases & right of use assets/Headroom | 18.8 | 18.8 | 18.8 | 18.8 |
| **Authorised Limit - total external debt** | **282.4** | **298.2** | **299.8** | **301.4** |

## 10. Investment strategy

10.1. Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

10.2. The Council's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local Councils or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

**Governance**

10.3. Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the S151 Officer or Deputy and their staff, who must act in line with the treasury management strategy approved by full Council. The draft 2025/26 strategy is considered alongside this paper with a final version to be put forward for approval by full Council in March 2025. In addition quarterly treasury reports on activity are presented to Governance and Audit Committee who are responsible for scrutinising treasury management decisions.

## 11. Investments for Service Purposes

11.1. The Council has historically incurred the majority of its capital expenditure on the assets required to provide its services such as schools, highways and corporate facilities.

11.2. However it may also invest in other entities for the wider economic and societal benefits of its communities or businesses. This may include making loans or taking an equity interest in local bodies or the Council's subsidiaries and joint ventures which in turn contribute to services to Monmouthshire residents. It may also include providing guarantees to other bodies.

11.3. In light of the public service objective, the Council traditionally is willing to take more risk on these investments than it would with more traditional treasury investments, which are more highly regulated, however any such arrangement should only be entered into if such investments are assessed to break even after all costs are taken into account or if the benefits of the scheme are considered to be worth the net cost.

11.4. Decisions on service related investments (e.g. vibrant homes loans afforded through WG repayable grant or economic development loans) can be made by the relevant service manager provided a 100% loss can be covered by the managers existing budgets. Should additional budget/funding be required in the event of a default, then before making the service expense/investment, the Section 151 officer is required to be consulted and where member approval is felt necessary that the details and risks involved presented to Cabinet for approval.

11.5. The criteria and limits laid down in the strategy for treasury Investments can be used as a comparator to measure risks against. Most loans and shares are capital expenditure and such decision requires approval of full Council to be added to the capital programme.

11.6. A list of investments for service purposes including loans and guarantees will be maintained by the Treasury team and they will be assessed at least annually and reported as part of the annual accounts and include Foster carer loans and Low cost home ownership equity interest.

## 12. Commercial Activities

12.1. Monmouthshire County Council adopted an Asset Investment Policy in May 2018, with a further amendment to the policy approved in February 2019, which afforded the authority the powers to acquire property to meet policy objectives. The commercial asset investment portfolio contains the strategic sites that are to generate a revenue return to MCC, and/or afford regenerative or social benefit via the ownership of strategic investments.

12.2. Total commercial investments held by the Council are currently valued at £31.3m:

***Table 7: Value of Commercial investments***

| Asset | Value @ 01/04/2023 | Movement | Value @ 31/03/2024 |
|---|---|---|---|
| Castlegate Business Park | 6,158,995 | 495,275 | 6,654,270 |
| Castlegate Business Park - Service Charge | 260,510 | -59,088 | 201,422 |
| Newport Leisure Park | 19,756,000 | -937,000 | 18,819,000 |
| Oak Grove Solar Farm | 5,484,818 | 126,119 | 5,610,937 |
| Broadway Loan | 792,293 | -792,293 | 0 |
| **Total** | **32,452,616** | **-1,166,987** | **31,285,629** |

12.3. The ratio of commercial income compared to the Council's net revenue budget is around 1.5% and is considered prudent and proportionate, and is not considered to expose the Council to undue risk if any one income stream was compromised. To assist in managing this risk the Council holds reserves for its commercial investments that look to further mitigate the factors that may impact upon future income generation.

**Governance**

12.4. The Council paused any further active consideration of commercial investments activity as a consequence of the pandemic and the resultant uncertainty in property and investment markets. No investments have been made subsequent to the strengthening of the Prudential code and confirmation has been provided on an annual basis to the DMO that no PWLB borrowing is intended for the purpose of acquiring investment assets primarily for the purposes of yield.

12.5. A residual capital budget of £1.85m is held to support any further capital investment required on existing investments, in order to maintain value and maximise return on investment.

12.6. As a result of the Council's risk appetite any further new investment will only be considered in order to support the core policy objectives contained within the Council's latest Community and Corporate Plan, and where deemed prudent, sustainable and affordable.

12.7. In terms of any future investment proposals, these can be considered in line with the Council's current constitution and decision-making processes through Council, Cabinet or otherwise.

12.8. The Investment Committee, as an existing sub-committee of Council, has been retained but put in abeyance. This therefore allows Council in future, and if it so wishes, to request the Investment Committee to preside over an investment proposal before making recommendation back to Council for consideration. In such circumstances this will retain the cross-party scrutiny and consideration of any such investment proposals.

12.9. The Performance & Overview Scrutiny Committee now focuses on maintaining oversight and scrutiny of the performance of the Council's property investment portfolio on a six-monthly basis.

12.10. The Governance and Audit Committee looks to seek ongoing assurance on overall governance arrangements of the commercial and property investments as part of the Council's overall land and property portfolio.

## 13. Knowledge & skills

### Internal expertise

13.1. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Section 151 officer, deputy Section 151 officer, and Head of Commercial and Integrated Landlord Services are professionally qualified with extensive Local Government experience between them.

13.2. The central finance team who manage day-to-day cashflow activities and monitor capital investment activity consists of experienced qualified and part-qualified accountants who maintain Continuous Professional Development (CPD) and attend courses on an ongoing basis to keep abreast of new developments and obtain relevant skills.

### External expertise

13.3. 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. The Council currently employs Arlingclose Limited as treasury management advisors, and Alder King as property investment advisors. This approach is more cost effective than employing such staff directly and ensures that the Council has access to expert knowledge and skills commensurate with its risk appetite.

### Members

13.4. Training is offered to members to ensure they have up to date skills to make capital and treasury decisions. The most recent training was provided in November 2022, with a number of new members attending for the first time. A register is also kept on member attendance.

**Appendix 2**

# 2025/26 Treasury Management Strategy

## 1. Economic background and forecasts for interest rates

1.1. **Economic background:** The impact on the UK from the government's Autumn Budget, slower expected interest rate cuts, a short-term boost to but 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.

1.2. The Bank of England's (BoE) Monetary Policy Committee (MPC) held Bank Rate at 4.75% at its December 2024 meeting, having reduced it to that level in November and following a previous 25bp cut from the 5.25% peak at the August MPC meeting. At the December meeting, six Committee members voted to maintain Bank Rate at 4.75% while three members preferred to reduce it to 4.50%.

1.3. The November quarterly Monetary Policy Report (MPR) expected 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 zero (0.0%) between July and September 2024 and 0.4% between April and June 2024, a further downward revision from the 0.5% rate previously reported by the Office for National Statistics (ONS).

1.4. ONS figures reported the annual Consumer Price Index (CPI) inflation rate at 2.6% in November 2024, up from 2.3% in the previous month and in line with expectations. Core CPI

also rose, but by more than expected, to 3.6% against a forecast of 3.5% and 3.3% in the previous month. 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.

1.5. The labour market appears to be easing slowly, but the data still require treating with some caution. The latest figures reported the unemployment rate rose to 4.3% in the three months to October 2024 and economic inactivity fell to 21.7%. Pay growth for the same period was reported at 5.2% for both regular earnings (excluding bonuses) and 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.

1.6. The US Federal Reserve has continued cutting interest rates, bringing down the Fed Funds Rate by 0.25% at its December 2024 monetary policy meeting to a range of 4.25%-4.50%, marking the third consecutive reduction. 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 (upwardly revised) annual rate of 3.1% 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.

1.7. Euro zone inflation rose above the European Central Bank (ECB) 2% target in November 2024, hitting 2.2% as was widely expected and a further increase from 2% in the previous month. Despite the rise, the ECB continued its rate cutting cycle and reduced its three key policy rates by 0.25% in December. Inflation is expected to rise further 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.

1.8. **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.

1.9. Higher 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.

1.10. 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.

1.11. 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.

1.12. **Interest rate forecast (December 2023):** The Authority's treasury management adviser Arlingclose expects the Bank of England's MPC will continue reducing Bank Rate through 2025, taking it 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.

1.13. 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.

1.14. A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix A.

1.15. For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate/yield of 4.25%, and that new long-term loans will be borrowed at an average rate of 5.5%.

## 2. Local Context

2.1. On 31st December 2024, the Council held £184.5m of borrowing and £15.5m of treasury investments as demonstrated below:

***Table 1: Current debt and investment levels***

| | 31st Dec 2023 Actual Portfolio £m's | Average Rate % | 31st Dec 2024 Actual Portfolio £m's | Average Rate % |
|---|---|---|---|---|
| **External borrowing:** | | | | |
| Public Works Loan Board | 122.2 | 3.3% | 135.8 | 3.52% |

| | | | | |
|---|---|---|---|---|
| LOBO loans from banks | 3.0 | 4.5% | 0.0 | 0.0% |
| Welsh Government Loans | 5.3 | 0.0% | 4.7 | 0.0% |
| Council to Council & other ST loans | 43.0 | 4.4% | 44.0 | 5.06% |
| **Total external borrowing** | **173.5** | **3.5%** | **184.5** | **3.71%** |
| **Treasury investments:** | | | | |
| Banks & building societies (unsecured) | 1.5 | 1.5% | 0.0 | 0.0% |
| Government (incl. local Councils) | 3.0 | 4.84% | 9.0 | 4.99% |
| Money Market Funds | 5.1 | 4.88% | 2.5 | 4.78% |
| Strategic pooled funds | 4.0 | 5.77% | 4.0 | 5.44% |
| **Total treasury investments** | **13.6** | **4.76%** | **15.5** | **5.03%** |
| **Net debt** | **159.9** | | **169.0** | |

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

2.3. The Council has an increasing CFR due to the indicative capital programme, but minimal investments and will therefore be required to borrow additional sums over the longer term.

2.4. **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes 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.

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

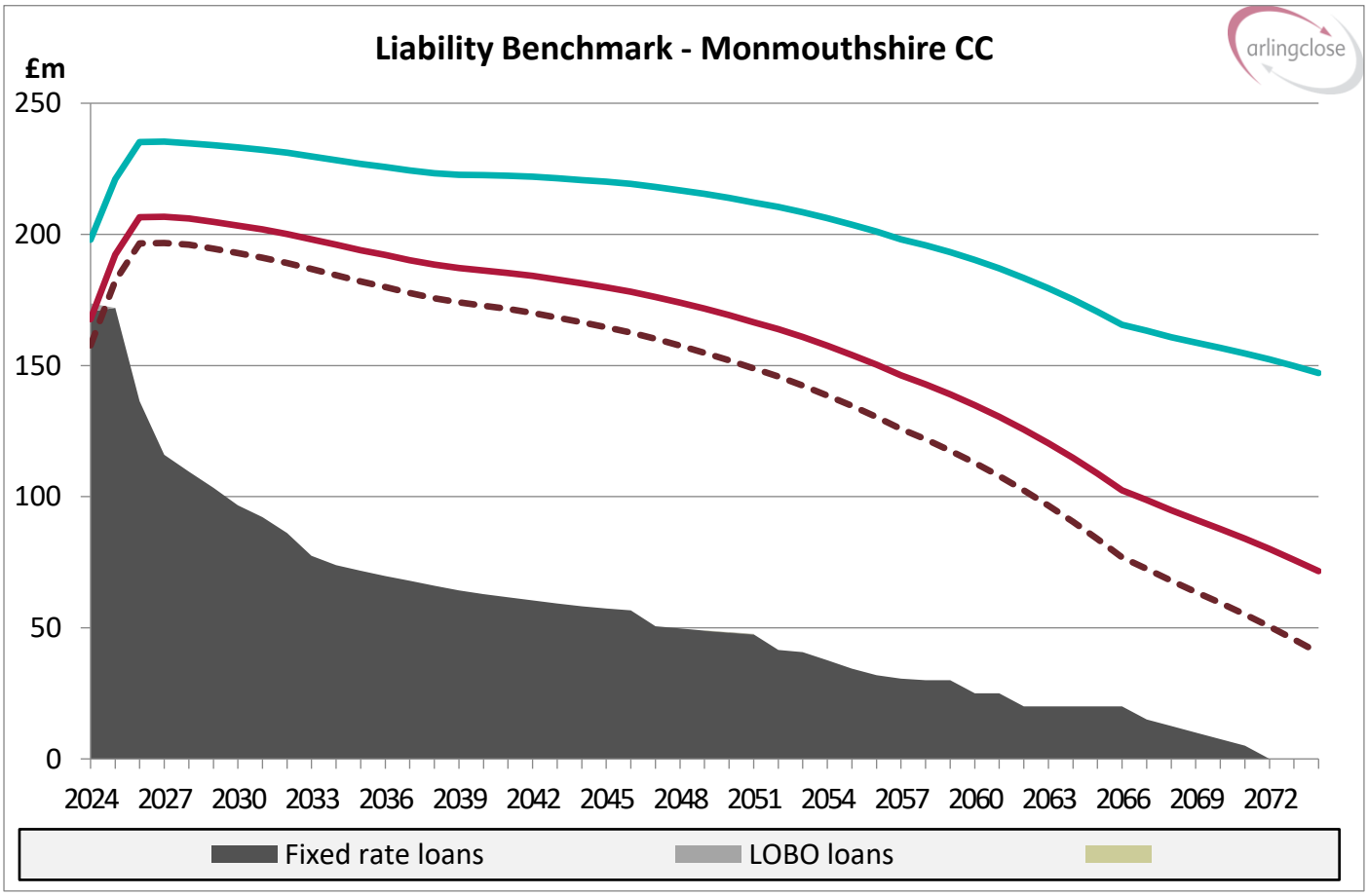
***Table 2: Liability benchmark***

| | **31.3.24 Actual** | **31.3.25 Forecast** | **31.3.26 Forecast** | **31.3.27 Forecast** | **31.3.28 Forecast** | **31.3.29 Forecast** |
|---|---|---|---|---|---|---|
| Loans CFR | 198.0 | 220.0 | 234.4 | 234.4 | 234.5 | 238.0 |
| Less: Balance sheet resources | (40.3) | (38.7) | (38.7) | (38.7) | (38.7) | (38.7) |
| **Net loans requirement** | **157.7** | **181.3** | **195.7** | **195.7** | **195.7** | **199.3** |

| | | | | | | |
|---|---|---|---|---|---|---|
| Plus: Liquidity allowance | 16.2 | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 |
| **Liability benchmark** | **173.9** | **191.3** | **205.7** | **205.7** | **205.7** | **209.3** |
| Current loan profile** | (173.9) | (172.5) | (137.0) | (116.5) | (110.1) | (103.8) |
| **Borrowing requirement** | **0.0** | **18.8** | **68.7** | **89.2** | **95.7** | **105.5** |

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

2.6. The long-term liability benchmark assumes capital expenditure funded by borrowing is in line with the medium-term financial plan, minimum revenue provision on new capital expenditure is based on the annuity method, and expenditure and reserves all increasing by inflation of 2.5% p.a. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:




2.7. Our underlying need to borrow is shown by the top blue line and increases sharply over the short term due to the current approved capital programme. However, due to the use of reserves and working capital, the Council is expected to need total external borrowing between the full and dotted red lines. As our existing loans portfolio (shown in grey) reduce as loans mature, new loans will therefore be required to fill the gap between the grey area and the red lines over the longer term. The Council intends to maintain a level of short term loans which will partly fill this gap, but we will still need to take out longer term loans, mainly to fund the long-term capital investment built into the Capital MTFP.

2.8. The Council does not intend to borrow in advance of need and will not do so just to gain financially from short term investment of that borrowing. However, this option may be considered if it is felt that borrowing in advance allows opportunities to lock into favourable long-term rates as part of risk mitigation. This will be limited to no more than the expected increase in the Council's Capital Financing Requirement over its medium term financial plan.

## 3. Borrowing Strategy

3.1. The Council currently holds £184.5m of loans, an increase of £11.0m on the previous year, as part of its strategy for funding previous years' capital programmes. The liability benchmark above shows that the Council expects to borrow up to £68.7m in 2025/26. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.

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

3.3. **Strategy:** Given the constraints on public expenditure over recent years and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Short-term interest rates are currently higher than in the recent past, but are expected to fall in the coming year 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. The risks of this approach will be managed by keeping the Authority's interest rate exposure within the limit set in the treasury management prudential indicators, see below.

3.4. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years.

3.5. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2025/26 with a view to keeping future interest costs low, even if this causes additional cost in the short-term**.**

3.6. The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local Councils, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local Councils planning to buy

investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

3.7. 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 to be achieved without suffering a cost of carry in the intervening period.

3.8. In addition, the Authority may borrow further short-term loans to cover unplanned cash flow shortages.

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- National Wealth Fund Ltd (formerly UK Infrastructure Bank Ltd)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Greater Gwent Pension Fund)
- Capital market bond investors
- Retail investors via a regulated peer-to-peer platform
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
- CSC Foundry Ltd

**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
- Private Finance Initiative
- sale and leaseback
- similar asset based finance

3.10. **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local Councils. This is a more complicated source of finance than the PWLB for two reasons: borrowing Councils 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 to full Council.

3.11. **LOBOs:** The Council no longer holds LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost.

3.12. **Short-term and variable rate loans**: These loans leave the Council 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).

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

3.14. Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen in the table above, the Council expects to comply with this over the medium term window based on current estimates of future debt levels.

3.15. **Authorised limit:** The Council is legally obliged to approve an affordable borrowing limit (also termed the 'authorised limit' for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

3.16. Based on the capital programme proposed, it is recommended that the Council approve the following authorised limits and operational boundaries. The undertaking of other long-term liabilities, within the overall limit, is delegated to the Section 151 Officer based on the outcome of financial option appraisals and best value considerations.

3.17. The operational boundary remains an internal management tool to monitor borrowing levels and exceeding the boundary would not represent a compliance failure.

***Table 3: Authorised limit and operational boundary for external debt in £m***

| **Operational boundary and Authorised limit** | **2025/26 Estimate £m's** | **2026/27 Estimate £m's** | **2027/28 Estimate £m's** | **2028/29 Estimate £m's** |
|---|---|---|---|---|
| Operational Boundary - borrowing | 248.2 | 264.1 | 265.6 | 267.2 |
| PFI, leases & right of use assets/Headroom | 17.8 | 17.8 | 17.8 | 17.8 |
| **Operational Boundary - total external debt** | **266.0** | **281.9** | **283.4** | **285.0** |
| | | | | |
| Authorised Limit - borrowing | 263.6 | 279.5 | 281.0 | 282.6 |
| PFI, leases & right of use assets/Headroom | 18.8 | 18.8 | 18.8 | 18.8 |
| **Authorised Limit - total external debt** | **282.4** | **298.2** | **299.8** | **301.4** |

**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:

***Table 4: (Treasury management indicator) - Maturity structure of borrowing***

| Refinancing rate risk indicator | Upper limit | Lower limit |
|---|---|---|
| Under 12 months | 50% | 0% |
| 12 months and within 24 months | 30% | 0% |
| 24 months and within 5 years | 30% | 0% |
| 5 years and within 10 years | 30% | 0% |
| 10 years and within 20 years | 30% | 0% |
| 20 years and within 30 years | 30% | 0% |
| 30 years and within 40 years | 30% | 0% |
| 40 years and within 50 years | 30% | 0% |
| 50 years and above | 30% | 0% |

## 4. Treasury investments

### Treasury Investment strategy

4.1. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the year to date, the Council's treasury investment balance has ranged between £10.2m and £50.1m million. It is anticipated that the level of investments held in 2025/26 will be lower, as cash balances are used in lieu of external borrowing, in line with the authority's internal borrowing strategy.

4.2. **Objectives:** Both the CIPFA Code and the WG Guidance require 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 Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

4.3. **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. The existing portfolio of strategic pooled funds currently provides a degree of risk diversification into different sectors, however

the Council will closely monitor the returns on these investments in light of a heightened interest rate environment.

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

4.5. **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 Council'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, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

4.6. An updated list of signatories to the three charters is provided by the Authority's treasury advisors each quarter and will continue to be monitored. Any counterparties not signed up to all three charters will be removed from the Authorities investment portfolio.

4.7. The Council will continue through 2025/26 to engage with its advisors Arlingclose to evaluate its existing investments and assess whether a more sophisticated ESG policy can be applied. Governance and Audit Committee will be kept informed of progress through the regular reporting of treasury performance into committee.

4.8. **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

4.9. **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the limits shown.

***Table 5: Treasury investment counterparties and limits***

| Sector | Time limit | Counterparty limit | Sector limit |
|---|---|---|---|
| The UK Government | 50 years | Unlimited | n/a |
| Local Councils & other government entities | 25 years | £4m | Unlimited |
| Secured investments * | 5 years | £4m | 75% |

| Sector | Time limit | Counterparty limit | Sector limit |
|---|---|---|---|
| Banks (unsecured) * | 13 months | £2m (£3m total for the Councils operational bank) | Unlimited |
| Building societies (unsecured) * | 13 months | £2m | 50% |
| Registered providers (e.g. Housing Associations (unsecured) * | 5 years | £2m | 50% |
| Money market funds * | n/a | £4m | Unlimited |
| Strategic pooled funds | n/a | £5m | £10m |
| Real estate investment trusts | n/a | £5m | £10m |
| Covered or Supranational bonds | n/a | £5m | £10m |
| Other Investments* | 13 months | £2m | £5m |

*** Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. 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.

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

| Credit rating | Banks unsecured | Secured investments | Government | Corporates |
|---|---|---|---|---|
| UK Govt | n/a | n/a | n/a | n/a |
| AAA – AA+ | £3m | £4m | n/a | £4m |
| | 13 months | 5 years | | 5 years |
| AA – AA- | £3m | £4m | n/a | £4m |
| | 13 months | 5 years | | 5 years |
| A+ - A | £3m | £4m | n/a | £4m |
| | 13 months | 2 years | | 2 years |
| A- | £3m | £4m | n/a | £4m |
| | 13 months | 13 months | | 13 months |

This table must be read in conjunction with the notes below

**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.

**Local authorities and other government entities**: Loans to, and bonds and bills issued or guaranteed by, other national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk.

**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.

**Banks and building societies (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.

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

**Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

**Strategic pooled funds:** 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 Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date but can be either withdrawn after a notice period or sold on an exchange, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

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

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

**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 be kept below £3m per bank. 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.

**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. The credit rating agencies in current use are listed in the Treasury Management Practices document. 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.

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

4.11. 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.

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

4.13. **Investment limits**: The Council's revenue reserves available to cover investment losses currently stand at £18.8m. In order that no more than a third of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5m. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

4.14. Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries as below. Investments in pooled funds and multilateral development banks

do not count against the limit for any single foreign country, since the risk is diversified over many countries.

***Table 6: Additional investment limits***

| | **Cash limit** |
|---|---|
| Any group of pooled funds under the same management | £5m per manager |
| Negotiable instruments held in a broker's nominee account | £5m per broker |
| Foreign countries | £4m per country |

4.15. **Liquidity management**: The Council uses its own cash flow forecasting system 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.

4.16. The Council will spread its liquid cash over at least two providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

**Treasury Management Indicators**

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

4.18. **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

| **Credit risk indicator** | **Target** |
|---|---|
| Portfolio average credit rating / score | A-/5.0 |

4.19. **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** | **2025/26** | **2026/27** | **2027/28** | **No fixed date** |
|---|---|---|---|---|
| Limit on principal invested beyond year end | £5m | £4m | £2m | £10m |

4.20. 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.

## 5. Related matters

5.1. The CIPFA Code requires the Council to include the following in its treasury management strategy:

5.2. **Financial derivatives:** ) Local Councils 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 24 of the Local Government and Elections (Wales) Act 2021 removes much of the uncertainty over local Councils' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

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

5.4. 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.

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

5.6. **External Funds**: The Council will from time to time hold fund on behalf of external organisations, companies or individuals. Unless a specific agreement is in place for the investment of the funds held, the Council will normally allocate interest returns based on a calculation of the average returns achieved from an overnight deposit rate with the Debt Management Office over the period held.

5.7. **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the

Council's treasury management activities, the Section 151 officer or deputy believes this to be the most appropriate status.

5.8. **Government Guidance:** Further matters required by the WG Guidance are included in Section 6 below.

**Financial Implications**

5.9. The budget for investment income in 2025/26 is £788k, based on an average investment portfolio of £10m and existing pooled fund investments. Returns are expected to come from pooled fund investments, from shorter term investments with the Government, from secured/unsecured investments, or from Money Market Funds.

5.10. The budget for debt interest paid in 2025/26 is £7.6m, based on existing loans and assumed new borrowing at an average rate of 5.5%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecasts, performance against budget will be correspondingly different.

**Other Options Considered**

5.11. The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local Councils 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 may be greater |
| Invest in a wider range of counterparties and/or for longer times | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses may be smaller |
| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain |

| | | |
|---|---|---|
| Reduce level of borrowing | Saving on debt interest is likely to exceed lost investment income | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain |

## 6. Additional requirements of Welsh Government Investment Guidance

6.1. The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local Councils that are not integral to this Council's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

6.2. **Contribution:** The Council's investments contribute to its service delivery objectives and/or to promote wellbeing as follows:

- treasury management investments support effective treasury management activities,
- loans to local organisations provide financial support to those organisations to enable them to deliver local public services that would otherwise be provided directly by the Council, and
- investment property provides a net financial surplus that is reinvested into local public services and supports economic regeneration.

6.3. **Climate change:** The Authority's investment decisions consider long term climate risks to support a low carbon economy to the extent that the Council has invested in, as part of the overall capital programme, a number of energy efficiency related schemes, including LED lighting and Solar PV, as well as ultra-low emission vehicles. In addition, the new Abergavenny 3-19 school is being constructed on a net carbon zero basis.

6.4. **Specified investments**: The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local Council,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local Council, parish council or community council, or
  - a body or investment scheme of "high credit quality".

6.5. The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating

of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of [A-] or higher.

6.6. **Loans:** The WG Guidance defines a loan as a written or oral agreement where the Council temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local Council.

6.7. The Council uses an allowed ‘expected credit loss’ model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Council has appropriate credit control arrangements to recover overdue repayments in place.

6.8. **Non-specified investments**: Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. Limits on non-specified investments are shown in table 18; the Council confirms that its current non-specified investments remain within these limits.

***Table 7: Non-specified investment limits***

| | **Cash limit** |
|---|---|
| Units in pooled funds without credit ratings or rated below [A-] | £10m |
| Shares in real estate investment trusts | £10m |
| Shares in local organisations | £5m |
| Total non-specified investments | £25m |

6.9. **Non-financial investments:** This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset’s purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. Based on current information, the Council’s investment property portfolio does not currently provide sufficient security for capital investment since its fair value is below its purchase price. The Council is therefore continue to closely review options to secure the capital invested, including:

- Retaining the asset and increasing net returns
- Disposing of the asset
- Retaining the asset for future capital gains
- Maximising return on capital in another way

6.10. The Council consider that the scale of its commercial investments including property are proportionate to the resources of the Council since gross income from such investments represent around 1.5% of the overall net revenue budget stream.

6.11. **Liquidity:** The Council's liquidity management has been detailed in the main Treasury report with regard to treasury activities. Before supporting local entities or placing a commercial investment the impact on liquidity is fully addressed, most commonly by taking out loans of an appropriate maturity to ensure funds are available for the life of the activity.

6.12. 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. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council will follow its Investment strategy for Commercial assets which ensures that any borrowed capital will be repaid with annual income earned from the investment or that an exit strategy identified during the due diligence will be followed.

6.13. **Investment advisers:** The Council has appointed Arlingclose Limited as treasury management advisers with the current contract running until 31st March 2025, and has used Alder King as advisers for the last two Commercial investment Property Acquisitions. The quality of these services is controlled by the Finance and Estates teams and also the Investment Committee appointed to oversee the Commercial Investments.

6.14. **Borrowing in advance of need:** Welsh Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority, after having regard to the guidance, will only borrow in advance of need as part of a strategy for reducing risk of future interest rate rises and would not undertake such activity purely in order to profit from an investment.

6.15. **Capacity and skills:** The Section 151 officer is responsible for ensuring that those elected members and statutory 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;
- assess individual investments in the context of the strategic objectives and risk profile of the local Council; and
- understand how the quantum of these decisions have changed the overall risk exposure of the local Council.

6.16. Steps taken include relevant training for elected members and a minimum level of qualification for statutory officers, as well as ensuring continuing professional development, via attendance at relevant training courses. Officers will always take advice from its independent advisers regarding investment and borrowing activity.

6.17. **Commercial deals:** The investment committee is responsible for ensuring that those tasked with negotiating commercial deals have the appropriate skills and access to information to

allow them to operate with regard to the principles of the prudential framework and regulatory regime within which the Council operates.

6.18. **Corporate Governance:** The Council has a clear corporate governance framework set out within its constitution, delegation framework and Annual Governance Statement. This ensures that decisions regarding investment are taken at the appropriate level. For example, the overarching treasury strategy and framework is approved by full Council. Operational decisions, such as day to day cashflow management, including borrowing, are delegated to the Section 151 officer or Deputy.

## 7. Advisors Economic & Interest Rate Forecast – December 2024

**Underlying assumptions:**

- As expected, the Monetary Policy Committee (MPC) held Bank Rate at 4.75% in December, although, with a 6-3 voting split and obvious concerns about economic growth, presented a much more dovish stance than had been expected given recent inflationary data.
- The Budget measures remain a concern for policymakers, for both growth and inflation. Additional government spending will boost demand in a constrained supply environment, while pushing up direct costs for employers. The short to medium-term inflationary effects will promote caution amongst policymakers.
- UK GDP recovered well in H1 2024 from technical recession, but underlying growth has petered out as the year has progressed. While government spending should boost GDP growth in 2025, private sector activity appears to be waning, partly due to Budget measures.
- Private sector wage growth and services inflation remain elevated; wage growth picked up sharply in October. 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.
- CPI inflation rates have risen due to higher energy prices and less favourable base effects. The current CPI rate of 2.6% could rise further in Q1 2025. The Bank of England (BoE) estimates the CPI rate at 2.7% by year end 2025 and to remain over target in 2026.
- The MPC re-emphasised that monetary policy will be eased gradually. Despite recent inflation-related data moving upwards or surprising to the upside, the minutes suggested a significant minority of policymakers are at least as worried about the flatlining UK economy.
- US government bond yields have risen following strong US data and uncertainty about the effects of Donald Trump's policies on the US economy, particularly in terms of inflation and monetary policy. The Federal Reserve pared back its expectations for rate cuts in light of these issues. Higher US yields are also pushing up UK gilt yields, a relationship that will be maintained unless monetary policy in the UK and US diverges.

**Forecast:**

- In line with our forecast, Bank Rate was held at 4.75% in December.
- The MPC will reduce Bank Rate in a gradual manner. We see a rate cut in February 2025, followed by a cut alongside every Monetary Policy Report publication, to a low of 3.75%.
- Long-term gilt yields have risen to reflect both UK and US economic, monetary and fiscal policy expectations, and increases in bond supply. Volatility will remain elevated as the market digests incoming data for clues around the impact of policy changes.
- This uncertainty may also necessitate more frequent changes to our forecast than has been the case recently.
- The risks around the forecasts lie to the upside over the next 12 months but are broadly balanced in the medium term.

| | Current | Mar-25 | Jun-25 | Sep-25 | Dec-25 | Mar-26 | Jun-26 | Sep-26 | Dec-26 | Mar-27 | Jun-27 | Sep-27 | Dec-27 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.25 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 |
| Central Case | 4.75 | 4.50 | 4.25 | 4.00 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 | 3.75 |
| Downside risk | 0.00 | -0.25 | -0.25 | -0.50 | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 |
| 3-month money market rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.25 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 |
| Central Case | 4.90 | 4.60 | 4.35 | 4.10 | 3.90 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 | 3.85 |
| Downside risk | 0.00 | -0.25 | -0.25 | -0.50 | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 |
| 5yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Central Case | 4.34 | 4.30 | 4.20 | 4.10 | 4.00 | 3.90 | 3.90 | 3.95 | 4.00 | 4.05 | 4.05 | 4.05 | 4.05 |
| Downside risk | 0.00 | -0.50 | -0.60 | -0.65 | -0.65 | -0.70 | -0.70 | -0.75 | -0.75 | -0.80 | -0.80 | -0.80 | -0.80 |
| 10yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Central Case | 4.56 | 4.55 | 4.45 | 4.30 | 4.20 | 4.20 | 4.20 | 4.20 | 4.25 | 4.25 | 4.25 | 4.25 | 4.25 |
| Downside risk | 0.00 | -0.50 | -0.60 | -0.65 | -0.65 | -0.70 | -0.70 | -0.75 | -0.75 | -0.80 | -0.80 | -0.80 | -0.80 |
| 20yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Central Case | 5.05 | 5.00 | 4.90 | 4.80 | 4.70 | 4.65 | 4.65 | 4.65 | 4.65 | 4.65 | 4.65 | 4.65 | 4.65 |
| Downside risk | 0.00 | -0.50 | -0.60 | -0.65 | -0.65 | -0.70 | -0.70 | -0.75 | -0.75 | -0.80 | -0.80 | -0.80 | -0.80 |
| 50yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.70 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Central Case | 4.52 | 4.70 | 4.60 | 4.50 | 4.40 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 |
| Downside risk | 0.00 | -0.50 | -0.60 | -0.65 | -0.65 | -0.70 | -0.70 | -0.75 | -0.75 | -0.80 | -0.80 | -0.80 | -0.80 |

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

## 8. MRP Policy Statement 2025/26

8.1. Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to Welsh Government's Guidance on Minimum Revenue Provision (the WG Guidance) most recently issued in 2018.

8.2. The broad aim of the WG Guidance is to ensure that capital expenditure is financed 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 Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

8.3. The WG Guidance requires the Council to approve an Annual MRP Statement each year and provides a number of options for calculating a prudent amount of MRP but does not preclude the use of other appropriate methods. The following statement only incorporates options recommended in the Guidance.

8.4. MRP is calculated by reference to the capital financing requirement (CFR) which is the total amount of past capital expenditure that has yet to be permanently financed, noting that debt must be repaid and therefore can only be a temporary form of funding. The CFR is calculated from the Authority's balance sheet in accordance with the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Expenditure in Local Authorities, 2021 edition.

8.5. MRP options recommended in the Guidance include:

| | |
|---|---|
| Option 1 | For capital expenditure incurred before 1st April 2008, and for supported capital expenditure incurred on or after that date, MRP will be determined in accordance with the former regulations that applied on 31st March 2008. |
| Option 2 | For General Fund capital expenditure incurred before 1st April 2008, and for supported capital expenditure incurred on or after that date, MRP will be determined as 4% of the capital financing requirement in respect of that expenditure. |
| Option 3 | For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset as the principal repayment on an annuity with an annual interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years. |
| Option 4 | For capital expenditure incurred after 31st March 2008, MRP will be determined as being equal to the accounting charge for depreciation and impairment on those assets (or parts of) continuing until the expenditure has been fully funded. |
| Option 5 | Where former operating leases have been brought onto the balance sheet due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or incentives, then the MRP charges will be adjusted so that the overall charge for MRP over the life of the lease reflects the value of the right-of-use asset recognised on transition rather than the liability. |
| Option 6 | For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital |

| | |
|---|---|
| | financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the WG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets. |

*Note: This does not preclude other prudent methods.*

**MRP in 2025/26:**

8.6. The following MRP policy will be applied in 2025/26:

| **Type of Expenditure** | **Option Applied** | **MRP Calculation** |
|---|---|---|
| Supported Borrowing funded Expenditure | Option 3 | Calculated on an annuity basis over the expected useful life of an asset, whereby the MRP element increases over time to reflect a consistent charge over life of the assets taking into account the real value of money |
| Unsupported Borrowing funded Expenditure | Option 3 | Calculated on an annuity basis over the expected useful life of an asset, whereby the MRP element increases over time to reflect a consistent charge over life of the assets taking into account the real value of money |
| Leases and PFI | Option 5 | MRP charges will be adjusted so that the overall charge for MRP over the life of the lease reflects the value of the right-of-use asset recognised on transition rather than the liability. |
| Loans classed as capital expenditure | Option 6 | As prescribed |

8.7. For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council may make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the WG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.

8.8. In all cases Capital expenditure incurred during 2025/26 will not be subject to an MRP charge until 2026/27. The 2025/26 budget proposals reflect these outlined positions.

## 9. Glossary of treasury terms

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| **Authorised Limit** | The affordable borrowing limit determined in compliance with the Local Government Act 2003 (English and Welsh Councils) and the Local Government in Scotland Act 2003. This Prudential Indicator is a statutory limit for total external debt. It is set by the Council and needs to be consistent with the Council's plans for capital expenditure financing and funding. The Authorised Limit provides headroom over and above the *Operational Boundary* to accommodate expected cash movements. Affordability and prudence are matters which must be taken into account when setting this limit.<br>(see **also** *Operational Boundary*, below) |
| **Balances and Reserves** | Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure. |
| **Bail-in** | Refers to the process which the banking regulatory Councils will use to restructure a financial institution which is failing or likely to fail. Unsecured creditors of and investors in that financial institution will participate in its restructure who will, as a consequence, incur a non-recoverable loss (commonly referred to as a 'haircut') on their obligation/investment. Local Council investments with banks and building societies such as term deposits, certificates of deposit, call accounts and non-collateralised bonds are unsecured investments and are therefore vulnerable to bail-in. |
| **Bank Rate** | The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". This rate is also referred to as the 'repo rate'. |

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| **Bond** | A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life. |
| **Capital Expenditure** | Expenditure on the acquisition, creation or enhancement of capital assets |
| **Capital Financing Requirement (CFR)** | The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local Council that has not been financed. |
| **Capital growth** | Increase in the value of the asset (in the context of a collective investment scheme, it will be the increase in the unit price of the fund) |
| **Capital receipts** | Money obtained on the sale of a capital asset. |
| **CIPFA** | Chartered Institute of Public Finance and Accountancy |
| **Constant Net Asset Value (CNAV)** | Also referred to as Stable Net Asset Value. A term used in relation to the valuation of 1 share in a fund. This means that at all times the value of 1 share is £1/€1/US$1 (depending on the currency of the fund). The Constant NAV is maintained since dividend income (or interest) is either added to the shareholders' account by creating shares equal to the value of interest earned or paid to the shareholder's bank account, depending on which option is selected by the shareholder. |
| **Collective Investment Schemes** | Funds in which several investors collectively hold units or shares. The assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'Pooled Funds'). Unit Trusts and Open-Ended Investment Companies are types of collective investment schemes / pooled funds. |
| **Corporate Bonds** | Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies. |
| **Corporate Bond Funds** | Collective Investment Schemes investing predominantly in bonds issued by companies and supranational organisations. |
| **CPI**<br>***Also see RPI*** | Consumer Price Index. (This measure is used as the Bank of England's inflation target.) |

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| **Credit Default Swap (CDS)** | A Credit Default Swap is similar to an insurance policy against a credit default. Both the buyer and seller of a CDS are exposed to credit risk. Naked CDS, i.e. one which is not linked to an underlying security, can lead to speculative trading. |
| **Credit Rating** | Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees. |
| **Cost of carry** | When a loan is borrowed in advance of requirement, this is the difference between the interest rate and (other associated costs) on the loan and the income earned from investing the cash in the interim. |
| **Credit default swaps** | Financial instrument for swapping the risk of debt default; the buyer effectively pays a premium against the risk of default. |
| **Diversification / diversified exposure** | The spreading of investments among different types of assets or between markets in order to reduce risk. |
| **Derivatives** | Financial instruments whose value, and price, are dependent on one or more underlying assets. Derivatives can be used to gain exposure to, or to help protect against, expected changes in the value of the underlying investments. Derivatives may be traded on a regulated exchange or traded 'over the counter'. |
| **ECB** | European Central Bank |
| **Federal Reserve** | The US central bank. (Often referred to as "the Fed") |
| **Floating Rate Notes** | A bond issued by a company where the interest rate paid on the bond changes at set intervals (generally every 3 months). The rate of interest is linked to LIBOR and may therefore increase or decrease at each rate setting |
| **GDP** | Gross domestic product – also termed as "growth" in the economy. The value of the national aggregate production of goods and services in the economy. |
| **General Fund** | This includes most of the day-to-day spending and income. (All spending and income related to the management and maintenance of the housing stock is kept separately in the HRA). |
| **Gilts (UK Govt)** | Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged': being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity. |

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| **Housing Revenue Account (HRA)** | A ring-fenced account of all housing income and expenditure, required by statute |
| **IFRS** | International Financial Reporting Standards |
| **Income Distribution** | The payment made to investors from the income generated by a fund; such a payment can also be referred to as a 'dividend' |
| **Investments**<br>- **Secured**<br>- **unsecured** | Secured investments which have underlying collateral in the form of assets which can be called upon in the event of default<br>Unsecured investments do not have underlying collateral. Such investments made by local Councils with banks and building societies are at risk of bail-in should the regulator determine that the bank is failing or likely to fail. |
| **Liability Benchmark** | Term in CIPFA's Risk Management Toolkit which refers to the minimum amount of borrowing required to keep investments at a minimum liquidity level (which may be zero). |
| **LOBOs** | LOBO stands for 'Lender's Option Borrower's Option'. The underlying loan facility is typically long term and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at predetermined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the 'option' to either accept the new imposed fixed rate or repay the loan facility. |
| **LVNAV (Low Volatility Net Asset Value)** | From 2019 Money Market Funds will have to operate under a variable Net Value Structure with minimal volatility (fluctuations around £1 limited to between 99.8p to 100.2p) |
| **Maturity** | The date when an investment or borrowing is repaid. |
| **Maturity profile** | A table or graph showing the amount (or percentage) of debt or investments maturing over a time period. The amount or percent maturing could be shown on a year-by-year or quarter-by-quarter or month-by-month basis. |
| **MiFID II** | MiFID II replaced the Markets in Financial Instruments Directive (MiFID I) from 3 January 2018. It is a legislative framework instituted by the European Union to regulate financial markets in the bloc and improve protections for investors. |
| **Money Market Funds (MMF)** | Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity. |

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| **Minimum Revenue Provision** | An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets |
| **Non-Specified Investments** | Term used in the Communities and Local Government Guidance and Welsh Assembly Guidance for Local Council Investments. It includes any investment for periods greater than one year or those with bodies that do not have a high credit rating, use of which must be justified. |
| **Net Asset Value (NAV)** | A fund's net asset value is calculated by taking the current value of the fund's assets and subtracting its liabilities. |
| **Operational Boundary** | This is the limit set by the Council as its most likely, i.e. prudent, estimate level of external debt, but not the worst case scenario. This limit links directly to the Council's plans for capital expenditure, the estimates of the Capital Financing Requirement (CFR) and the estimate of cashflow requirements for the year. |
| **Permitted Investments** | Term used by Scottish Councils as those the Council has formally approved for use. |
| **Pooled funds** | See Collective Investment Schemes (above) |
| **Premiums and Discounts** | In the context of local Council borrowing, (a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and (b) the discount is the gain arising when a loan is redeemed prior to its maturity date. If on a £1 million loan, it is calculated* that a £100,000 premium is payable on premature redemption, then the amount paid by the borrower to redeem the loan is £1,100,000 plus accrued interest. If on a £1 million loan, it is calculated that a £100,000 discount receivable on premature redemption, then the amount paid by the borrower to redeem the loan is £900,000 plus accrued interest.<br><br>PWLB premium/discount rates are calculated according to the length of time to maturity, current market rates (plus a margin), and the existing loan rate which then produces a premium/discount dependent on whether the discount rate is lower/higher than the coupon rate.<br><br>*The calculation of the total amount payable to redeem a loan borrowed from the Public Works Loans Board (PWLB) is the present value of the remaining payments of principal and interest due in respect of the loan being repaid prematurely, calculated on normal actuarial principles. More details are contained in the PWLB's lending arrangements circular. |

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| **Private Finance Initiative (PFI)** | Private Finance Initiative (PFI) provides a way of funding major capital investments, without immediate recourse to the public purse. Private consortia, usually involving large construction firms, are contracted to design, build, and in some cases manage new projects. Contracts can typically last for 30 years, during which time the asset is leased by a public Council. |
| **Prudential Code** | Developed by CIPFA and introduced on 01/4/2004 as a professional code of practice to support local Council capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice. |
| **Prudential Indicators** | Indicators determined by the local Council to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators between Councils. |
| **PWLB** | Public Works Loans Board. It is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local Councils and other prescribed bodies, and to collect the repayments. |
| **Quantitative Easing** | In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It "does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller's bank account. So the seller has more money in their bank account, while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy". Source: Bank of England |
| **Registered Provider of Social Housing** | Formerly known as Housing Association |
| **Revenue Expenditure** | Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges |
| **RPI** | Retail Prices Index. A monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent. Pensions and index-linked gilts are uprated using the CPI index. |

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| **SORP** | Statement of Recommended Practice for Accounting (Code of Practice on Local Council Accounting in the United Kingdom). |
| **Specified Investments** | Term used in the CLG Guidance and Welsh Assembly Guidance for Local Council Investments. Investments that offer high security and high liquidity, in sterling and for no more than 1 year. UK government, local Councils and bodies that have a high credit rating. |
| **Supported Borrowing** | Borrowing for which the costs are supported by the government or third party. |
| **Supranational Bonds** | Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry an AAA rating in their own right. Examples of supranational organisations are those issued by the European Investment Bank, the International Bank for Reconstruction and Development. |
| **Treasury Management Code** | CIPFA's Code of Practice for Treasury Management in the Public Services. The current Code is the edition released in autumn 2011. |
| **Temporary Borrowing** | Borrowing to cover peaks and troughs of cash flow, not to fund spending. |
| **Term Deposits** | Deposits of cash with terms attached relating to maturity and rate of return (interest) |
| **Unsupported Borrowing** | Borrowing which is self-financed by the local Council. This is also sometimes referred to as Prudential Borrowing. |
| **Usable Reserves** | Resources available to finance future revenue and capital expenditure |
| **Variable Net Asset Value (VNAV)** | A term used in relation to the valuation of 1 share in a fund. This means that the net asset value (NAV) of these funds is calculated daily based on market prices. |
| **Working Capital** | Timing differences between income/expenditure and receipts/payments |
| **Yield** | The measure of the return on an investment instrument |