APPENDIX 1

SCOTTISH BORDERS COUNCIL

TREASURY MANAGEMENT STRATEGY
(incorporating the Annual Investment Strategy)
2024/25

CONTENTS

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 loans fund advances, (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
- An Annual 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** and the information is contained within the quarterly Capital Report. (These reports, specifically, should comprise updated Treasury/Prudential Indicators.)

1.2 Scrutiny
The 3 main 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 Treasury Management Strategy for 2024/25
The strategy for 2024/25 covers two main areas:

Capital Issues
- the capital expenditure plans and the associated prudential indicators;
- the statutory 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 (Chartered Institute of Public Finance and Accountancy) Prudential Code (the Prudential Code), the CIPFA Treasury Management Code (the Code) and Scottish Government loans fund repayment regulations and investment regulations, particularly Finance Circulars 5/2010 and 7/2016.

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, depending on need, 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, Link Treasury Services Limited as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions always remains with the Council 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) and the cash managed by the Council on behalf of the Scottish Borders Council Pension, 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 Council, 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. A Council must not borrow to invest primarily for financial return.

The revised Treasury Management Code requires 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 Director of Finance and Procurement is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The Director 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 Council's integrated revenue, capital and balance sheet monitoring;

6. **Environmental, social and governance (ESG)** issues to be addressed within a Council's treasury management policies and practices (Annex D).

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 deferred implementation of IFRS16 until 1st April 2024, the 2024/25 financial year. From this date, most leases which were previously off balance sheet and funded via revenue, will now be included as part of the other long term liabilities. The full impact of this change will be reflected in the Financial Statements for the year to 31 March 2025 and the Prudential and Treasury Indicators in the Treasury Management Strategy Statement for 2025/2026 onwards.

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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 Council 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."

3 The Capital Prudential Indicators 2024/25 – 2028/29

The Council's Financial Strategy sets out financial resource and management parameters within which it will deliver its Council Plan. The Financial Strategy brings together various elements, 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 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.

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 £18.2m in 2024/25, rising to £26.9m in 2028/29.

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 2024/25 – 2033/34 includes the following capital expenditure forecasts for the first five years. 2023/24 projected outturn figures are also shown:

Capital Expenditure (PI-1)	Estimate					
£m	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
Assets & Infrastructure	46.5	20.8	14.8	13.0	12.9	12.5
Other Corporate Services	8.4	5.7	0.1	0.5	0.2	0.2
Children & Young People	35.0	68.8	51.9	32.9	21.9	2.5
Culture & Sport	1.0	0.4	2.0	0.8	0.8	0.8
Economic Regeneration	4.1	20.8	16.6	15.2	9.9	8.2
Housing Strategy & Services	1.0	0.5	0.5	0.5	0.5	0.5
Social Care Infrastructure	1.3	4.0	12.2	3.2	13.2	-
Emergency & Unplanned & Planned programme adjustments	-0.4	0.2	0.2	0.2	0.2	0.2
Total	**96.9**	**121.2**	**98.3**	**66.3**	**59.6**	**24.9**

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	**Estimate**					
£m	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
Capital Expenditure – per plan	96.9	121.2	98.3	66.3	59.6	24.9
Other Relevant Expenditure	-	-	-	-	-	-
Total Expenditure	**96.9**	**121.2**	**98.3**	**66.3**	**59.6**	**24.9**
Financed by:						
Capital receipts	2.1	3.9	1.5	1.5	1.5	-
CFCR	0.9	1.9	-	-	-	-
Developer Contributions	0.6	5.9	0.1	0.1	0.1	0.1
Govt. General Capital Grants	26.2	9.8	12.5	11.1	11.1	11.1
Govt. Specific Capital Grants	1.6	2.9	1.0	0.3	0.3	0.2
Other Grants & Contributions	11.2	19.1	17.2	15.6	9.8	8.1
Plant & Vehicle / Infrastructure Fund	6.4	2.0	2.0	2.0	2.0	2.0
Synthetic Pitch Replacement Fund	-	0.4	1.1	0.5	0.5	0.5
Net financing need for the year met by borrowing	**47.9**	**75.3**	**62.9**	**35.2**	**34.3**	**2.9**

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 have been able to choose whether to use scheduled debt amortisation (loans pool charges), or another suitable method of calculation in order to repay borrowing. The Council calculates repayment of loans fund advances with reference to the life of an asset using the annuity method (option 3) – further details at 3.5 below.

b) The CFR also 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 following CFR projections on the page below:

Capital Financing Requirement (PI-2) £m	Actual	Estimate					
	22/23	23/24	24/25	25/26	26/27	27/28	28/29
Total CFR (PI-2) *	**347.7**	**415.5**	**480.7**	**532.4**	**555.3**	**576.5**	**565.3**
Movement in CFR represented by:							
Net financing need for the year (above)		**47.9**	**75.3**	**62.9**	**35.2**	**34.3**	**2.9**
Less scheduled debt amortisation and other financing movements		19.9	(10.1)	(11.2)	(12.3)	(13.1)	(14.1)
Movement in CFR		**67.8**	**65.2**	**51.7**	**22.9**	**21.2**	**(11.2)**

* *The CFR for this calculation includes projected capital expenditure to 31 March of each financial year and the retrospective service concession arrangements for 23/24.*

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. This Council does not currently have any commercial activity.

3.4 Liability Benchmark

The third prudential indicator 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 however CIPFA strongly recommends that the LB is produced for at least ten years. The Council has measured the LB for a ten year period in line with the Capital Plan as shown in the graph below.

There are four components to the LB: -

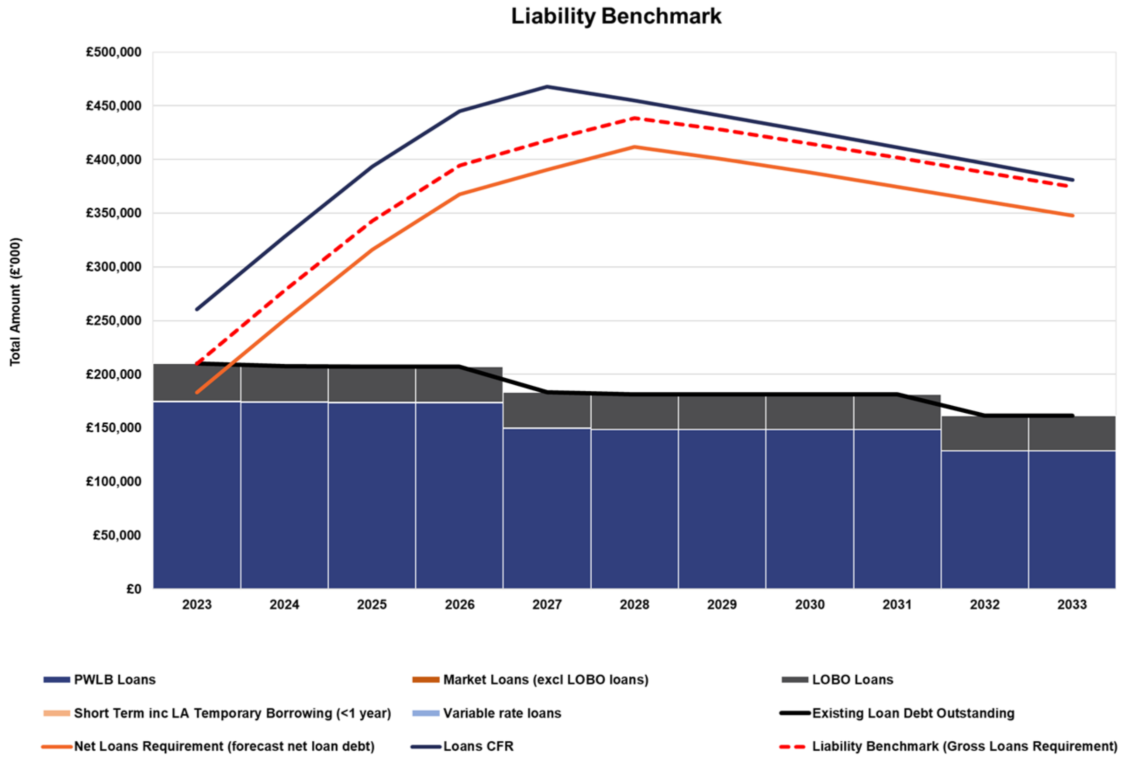
1 **Existing loan debt outstanding**: the Authority's existing loans that are still outstanding in future years, with no new borrowing added.

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 3.18%.

A consultation was issued for an amendment to the regulation 14 in December 2023 however no conclusion has been reached yet.

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 2023 and for the position as at 31 December 2023 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	actual **31.3.23**	actual **31.3.23**	current **31.12.23**	current **31.12.23**
Treasury investments	£000	%	£000	%
Banks	2,163	7%	1,450	39%
DMADF (H.M.Treasury)	8,500	30%	0	0%
Money Market Funds	18,500	63%	2,250	61%
Total managed in house	**29,163**	**100%**	**3,700**	**100%**
Total managed externally	**0**	**0%**	**0**	**0%**
Total treasury investments	**29,163**	**100%**	**3,700**	**100%**
Treasury external borrowing				
Third party loans	600	0.3%	600	0.3%
PWLB	174,308	83%	173,737	84%
LOBOs	35,000	16.7%	33,000	15.7%
Total external borrowing	**209,908**	**100%**	**207,337**	**100%**
Net treasury investments / (borrowing)	**(180,745)**	**0**	**(203,637)**	**0**

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**					
	2023/24	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
Borrowing	237.3	289.5	340.5	370.5	391.5	385.0
Other Long Term Liabilities (Finance Leases)	111.3	110.2	109.1	108.0	106.7	105.4
Total Gross Borrowing (Prudential Indicator PI-5)	**348.6**	**399.7**	**449.6**	**478.5**	**498.2**	**490.4**
Capital Financing Requirement*	**532.4**	**555.3**	**576.5**	**565.3**	**552.6**	**539.5**
(Under) / Over Borrowing (Prudential Indicator PI-6)	**(183.8)**	**(155.6)**	**(126.9)**	**(86.8)**	**(54.4)**	**(49.1)**

** 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 in PI-5)) 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 2024/25.

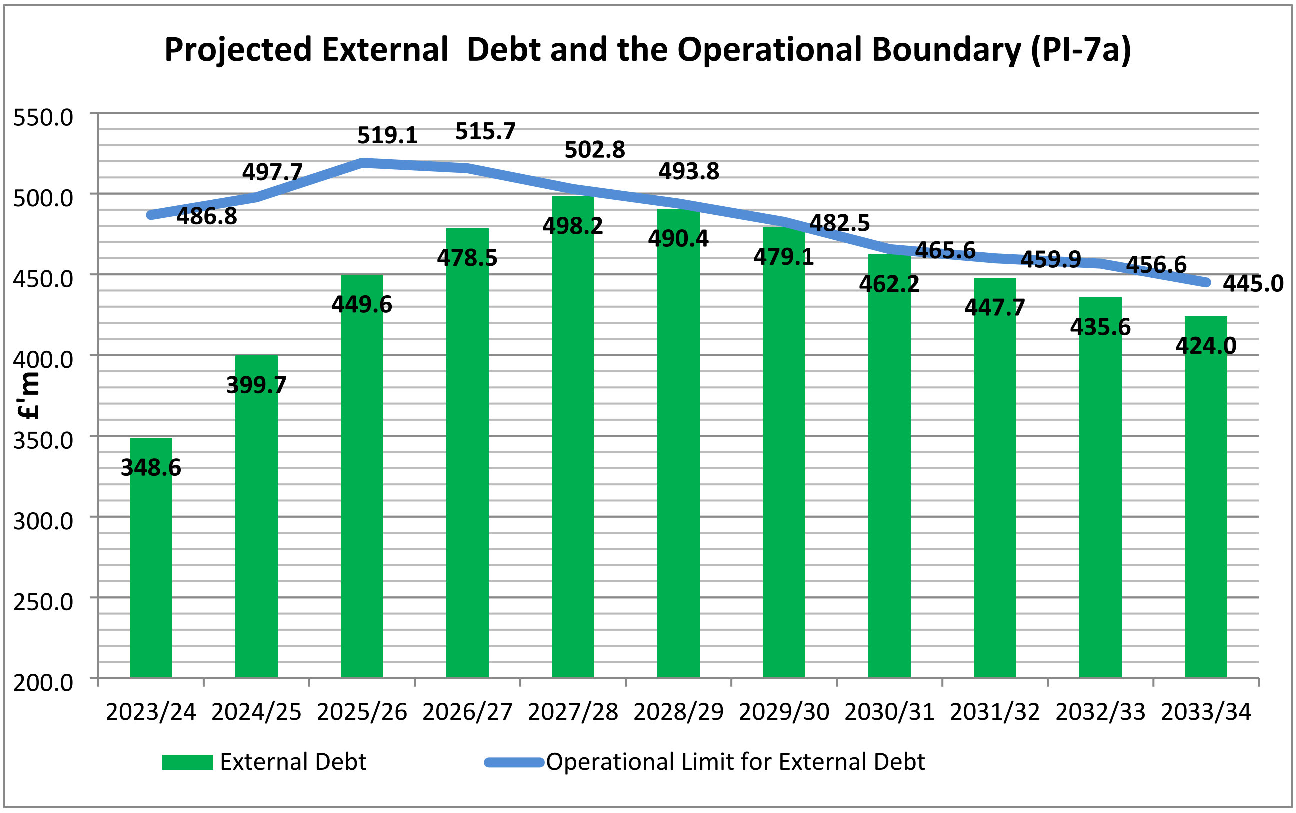
4.2 Treasury Indicators: Limits to Borrowing Activity

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					
	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Total Operational Boundary (PI-7a)	**486.8**	**497.7**	**519.1**	**515.7**	**502.8**	**493.8**
Less: Other long term liabilities	(111.3)	(110.2)	(109.1)	(108.0)	(106.7)	(105.4)
Operational Boundary exc. Other Long Term Liabilities (PI-7b)	**375.5**	**387.5**	**410.0**	**407.7**	**396.1**	**388.4**

b) The following chart shows how the current and projected Operational Borrowing limit compare with the anticipated levels of gross external debt (PI-5).



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

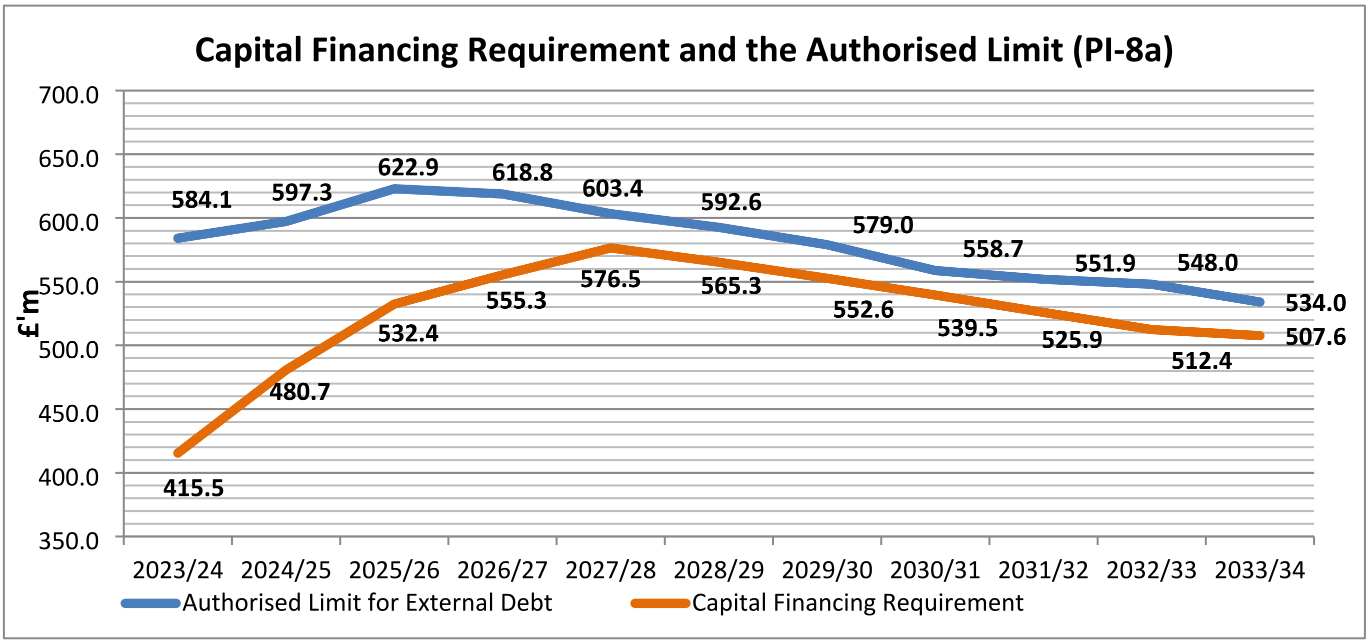
c) A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be 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, being the Operational Boundary (PI-7a) plus 20% margin:

Authorised Limit £m	Estimate					
	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Total Authorised Limit (PI-8a)	**584.1**	**597.3**	**622.9**	**618.8**	**603.4**	**592.6**
Less: Other long term liabilities	(111.3)	(110.2)	(109.1)	(107.9)	(106.7)	(105.4)
Authorised Limit exc. Other Long-Term Liabilities (PI-8b)	**472.8**	**487.1**	**513.8**	**510.9**	**496.7**	**487.2**

f) The chart on the below shows how the current and projected Capital Financing Requirement (PI-2) compares to the Authorised Limit for External Debt (PI – 8a).



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 and associated commentary on 8th January 2024.

These are forecasts for certainty rates (gilt yields plus 80bps):

Link Group Interest Rate View 08.01.24	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

Additional notes by Link on this forecast table: -

Our central forecast for interest rates was previously updated on 7 November and reflected a view that the Monetary Policy Committee (MPC) would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least H2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent GDP releases have surprised with their on-going robustness).

Naturally, timing on this matter will remain 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.

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 also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

PWLB RATES

The short and medium part of the gilt curve has rallied since the start of November as markets price in a quicker reduction in Bank Rate through 2024 and 2025 than held sway back then. This reflects market confidence in inflation falling back in a similar manner to that already seen in the US and the Euro-zone. At the time of writing there is c70 basis points difference between the 5 and 50 year parts of the curve.

The balance of risks to the UK economy: -
The overall balance of risks to economic growth in the UK is even.

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, could keep gilt yields high for longer).

- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- **Geopolitical risks,** for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

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

- Despite the tightening in bank rate to 5.25%, the **Bank of England allows inflationary pressures to remain elevated** for a long period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.
- **The pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, which may prove inflationary, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields consequently.

LINK GROUP FORECASTS

We expect the Monetary Policy Committee (MPC) will keep Bank Rate at 5.25% until the second half of 2024, to combat on-going inflationary and wage pressures, even if they have dampened somewhat of late. We do not think that the MPC will increase Bank Rate above 5.25%.

Gilt yields and PWLB rates

The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation continues to fall through 2024.

Our target borrowing rates are set **two years forward** (as we expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below: -

PWLB debt	Current borrowing rate as at 08.01.24 p.m.	Target borrowing rate now (end of Q4 2025)	Target borrowing rate previous (end of Q3 2025)
5 years	4.53%	3.70%	3.80%
10 years	4.67%	3.90%	3.80%
25 years	5.19%	4.20%	4.20%
50 years	4.97%	4.00%	4.00%

Borrowing advice

Our long-term (beyond 10 years) forecast for Bank Rate remains at 3% and reflects Capital Economics' research that suggests AI and general improvements in productivity will be supportive of a higher neutral interest rate. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to factor in Bank Rate reductions for 2024 and later.

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are set out below.

Average earnings in each year	Now	Previously
2023/24 (residual)	5.30%	5.30%
2024/25	4.55%	4.70%
2025/26	3.10%	3.20%
2026/27	3.00%	3.00%
2027/28	3.25%	3.25%
2028/29	3.25%	3.25%
Years 6 to 10	3.25%	3.25%
Years 10+	3.25%	3.25%

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 Council 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 Council'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 remains elevated through to the second half of 2024.

b) Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The Director of Finance and Procurement 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 Director of Finance and Procurement 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 Director of Finance and Procurement 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 non-Housing Revenue Account 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 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 (**Annex I**).

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) The Council has defined the list of **types of investment instruments** that are permitted investments authorised for use in **Annex D**. **Annex 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,** the Council 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) The Council 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) The 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)

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

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. More detail is seen in Annex I.

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, the 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. Nonetheless, when setting minimum sovereign debt ratings, the Council 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:

UK Building Societies	**£25 m**
Banks	**£35 m**
UK Local Authorities	**£40 m**
UK Government Debt Management Office	**£unlimited**
UK Gilts and Treasury Bills	**£20 m**
Institutions covered by Government Guarantee	**£10 m**
Part Nationalised Banks	**£35 m**
Money Market Funds (AAA)	**£25 m**

These limits will be monitored regularly for appropriateness.

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, if 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.

Group Limits

c) 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

d) 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, if 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.

5.6 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 Debt Management Account Deposit Facility (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 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 have peaked 5.25% in Q4 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 (residual)	5.30%
2024/25	4.55%
2025/26	3.10%
2026/27	3.00%
2027/28	3.25%
Years 6 to 10	3.25%
Years 10+	3.25%

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

d) This indicator is concerned with 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	2028/29
Principal sums invested for longer than 365 days	20%	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 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 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 are:

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

At the end of the financial year, the Council 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 2023/24.

(ii) Average borrowing rate movement year on year

Target is to maintain or reduce the average borrowing rate for the Council versus 2023/24.

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 2024/25 are expected to be at or below the Revenue Budget estimate contained in the Council’s Financial Plans to be approved in February 2024, which are estimated as follows:

£m	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Total Loan Charges *	**13.6**	**18.2**	**20.9**	**23.8**	**25.7**	**26.9**

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

b) The expected outturn for 2023/24 reflects the cumulative adjustment for service concession arrangements. The above budgets exclude the revenue impact of funding the cost of the National Housing Trust (NHT) and the lending to Registered Social Landlords (RSL) 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 2024/25.

ANNEXES

ANNEX A
SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Ref.	Indicator	Page Ref.	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
PRUDENTIAL INDICATORS								
Capital Expenditure Indicator								
PI-1	Capital Expenditure Limits (£m)	8	96.9	121.2	98.3	66.3	59.6	24.9
PI-2	Capital Financing Requirement (CFR) (£m)	10	415.5	480.7	532.4	555.3	576.5	565.3
Affordability Indicator								
PI-3	Ratio of Financing Costs to Net Revenue (inc. capital PPP repayment costs)	29	5.8%	7.5%	8.1%	8.9%	9.3%	9.6%
PI-4	Incremental movement of Capital Investment Decisions on Council Tax		£(0.09)	£(0.06)	£(0.05)	£(0.04)	£(0.02)	£(0.00)
External Debt Indicators								
PI-5	Actual Debt (£m)	12	348.6	399.7	449.6	478.5	498.2	490.4
PI-7a	Operational Boundary (inc. Other Long Term Liabilities) (£m)	13	468.8	497.7	519.1	515.7	502.8	493.8
PI-7b	Operational Boundary (exc. Other Long Term Liabilities) (£m)	13	375.5	387.5	410.0	407.7	396.1	388.4
PI-8a	Authorised Limit (inc. Other Long Term Liabilities) (£m)	14	584.1	597.3	622.9	618.8	603.4	592.6
PI-8b	Authorised Limit (exc. Other Long Term Liabilities) (£m)	14	472.8	487.1	513.8	510.9	496.7	487.2
Indicators of Prudence								
PI-6	(Under)/Over Gross Borrowing against the CFR (£m)	12	(183.8)	(155.6)	(126.9)	(86.8)	(54.4)	(49.1)
TREASURY INDICATORS								
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt (£m)	30	486.8	497.7	519.1	515.7	502.8	493.8
TI-2	Upper Limit to Variable Interest Rates based on Net Debt (£m)	30	170.4	174.2	181.7	180.5	176.0	172.8
TI-3	Maturity Structure of Fixed Interest Rate Borrowing 2023/24	30	**Lower**		**Upper**			
	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	25	20%	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					
	22/23	**23/24**	**24/25**	**25/26**	**26/27**	**27/28**	**28/29**
Ratio of Financing Costs to Net Revenue Stream (PI-3) *(inc. capital PPP repayment costs)*	7.7%	5.8%	7.5%	8.1%	8.9%	9.2%	9.6%

The estimates of financing costs include current commitments, the revisions due to the rebasing of the service concession arrangements and the proposals in the Financial Plans for 2024/25. The movements in the above ratio from 2023/24 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	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Interest rate exposures						
	Upper	**Upper**	**Upper**	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt (TI-1)	486.8	497.7	519.1	515.7	502.8	493.8
Limits on variable interest rates based on net debt (TI-2)	170.4	174.2	181.7	180.5	176.0	172.8

Maturity Structure of fixed interest rate borrowing 2023/24 (TI-3)		
	Lower	**Upper**
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 2024-27

[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 30.01.24.

Link Group Interest Rate View 08.01.24													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

Interest Rate Forecasts								
Bank Rate	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link	5.25%	5.25%	4.75%	4.25%	3.75%	3.25%	3.00%	3.00%
Cap Econ	5.25%	5.00%	4.50%	4.00%	3.50%	3.00%	3.00%	3.00%
5Y PWLB RATE								
Link	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.80%	3.70%
Cap Econ	4.50%	4.30%	4.20%	4.00%	3.90%	3.80%	3.80%	3.70%
10Y PWLB RATE								
Link	4.70%	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.90%
Cap Econ	4.50%	4.40%	4.20%	4.10%	4.10%	4.10%	4.10%	4.10%
25Y PWLB RATE								
Link	5.20%	5.10%	4.90%	4.80%	4.60%	4.40%	4.30%	4.20%
Cap Econ	5.10%	4.80%	4.60%	4.30%	4.40%	4.40%	4.50%	4.60%
50Y PWLB RATE								
Link	5.00%	4.90%	4.70%	4.60%	4.40%	4.20%	4.10%	4.00%
Cap Econ	4.70%	4.60%	4.50%	4.30%	4.30%	4.30%	4.40%	4.40%

Source: Link Treasury Services, January 2024

ANNEX C: ECONOMIC BACKGROUND – supplied by Link

The third quarter of 2023/24 saw:

- A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;

- A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;

- CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;

- Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;

- The Bank of England holding Bank Rate at 5.25% in November and December;

- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.

However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22.

The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.

The 0.3% m/m fall in retail sales volumes in October means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.

Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with the Halifax house price index recently pointing to a 1.7% year on year increase whilst Nationwide's December data pointed to a -1.8% year on year decrease. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.

The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.

CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.

The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.

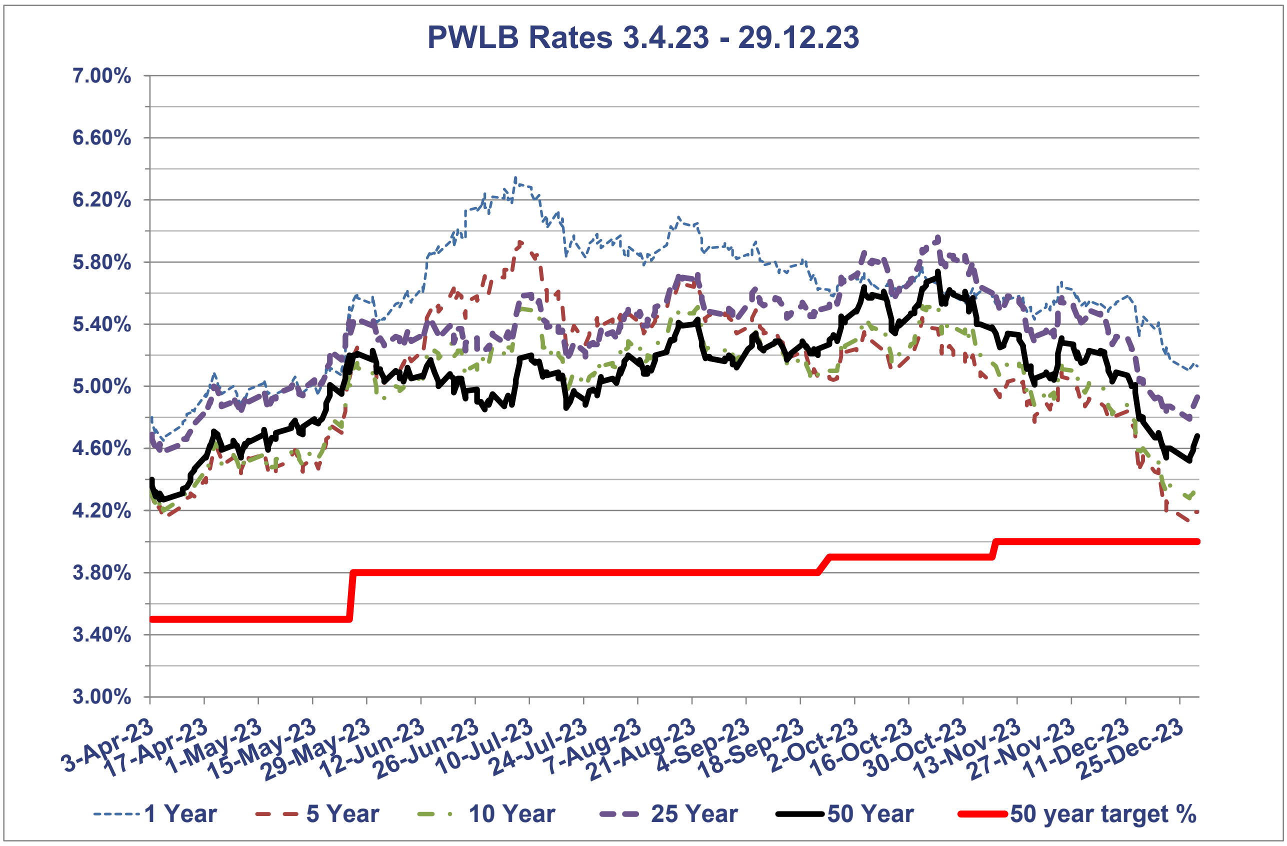
The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% in early January, with further declines likely if the falling inflation story is maintained.

Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.

The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February 2023. This modest rise in equities appear to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%.

This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein PWLB rates, is clear to see, prior to the end of year rally based on a mix of supportive domestic and international factors.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.60%	5.09%	5.03%	5.35%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

MPC meetings 2nd November and 14th December 2023

On 2nd November, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.

Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the

indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.

In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

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 because 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 extoling 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" (governance) 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.

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 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 Funds Limits	Pension Fund In-house Limits
Cash type instruments					
a. Deposits with the Debt Management Account Facility (UK Government) (**Very low risk)**	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 **(Very low risk)**	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 and maximum 1 year	£5m and maximum 1 year	£40m and maximum 1 year
c. Money Market Funds (MMFs) **(very low risk)**	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 total	£5m per fund/£25m total	£5m per fund/£25m total

Type of Investment	**Treasury Risks**	**Mitigating Controls**	**Council Limits**	**Common Good & Trust Funds Limits**	**Pension Fund In-house Limits**
d. Ultra-short dated bond funds **(low risk)**	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) **(Low risk depending on credit rating)**	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 these 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) **(Low to medium risk depending on period & credit rating)**	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 these 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 Funds Limits	Pension Fund In-house Limits
g. Government Gilts and Treasury Bills **(Very low risk)**	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
Other types of investments					
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 revalued regularly and reported annually with gross and net rental streams.	£30m	£25m.	N/A
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 **(Very Low Risk due to Scottish Government Underwriting** Shareholdings in a local authority company	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 10 year period when the properties are sold. These are service investments which may exhibit market risk and are likely to be highly illiquid.	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

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-house Limits
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 **(Very Low Risk)**	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

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 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)

AA-

m) Belgium
n) France
o) Qatar
p) **U.K.**

[Ratings provided by Link Group as at 30 January 2024]

ANNEX G: SCHEME OF DELEGATION

Full Council

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

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.

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 Strategy.
- Responsible for execution and administration of treasury management decisions in accordance with the Council's Treasury Management Strategy, 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.

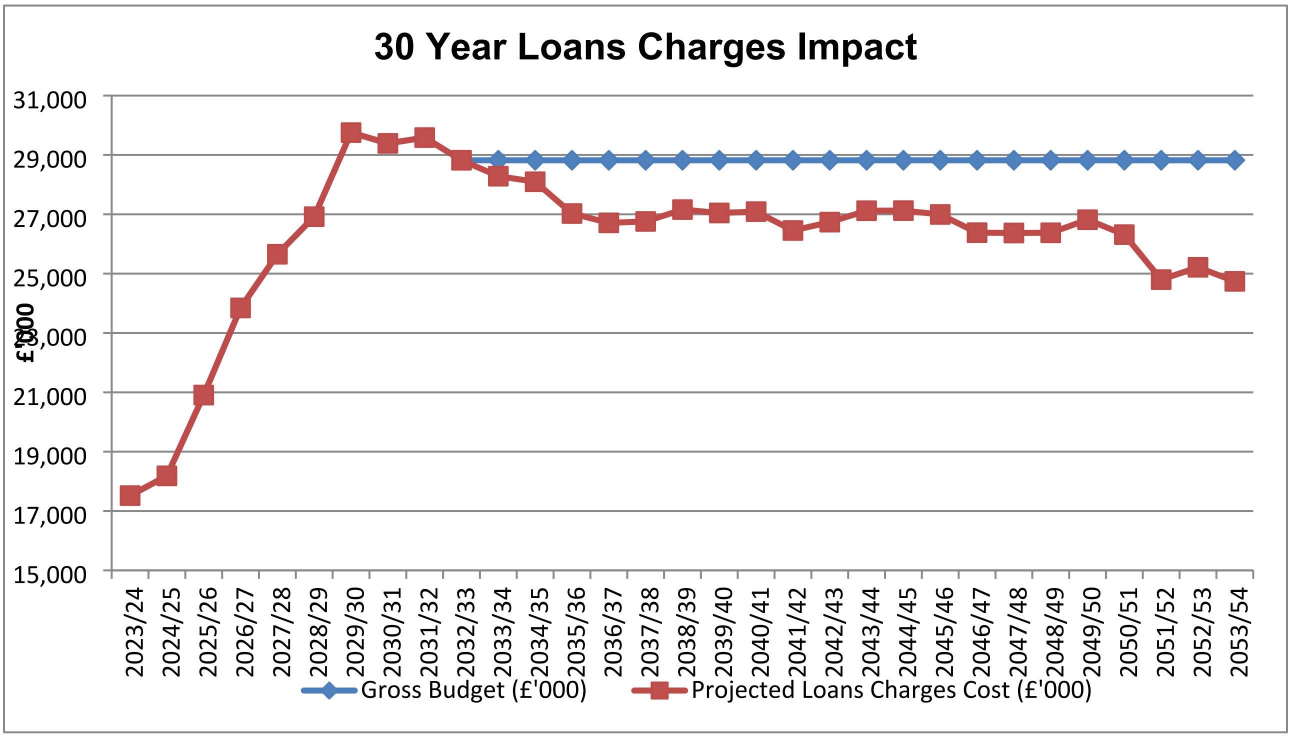
- Ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council.
- Ensure that the Council has appropriate legal powers to undertake expenditure on non-financial assets and their financing.
- Ensuring the proportionality of all investments so that the Council 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 the Council.
- Ensuring that the Council 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 Year) 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 create an increasing charge 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 outwith the current 10 year Capital Plan, a 10 year average capital expenditure, and annual borrowing requirement of £10.5m, has been assumed and the gross budget remains at the 2033-34 amount.



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+ AA AA-	F1+ F1+ F1+	Aa1 Aa2 Aa3	P-1 P-1 P-1	AA+ AA AA-	A-1+ A-1+ A-1+
Strong grade But susceptible to adverse conditions	A+ A A-	F1+ / F1 F1 F1	A1 A2 A3	P-1 P-1 / P-2 P-1 / P-2	A+ A A	A-1+ / A-1 A-1 A-1 / A-2
Adequate Grade	BBB+ BBB BBB-	F2 F2 / F3 F3	Baa1 Baa2 Baa3	P-2 P-2 / P-3 P-3	BBB+ BBB BBB-	A-2 A-2 / A-3 A-2
Speculative Grade	BB+ BB BB-	B B B	Ba1 Ba2 Ba3	NP * NP NP	BB+ BB BB-	B-1 B-2 B-3
Very Speculative Grade	B+ B B-	B B B	Ba1 Ba2 Ba3	NP NP NP	B+ B B-	- - -
Vulnerable Grade	CCC CCC CCC CC C	C C C C C	Caa1 Caa2 Caa3 - Ca	NP NP NP NP NP	CCC+ CCC CCC- CC C	C C C 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

ANNEX J: INVESTMENT PERFORMANCE/RISK BENCHMARKING

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 using 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

CIPFA	Chartered Institute of Public Finance and Accountancy
CIPFA Code	Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes
CFR	Capital Financing Requirement is the estimated level of borrowing or financing needed to fund capital expenditure.
Consent to Borrow	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.
Gilts	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 reflects the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.
MPC	Monetary Policy Committee
NHT	National Housing Trust initiative undertaken in partnership with the Scottish Futures Trust.
Other Long-Term Liabilities	Balance sheet items such as Public Private Partnership (PPP), and leasing arrangements which already include borrowing instruments.
PPP	Public-Private Partnership.
Prudential Indicators	The Prudential Code sets out a basket of indicators (the Prudential Indicators) that must be prepared and used to demonstrate that local authorities have fulfilled the objectives of the Prudential Code.
QE	Quantitative Easing
SONIA	SONIA (Sterling Overnight Index Average), is the risk-free rate for sterling markets administered by the Bank of England.
Treasury Indicators	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.

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