Appendix 2

Inverclyde council

Treasury Management Strategy
and
Annual Investment Strategy

2023/24 – 2026/27

Index

1.0 INTRODUCTION

1.1 CIPFA revised the CIPFA Prudential Code and the CIPFA Code of Practice on Treasury Management in December 2021. Inverclyde Council have adopted the Code of Practice on Treasury Management and comply with the Prudential Code.

The revised codes had an immediate requirement that Councils must not borrow to invest primarily for financial return (which this Council does not do) with the following main changes to be implemented from financial year 2023/24:

a. All investments are to be attributed to either Treasury Management, Service Purposes or Commercial Purposes.
b. The risks associated with investments for Service or Commercial Purposes should be proportionate to the Council's financial capacity.
c. Councils must not borrow to invest for the primary Commercial purpose of financial return. Where financial returns arise from a project, they should be incidental to its primary purpose.
d. An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt (Inverclyde Council has no commercial investments).
e. A new prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream.
f. A new treasury indicator known as the Liability Benchmark is required.
g. The monitoring and reporting of all forward-looking prudential indicators is required at least quarterly and any significant deviations must be highlighted (this will be done as part of the regular budget monitoring to the Policy & Resources Committee)
h. The knowledge and skills required by Officers and by Elected Members is to be proportionate to the size and complexity of the treasury management conducted by the Council.
i. The Council must create new Investment Management Practices to manage risks associated with non-treasury investments (similar to the current Treasury Management Practices - TMPs).
j. Environmental, social and governance (ESG) issues are to be addressed within the Council's treasury management policies and practices (including in TMP1).

1.2 The Local Government in Scotland Act 2003 and supporting regulations (the Act) require the Council to 'have regard to' the CIPFA Prudential Code (the Prudential Code) and the CIPFA Code of Practice on Treasury Management (the Code) to set Prudential and Treasury Indicators for at least the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

1.3 The Act and supporting regulations require the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act) which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.4 It is a statutory requirement for the Council to produce a balanced budget. In particular, a local authority must calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue are affordable within the projected income of the Council for the foreseeable future. The projected revenue impact of the 2023/26 Capital Programme was built into the approved 2023/24 Revenue Budget and 2024/27 financial projections.

2.0 CAPITAL/TREASURY MANAGEMENT POSITION, PRUDENTIAL INDICATORS, TREASURY MANAGEMENT INDICATORS AND POLICY LIMITS

Current Treasury Management Position

2.1 The Council's treasury management position at 15 February 2023 comprised:

		Principal		Average Rate
		£000	£000	
DEBT				
Fixed Rate funding	PWLB	74,414		
	Market	41,500	115,914	3.59%
Variable Rate funding	PWLB	0		
	Market	59,764	59,764	4.90%
			175,678	4.04%
Other Long Term Liabilities (PPP)			55,653	---
TOTAL DEBT			**231,331**	
INVESTMENTS				
Call Accounts			4,491	3.90%
Notice Accounts			50	2.09%
Fixed Term Deposits			22,000	3.21%
TOTAL INVESTMENTS			**26,541**	3.33%

The Investments above are for treasury management cash balances only and exclude non-cash balances treated as investments under Investment Regulation 31 (see Appendix 3 for categories).

Capital Expenditure and Borrowing

2.2 The Council's Gross Capital Expenditure is estimated as:

	2022/23	2023/24	2024/25	2025/26	2026/27
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000	£000
Capital Programme	17,347	21,569	39,420	21,979	6,000

2.3 The Council's borrowing requirement (which takes account of the estimated Capital Expenditure, borrowing maturing and requiring to be refinanced, estimated future Council investment balances and expenditure to be incurred from using the PPP Service Concession Arrangement flexibility) is as follows:

	2022/23	2023/24	2024/25	2025/26	2026/27
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000	£000
New borrowing	0	0	25,000	15,000	0
Alternative financing arrangements	0	0	0	0	0
Replacement borrowing	0	5,000	0	0	0
TOTAL	0	5,000	25,000	15,000	0

2.4 The Capital Financing Requirement is the amount of capital expenditure to be funded from borrowing that has not yet been repaid by the Revenue Budget as part of the loan charges.

The Council's Gross External Debt compared to the Capital Financing Requirement as at each year-end (including the effect of the proposed borrowing in paragraph 2.3) is as follows:

	2022/23	2023/24	2024/25	2025/26	2026/27
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000	£000
Capital Financing Requirement (CFR)	277,760	286,890	300,289	297,618	287,809
External Debt (Including PPP)	229,604	224,860	247,543	259,789	249,690
Under/(Over) Against CFR	48,156	62,030	52,746	37,829	38,119

The increase in the CFR and the Under/(Over) Against CFR between 2022/23 and 2023/24 above is due to a transfer from the Capital Adjustment Account to the General Fund, linked to the Service Concession Agreement (SCA) for the PPP contract. The effect of the SCA and the Under/(Over) Against CFR above is:

	2022/23	2023/24	2024/25	2025/26	2026/27
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000	£000
Impact on CFR of SCA	0	16,146	17,604	19,446	21,077
Under/(Over) Against CFR Excluding SCA Adjustments	48,156	45,884	35,142	18,383	17,042

The above table shows that the Council expects to be under borrowed each year. Under borrowing means that the Council is using cash it already has (e.g. in earmarked reserves and other balances) to cash flow capital expenditure rather than bringing in new funds from borrowing. The projected level of under borrowing is considered reasonable but the position is kept under review in light of Council capital financing and other funding requirements.

This report does not include the impact on borrowing/investments of the transfer of HSCP reserves held by the Council to the proposed National Care Service.

Debt Limits

2.5 The Council's Authorised Limit is a control on the maximum level of debt whilst the Operational Boundary is a limit that debt is not normally expected to exceed. It is proposed that the limits are:

	2022/23	2023/24	2024/25	2025/26	2026/27
	Limit	**Limit**	**Limit**	**Limit**	**Limit**
Authorised limit for external debt	£000	£000	£000	£000	£000
Borrowing	230,000	222,000	229,000	232,000	230,000
Other Long Term Liabilities (PPP)	58,000	56,000	54,000	51,000	49,000
TOTAL	288,000	278,000	283,000	283,000	279,000
Operational boundary for external debt	£000	£000	£000	£000	£000
Borrowing	212,000	207,000	214,000	217,000	215,000
Other Long Term Liabilities (PPP)	58,000	56,000	54,000	51,000	49,000
TOTAL	270,000	263,000	268,000	268,000	264,000

Approval is being sought for the Authorised Limits for 2023/24 to 2026/27.

2.6 The Council sets limits on the maturity of fixed rate and variable rate borrowing for the coming financial year. The limits proposed for 2023/24 are:

Maturity Structure	Fixed Rate		Variable Rate	
	Upper Limit	Lower Limit	Upper Limit	Lower Limit
Under 12 months	45%	0%	35%	0%
12 months and within 24 months	45%	0%	35%	0%
24 months and within 5 years	45%	0%	35%	0%
5 years and within 10 years	45%	0%	35%	0%
10 years and within 30 years	45%	0%	35%	0%
30 years and within 50 years	45%	0%	35%	0%
50 years and within 70 years	45%	0%	35%	0%

The proposed limits are the same as set in 2022. They reflect the requirement that the Council's Market debt is treated based not on when the debt is due to mature but on when the lender could request an increase in the interest rate (when the Council could accept the increase or repay the debt).

2.7 The Council sets limits relating to the management of debt. The limits proposed are:

	2023/24	**2024/25**	**2025/26**	**2026/27**	**2022/23**
	Limit	**Limit**	**Limit**	**Limit**	**Projected Outturn at Year-End**
Maximum percentage of debt repayable in any year	25%	25%	25%	25%	22.97% (Repayable in 2077/78)
Maximum proportion of debt at variable rates	45%	45%	45%	45%	34.32%
Maximum percentage of debt restructured in any year	30%	30%	30%	30%	3.71%

The proposed limits are the same as set in 2022.

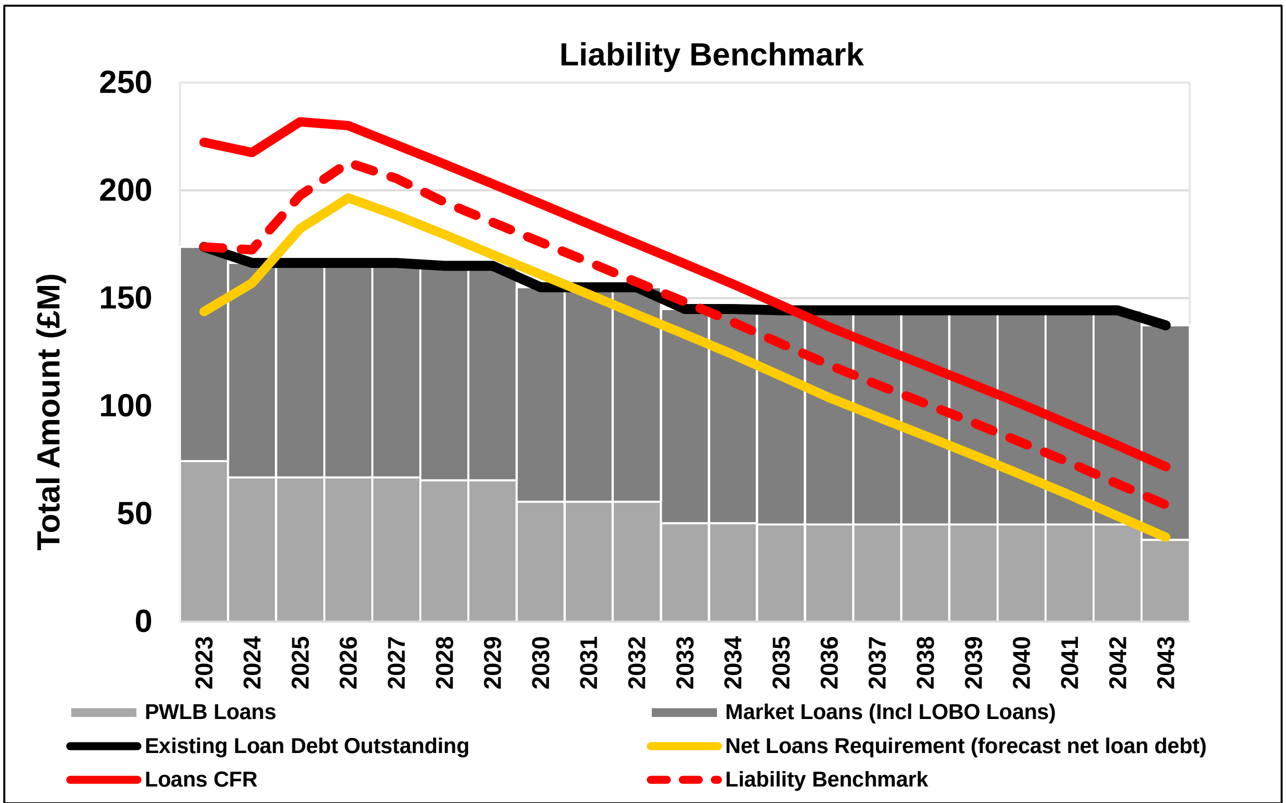
2.8 The Prudential Code requires that the Council states how interest rate exposure is managed and monitored:

All of the Council's PWLB debt is currently at fixed rates. The Market debt contains some debt at fixed rates, some small elements at variable rates and some where the rates can change (subject to the terms of the debt contract). The Council's investments, which are all for less than 1 year, are all variable or regarded as variable under the treasury management rules.

These interest rate exposures are managed and monitored by the Council through management reports on treasury management that are received and reviewed by the Chief Financial Officer.

Liability Benchmark

2.9 The Liability Benchmark is requirement in the revised Treasury Management Code. It is calculated from the Council's treasury management debt less investments plus an amount for cash flow/liquidity requirements and is shown in the graph below (the dashed line) with the existing loan debt (PWLB and Market Loans), the Loans CFR (Capital Financing Requirement excluding PPP), and the forecast net loan debt position.



The following points should be noted:

a. The graph shows the current Liability Benchmark for 2022/23 plus 20 years (longer than the minimum recommended by CIPFA) but the Council's treasury management debt runs beyond that period.

b. The graph includes the impact of the current position plus the approved capital programme (including prudential borrowing) which covers the years up to 2026/27. It does not include any projected additional borrowing or requirement beyond that (albeit that borrowing may well be required depending on plans at the time).

c. Where loans outstanding are currently projected to be less than the Liability Benchmark above, this indicates a borrowing requirement (where the Council is underborrowed and exposed to interest rate, liquidity and refinancing risks). Where loans outstanding are projected to be greater than the Liability Benchmark, this indicates a borrowing requirement (where the Council is overborrowed and exposed to credit and reinvestment risks and a possible cost of carry due to different debt and investment interest rates).

Affordability

2.10 In relation to affordability, the ratio of financing costs (including for PPP) to the Council's net revenue stream is estimated as:

	2022/23	**2023/24**	**2024/25**	**2025/26**	**2026/27**
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Ratio of financing costs (including PPP) to net revenue stream	10.63%	9.54%	9.31%	9.63%	9.55%

2.11 The ratio of net debt to the Council's net revenue stream is estimated as:

	2022/23	2023/24	2024/25	2025/26	2026/27
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Ratio of net debt (debt and PPP less investments) to net revenue stream	89.8%	88.5%	97.2%	101.3%	96.1%

2.12 The ratio of net income from commercial and service investments to the Council's net revenue stream (a new requirement from 2023/24) is estimated as NIL, as follows:

	2022/23	2023/24	2024/25	2025/26	2026/27
	Projected	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Ratio of net income from commercial and service investments to net revenue stream	0.00%	0.00%	0.00%	0.00%	0.00%

Investments

2.13 The Council's estimated investments position (after the proposed borrowing in paragraph 2.3) is shown in Appendix B and includes transactions treated as investments under the Investment Regulations. Included in Appendix B (as Cash balances managed in house) are the following estimated Bank Deposits:

	2023/24	2024/25	2025/26	2026/27
	Estimate	**Estimate**	**Estimate**	**Estimate**
	£000	£000	£000	£000
Cash balances managed in house				
1 April	30,000	15,355	15,444	16,373
31 March	15,355	15,444	16,373	17,063
Change in year	(14,645)	89	929	690

2.14 The Council sets upper limits for the total investments invested for over 365 days. The proposed limits are as follows:

	2022/23	2023/24	2024/25	2025/26	2026/27
	Limit	**Limit**	**Limit**	**Limit**	**Limit**
Upper limit for total principal sums invested for over 365 days	£000 10,000	£000 10,000	£000 10,000	£000 10,000	£000 10,000

The Council has not entered into any investments of more than 365 days during the year to date and does not expect to do so during the remainder of the year.

Accounting Changes – Leases

2.15 As of 31 March 2024, the accounting treatment of operating leases is planned to change and the value of those leases must be added to the Council's debt and assets. The values for the leases are being determined to comply with the changes to the accounting treatment. Any impact on the indicators and limits above will be included in future reports on Treasury Management activities.

3.0 PROPOSED TREASURY STRATEGY AND INVESTMENT STRATEGY

Interest Rate Forecasts

3.1 The Council has appointed Link Treasury Services Limited as treasury advisers with part of their service being to assist the Council to formulate a view on interest rates. Link's latest interest rate forecasts (as at 7 February 2023) are:

As At	Bank Rate	Investment Rates			PWLB Borrowing Rates			
		3 month	6 month	1 year	5 year	10 year	25 year	50 year
	%	%	%	%	%	%	%	%
March 2023	4.25	4.30	4.40	4.50	4.00	4.20	4.60	4.30
June 2023	4.50	4.50	4.50	↓	↓	↓	↓	↓
Sept 2023	↓	↓	4.40	4.40	3.90	4.10	4.40	4.20
Dec 2023	4.25	4.30	4.20	4.20	3.80	4.00	4.30	4.10
March 2024	4.00	4.00	3.90	3.80	3.70	3.90	4.20	3.90
June 2024	3.75	3.80	3.70	3.60	3.60	3.80	4.10	3.80
Sept 2024	3.25	3.30	3.20	3.10	3.50	3.60	3.90	3.60
Dec 2024	3.00	3.00	2.90	2.70	3.40	3.50	3.80	↓
March 2025	2.75	2.80	2.80	↓	3.30	↓	3.70	3.40
June 2025	↓	↓	↓	↓	3.20	3.40	3.60	3.30
Sept 2025	2.50	2.50	2.60	↓	3.10	3.30	3.50	3.20
Dec 2025	↓	↓	↓	↓	↓	↓	3.40	↓
March 2026	↓	↓	↓	↓	↓	3.20	↓	3.10

3.2 The UK Bank rate of 4.00% follows increases at each of the 7 Monetary Policy Committee meetings in 2022/23 up to February, having started the year at 0.75%. As shown above, further increases are forecast in March 2023 and early in 2023/24 before starting to fall towards the end of 2023/24.

Treasury Strategy – Borrowing

3.3 The proposed borrowing is as shown in paragraph 2.3 whilst the proposed authorised limit for 2023/24 is shown in paragraph 2.5.

3.4 Any borrowing will depend on an assessment by the Chief Financial Officer based on the Council's requirements and financial position, adopting a cautious but pragmatic approach and after seeking advice and interest rate/economic forecasts from the Council's treasury advisers.

Any borrowing undertaken will be reported to the Policy & Resources Committee.

3.5 <u>Policy on Borrowing in Advance of Need</u>

The Council does not and will not borrow more than its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Council will:

- Consider the definition of such borrowing within the Code on the Investment of Money By Scottish Local Authorities
- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and for the budgets have been considered
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- Consider the merits and demerits of alternative forms of funding
- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- Consider/

- Consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk and other risks and the level of such risks given the controls in place to minimise them.

The maximum extent to which borrowing in advance would be undertaken by this Council is the borrowing requirement identified in paragraph 2.5 above for 2023/2026.

Treasury Strategy - Debt Rescheduling

3.6 PWLB-to-PWLB debt restructuring would normally give rise to large premiums unless, as has been the case since the autumn of 2022, rates increased to levels at which some loans could be repaid either for low premiums payable by the Council or discounts receivable by the Council.

3.7 As short-term borrowing rates are expected to be cheaper than longer term rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short-term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

3.8 The Council is more likely to look at making savings by running down investment balances as short-term rates on investments are expected to continue to be around or lower than the rates paid on the debt currently held (albeit that the differential is expected to be lower than for some years).

3.9 The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cash flow savings but at minimum risk;
- Helping to fulfil the strategy outlined above; and

Enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

3.10 Any debt rescheduling will be reported to the Policy & Resources Committee and the Full Council and will be within the Treasury Policy Limits.

Investments – Policies/Strategy

3.11 <u>Investment Policy</u>

The Council will have regard to the Local Government Investment (Scotland) Regulations 2010 and accompanying finance circular and the revised CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (“the CIPFA TM Code”). The Council’s investment priorities are:

(a) The security of capital
and
(b) The liquidity of its investments.

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity (i.e. Council’s investment priorities for treasury investments will consider security then liquidity and then yield/return). The risk appetite of this Council is low in order to give priority to the security of its investments.

3.12 The Treasury Management code revised in December 2021 requires that “The organisation's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations. This is a developing area, and it is not implied that the organisation’s ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level.”

3.13 The proposed policy for ESG considerations is as follows:

"This Council will seek to bring ESG (environmental, social and governance) factors into the decision-making process for investments.

For short term investments with counterparties, this Council utilises the ratings provided by Fitch, Moody's and Standard & Poor's to assess creditworthiness, which include analysis of ESG factors when assigning ratings. The Council will continue to evaluate additional ESG-related metrics and assessment processes that it could incorporate into its investment process and will update accordingly."

3.14 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

3.15 Counterparty limits will be as set through the Council's Treasury Management Practices.

3.16 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

3.17 <u>Permitted Investment Types</u>
There are many investment instruments that the Council could use, each having different features and risks.

The list of investment instruments proposed for possible use by the Council (including those for the Common Good Fund) and for which Council approval is being sought are listed in Appendix A along with details of the risks from each type of investment.

The list of proposed investments reflects a low risk appetite and approach to investments by the Council.

<u>There are no changes to the proposed Permitted Investments from those agreed in 2022.</u>

3.18 <u>Creditworthiness Policy</u>
The Council's proposed Creditworthiness Policy for 2023/24, as follows, is unchanged from that agreed in 2022.

3.19 The Council uses the creditworthiness service provided by Link Treasury Services Limited. This service uses a sophisticated modelling approach using credit ratings from the three main rating agencies - Fitch, Moody's, and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies (indicating the likelihood of ratings changes for a counterparty or the expected direction of ratings for a counterparty)
- Credit Default Swap ("CDS") spreads to give early warning of likely changes in credit ratings

Sovereign ratings to select counterparties from only the most creditworthy countries.

3.20 This modelling approach combines credit ratings, credit watches and credit outlooks in a risk weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments.

The approach is reviewed by Link as required in light of banking system and regulatory changes e.g. as happened with the reduction in importance of support ratings for individual banks due to the removal of implied government support to banks.

3.21 The Council will use counterparties within the following durational bands and with the following limits per counterparty (bands and limits as set through the Council's Treasury Management Practices):

Colour Category	Maximum Period for Individual Investments	Current Limit for Total Investments with Individual Counterparty
Purple	2 Years	£15m
Blue (Nationalised or Semi-Nationalised UK Banks)	1 Year	£15m
Orange	1 Year	£15m
Red	6 Months	£15m
Green	100 Days	£10m
No Colour	Not To Be Used	£NIL

The maximum period for individual investments with the Council's own bankers will be as in accordance with the above table whilst the limit for total investments with them will be £50m or as agreed by Committee or Full Council. The limit for any other group of counterparties will be £30m or as agreed by Committee or Full Council.

Members should note that these are the maximum periods for which any investment with a counterparty meeting the criteria would take place but subject to the Council's policy on Permitted Investments and instruments.

3.22 The Link creditworthiness service uses a wider array of information than just primary ratings and, by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of Short Term rating of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

3.23 All credit ratings are monitored on an ongoing basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap spreads against the iTraxx European Senior Financials benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. The Council also uses (where available) market data, market information and information on external support for banks.

3.24 It is proposed that the Council will only use approved counterparties:

a. from the UK
   or
b. from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if not issued by Fitch).

Countries currently meeting this criterion (as at 17 February 2023) include Australia, Canada, France, Germany, Sweden, the USA, and the UK.

3.25 <u>Investment Strategy</u>
Appendix B includes forecasts of investment balances.

3.26 The Bank Rate was increased from 0.75% to 1.00% in May 2022 and has been increased at each Monetary Policy Committee meeting up to February 2023, currently being 4.00%. Link's forecast is for further increases to 4.25% in March 2023 then 4.50% in May 2023 before starting to fall in the first Quarter of 2024. Their Bank Rate forecasts for financial year ends (March) are as follows:

- 2023/24 4.00%
- 2024/25 2.75%
- 2025/26 2.50%.

3.27 Link advise that, for 2023/24, clients should budget for an investment return of 4.30% on investments placed during the financial year for periods of up to 100 days.

3.28 The Council uses an investment benchmark to assess the performance of its investments. The benchmark now being used is the 3-month SONIA compounded interest rate. This replaced LIBID rates which, for all periods, stopped being produced at the end of 2021.

3.29 The Council will avoid locking into longer term deals unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this Council.

Policy on Use of External Service Providers

3.30 The Council uses Link Treasury Services Limited as its external treasury management advisers and uses the services of brokers for investment deals as required.

3.31 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon external service providers. All decisions will be undertaken with regards to all available information including, but not solely, the treasury advisers.

3.32 The Council also recognises that there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Policy on Scrutiny, Monitoring and Change of Investment Policies and Practices

3.33 The Treasury Management Practices (TMPs) of the Council set out the operational policies and procedures in place to implement the treasury management strategy and the principles set out in the treasury management policy statement. They are intended to minimise the risk to the capital sum of investments and for optimising the return on the funds consistent with those risks.

3.34 The TMPs are kept under review, with a full revision every 3 years. The TMPs were updated in February 2023 to include issues required by the revised Code.

3.35 Investment Management Practices (IMPs) were prepared in February 2023 as required by the revised Treasury Management Code.

3.36 A copy of the TMPs and the IMPs may be obtained from Finance Services.

Training for Members

3.37 The last training session on Treasury Management was held for Members on 6 September 2022.

4.0 LOANS FUND ADVANCES

4.1 Where capital expenditure is funded by borrowing (referred to as loans fund advances), the debt financing costs are paid from the Revenue Budget as loan charges comprised of the repayment of debt and interest and expenses costs on the borrowing.

4.2 The Council is required to set out its policy for the repayment of loans fund advances from options set by the Scottish Government:

a. For loans fund advances made before 1 April 2016 the policy will be to maintain the practice of previous years and use the Statutory Method with annual principal repayments being calculated using the annuity method.
b. The annuity method is also being used for loans fund advances made after 1 April 2016. In applying the annuity method to new advances in any year, the interest rate used in the annuity calculation will be the Council's loans fund pool rate for the year (including expenses) as rounded up to the nearest 0.01%.

4.3 The outstanding loans fund advances (representing capital expenditure still to be repaid from the Revenue Budget) are:

	2021/22	2022/23	2023/24
	Actual	Projected	Estimated
	£000	£000	£000
Balance As At 1 April	232,106	226,748	221,330
Add: Advances For The Year	2,917	2,765	3,228
Less: Repayments For The Year	8,275	8,183	8,036
Balance As At 31 March	226,748	221,330	216,522

4.4 For the projected loans fund advances outstanding as at 31 March 2023, the liability to make future repayments (excluding debt interest and expenses) is as follows:

	£000
Year 1	8,036
Years 2-5	31,910
Years 6-10	40,505
Years 11-15	38,749
Years 16-20	35,629
Years 21-25	33,922
Years 26-30	18,623
Years 31-35	7,658
Years 36-40	2,329
Years 41-45	1,113
Years 46-50	1,140
Years 51-55	823
Years 56-60	119
Years 61-65	53
Years 66-70	64
Years 71-75	77
Years 76-80	92
Years 81-85	110
Years 86-90	132
Years 91-95	158
Years 96-100	88
TOTAL	221,330

Appendix A

PERMITTED INVESTMENTS
AND RISKS/CONTROLS/OBJECTIVES FOR EACH TYPE OF PERMITTED INVESTMENT

The Council approves the following forms of investment instrument for use as Permitted Investments:

	Minimum Credit Criteria	**Liquidity Risk**	**Market Risk**	**Max % of Total Investments**	**Max. Maturity Period**
Deposits					
Debt Management Agency Deposit Facility (DMADF)	---	Term	No	Unlimited	6 Months
Term Deposits – Local Authorities	---	Term	No	80%	2 Years
Call Accounts – Banks and Building Societies	Link Colour Category GREEN	Instant	No	Unlimited	Call Facility
Notice Accounts – Banks and Building Societies	Link Colour Category GREEN	Notice Period	No	80%	6 Months
Term Deposits – Banks and Building Societies	Link Colour Category GREEN	Term	No	95%	2 Years
Deposits With Counterparties Currently In Receipt of Government Support / Ownership					
Call Accounts – UK Nationalised/ Part-Nationalised Banks	Link Colour Category BLUE	Instant	No	Unlimited	Call Facility
Notice Accounts – UK Nationalised/ Part-Nationalised Banks	Link Colour Category BLUE	Notice Period	No	80%	6 Months
Term Deposits – UK Nationalised/ Part-Nationalised Banks	Link Colour Category BLUE	Term	No	95%	1 Year
Securities					
Certificates of Deposit – Banks and Building Societies	Link Colour Category GREEN	See Note 1 Below	See Note 1 Below	80%	2 Years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)					
Money Market Funds (CNAV or LVNAV)	AAAmmf with Fitch or equivalent with Moody's/ Standard & Poor's	See Note 2 Below	See Note 2 Below	50%	Call Facility

Notes:

1. The Liquidity Risk on a Certificate of Deposit is for the Term of the Deposit (if the Certificate is held to maturity) or the Next Banking Day (if sold prior to maturity). There is no Market Risk if the Certificate is held to maturity, only if the Certificate is sold prior to maturity (with an implied assumption that markets will not freeze up and so there will be a ready buyer).
2. The objective of Money Market Funds is to maintain the value of assets but such Funds hold assets that can vary in value. The credit ratings agencies, however, require the unit values to vary by almost zero. CNAV funds are Public Debt Constant Net Asset Value funds whilst LVNAV funds are Low Volatility Net Asset Value funds. There are also Variable Net Asset Value funds (VNAV) but these are <u>not</u> to be included as Permitted Investments.

Investments will only be made with banks/building societies that do not have a credit rating in their own right where the Council's treasury advisers have confirmed that any obligations of that bank/building society are guaranteed by another bank/building society with suitable ratings.

The Council will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). Countries currently meeting this criterion include Australia, Canada, France, Germany, Sweden, the USA, and the UK.

<u>Non-Treasury Investments</u>

In addition to the table of treasury investments above, the definition of "investments" under the Investment Regulations includes the following items that the Council approves as Permitted Investments:

	Minimum Credit Criteria	**Liquidity Risk**	**Market Risk**	**Max % of Total Investments**	**Max. Maturity Period**
Non-Treasury Investments					
(a) Share holding, unit holding and bond holding, including those in a local authority owned company	Assessment would be made of company in which any holding was to be made	Period of holding	Yes	10%	Unlimited
(b) Loans to a local authority company or other entity formed by a local authority to deliver services	Assessment would be made of company or entity to which any loan was to be made	Period of loan	No	20%	Unlimited
(c) Loans made to third parties	Assessment would be made of third party to which any loan was to be made	Period of loan	No	25%	Unlimited
(d) Investment property	Assessment would be made of property to be held as investment property	Period of holding	Yes	10%	Unlimited

In relation to the above, Members should note that the Council is unlikely to become involved with category (a), will have loans under category (b) (to Inverclyde Leisure), will have loans to third parties under category (c) arising from decisions on such loans made by the Council, and may have investment property under category (d) should there be a reclassification, due to accounting rules, of individual properties held by the Council.

Independent and expert advice and scrutiny arrangements will be put in place for non-Treasury Investments where required and the powers under which new non-Treasury Investments are proposed will be determined as part of the process for proposing and agreeing such investments.

Permitted Investments – Common Good

The Common Good Fund's permitted investments are approved as follows:

	Minimum Credit Criteria	Liquidity Risk	Market Risk	Max % of Total Investments	Max. Maturity Period
Funds deposited with Inverclyde Council	---	Instant	No	Unlimited	Unlimited
Share holding, unit holding and bond holding, including those in a local authority owned company	Assessment would be made of company in which any holding was to be made	Period of holding	Yes	10%	Unlimited
Investment property	Assessment would be made of property to be held as investment property	Period of holding	Yes	95%	Unlimited

Treasury Risks Arising From Permitted Instruments

All of the investment instruments in the above tables are subject to the following risks:

1. **Credit and counter-party risk**
   This is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the Council particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the Council's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA-rated organisations have the highest, relative, level of creditworthiness.

2. **Liquidity risk**
   This is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. The column in the above tables headed as 'market risk' show each investment instrument as being instant access, notice period i.e. money is available after the notice period (although it may also be available without notice but with a loss of interest), or term i.e. money is locked in until an agreed maturity date.

3. **Market risk**
   This is the risk that, through adverse market fluctuations in the value of the principal sums that the Council borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately. However, some cash rich local authorities may positively want exposure to market risk e.g. those investing in investment instruments with a view to obtaining a long term increase in value.

4. **Interest rate risk**
   This is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances, against which the Council has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Prudential Indicators and Treasury Management Indicators in this report.

5. **Legal and regulatory risk**
   This is the risk that the Council, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the Council suffers losses accordingly.

   The risk exposure of various types of investment instrument can be summarised as:
   - low risk = low rate of return
   - higher risk = higher rate of return.

For liquidity, the position can be summarised as:
- high liquidity = low return
- low liquidity = higher returns.

Controls on Treasury Risks

1. Credit and counter-party risk
This Council has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes.

2. Liquidity risk
This Council undertakes cash flow forecasting to enable it to determine how long investments can be made for and how much can be invested.

3. Market risk
The only investment instruments that the Council has agreed as Permitted Investments and that can have market risk are Certificates of Deposit. Although they have a market value that fluctuates, the market risk does not arise if the Certificates are retained until maturity - only if they were traded prior to maturity if the need arose.

4. Interest rate risk
This Council manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or, alternatively, seeks to minimise expenditure on interest costs on borrowing.

5. Legal and regulatory risk
This Council will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Unlimited Investments

Investment Regulation 24 states that an investment can be shown in the above Permitted Investments tables as being 'unlimited' in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category.

The authority has given the following types of investment an unlimited category:

1. Debt Management Agency Deposit Facility (DMADF)
   This is considered to be the lowest risk form of investment available to local authorities as it is operated by the Debt Management Office which is part of H.M. Treasury i.e. the UK Government's credit rating stands behind the DMADF. It is also a deposit account and avoids the complications of buying and holding Government-issued treasury bills or gilts.

2. High Credit Worthiness Banks and Building Societies
   See paragraphs 3.18 to 3.24 for an explanation of this authority's definition of high credit worthiness. While an unlimited amount of the investment portfolio may be put into banks and building societies with high credit worthiness, the authority will seek to ensure diversification of its portfolio with the following limits:
   - Limit for any single institution (except Council's bankers): £15m
   - Limit for Council's bankers: £50m (or as approved by the Council or Committee)
   - Limit for any one group of counterparties: £30m (£50m or as approved by the Council or Committee for the group including the Council's bankers).

3. Funds Deposited with Inverclyde Council (for Common Good funds)
   This has been included so that, under the Permitted Investments, all funds belonging to the Common Good can be deposited with Inverclyde Council (and receive interest from the Council) rather than requiring the Common Good funds to be invested under separate Treasury Management arrangements.

Objectives of Each Type of Investment Instrument

Investment Regulation 25 requires an explanation of the objectives of every type of investment instrument which an authority approves as being ‘permitted’:

1. Deposits

   The following forms of ‘investments’ are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date, or until the end of an agreed notice period, or is held at call.

   a) Debt Management Agency Deposit Facility (DMADF)

      This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. It is, however, very useful for authorities whose overriding priority is the avoidance of risk. The longest term deposit that can be made with the DMADF is 6 months.

   b) Term deposits with high credit worthiness banks and building societies

      See paragraphs 3.18 to 3.24 for an explanation of this authority’s definition of high credit worthiness. This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term). The Council will seek to ensure diversification of its portfolio of deposits as practicable and as explained above. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

   c) Notice accounts with high credit worthiness banks and building societies

      The objectives are as for 1.b) above but there is access to cash after the agreed notice period (and sometimes access without giving notice but with loss of interest). This can mean accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit.

   d) Call accounts with high credit worthiness banks and building societies

      The objectives are as for 1.b) above but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

2. Deposits With Counterparties Currently In Receipt of Government Support/Ownership

   These institutions offer another dimension of creditworthiness in terms of Government backing through either direct (partial or full) ownership or the banking support package. The view of this Council is that such backing makes these banks attractive institutions with whom to place deposits, and that will remain our view even if the UK sovereign rating were to be downgraded in the coming year.

   a) Term deposits, notice accounts and call accounts with high credit worthiness banks which are fully or semi nationalised

      As for 1.b), 1.c) and1.d) above but Government ownership implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This Council considers that this indicates a low and acceptable level of residual risk.

3. Securities

   a) Certificates of Deposit

      These are shorter term negotiable instruments issued by deposit taking institutions (mainly banks) so they can be sold ahead of maturity if the need arises. However, that liquidity (and flexibility) comes at a price so the interest rate on a Certificate of Deposit is less than placing a Term Deposit with the same bank.

4. Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)
    a) Money Market Funds (MMFs)
    By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or risk appetite to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g. a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still getting much better rates of return than available through the DMADF.

5. Non-Treasury Investments
    a) Share holding, unit holding and bond holding, including those in a local authority owned company
    The objectives for the holding of shares, units, or bonds (including those in a local authority owned company) will vary depending on whether the Council wishes to undertake actual investments in the market or has the holding as a result of a previous decision relating to the management or provision of Council services. This Council will not undertake investments in the market in shares, units, or bonds but may, if required, hold shares, units, or bonds arising from any decisions taken by the Council in relation to the management or provision of Council services.

    b) Loans to a local authority company or other entity formed by a local authority to deliver services
    Having established a company or other entity to deliver services, a local authority may wish to provide loan funding to assist the company or entity. Any such loan funding would be provided only after consideration of the reasons for the loan, the repayment period for the loan, and the likelihood that the loan would be able to be repaid by the company or entity. Such loan funding would be provided from Council Revenue Reserves rather than from borrowing.

    c) Loans made to third parties
    Such loans could be provided for a variety of reasons such as economic development or to assist local voluntary groups. Any such loan funding would be provided only after consideration of the reasons for the loan, the repayment period for the loan, and the likelihood that the loan would be able to be repaid by the third party concerned.

    d) Investment property
    An investment in property would give the Council exposure to risks such as market risk (movements in property prices), maintenance costs, tenants not paying their rent, leasing issues, etc. This Council does not currently undertake investments involving property but may have investment property should there be a reclassification, due to accounting rules, of individual properties held by the Council.

Appendix B

FORECASTS OF INVESTMENT BALANCES

Investment Regulation 31 requires the Council to provide forecasts for the level of investments for the next three years, in line with the time frame of the Council's capital investment programme. The following forecasts are for the next four years:

INVESTMENT FORECASTS	Purpose Of Investment	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
		£000	£000	£000	£000
Cash balances managed in house	Treasury				
1 April		30,000	15,355	15,444	16,373
31 March		15,355	15,444	16,373	17,063
Change in year		(14,645)	89	929	690
Average daily cash balances		22,678	15,400	15,909	16,718
Holdings of shares, bonds, units (includes authority owned company)	Service				
1 April		2	2	2	2
Purchases		0	0	0	0
Sales		0	0	0	0
31 March		2	2	2	2
Loans to local authority company or other entity to deliver services (Inverclyde Leisure)	Service				
1 April		297	250	201	151
Advances		0	0	0	0
Repayments		47	49	50	52
31 March		250	201	151	99
Loans made to third parties	Service				
1 April		100	77	65	52
Advances		0	0	0	0
Repayments		23	12	13	1
31 March		77	65	52	51
Investment properties	Commercial				
1 April		0	0	0	0
Purchases		0	0	0	0
Sales		0	0	0	0
31 March		0	0	0	0
TOTAL OF ALL INVESTMENTS					
1 April		30,399	15,684	15,712	16,578
31 March		15,684	15,712	16,578	17,215
Change in year		(14,715)	29	866	637

The movements in the forecast investment balances shown above are due largely to ongoing treasury management activity in accordance with the Council's treasury management strategy or, for loans made to third parties, in accordance with Council decisions made in respect of such loans.

All of the Council's cash balances are managed in-house with no funds managed by external fund managers.

The "holdings of shares, bonds, units (includes authority owned company)" are unredeemable bonds that have been held by the Common Good Fund for many years. Given their nature, they have been shown as being for Service Purposes rather than for Commercial Purposes.