

# Public Document Pack



## AUDIT COMMITTEE TO BE HELD ON MONDAY, 13TH FEBRUARY, 2023

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**Please find attached the report in respect Item 6 on the agenda for the above meeting**

6.	<b>Draft Treasury Management and Investment Strategy 2023-24</b> (Pages 3 - 56) Consider report by Acting Chief Financial Officer. (Copy attached.)	15 mins
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## **TREASURY MANAGEMENT STRATEGY 2023/24**

**Report by Acting Chief Financial Officer**

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### **AUDIT COMMITTEE**

**13 February 2023**

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#### **1 PURPOSE AND SUMMARY**

- 1.1 **This report is to enable the Audit Committee to undertake their scrutiny role in relation to the Treasury Management activities of the Council. It presents the proposed Treasury Management Strategy for 2023/24 for consideration prior to Council approval.**
- 1.2 The Treasury Management Strategy is the framework which ensures that the Council operates within prudent, affordable limits in compliance with the CIPFA Code.
- 1.3 The Strategy for 2023/24 to be submitted to Council on 23 February 2023 is included in this report at Appendix 1 and reflects the impact of the Administration's draft Financial Plans for 2023/24 onwards on the prudential and treasury indicators for the Council.

#### **2 STATUS OF REPORT**

- 2.1 Allowing the maximum time for finalisation of the proposals in the draft Financial Capital Plans for 2023/24 to 2032/33 has impacted on the drafting of the treasury strategy. The report is currently out for consultation and comments will be reported at the meeting.

#### **3 RECOMMENDATIONS**

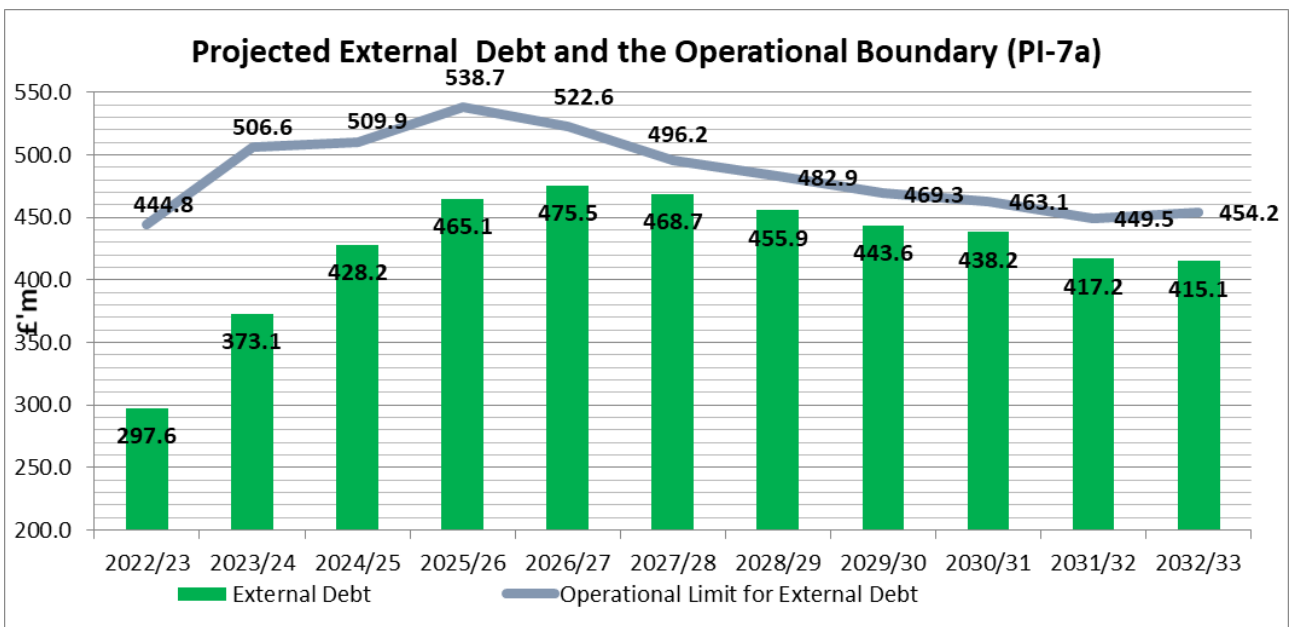
- 3.1 **It is recommended that the Committee considers whether to make any comments or recommendations on the draft Treasury Management Strategy for 2023/24 prior to presentation to Council for approval.**

## **4 BACKGROUND**

- 4.1 The Audit Committee is responsible for scrutinising the Treasury Management Strategy in line with recommended practice set out in the CIPFA (Chartered Institute of Public Finance and Accountancy) Code (i.e. Treasury Management in the Public Services: Code of Practice and Cross-Sectorial Guidance Notes).

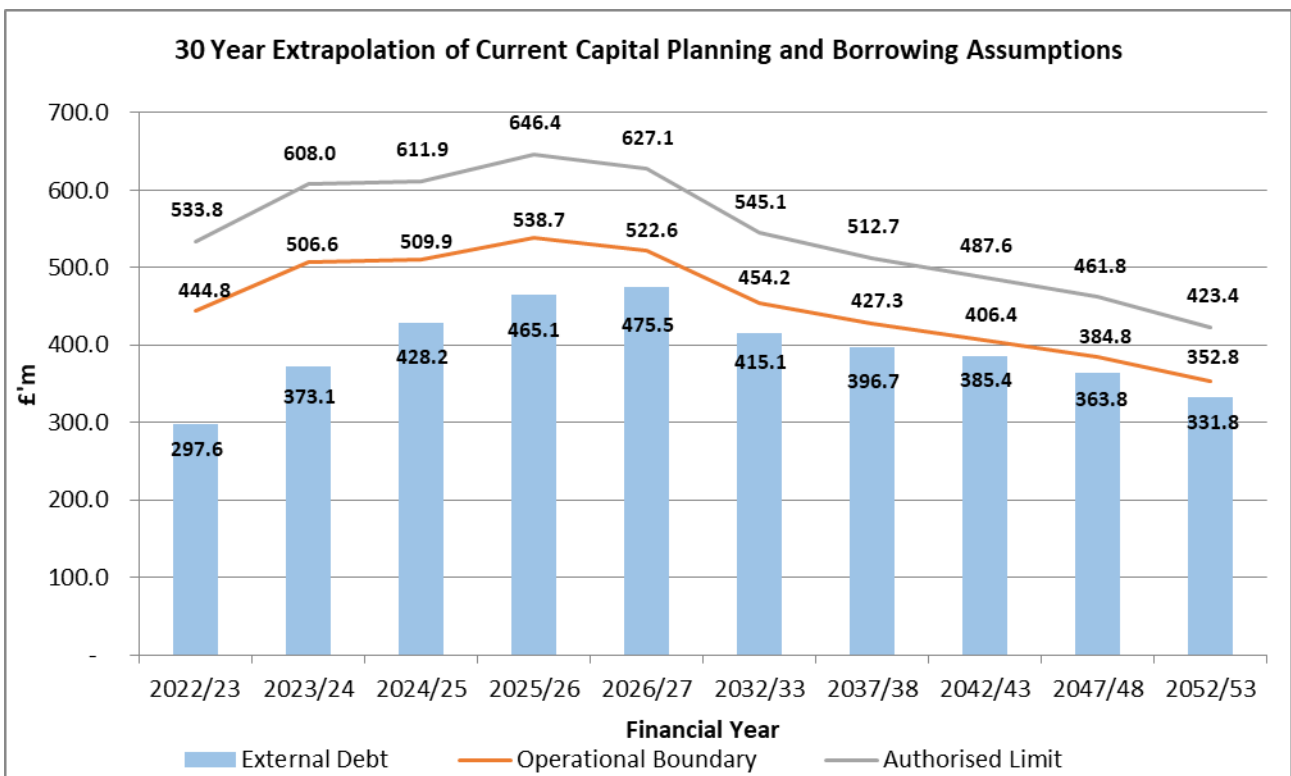
## **5 TREASURY MANAGEMENT STRATEGY 2023/24**

- 5.1 Appendix 1 contains the draft Treasury Management Strategy for 2023/24 for consideration by the Audit Committee.
- 5.2 This is based on the Administration's current draft Financial Capital Plans for 2023/24 to 2032/33, yet to be published and as such is subject to change as these plans will not be presented to Council for approval until 23 February 2023. The final version of this report which will be reported to Council will include a 30 year loans charges projection based on assumed future capital expenditure.
- 5.3 Appendix 1, Annex A contains a summary of the proposed indicators within the strategy. The significant change from the 2022/23 strategy is:
- (a) An increase in the Capital Financing Requirement (CFR) of £29.093m as a result of reprofiling of the debt liability repayments of the Council's PPP contracts as at 1 April 2023. The increase in the CFR will continue to be reduced by the revised repayments after each Service Concession Arrangement contract has expired until the end of the revised period.
- 5.4 The table overleaf shows the "Operational Boundary" against the anticipated levels of external borrowing. The external borrowing levels should not normally exceed the operational boundary limit, defined by the Prudential Framework. The gap between these two elements as seen in the table, consistently shows that the Council maintains an "under-borrowed" position. The gap however is reducing over the years due to the ambitious capital programme.



5.5 The chart below details projected external borrowing for the next 5 financial years and then at each 5 year interval up to 2052/53. Alongside this, the Operational Boundary and Authorised Limit are also shown. The chart is designed to inform long term scenario planning in line with best practice.

It should be noted that from 2032-33, the first year outwith the current 10 year Capital Plan, a 10 year average capital expenditure, and annual borrowing requirement of £10.5m, has been assumed.



5.6 A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Council has measured the LB for a 10 year period in line with the Capital Plan. There are four components to the LB: -

- 1 Existing loan debt outstanding
- 2 Loans CFR
- 3 Net loans requirement
- 4 Liability benchmark (or gross loans requirement)

The measurement shows the Council to be in an under-borrowed position with a requirement for further borrowing in future years. The Council will actively monitor the progress of the Capital Plan and align forecast spend to the most efficient borrowing options available at that time.

- 5.7 The implementation of IFRS16 has been delayed until 2023/24 year end. When implemented this will mean that leases which were previously off balance sheet will now be included. Leases form part of the other long term liability figures which make up the Prudential Indicators. The data gathering has been substantially completed and the financial implications are being assessed.

## **6 IMPLICATIONS**

### **6.1 Financial**

There are no additional financial implications in relation to this report, its content specifically relating to the financing and investment activities of the Council.

### **6.2 Risk and Mitigations**

The key purpose of presenting the Strategy to Audit Committee is to ensure that the members are satisfied with this element of the risk management framework for the treasury management function within the Council. The risks to delivering the Strategy have been identified within the Strategy itself at Appendix 1. Controls and mitigating actions have been implemented, monitored and reviewed in line with the Council's Risk Management Policy. The Strategy provides the parameters and guidance for the investment and borrowing decisions for the Council.

### **6.3 Integrated Impact Assessment**

There is no impact or relevance to Equality Duty or the Fairer Scotland Duty for this report. This is a routine financial monitoring report which forms part of the governance of the Treasury function within the Council. Nevertheless, a light touch assessment has been conducted and this will be published on SBC's Equality and Diversity Pages of the website as in doing so, signifies that equality, diversity and socio-economic factors have duly been considered when preparing this report.

### **6.4 Sustainable Development Goals**

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

### **6.5 Climate Change**

There are no direct carbon emissions impacts as a result of this report.

### **6.6 Rural Proofing**

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

### **6.7 Data Protection Impact Statement**

There are no personal data implications arising from the proposals contained in this report

### **6.8 Changes to Scheme of Administration or Scheme of Delegation**

No changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report.

## 7 CONSULTATION

7.1 The Chief Legal Officer (including as Monitoring Officer), the Chief Officer Audit and Risk, Director People Performance & Change, Communications and the Clerk to the Council are being consulted and any comments received will be reported to the meeting.

### Approved by

**Suzy Douglas**  
**Acting Chief Financial Officer**

**Signature .....**

### Author(s)

Name	Designation and Contact Number
Suzy Douglas	Acting Chief Financial Officer (X5881)

### Background Papers:

**Previous Minute Reference:** not applicable

**Note** – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Capital and Investment Team can also give information on other language translations as well as providing additional copies.

Contact us at Capital & Investments Team, Finance, Scottish Borders Council, Council Headquarters, Newtown St Boswells, Melrose, TD6 0SA Tel: 01835 825249 Fax 01835 825166. email: <mailto:treasuryteam@scotborders.gov.uk>

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## **SCOTTISH BORDERS COUNCIL**

# **TREASURY MANAGEMENT STRATEGY (incorporating the Annual Investment Strategy) 2023/24**

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## 1 Purpose and Scope

1.1 The Council is currently required to receive and approve, as a minimum, three main reports on treasury activity each year, which incorporate a variety of policies, estimates and actual figures.

a) **Treasury Management Strategy** (this report) – The first, and most important of the three reports, is forward looking and covers:

- The capital plans of the Council (including prudential indicators);
- A policy for the statutory repayment of debt, (how residual capital expenditure is charged to revenue over time);
- The treasury management strategy (how the investments and borrowings are organised), including treasury indicators, and
- A permitted investment strategy (the parameters on how investments are to be managed).

b) **Mid Year Treasury Management Report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c) **Annual Treasury Report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

d) **Quarterly reports** – In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to Council but do require to be adequately scrutinised. This role is undertaken by the **Executive Committee**. (The reports, specifically, should comprise updated Treasury/Prudential Indicators.)

### 1.2 Scrutiny

These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the **Audit Committee**.

1.3 The treasury management issues covered by this report are:

#### Capital Issues

- the capital expenditure plans and the associated prudential indicators;
- the loans fund repayment policy.

#### Treasury management issues

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers

1.4 These elements cover the requirements of the Local Government in Scotland Act 2003, the CIFPA Prudential Code (the Prudential Code), the CIPFA Treasury Management Code (the Code) and Scottish Government loans fund repayment regulations and investment regulations.

- 1.5** The increased Member consideration of treasury management matters and the need to ensure that officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council will continue to address this important issue by:
- a) Elected Members**
    - Working with members of the Audit Committee to identify their training needs
    - Working with Link Treasury Services to identify appropriate training provision for elected members
  - b) Officers** dealing with treasury management matters will have the option of various levels of training including:
    - Treasury courses run by the Council's advisers
    - Attendance at CIPFA treasury management training events
    - Attendance at the CIPFA Scottish Treasury Management Forum and information exchanged via the Treasury Management Forum network
    - On the job training in line with the approved Treasury Management Practices (TMPs).

## **1.6 Treasury Management Consultants**

The Council uses Link Group, Treasury solutions as its external treasury management advisors.

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

It also recognises that there is value in employing external providers of treasury management services in order 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.

- 1.7** The Treasury Management Strategy covers the treasury management activities for the Council (including any subsidiary organisations), the cash managed by the Council on behalf of the Scottish Borders Council Pension Fund, the Common Good and Trust Funds.
- 1.8 2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact on future TMSS/AIS reports and the risk management framework**

CIPFA published the revised Codes on 20th December 2021 and has stated that revisions need to be included in the reporting framework from the 2023/24 financial year. This Authority, therefore, has to have regard to these Codes of Practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to Full Council for approval.

**The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes: -**

### **Treasury management**

Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

### **Service delivery**

Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is “either related to the financial viability of the project in question or otherwise incidental to the primary purpose”.

### **Commercial return**

Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to an authority’s financial capacity – i.e., that ‘plausible losses’ could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not borrow to invest primarily for financial return.

### **The revised Treasury Management Code will require an authority to implement the following: -**

1. Adopt a new liability benchmark treasury indicator to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;
2. Long-term treasury investments, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;
3. Pooled funds are to be included in the indicator for principal sums maturing in years beyond the initial budget year;
4. Amendment to the knowledge and skills register for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority;
5. Reporting to members is to be done quarterly. Specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to Full Council and should be reported as part of the Authority’s integrated revenue, capital and balance sheet monitoring;
6. Environmental, social and governance (ESG) issues to be addressed within an authority’s treasury management policies and practices (TMP1).

### **The main requirements of the Prudential Code relating to service and commercial investments are: -**

1. The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;
2. An authority must not borrow to invest for the primary purpose of commercial return;
3. It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;
4. 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;
5. A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream;

6. Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

**An authority's Capital Strategy or Annual Investment Strategy should include: -**

1. The authority's approach to investments for service or commercial purposes (together referred to as non-treasury investments), including defining the authority's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence;
2. An assessment of affordability, prudence and proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services);
3. Details of financial and other risks of undertaking investments for service or commercial purposes and how these are managed;
4. Limits on total investments for service purposes and for commercial purposes respectively (consistent with any limits required by other statutory guidance on investments);
5. Requirements for independent and expert advice and scrutiny arrangements (while business cases may provide some of this material, the information contained in them will need to be periodically re-evaluated to inform the authority's overall strategy);
6. State compliance with paragraph 51 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that an authority must not borrow to invest primarily for financial return.

### **1.9 International Financial Reporting Standard (IFRS) 16 – Leasing**

The CIPFA LAASAC Local Authority Accounting Code Board has deferred implementation of IFRS16 until 1.4.24, the 2024/25 financial year. From this date, leases which were previously off balance sheet will now be included. As leases form part of the other long term liability figures which make up the Prudential Indicators below, it is possible that the Indicators currently suggested will be exceeded. The data gathering has been substantially completed and the financial implications are currently being assessed. Once this exercise is completed, during 2023/24, an updated report may be required to inform members of the detailed impact of IFRS 16 with amended Prudential Indicators for approval.

## 2 Background

- 2.1** The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 2.2** The second main function of the treasury management service is the funding of the Council's capital plans and strategy. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 2.3** The Prudential and Treasury Indicators (summarised in **Annex A**) consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. These Indicators have been developed in line with both the Prudential and Treasury Codes. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992. The Treasury Management Strategy therefore forms an integral part of the Council's overall Financial Strategy covering both its revenue and capital budgets.
- 2.4** The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
- 2.5** Whilst any loans to third parties, commercial investment initiatives or other non-financial investments will impact on the treasury function, these activities are generally classed as non-treasury activities and are separate from the day to day treasury management activities.
- 2.6** CIPFA defines treasury management as:
- “The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”
- 2.7** Revised reporting was introduced in the 2019/20 reporting cycle due to revisions to the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes included the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity if that is going to be undertaken. The capital strategy is being reported separately.

### 3 The Capital Prudential Indicators 2023/24 – 2027/28

The Council's Financial Strategy sets out financial resource and management parameters within which it will deliver its Corporate Vision and Priorities. The Financial Strategy brings together various elements of financial policy and strategy, including the Treasury Management Strategy, and establishes the financial planning framework for the Council in terms of Revenue Expenditure and Capital Investment. The output from this framework is the Council's Financial Plan, approved annually in February, presenting the financial proposals for delivering its services and objectives.

The Financial Strategy establishes that the Financial Principles underpinning the planning for the Council's future service delivery are to:

- (i) Raise the funds required by the Council to meet approved service levels in the most effective manner;
- (ii) Manage the effective deployment of those funds in line with the Council's corporate objectives and priorities; and
- (iii) Provide stability in resource planning and service delivery as expressed through Corporate and Business Plans and the Revenue and Capital Financial Plan.

In order to adhere to these Principles, the Financial Strategy states that the Council will adopt Financial Objectives to:

***"ensure capital borrowing is within prudential borrowing limits and sustainable in the longer term. In this regard it is important to recognise the capital investment decisions taken now have long term borrowing implications and these have the potential to place a significant burden on future tax payers".***

The draft revenue budget sets loans charges associated with capital borrowing over the next 5 years at £19.3 in 2023/24, rising to £25.9m in 2027/28.

The Council's Capital Financial Plan is the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

#### 3.1 Capital Expenditure (Prudential Indicator PI-1)

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this planning cycle. The Capital Financial Plan for 2023/24 – 2032/33 includes the following capital expenditure forecasts for the first five years. 2022/23 projected outturn figures are also shown:

Capital Expenditure (PI-1) £m	Estimate					
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Assets & Infrastructure	46.4	39.9	15.5	13.3	12.4	12.9
Other Corporate Services	5.7	11.1	0.2	0.1	0.5	0.2
Children & Young People	16.1	40	69.9	28.9	27.7	21.9
Culture & Sport	1.9	0.9	0.6	2	0.8	0.8
Economic Regeneration	3.8	18.8	17	14.2	14.9	6.6
Housing Strategy & Services	0.4	0.6	0.5	0.5	0.5	0.5
Social Care Infrastructure	0.7	14.1	14.8	0.5	0	0
Emergency & Unplanned & Planned programme adjustments	0.1	-1.7	-1.7	-1.7	-1.7	-1.7
<b>Total</b>	<b>75.1</b>	<b>123.7</b>	<b>116.8</b>	<b>57.8</b>	<b>55.1</b>	<b>41.2</b>



### 3.2 Capital Financing Assumptions

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a financing need.

Capital Expenditure £m	Estimate					
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Capital Expenditure – per plan	75.1	123.7	116.8	57.8	55.1	41.2
Other Relevant Expenditure	-	-	-	-	-	-
<b>Total Expenditure</b>	<b>75.1</b>	<b>123.7</b>	<b>116.8</b>	<b>57.8</b>	<b>55.1</b>	<b>41.2</b>
<b>Financed by:</b>						
Capital receipts	0.7	0	2	0.1	0	0.6
CFCR	0.3	2.9	1	0	0	0
Developer Contributions	0.2	0.5	4.9	0.1	0.1	0.1
Govt. General Capital Grants	24.6	12	11.1	11.1	11.1	11.1
Govt. Specific Capital Grants	2	15	1.2	1.9	0.2	0.2
Other Grants & Contributions	18.3	20.8	17	14.2	14.8	6.5
Plant & Vehicle / Infrastructure Fund	4.2	2	2	2	2	2
Synthetic Pitch Replacement Fund	0	0.4	0.4	1.1	0.5	0.5
<b>Element of Net financing need for the year met by borrowing</b>	<b>24.8</b>	<b>70.1</b>	<b>77.2</b>	<b>27.3</b>	<b>26.4</b>	<b>20.2</b>

### 3.3 The Council's Borrowing Need (the Capital Financing Requirement – Prudential Indicator PI-2)

- a) The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure identified above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR. The CFR does not increase indefinitely, as prudent annual repayments from revenue need to be made which reflect the useful life of capital assets financed by borrowing. From 1 April 2016, authorities may choose whether to use scheduled debt amortisation (loans pool charges), or another suitable method of calculation in order to repay borrowing.
- b) The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council has £111.3m of liabilities relating to such schemes within the 2023/24 long term liabilities figure. The CFR may be impacted by the changes under IFRS 16 (see 1.9 above).
- c) The Council is asked to approve the CFR projections on the page below:

Capital Financing Requirement (PI-2) £m	Actual	Estimate					
	21/22	22/23	23/24	24/25	25/26	26/27	27/28
<b>Total CFR (PI-2) *</b>	<b>342.3</b>	<b>354.7</b>	<b>444.4</b>	<b>510.7</b>	<b>526.6</b>	<b>540.9</b>	<b>548.2</b>
<b>Movement in CFR represented by:</b>							
Net financing need for the year (above)		<b>24.8</b>	<b>70.1</b>	<b>77.2</b>	<b>27.3</b>	<b>26.4</b>	<b>20.2</b>
Less scheduled debt amortisation and other financing movements		(12.4)	19.5	(10.8)	(11.4)	(12.1)	(12.8)
<b>Movement in CFR</b>		<b>12.4</b>	<b>89.6</b>	<b>66.4</b>	<b>15.9</b>	<b>14.3</b>	<b>7.4</b>

\* The CFR for this calculation includes capital expenditure to 31 March of each financial year.

- d) A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 3.1, 3.2 and 3.3, and the details above, demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity. This Council does not currently have any commercial activity.

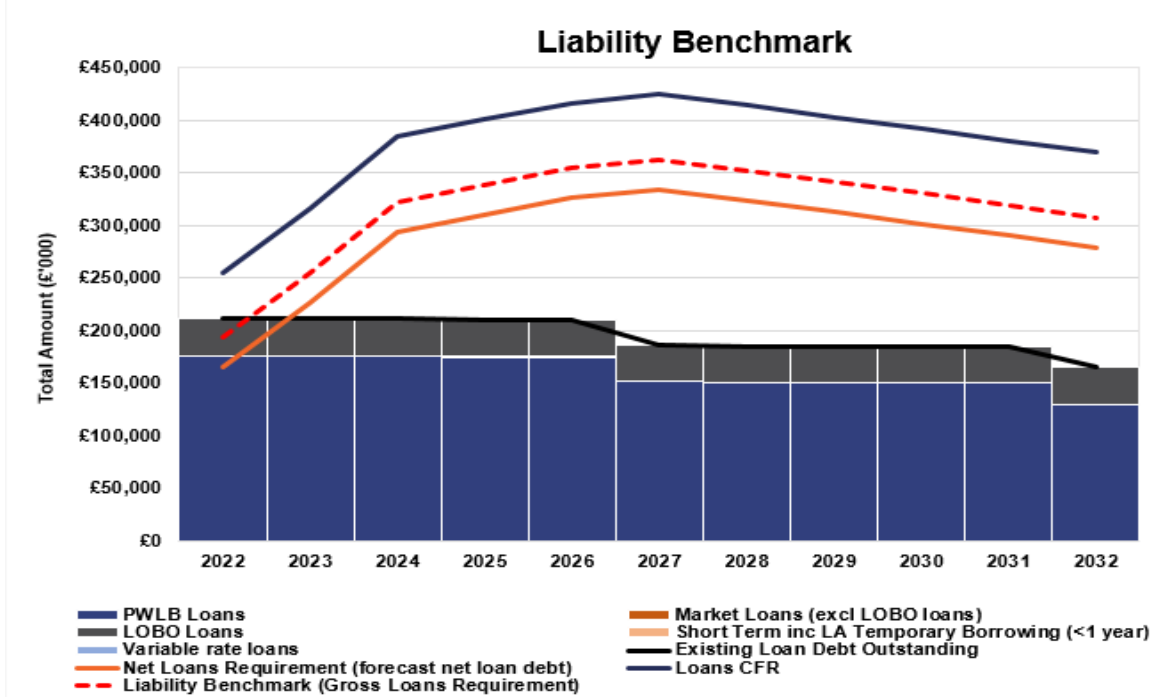
### 3.4 Liability Benchmark

A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum. The Council has measured the LB for a 10 year period in line with the Capital Plan as shown in the graph below.

There are four components to the LB: -

- 1 **Existing loan debt outstanding:** the Authority's existing loans that are still outstanding in future years.
- 2 **Loans CFR:** this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned Loans Fund advances/Loans Fund principal repayments.
- 3 **Net loans requirement:** this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned Loans Fund principal repayments and any other major cash flows forecast.
- 4 **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.

The graph below shows the Council to be in an under-borrowed position with a requirement for further borrowing in future years. The Council will actively monitor the progress of the Capital Plan and align forecast spend to the most efficient borrowing options available at that time.



### 3.5 Statutory Repayment of Loans Fund Advances

a) The Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of the financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

b) A variety of options are provided to Councils so long as a prudent provision is made each year. The Council is recommended to approve the following policy on the repayment of loans fund advances:-  
 For loans fund advances made before 1 April 2016, the policy will be to maintain the practice of previous years and apply the **Statutory Method (option 1)**, with all loans fund advances being repaid by the annuity method.

For loans fund advances made after 1 April 2016, the policy for the repayment of loans advances will be the:-

1. **Asset life method** – loans fund advances will be repaid with reference to the life of an asset using either the equal instalment or annuity method (option 3).

Under regulation 14 (2) of SSI 2016 No 123, the Council calculates the annuity rate based on historic annuity rates to ensure that it is a prudent application and it is currently 3.62%.

## 4 Treasury Management Strategy

The capital expenditure plans set out in Section 3 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional Codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

### 4.1 Current Portfolio Position

- a) The overall treasury management portfolio as at 31 March 2022 and for the position as at 31 December 2022 are shown below for both borrowing and investments.

<b>TREASURY PORTFOLIO</b>				
	actual <b>31.3.22</b> £000	actual <b>31.3.22</b> %	current <b>31.12.22</b> £000	current <b>31.12.22</b> %
<b>Treasury investments</b>				
Banks	1,359	3%	9,114	19%
DMADF (H.M.Treasury)	20,500	44%	13,800	29%
money market funds	25,000	53%	25,000	52%
<b>Total managed in house</b>	<b>46,859</b>	<b>100%</b>	<b>47,914</b>	<b>100%</b>
<b>Total managed externally</b>	<b>0</b>	<b>0%</b>	<b>0</b>	<b>0%</b>
<b>Total treasury investments</b>	<b>46,859</b>	<b>100%</b>	<b>47,914</b>	<b>100%</b>
<b>Treasury external borrowing</b>				
Third party loans	600	0.5%	600	0.5%
PWLB	176,086	83%	174,308	83%
LOBOs	35,000	16.5%	35,000	16.5%
<b>Total external borrowing</b>	<b>211,686</b>	<b>100%</b>	<b>209,908</b>	<b>100%</b>
<b>Net treasury investments / (borrowing)</b>	<b>(164,827)</b>	<b>0</b>	<b>(161,994)</b>	<b>0</b>

- b) The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

as at 31 March £m	Estimate					
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
<b>Borrowing</b>	215.4	261.8	318.0	355.9	367.5	362.0
<b>Other Long Term Liabilities</b>	82.2	111.3	110.2	109.1	108.0	106.7
<b>Total Gross Borrowing (Prudential Indicator PI-5)</b>	<b>297.6</b>	<b>373.1</b>	<b>428.2</b>	<b>465.0</b>	<b>475.5</b>	<b>468.7</b>
<b>Capital Financing Requirement*</b>	<b>510.7</b>	<b>526.6</b>	<b>540.9</b>	<b>548.2</b>	<b>535.8</b>	<b>524.0</b>
<b>(Under) / Over Borrowing (Prudential Indicator PI-6)</b>	<b>(213.1)</b>	<b>(153.5)</b>	<b>(112.7)</b>	<b>(83.2)</b>	<b>(60.3)</b>	<b>(55.3)</b>

\* The CFR for this calculation includes the current and two future years projected capital expenditure see 4.1b)

- c) Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these (PI-6) is that the Council needs to ensure that its gross debt figure (shown above) does not, except in the short term, exceed the total of the CFR

in the preceding year plus the estimates of any additional CFR for 2023/24 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

- d) The Council has complied with this prudential indicator in the current year and no difficulties are currently envisaged for the long term future. This view takes into account current commitments, existing plans, and the proposals in the Financial Plans for 2023/24.

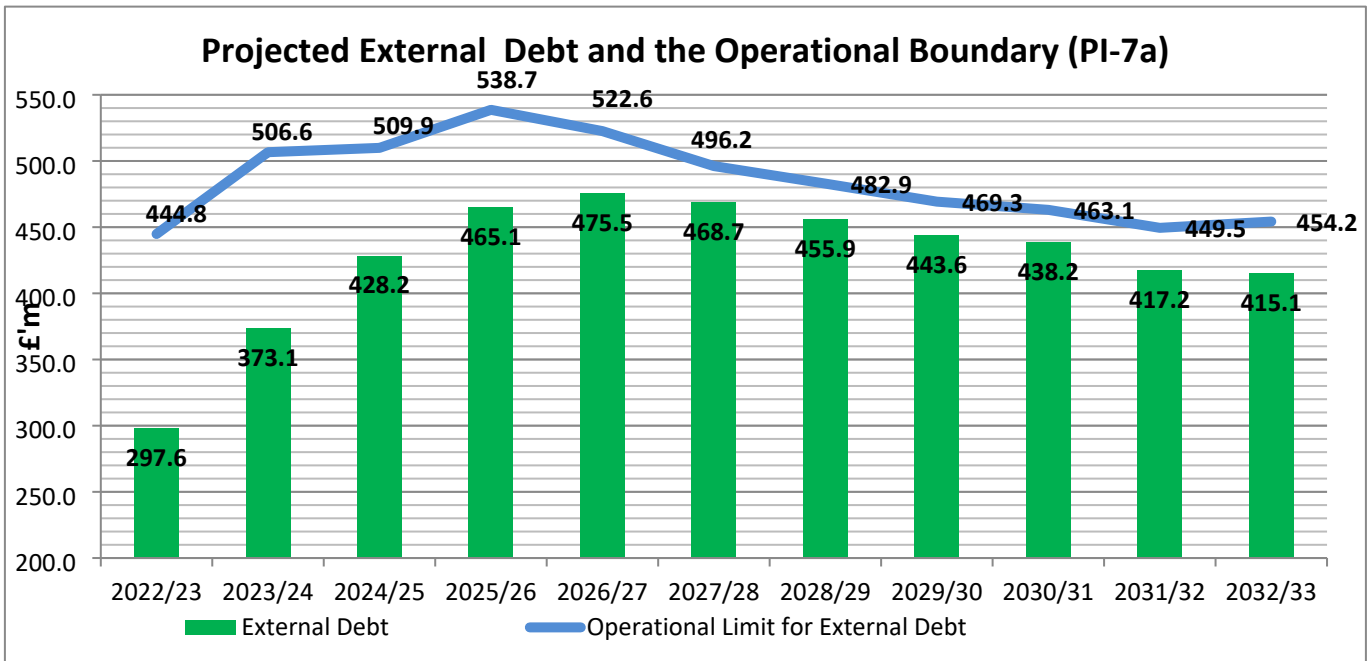
## 4.2 Treasury Indicators: Limits to Borrowing Activity

### The Operational Boundary (Prudential Indicator PI-7)

- a) This is the limit beyond which external borrowing is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	Estimate					
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
<b>Total Operational Boundary (PI-7a)</b>	<b>444.8</b>	<b>506.6</b>	<b>509.9</b>	<b>538.7</b>	<b>522.6</b>	<b>496.2</b>
Less: Other long term liabilities	(82.2)	(111.3)	(110.2)	(109.1)	(107.9)	(106.7)
<b>Operational Boundary exc. Other Long Term Liabilities (PI-7b)</b>	<b>362.6</b>	<b>366.3</b>	<b>371.6</b>	<b>402.5</b>	<b>388.7</b>	<b>364.6</b>

- b) The following chart shows how the current and projected Operational Borrowing limit compare with the anticipated levels of actual debt.

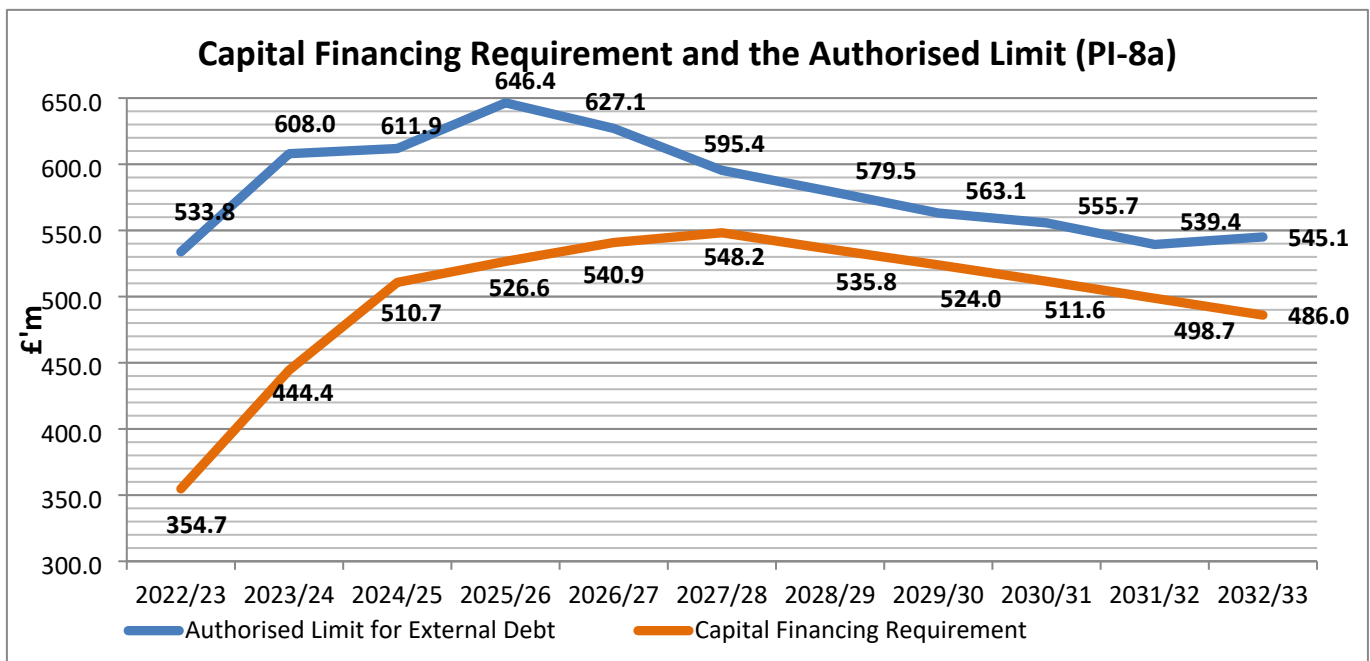


### The Authorised Limit for External Debt (Prudential Indicator PI-8)

- c) A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.
- d) The authorised limits for external debt for the current year and two subsequent years are the legislative limits determined under Regulation 6(1) of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016.
- e) The Council is asked to approve the following authorised limit:

Authorised Limit £m	Estimate					
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
<b>Total Authorised Limit (PI-8a)</b>	<b>533.8</b>	<b>608.0</b>	<b>611.9</b>	<b>646.4</b>	<b>627.1</b>	<b>595.4</b>
Less: Other long term liabilities	(82.2)	(111.3)	(110.2)	(109.1)	(107.9)	(106.7)
<b>Authorised Limit exc. Other Long-Term Liabilities (PI-8b)</b>	<b>451.6</b>	<b>496.7</b>	<b>501.7</b>	<b>537.3</b>	<b>519.2</b>	<b>488.7</b>

- f) The chart on the below shows how the current and projected Capital Financing Requirement compares to the Authorised Limit for External Debt.



### 4.3 Prospects for Interest Rates

- a) The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 19.12.22. These are forecasts for certainty rates, gilt yields plus 80bps:

Link Group Interest Rate View	19.12.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
<b>BANK RATE</b>	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

*Additional notes by Link on this forecast table: -*

Our central forecast for interest rates was updated on 19 December and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. Bank Rate stands at 3.5% currently, but is expected to reach a peak of 4.5% in H1 2023.

Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.7%). Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure, now that the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy are firmly in the rear-view mirror.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

## PWLB RATES

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.
- We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

### The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside.

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).
- **The Bank of England** acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Geopolitical risks**, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

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

**Borrowing advice:** Our long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are currently above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.

Our suggested budgeted earnings rates for investments up to about three months’ duration in each financial year are rounded to the nearest 10bps as follows: -

Average earnings in each year	
2022/23 (remainder)	4.00%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.



#### 4.4 Borrowing Strategy

- a) The Authority is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the remainder of 2022 and the first half of 2023.
- b) Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Acting Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates*, then borrowing will be postponed.
  - *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast*, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
- c) Any decisions will be reported to the appropriate decision-making body at the next available opportunity.

#### 4.5 Policy on borrowing in advance of need

- a) Borrowing in advance of need is defined as any borrowing undertaken by the local authority which will result in the total external debt of the local authority exceeding the capital financing requirement (CFR) of the local authority for the following twelve month period. This twelve month period is on a rolling twelve month basis.
- b) The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.
- c) Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
- d) The Acting Chief Financial Officer has the authority to borrow in advance of need under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. The Acting Chief Financial Officer will adopt a cautious approach to any such borrowing and a business case to support the decision making process must consider:
- the benefits of borrowing in advance,
  - the risks created by additional levels of borrowing and investment, and
  - how far in advance it is reasonable to borrow considering the risks identified
- e) Any such advance borrowing should be reported through the mid-year or annual Treasury Management reporting mechanism.

#### 4.6 Debt Rescheduling

- a) All rescheduling will be reported to the **Executive Committee** at the earliest meeting following its action.

#### 4.7 New financial institutions as a source of borrowing and/or types of borrowing

- a) Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
  - Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
  - Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).
- b)** Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

## 5 Investment Strategy

### 5.1 Investment Objectives and Policy

- a) The Council's investment policy implements the requirements of the following:-
- Local Government Investments (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010);
  - CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021, ("the Code");
  - CIPFA Treasury Management Guidance Notes 2021.
- b) The Council's primary investment objectives are as follows, in order of importance:
- (i) The safeguarding or **security** of the re-payment of principal and interest of investments on a timely basis;
  - (ii) The **liquidity** of its investments;
  - (iii) The **returns on investments** that can be realised.

The Council will therefore aim to achieve the optimum return on its investments corresponding with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions.

- c) Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- d) **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.
- e) **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- f) This authority has defined the list of **types of investment instruments** that are permitted investments authorised for use in appendix D. Appendix E expands on the risks involved in each type of investment and the mitigating controls.
- g) **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 5.3.
- h) This authority has engaged **external consultants** to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year
- i) All investments will be denominated in **sterling**.
- j) As a result of the change in accounting standards for 2023/24 under **IFRS 9**, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

- k) This authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.
- l) The above criteria are unchanged from last year.

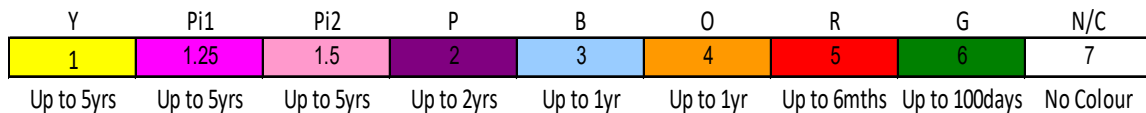
### 5.2 Council Permitted Investments

The proposed criteria for permitted investments are shown in annex D approval.

### 5.3 Creditworthiness Policy

- a) This Council applies the creditworthiness service provided by the Link Group. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit 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;
  - Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings;
  - sovereign ratings to select counterparties from only the most creditworthy countries.
- b) This modelling approach combines credit ratings, and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

Creditworthiness Colour Banding	Maximum Investment Duration
Yellow	5 years*
Dark pink	5 years for Ultra short dated bond funds with a credit score of 1.25
Light pink	5 years for Ultra short dated bond funds with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised or semi-nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	not to be used (ie do n’t invest)



- c) The Link creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency’s ratings.
- d) Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) 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.
- e) All credit ratings will be monitored on a real time basis. The Council is alerted to changes to ratings of all three agencies through its use of a creditworthiness service provided by the Link Group.

- 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 benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
- f) Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.
- g) Significant levels of downgrades to Short and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. Accordingly, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK.
- h) Although bank CDS prices, (these are market indicators of credit risk), spiked upwards during the days of the Truss/Kwarteng government, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Authority has access to this information via its Link-provided Passport portal.

## 5.4 Country and Sector Considerations

- a) Due care will be taken to consider the country and sector exposure of the Council's investments.

### Country Limits

- b) The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix F. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
- c) No more than **10%** will be placed with any non-UK country at any time.

### Institutional Sector Limits

- d) These institutions must either be UK Local Authorities or UK Incorporated Institutions, UK Banks and Building Societies incorporated in the European Economic Area entitled to accept deposits through a branch in the UK. The Council may also use the UK Government including in the form of gilts and the Debt Management Account Deposit Facility (DMADF).
- e) Limits will be applied to the overall amount lent out to any one sector at any one time in order to limit sector specific exposure risk, as follows:

<b>UK Building Societies</b>	<b>£25 m</b>
<b>Banks</b>	<b>£35 m</b>
<b>UK Local Authorities</b>	<b>£40 m</b>
<b>UK Government Debt Management Office</b>	<b>£unlimited</b>
<b>UK Gilts and Treasury Bills</b>	<b>£20 m</b>
<b>Institutions covered by Government Guarantee</b>	<b>£10 m</b>
<b>Part Nationalised Banks</b>	<b>£35 m</b>

**Money Market Funds (AAA)**

**£25 m**

These limits will be monitored regularly for appropriateness.

**Group Limits**

- g)** Limits will be applied to the overall amount lent out to institutions within the same group at any one time in order to limit group specific exposure risk, as follows, and subject to the parent company appearing on Link Groups' creditworthiness list:

**Group of Banks**

**£10m**

**Council's Own Banker**

- h)** The Council's own banker (currently Royal Bank of Scotland) will be maintained on the Council's counterparty list in situations where rating changes may mean this is below the above criteria. This is to allow the Council to continue to operate normal current account banking facilities and overnight and short-term investment facilities. However, in the event that the rating does change below the criteria, officers will review the situation carefully and identify any appropriate action required to manage the risk that this change creates for the Council.

**5.5 Individual Institution Monetary Limits**

- a)** The monetary limits for institutions on the Council's Counterparty List are as follows:

	Money Limit
UK Building Societies	£5m
Banks	£5m
UK Local Authorities (i)	£40m
UK Government Debt Management Office	Unlimited
UK Gilts & Treasury Bills	£20m
Government Guaranteed Institutions	£2m
AAA rated Money Market Funds	£5m
Council's Own Banker (ii)	£5m

- (i) No individual limit will be applied on lending to a UK local authority, other than it must not exceed the relevant sector limit of £40m.
- (ii) Further to Sections 5.4 and 5.5, in the event that the rating of the Council's own banker falls below the criteria, the time limit on money deposited with the bank will be reduced to an overnight basis.
- b)** As mentioned earlier, the treasury function manages the funds of the Council, any subsidiary organisations, the Pension Fund and the Common Good and Trust Funds. When applying the limits set out in the table above, these limits will apply to the cumulative investment with an institution from the Council, the Pension Fund and the Common Good Funds and Trust Funds.

## 5.6 Types of Investments

- a) For institutions on the approved counterparty list, investments will be restricted to safer instruments (such as deposits). Currently this involves the use of money market funds, the DMADF and institutions with higher credit ratings than the minimum permissible rating outlined in the investment strategy, as well as the Council’s own bank.
- b) Where appropriate, investments will be made through approved brokers. The current list of approved brokers comprises:
  - BGC Brokers L.P.
  - ICAP Securities Limited
  - Sterling International Brokers Limited
  - Tradition (UK) Limited

## 5.7 Investment Strategy and bank rate projections

### In-house funds

- a) Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.
  - If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
  - Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

### Investment returns expectations

- b) The current forecast shown in paragraph 4.3, includes a forecast for Bank Rate to reach 4.5% in Q2 2023
- c) The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

Average earnings in each year	
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Long term later years	2.80%

### Investment Treasury Indicator and Limit (Treasury Indicator TI-5)

- d) Total principal funds invested for greater than 365 days. These limits are set with regard to the Council’s liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year end.

The Council is asked to approve the treasury indicator and limit:

Maximum principal sums invested for longer than 365 days (TI-5)					
£m	2023/24	2024/25	2025/26	2026/27	2027/28
Principal sums invested for longer than 365 days	20%	20%	20%	20%	20%

- e) For positive cash balances and in order to maintain liquidity, the Council will seek to use overnight investment accounts, short term (< 1 month) notice accounts, money market funds and short-dated deposits (overnight to three months).

### 5.8 Investment Risk Benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

#### a) Security

The Council’s **maximum** security risk benchmark for the current portfolio, when compared to historic default tables, is:

**0.002% historic risk of default when compared to the whole portfolio.**

#### b) Liquidity

In respect of this area the Council seeks to maintain:

- Bank Overdraft: £2,000,000
- Liquid short term deposits of at least £1,500,000 available with a week’s notice.
- Weighted Average Life benchmark is **expected to be 0.5 years** (equivalent to an weighted average life of 6 months), with a **maximum of 1.00 years**

#### c) Yield

Local measures of yield benchmarks are:

Investments – **Internal returns above the 7 day SONIA compounded rate**

- d) At the end of the financial year, the Acting Chief Financial Officer will report on its investment activity as part of the Annual Treasury Report.



## 6 Performance Indicators

**6.1** The CIPFA Code requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

### 6.2 Debt Performance Indicators

- (i) Average “Pool Rate” charged by the Loans Fund compared to Scottish Local Authority average Pool Rate.

Target is to be at or below the Scottish Average for 2022/23.

- (ii) Average borrowing rate movement year on year

Target is to maintain or reduce the average borrowing rate for the Council versus 2022/23.

**6.3 Investment Risk Benchmark Indicators** for Security, Liquidity and Yield, as set out in paragraph 5.8.

### 6.4 Loans Charges

- a) Loans Charges for 2023/24 are expected to be at or below the Revenue Budget estimate contained in the Council’s Financial Plans to be approved in February 2023, which are estimated as follows:

£m	2023/24	2024/25	2025/26	2026/27	2027/28
<b>Total Loan Charges *</b>	<b>19.3</b>	<b>22.1</b>	<b>24.0</b>	<b>25.3</b>	<b>25.9</b>

*\*The Loan Charges exclude the capital element of PPP repayments.*

- b) The above budget excludes the revenue impact of funding the cost of the NHT and the lending to RSLs and lending in respect of the Council-led house building programme with the Scottish Futures Trust, as these are assumed to be revenue neutral overall.

**6.5** The indicators, based on actual performance for the year, will be included in the Treasury Management Annual Report for 2023/24.

# ANNEXES

## ANNEX A SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Ref.	Indicator	Page Ref.	2022/23	2023/24	2024/25	2025/26	2026/27
<b>PRUDENTIAL INDICATORS</b>							
<b>Capital Expenditure Indicator</b>							
PI-1	Capital Expenditure Limits (£m)	8	75.1	123.7	116.8	57.8	55.1
PI-2	Capital Financing Requirement (CFR) (£m)	10	354.7	444.4	510.7	526.6	540.9
<b>Affordability Indicator</b>							
PI-3	Ratio of Financing Costs to Net Revenue (inc. PPP repayment costs)	28	7.9%	8.5%	8.8%	8.9%	8.9%
PI-4	Incremental movement of Capital Investment Decisions on Council Tax		£(0.00)	£(0.02)	£(0.02)	£(0.03)	£(0.03)
<b>External Debt Indicators</b>							
PI-5	Actual Debt (£m)	12	297.6	373.1	428.2	465.0	475.5
PI-7a	Operational Boundary (inc. Other Long Term Liabilities) (£m)	13	444.8	506.6	509.9	538.7	522.6
PI-7b	Operational Boundary (exc. Other Long Term Liabilities) (£m)	13	362.6	366.3	371.6	402.5	388.7
PI-8a	Authorised Limit (inc. Other Long Term Liabilities) (£m)	14	533.8	608.0	611.9	646.4	627.1
PI-8b	Authorised Limit (exc. Other Long Term Liabilities) (£m)	14	451.6	496.7	501.7	537.3	519.2
<b>Indicators of Prudence</b>							
PI-6	(Under)/Over Gross Borrowing against the CFR (£m)	12	(213.1)	(153.5)	(112.7)	(83.2)	(60.3)
<b>TREASURY INDICATORS</b>							
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt (£m)	29	444.8	506.6	509.9	538.7	522.6
TI-2	Upper Limit to Variable Interest Rates based on Net Debt (£m)	29	155.7	177.3	178.5	188.5	182.9
TI-3	Maturity Structure of Fixed Interest Rate Borrowing 2022/23	29	<b>Lower</b>		<b>Upper</b>		
	Under 12 months		0%		20%		
	12 months to 2 years		0%		20%		
	2 years to 5 years		0%		20%		
	5 years to 10 years		0%		20%		
	10 years and above		20%		100%		
TI-5	Maximum Principal Sum invested greater than 365 days	23	20%	20%	20%	20%	20%

Further prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council’s overall finances. The updated indicators are as follows:

**Ratio of financing costs to net revenue stream (Prudential Indicator PI-3)**

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs, net of investment income) against the net revenue stream.

%	Actual	Estimate				
	21/22	22/23	23/24	24/25	25/26	26/27
<b>Ratio of Financing Costs to Net Revenue Stream (PI-3)</b> <i>(inc. PPP repayment costs)</i>	8.6%	7.9%	8.5%	8.8%	8.9%	8.9%

The estimates of financing costs include current commitments and the proposals in the Financial Plans for 2023/24. The movements in the above ratio from 2022/23 onwards reflect a real-time reduction in overall financial resources available to the Council.

**Treasury Management Limits on Activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs / improve performance. The indicators are:

**(i) Upper limits on fixed interest rate exposure (Treasury Indicator TI-1)**

This identifies a maximum limit for borrowing exposure to fixed interest rates, based on the debt position net of investments.

**(ii) Upper limits on variable interest rate exposure (Treasury Indicator TI-2)**

This identifies a maximum limit for borrowing exposure to variable interest rates based upon the debt position net of investments.

**(iii) Maturity structure of borrowing (Treasury Indicator TI-3)**

These gross limits are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

**(iv) The following table highlights the proposed treasury indicators and limits:**

£m	2022/23	2023/24	2024/25	2025/26	2026/27
<b>Interest rate exposures</b>					
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt (TI-1)</b>	444.8	506.6	509.9	538.7	522.6
<b>Limits on variable interest rates based on net debt (TI-2)</b>	155.7	177.3	178.5	188.5	182.9
<b>Maturity Structure of fixed interest rate borrowing 2023/24 (TI-3)</b>					
	<b>Lower</b>			<b>Upper</b>	
Under 12 months	0%			20%	
12 months to 2 years	0%			20%	
2 years to 5 years	0%			20%	
5 years to 10 years	0%			20%	
10 years and above	20%			100%	

### ANNEX B: INTEREST RATE FORECASTS 2023-25

[PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.] There are no changes to these forecasts as at 25.01.23.

Link Group Interest Rate View	19.12.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
<b>BANK RATE</b>	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave eamings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

Bank Rate													
	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	3.50%	4.25%	4.50%	4.50%	4.50%	4.00%	3.75%	3.50%	3.25%	3.00%	2.75%	2.50%	2.50%
Capital Economics	3.50%	4.50%	4.50%	4.50%	4.50%	4.25%	4.00%	3.50%	3.00%	-	-	-	-

5yr PWLB Rate													
	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	4.08%	4.20%	4.20%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.20%	3.10%
Capital Economics	4.08%	4.00%	3.80%	3.70%	3.50%	3.50%	3.40%	3.30%	3.30%	-	-	-	-

10yr PWLB Rate													
	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	4.22%	4.40%	4.40%	4.30%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.30%
Capital Economics	4.22%	4.00%	3.80%	3.70%	3.60%	3.50%	3.40%	3.40%	3.30%	-	-	-	-

25yr PWLB Rate													
	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	4.56%	4.60%	4.60%	4.50%	4.40%	4.20%	4.10%	4.00%	3.90%	3.70%	3.60%	3.50%	3.50%
Capital Economics	4.56%	4.40%	4.20%	4.00%	3.80%	3.80%	3.70%	3.60%	3.60%	-	-	-	-

50yr PWLB Rate													
	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	4.23%	4.30%	4.30%	4.20%	4.10%	3.90%	3.80%	3.70%	3.60%	3.50%	3.30%	3.20%	3.20%
Capital Economics	4.23%	4.10%	4.00%	3.90%	3.80%	3.80%	3.70%	3.60%	3.60%	-	-	-	-

Source: Link Treasury Services, February 2023

## ANNEX C Economic Background

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps since the turn of the year. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	<b>UK</b>	<b>Eurozone</b>	<b>US</b>
<b>Bank Rate</b>	3.5%	2.0%	4.25%-4.50%
<b>GDP</b>	-0.2%q/q Q3 (2.4%/y/y)	+0.2%q/q Q3 (2.1%/y/y)	2.6% Q3 Annualised
<b>Inflation</b>	10.7%/y/y (Nov)	10.1%/y/y (Nov)	7.1%/y/y (Nov)
<b>Unemployment Rate</b>	3.7% (Oct)	6.5% (Oct)	3.7% (Nov)

Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation has picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will spike higher again before dropping back slowly through 2023.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3.5% in December and the market expects Bank Rate to hit 4.5% by May 2023.

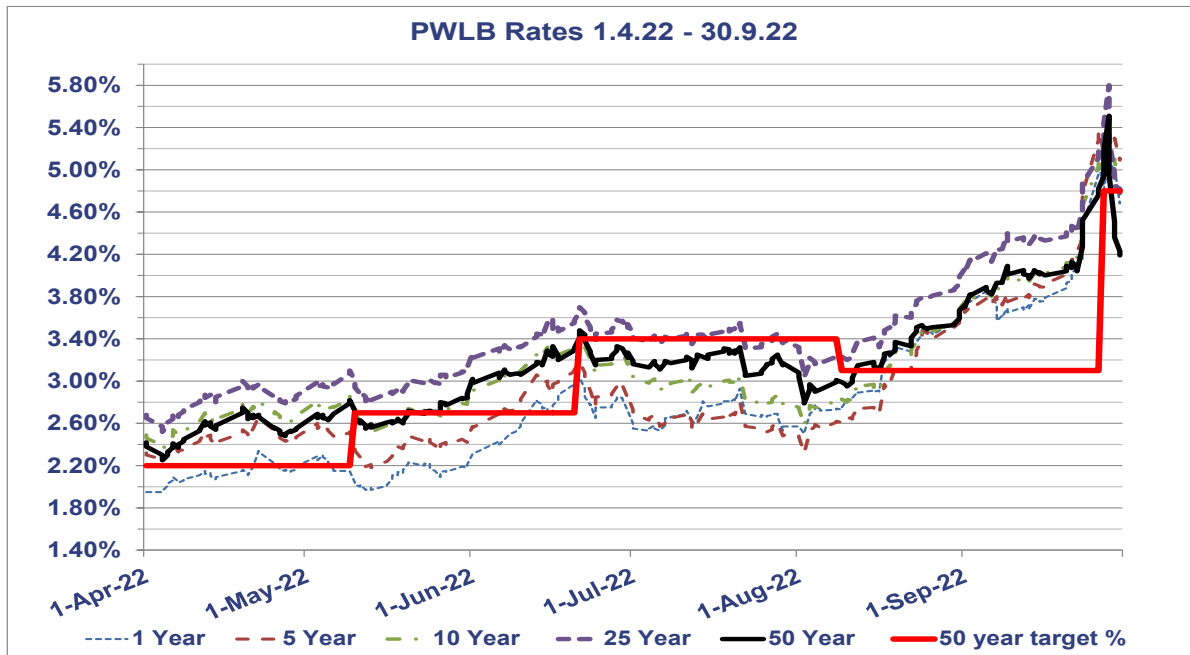
Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17<sup>th</sup> November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have almost completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one, if not more, quarters of GDP contraction. In November, the MPC projected eight quarters of negative

growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

The £ has strengthened of late, recovering from a record low of \$1.035, on the Monday following the Truss government's "fiscal event", to \$1.22. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28<sup>th</sup> September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
<b>Low</b>	1.95%	2.18%	2.36%	2.52%	2.25%
<b>Date</b>	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
<b>High</b>	5.11%	5.44%	5.35%	5.80%	5.51%
<b>Date</b>	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
<b>Average</b>	2.81%	2.92%	3.13%	3.44%	3.17%
<b>Spread</b>	3.16%	3.26%	2.99%	3.28%	3.26%

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in recent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

### CENTRAL BANK CONCERNS – DECEMBER 2022

In December, the Fed decided to push up US rates by 0.5% to a range of 4.25% to 4.5%, whilst the MPC followed by raising Bank Rate from 3% to 3.5%, in line with market expectations. EZ rates have also increased to 2% with further tightening in the pipeline.

Having said that, the sentiment expressed in the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than markets had expected. Governor Bailey, here in the UK, said the opposite and explained



that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.5% - 4.75%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data has proven stronger than expected.

In addition, the Bank's central message that GDP will fall for eight quarters starting with Q3 2022 may prove to be a little pessimistic. Will the £160bn excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

## Annex D

### TREASURY MANAGEMENT PRACTICE: PERMITTED INVESTMENTS, ASSOCIATED CONTROLS AND LIMITS

This Council approves the following forms of investment instrument for use as permitted investments

#### Treasury risks

All the investment instruments 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 organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation'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. However, it has to be pointed out that while some forms of investment e.g. gilts, CDs, corporate bonds can usually be sold immediately if the need arises, there are two caveats: - a. cash may not be available until a settlement date up to three days after the sale b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer.
3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation 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 organisation's finances, against which the organisation has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report.
5. **Legal and regulatory risk:** this is the risk that the organisation itself, 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 organisation suffers losses accordingly.

#### Controls on treasury risks

1. **Credit and counter-party risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes. See paragraphs 5.3 and 5.4.
2. **Liquidity risk:** this authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.
3. **Market risk:** this authority does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value.
4. **Interest rate risk:** this authority 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. See paragraph 5.7.

- 5. Legal and regulatory risk:** this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations. All types of investment instruments

### **Unlimited investments**

Regulation 24 states that an investment can be shown 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.** 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. However, it is very useful for authorities whose overriding priority is the avoidance of risk. The longest period for a term deposit with the DMADF is 6 months.

### **Environmental, Social & Governance (ESG) Considerations**

This topic is becoming a more commonplace discussion within the wider investment community, including Local Authorities. While around two thirds of councils have declared a "climate emergency" to date, this has not translated into the incorporation of something more formal within their treasury-related Annual Investment Strategy. Changes to the CIPFA TM Code 2021 will see ESG incorporated into Treasury Management Practice 1. The following wording (page 18 of the Treasury Management Code) suggests the scope of what is included: "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."

Furthermore, page 50 of the Treasury Management Code states "ESG issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits, and there is a diversity of market approaches to ESG classification and analysis. This means that a consistent and developed approach to ESG for public service organisations is currently difficult. Organisations are therefore recommended to consider their credit and counterparty policies in light of ESG information and develop their own ESG investment policies and treasury management practices consistent with their organisation's own relevant policies, such as environmental and climate change policies."

From Link's perspective, the most important issue is ensuring that there is a clear understanding of what "environmental, social and governance (ESG)" investment considerations means. It is about understanding the ESG "risks" that an entity is exposed to and evaluating how well it manages these risks, (all entities will be subject to these to one extent or other). It is NOT the same as Socially Responsible Investing, (typically where you apply negative screens), and equally, it is NOT the same as Sustainable Investing, (investing in products / companies based on expected sustainable and beneficial societal impact, alongside a financial return).

There is such a huge potential for misunderstanding which could have material unintended consequence i.e., limiting of potential counterparty options, thus decreasing diversification. The above could then lead to authorities widening credit criteria to take on more names, or those with a stronger "ESG" performance, which could then increase credit risk...which would place the cornerstone of prudent investing at risk.

The other factor, i.e., what local authorities can or already do to take this into account, is credit ratings. All the main agencies are now extolling how they incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings. As such, you could argue that their incorporation is already being done, to an extent, by the use of mainstream rating agencies.

Also, a final note to point out is that given ESG risks are all about potential impact on entity enterprise value; the “G” is by far the most important one when considering treasury investments, the majority of which will be shorter-term in nature. This is because poor governance can have a more immediate impact on the financial circumstances of an entity and the potential for a default event that would impact the amount the local authorities receive back from their investments. Those financial institutions that are viewed as having poor/weak corporate governance are generally less well rated in the first instance or have a higher propensity for being subject to negative rating action. So, this element of ESG is of high importance to an investor that is following investment guidance with the security, liquidity and yield (SLY) principle at its core. Environmental & Social factors are also important, but more for the long-term impact, unless you are specifically going down the “impact” / “sustainable” type investment route...and there are not many options for that in respect of short-term investments.

We have set out our views more fully in our August 2020 and January 2021 CityWatch articles on Environmental, Social and Governance (ESG) issues. We emphasised the use of SMART, focusing on the specific, measurable, appropriate, realistic and timely. Moreover, this approach seems more relevant than ever as recent news flows highlight the weaknesses in the ability of many fund managers to accurately report on the degree to which their funds/products are ESG compliant.

Naturally, Link continues to look at ways in which we can incorporate these factors into our creditworthiness assessment service. However, the lack of consistency, as well as uncertainty as to how the Treasury Management Code may develop TMP1, means that although we continue to review the options and will update clients as progress is made, it is not practicable to expand broadly upon ESG matters in this template at the current time.

## Annex E

### Credit and Counterparty Risk Management Permitted Investments, Associated Controls and Limits for Scottish Borders Council, Common Good and Trust Funds and In-house Managed Pension Fund

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
<b>Cash type instruments</b>					
a. Deposits with the Debt Management Account Facility (UK Government) <b>(Very low risk)</b>	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments	£unlimited, maximum 6 months.	£unlimited, maximum 6 months.	£unlimited, maximum 6 months.
b. Deposits with other local authorities or public bodies <b>(Very low risk)</b>	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply.  Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment.  Non- local authority deposits will follow the approved credit rating criteria.	£40m, maximum 1 year.	£5m, maximum 1 year.	£40m, maximum 1 year.
c. Money Market Funds (MMFs) <b>(Very low risk)</b>	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs has a "AAA" rated status from either Fitch, Moody's or Standard and Poor's.	£5m per fund/£25m overall	£5m per fund/£25m overall	£5m per fund/£25m overall

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
d. Ultra short dated bond funds <b>(low risk)</b>	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where they have a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	N/A	N/A	N/A
e. Call account deposit accounts with financial institutions (banks and building societies) <b>(Low risk depending on credit rating)</b>	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody’s and Standard and Poor’s. Day to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.
f. Term deposits with financial institutions (banks and building societies) <b>(Low to medium risk depending on period &amp; credit rating)</b>	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody’s and Standard and Poor’s. Day to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
g. Government Gilts and Treasury Bills ( <b>Very low risk</b> )	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity).	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	£20m, maximum 1 year.	£5m, maximum 1 year	£20m, maximum 1 year.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
<b>Other types of investments</b>					
a. Investment properties	These are non-service properties which are being held pending disposal or for a longer term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).	In larger investment portfolios some small allocation of property based investment may counterbalance/compliment the wider cash portfolio.  Property holding will be re-valued regularly and reported annually with gross and net rental streams.	£30m	£25m	N/A
Page 48 b. Loans to third parties, including soft loans	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	£25m	£1m	N/A
c. Loans to a local authority company	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each loan to a local authority company requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	£25m	N/A	N/A
d. National Housing Trust ( <b>Very Low Risk due to Scottish Government Underwriting</b> )	These are loans to a Special Purpose Vehicle to allow it to purchase new homes under the NHT umbrella. These loans represent either 65% or 70% of the purchase price, the remainder being funded by the developer. The loan is redeemed after a 5 to	Loan redemption arises when the homes are sold. Interest payments are made to the Council by the SPV from rental payments in the intervening period. Both the loan amount and associated interest payments are underwritten by Scottish Government.	£8m	N/A	N/A



	10 year period when the properties are sold.				
e. Shareholdings in a local authority company	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	£1m	N/A	N/A
f. Investment in the Subordinated Debt of projects delivered via the 'HubCo' model ( <b>Very Low Risk</b> )	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council and Scottish Government (via the SFT) are participants in and party to the governance and controls within the project structure. As such they are well placed to influence and ensure the successful completion of the project's term. These projects are based on robust business cases with a cashflow from public sector organisations (i.e. low credit risk)	£600,000	N/A	N/A

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### The Monitoring of Investment Counterparties

The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Link Group, including when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Acting Chief Financial Officer, and if required new counterparties which meet the criteria will be added to the list.

### Use of External Fund Managers

It is the Council's policy to use external fund managers to manage the investment portfolios of the Scottish Borders Council Pension Fund and the pooled investment fund of the Common Good and Trust Funds. This Annex reflects the approved policies around the Common Good and Trust Fund Investment Strategy but specifically excludes, as allowed by regulations, the work undertaken by External Fund Managers in relation to the Scottish Borders Council Pension Fund.

## Annex F

### Approved Countries for Investments

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link creditworthiness service.

#### ***Based on lowest available rating***

##### **AAA**

- a) Australia
- b) Denmark
- c) Germany
- d) Netherlands
- e) Norway
- f) Singapore
- g) Sweden
- h) Switzerland

##### **AA+**

- i) Canada
- j) Finland
- k) U.S.A.

##### **AA**

- l) Abu Dhabi (UAE)
- m) France

##### **AA-**

- n) Belgium
- o) Qatar
- p) **U.K.**

[Ratings provided by Link Group as at 19 December 2022]

## Annex G

### Scheme of Delegation

#### (i) Full board/council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

#### (ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

#### (iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

### THE TREASURY MANAGEMENT ROLE OF THE SECTION 95 OFFICER

#### The S95 (responsible) officer

- Take and/or authorise all operational decisions regarding the Council's investments and borrowing, in accordance with approved Treasury Management Policy and Strategy.
- Responsible for execution and administration of treasury management decisions in accordance with the Council's Treasury Management policy statement and Treasury Management Practice, and if (s)he is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
- In terms of Treasury Management, from time to time, formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and construct a lending list defining appropriate limits.
- Borrow, in advance of need, where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Adopt a cautious approach to any such borrowing, and a business case to support the decision-making process must consider:
  - the benefits of borrowing in advance,
  - the investment risks created by the existence of investments at the same time as additional borrowing being outstanding; and
  - how far in advance it is reasonable to borrow, considering the risks identified. Any such advance borrowing shall be reported through the mid-year or annual Treasury Management reporting mechanism.
- Take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast contained in the Treasury Management Strategy.
- Maintain a counterparty list consistent with the Investment Counterparty Selection Criteria and revise the criteria and submit them to Committee for approval as necessary, and in addition, set out the types of investment to be made (Permitted Investments).

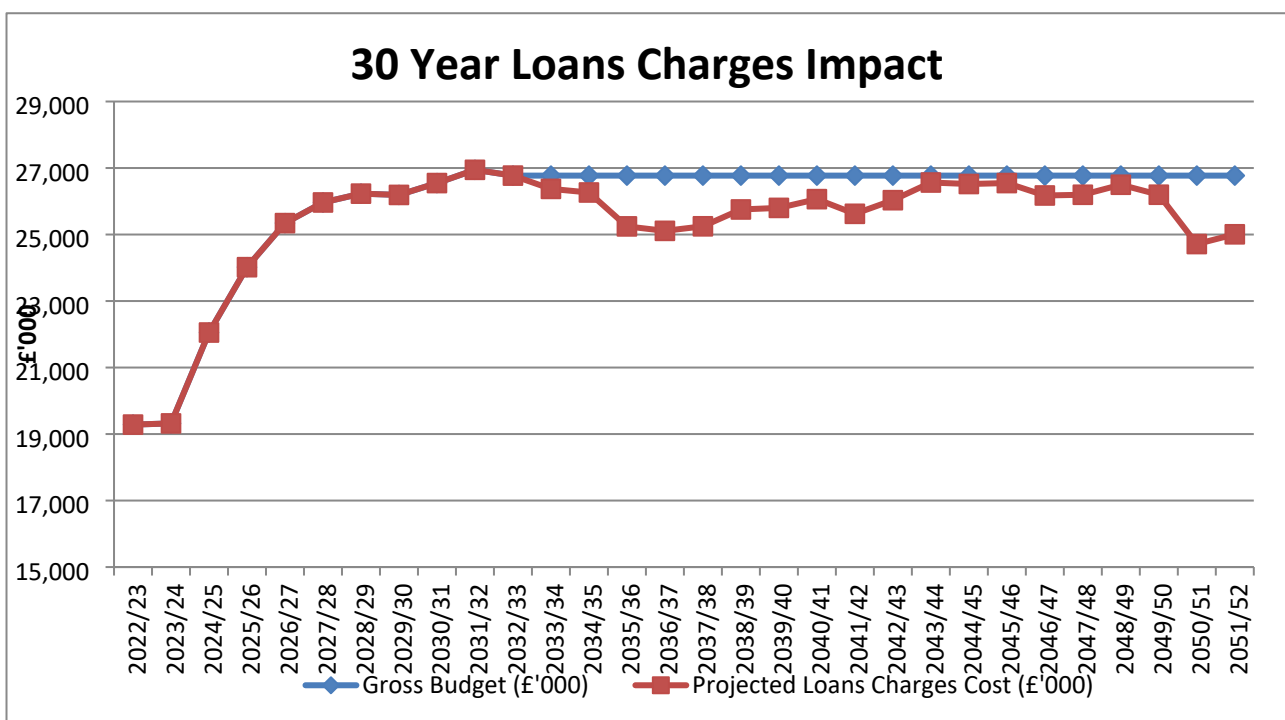
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non-treasury investments will be carried out and managed, to include the following (*TM Code p54*): -
  - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*
  - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*
  - *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*
  - *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*
  - *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*

## ANNEX H

### Long Term (30 Yr) Loans Charges Analysis

Current capital and revenue plans have been extrapolated over a 30 year period in order to assess the impact on the revenue Loans Charges budget. In line with assumptions made when assessing external debt and associated limits, long term capital planning will cause a small pressure on the loans charges budget from financial year 2031/32, as detailed in the chart below which will require to be addressed through the revenue financial planning process. Movements in notional loans charges associated with internal borrowing also impact on these figures.

It should be noted that from 2033-34, the first year out with the current 10 year Capital Plan, a 10 year average capital expenditure, and annual borrowing requirement of £10.5m, has been assumed.



## ANNEX I

### Credit Ratings

#### Long and Short Term Credit Ratings

Audit Commission Grading#	Fitch		Moody's		Standard and Poor's	
	Long Term	Short Term	Long Term	Short Term	Long Term	Short Term
Extremely strong grade	AAA	F1+	Aaa	P-1	AAA	A-1+
Very strong grade	AA+	F1+	Aa1	P-1	AA+	A-1+
	AA	F1+	Aa2	P-1	AA	A-1+
	AA-	F1+	Aa3	P-1	AA-	A-1+
Strong grade But susceptible to adverse conditions	A+	F1+ / F1	A1	P-1	A+	A-1+ / A-1
	A	F1	A2	P-1 / P-2	A	A-1
	A-	F1	A3	P-1 / P-2	A	A-1 / A-2
Adequate Grade	BBB+	F2	Baa1	P-2	BBB+	A-2
	BBB	F2 / F3	Baa2	P-2 / P-3	BBB	A-2 / A-3
	BBB-	F3	Baa3	P-3	BBB-	A-2
Speculative Grade	BB+	B	Ba1	NP *	BB+	B-1
	BB	B	Ba2	NP	BB	B-2
	BB-	B	Ba3	NP	BB-	B-3
Very Speculative Grade	B+	B	Ba1	NP	B+	-
	B	B	Ba2	NP	B	-
	B-	B	Ba3	NP	B-	-
Vulnerable Grade	CCC	C	Caa1	NP	CCC+	C
	CCC	C	Caa2	NP	CCC	C
	CCC	C	Caa3	NP	CCC-	C
	CC	C	-	NP	CC	C
	C	C	Ca	NP	C	C
Defaulting Grade	D	D	C	NP	D	D

# for the purpose of standardisation based on Standard and Poor's credit rating definitions.

\* NP – Not Prime

Source: Audit Commission adaptation of information from Fitch, Moody's and Standard & Poor's

## Benchmarking and Monitoring Security, Liquidity and Yield

The consideration and approval of security and liquidity benchmarks are also part of Member reporting. These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons, in the annual treasury report.

### Yield

These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – **Internal returns above the 365 day backward looking SONIA (Sterling Overnight Index Average) uncompounded rate.**

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. Benchmarks for the cash type investments are below. In the other investment categories, appropriate benchmarks will be used where available.

### Liquidity

This is defined as an organisation “having adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives” (CIPFA Treasury Management Code of Practice). In respect of liquidity, the Council seeks to maintain:

- Bank overdraft - £2,000,000
- Liquid short term deposits of at least £1,500,000 available with a week’s notice.

The availability of liquidity in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect, the proposed benchmark to be used is:

- **WAL benchmark is expected to be 0.5 years, with a maximum of 1.00 years.**

### Security of the investments

In the context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of the Creditworthiness service provided by Link Group. Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council’s investment strategy.

The Council’s maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- **0.002% historic risk of default when compared to the whole portfolio.**

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Annual Treasury Management Report. As this data is collated, trends and analysis will be collected and reported.

## GLOSSARY OF TERMS

<b>CIPFA</b>	Chartered Institute of Public Finance and Accountancy
<b>CIPFA Code</b>	Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes
<b>CFR</b>	Capital Financing Requirement is the estimated level of borrowing or financing needed to fund capital expenditure.
<b>Consent to Borrow</b>	Para 1 (1) of Schedule 3 of the Local Government (Scotland) Act 1975 (the 1975 Act) effectively restricts local authorities to borrowing only for capital expenditure. Under the legislation Scottish Ministers may provide consent for local authorities to borrow for expenditure not covered by this paragraph, where they are satisfied that the expenditure should be met by borrowing.
<b>Gilts</b>	A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. The term “gilt” or “gilt-edged security” is a reference to the primary characteristic of gilts as an investment: their security. This is a reflection of the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.
<b>MPC</b>	Monetary Policy Committee
<b>NHT</b>	National Housing Trust initiative undertaken in partnership with the Scottish Futures Trust.
<b>Other Long Term Liabilities</b>	Balance sheet items such as Public Private Partnership (PPP), and leasing arrangements which already include borrowing instruments.
<b>PPP</b>	Public-Private Partnership.
<b>Prudential Indicators</b>	The Prudential Code sets out a basket of indicators (the Prudential Indicators) that must be prepared and used in order to demonstrate that local authorities have fulfilled the objectives of the Prudential Code.
<b>QE</b>	Quantitative Easing
<b>SONIA</b>	SONIA (Sterling Overnight Index Average), is the risk-free rate for sterling markets administered by the Bank of England.
<b>Treasury Indicators</b>	These consist of a number of Treasury Management Indicators that local authorities are expected to ‘have regard’ to, to demonstrate compliance with the Treasury Management Code of Practice.

You can get this document on tape, in Braille, large print and various computer formats by contacting the address below.

Pensions & Investments Team, Finance, Scottish Borders Council, Council HQ, Newtown St Boswells

01835 824000, [t&cteam@scotborders.gov.uk](mailto:t&cteam@scotborders.gov.uk)