TORBAY COUNCIL

DRAFT Treasury Management Strategy 2025/26

November 2024

Contents

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1 Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council borrows and invests substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires Full Council to approve a Treasury Management Strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and also complies with CIPFA Prudential Code for Capital Finance in Local Authorities 2021 guidance.

The Strategy for 2025/26 covers:

- Capital expenditure and Prudential Indicators
- the Minimum Revenue Provision (MRP) policy
- forecasts for future interest rates;
- the Borrowing Strategy;
- the Investment Strategy;
- Treasury indicators which limit the treasury risk and activities of the Council;
- policy on the use of external service providers;
- reporting arrangements and management evaluation

2 Capital Expenditure and Prudential Indicators

The Council's capital expenditure plans are a key driver of treasury management activity. The output of the Council's Capital Investment Plan is reflected in the prudential indicators below, which are designed to assist Members' overview.

Capital Expenditure and Financing

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

A different approach has been taken in respect of setting an approved Capital Investment Plan from 2024/25, whereby various elements of grant funding are being held within a 'Project Pending' list prior to establishing affordable, tangible business cases for each respective project. The proposed 2025/26 capital expenditure of £31m, as at November 2024, only reflects the true costs, and timing, of progressing each project to the next stage, (or gateway), of Council approval which might be initial feasibility, Outline Business Case, Full Business Case or Final Delivery.

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

£M	2023/24 actual	2024/25 forecast	2025/26 budget	2026/27 budget	2027/28 budget
General Fund services	47	33	31	15	8

It is anticipated that, during the course of the year, these figures will significantly increase as projects work through the gateway process and subsequent approvals granted which will move projects, and funds, from the pending list into the approved Capital Investment Plan. Such changes will be reported in, and approved through, quarterly budget monitoring reports presented to Overview and Scrutiny, Cabinet and Council, or stand-alone project reports where it is proposed to commit long-term borrowing towards the cost of delivery.

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

Table 2: Capital financing in £ millions

£M	2023/24 actual	2024/25 forecast	2025/26 budget	2026/27 budget	2027/28 budget
External sources	17	28	31	15	8
Own resources	2	1	0	0	0
Debt	28	4	0	0	0
TOTAL	**47**	**33**	**31**	**15**	**8**

Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets, (known as capital receipts), may be used to replace debt finance. Planned MRP is set out in Table 3:

Table 3: MRP for financing debt on maturity in £ millions (schemes in current Capital Plan)

£M	2023/24 actual	2024/25 forecast	2025/26 budget	2026/27 budget	2027/28 budget
Minimum Revenue Provision	8	8	8	8	8

The Council's full policy on **Minimum Revenue Provision** is set out at **Appendix 1**

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

Whereas Council borrowing will still be an integral part of delivering much needed capital investment within the Bay, the level of long-term debt, as reported in the 2024/25 Treasury Management Strategy, was £359m (almost three times the Council's net annual revenue budget). Therefore, future borrowing requirements have been constructively challenged with any future approvals needing to be supported by robust and realistic revenue streams sufficient to repay the debt and interest incurred.

Table 4: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2024/25 limit	2025/26 limit	2026/27 limit	2027/28 limit
Authorised limit – borrowing	480	500	520	520
Authorised limit – PFI and leases	20	20	20	20
Authorised limit – total external debt	500	520	540	540
Operational boundary – borrowing	430	450	470	470
Operational boundary – PFI and leases	20	20	20	20
Operational boundary – total external debt	450	470	490	490

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, partially offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, Business Rates and general government grants.

Table 5: Prudential Indicator: Proportion of financing costs to net revenue stream

	2023/24 actual	2024/25 forecast	2025/26 budget	2026/27 estimate	2027/28 estimate
Net Revenue Stream	£130m	£139m	£147m	£152m	£157m
Financing costs (£m)	£14m	£17m	£16m	£16m	£16m
Proportion of net revenue stream	**10.8%**	**12.2%**	**10.9%**	**10.5%**	**10.2%**

3 Local Context

In November 2023, the Council repaid circa £19m of long-term debt in order to provide a better balance of the overall level of debt compared with relatively high cash balances held over recent years. As a result, as at 30th November 2024, the Council held £359m of borrowing and £63m of treasury investments. Forecasted changes in these sums are shown in the balance sheet analysis in table 6 below.

Table 6: Balance sheet summary and forecast:

	31.3.24 Actual £m	31.3.25 Estimate £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m
Capital Financing Requirement	**449**	**436**	**431**	**422**	**414**
Less: Other debt liabilities *	(14)	(13)	(12)	(11)	(10)
Loans CFR	**435**	**423**	**419**	**411**	**404**
Less: External borrowing	(359)	(355)	(349)	(347)	(340)
Internal borrowing	**76**	**68**	**70**	**64**	**64**
Less: Usable reserves	(86)	(76)	(76)	(75)	(75)
Less: Working capital and other cash backed balance sheet items	(46)	(46)	(45)	(47)	(47)
Treasury investments	**(56)**	**(54)**	**(51)**	**(58)**	**(58)**

* PFI liabilities that form part of the Council's total debt

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Council's current strategy is to apply its cash resources in place of external borrowing in the short term, i.e. internal borrowing.

The Council has a reducing CFR, due to the finite Capital Investment Plan and ongoing MRP adjustments, which can be funded from internal resources over the medium term thereby delaying the need to borrow.

As part of the annual budget setting process, the Council has reviewed and revised the affordability and deliverability of its Capital Investment Plan with the updated plan reducing the overall Capital Financing Requirement and future loans required.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 6 shows that the Council expects to comply with this recommendation during 2025/26.

Liability benchmark: The Code requires a "liability benchmark" to be calculated showing the lowest risk level of borrowing. This assumes the spend forecasts as detailed in table 1, but that cash and investment balances are kept to a minimum level of £20m at each year-end to maintain sufficient liquidity and minimise credit risk.

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

Consideration will be given regarding the use of cash balances, at any point in time, to fund a long-term borrowing requirement as this could minimise the risks around higher long term debt costs.

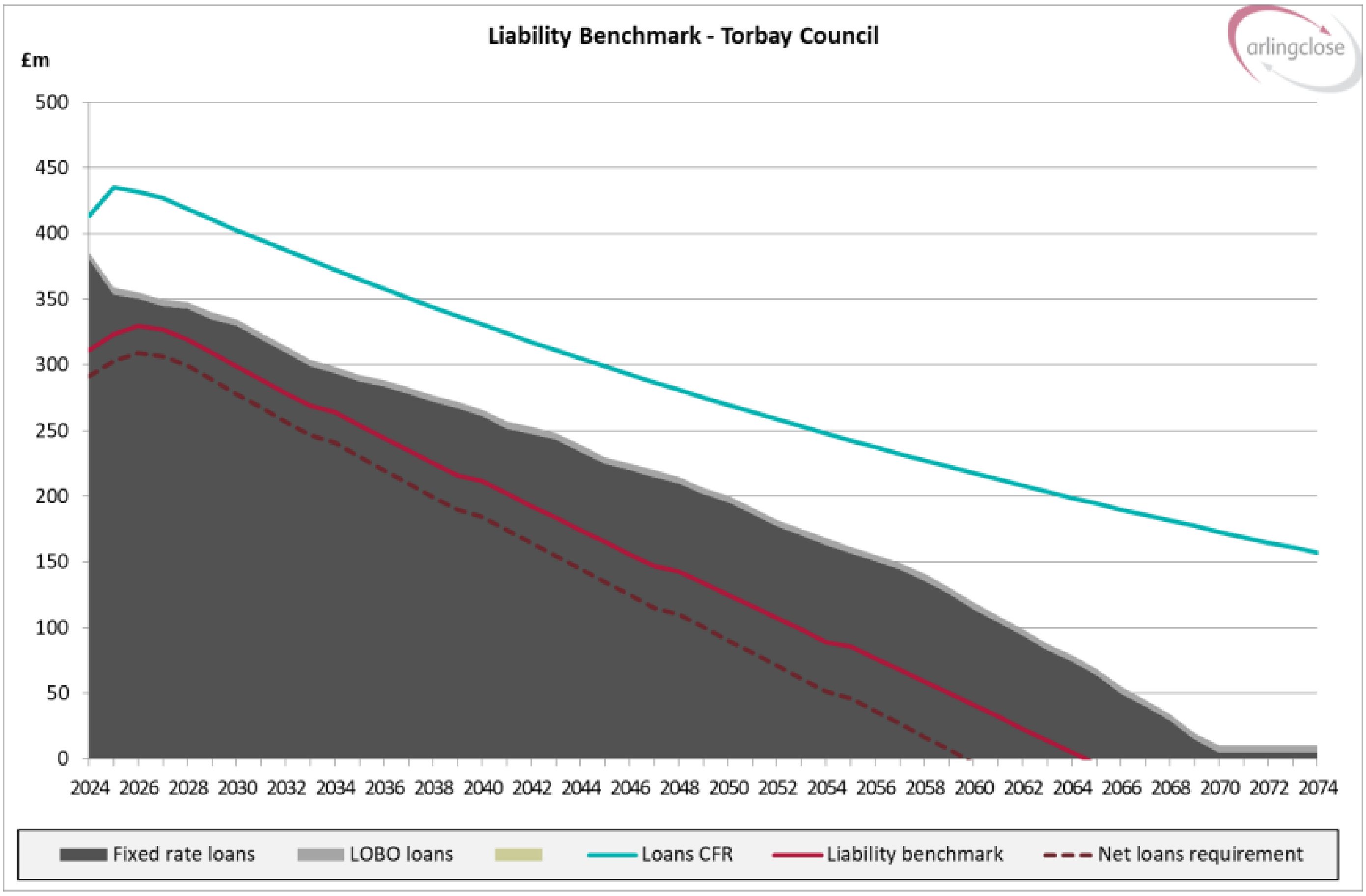
Table 7: Prudential Indicator - Liability benchmark

	31.3.24 Actual £m	**31.3.25 Estimate £m**	**31.3.26 Forecast £m**	**31.3.27 Forecast £m**	**31.3.28 Forecast £m**
Loans CFR	435	423	419	411	404
Less: Balance sheet resources	(119)	(120)	(110)	(108)	(107)
Net loans requirement	316	303	309	303	297
Plus: Liquidity allowance	20	20	20	20	20
Liability benchmark	**336**	**323**	**329**	**323**	**317**

The maturity profile of the Council's existing borrowing compared with the Capital Financing Requirement and 'Liability Benchmark' are detailed in the following graph:

The concept is that the chart allows a comparison of current borrowing against the need to borrow, looking at both the amount (on the y axis) and the term (on the x axis). Where actual loans exceed the Liability Benchmark, the authority can make long-term investments for cash flow management or repay loans early; where the Liability Benchmark exceeds loans, the authority can take long-term borrowing or sell investments.

There is no requirement to borrow exactly to the Liability Benchmark, but a decision to borrow more or less, or longer or shorter, than the Liability Benchmark implies a deliberate decision to accept additional risk. This may be entirely appropriate if it is accompanied by a reduction in cost, for example through short-term borrowing at lower margins. The Liability Benchmark provides the tool for local authorities to measure this risk and make such risk/reward decisions openly and explicitly.


Liability Benchmark - Torbay Council
£m
500
450
400
350
300
250
200
150
100
50
0
2024 2026 2028 2030 2032 2034 2036 2038 2040 2042 2044 2046 2048 2050 2052 2054 2056 2058 2060 2062 2064 2066 2068 2070 2072 2074
Fixed rate loans
LOBO loans
Loans CFR
Liability benchmark
Net loans requirement

4 Economic and Interest Rate Forecast

The Council's advisors, Arlingclose Ltd have provided an economic commentary (updated for November 2024) detailed as **Appendix 2** together with their interest rate forecasts for future years as shown in table 8:

Table 8: Arlingclose Ltd interest rates forecast

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

Note: The Council will borrow at PWLB certainty rate which is the relevant gilt yield + 0.80%

Arlingclose have highlighted the following key points:

- In line with forecast, Bank Rate was cut to 4.75% in November 2024.
- The Monetary Policy Committee will continue to lower Bank Rate to reduce the restrictiveness of monetary policy, but more slowly and to a higher level. We anticipate another rate cut in February 2025, followed by one cut per quarter to a low of 3.75%.
- Long-term gilt yields have risen to reflect both UK and US economic, monetary and fiscal policy expectations, and increases in bond supply. Volatility is likely to remain elevated as the market digests incoming data.
- This uncertainty may also necessitate more frequent changes to forecasts than has been the case recently.
- Upside risks to inflation over the next 12 months could limit the extent of monetary easing, but we see the risks as broadly balanced over the medium term.

5 Borrowing Strategy

The Council currently holds £359 million of loans. The balance sheet forecast in table 6 shows that the Council does not expect to need to borrow in 2025/26 due to internal resources being available to fund capital expenditure in the short term. However, should the Capital Investment Plan be expanded, the Council may borrow to pre-fund future years' requirements providing this does not exceed the Authorised Limit for borrowing.

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

Strategy: Given the significant cuts to public expenditure, particularly to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently high, but expected to fall in the coming year, it is likely to be more cost effective over the medium-term to either use internal resources, or to borrow short-term loans as opposed to any further long term borrowing. The risks of this approach will be managed by keeping the Authority's interest rate exposure within the limit set in the treasury management prudential indicators.

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

In the event of any new external borrowing requirements over and above internal borrowing capacity, the Council will look to the PWLB to secure long-term funding of projects. However, alternative sources will be considered.

PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council continues to avoid this activity in order to retain its access to PWLB loans.

The budget for payment of interest on debt for 2025/26 has been based on an assumed £359m of "historic" borrowing as at 31/03/25 with an overall borrowing rate of 2.91%.

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- National Wealth Fund Ltd (formerly UK Infrastructure Bank Ltd)
- any institution approved for investments
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Peninsula Pension Fund)
- capital market bond investors

- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- retail investors via a regulated peer-to-peer platform
- Municipal Investments using loans and bonds
- “Green” bonds (loans to Council)

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback
- similar asset based finance

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Chief Finance Officer may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years. In response to this the Council repaid circa £19m of long-term loans in 2023/24.

6 Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year the Council's investment balance has ranged from a high of £98 million down to around £50 million currently. That current level is likely to be maintained in the forthcoming year.

Objectives: The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy: As demonstrated by the liability benchmark, the Council expects to be a long-term investor and treasury investments will therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income to support local public services.

To achieve this the Director of Finance regularly reviews opportunities for further diversification into strategic investments as part of a balanced portfolio of holdings. The policy for who the Council can invest with, (counterparty selection), and investment limits is detailed in **Appendix 3**.

Environmental, Social and Governance (ESG) Investments

Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG considerations do not currently include ESG scoring or other real-time ESG criteria at an individual investment level. Officers will continue to monitor and evaluate ESG investment opportunities, and these may be incorporated into future investment strategies subject to yield and security. Given the limited range of counterparties the Council can use for its investments and that borrowing is mainly from the Government there are limited opportunities to apply ESG principles in this Strategy.

Non-Treasury Investments Strategy

The Government and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. The current schedule of non-financial investments is detailed at **Appendix 4**. All decisions have followed the appropriate risk management framework and strategy for non-financial investments as approved by Council.

Any involvement by the Council in community investment schemes, such as Credit Unions and Mutual Banks, would fall into this category and would not be managed within the Treasury Management policies.

Guidance within the Prudential Code states that, *"Councils with existing commercial investments are not required by this Code to sell these investments,* ***however Councils that have an expected***

need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual Treasury Management Strategy*. These reviews should evaluate whether to address expected borrowing needs by taking new borrowing or repaying investments based on a financial appraisal that takes into account of financial implications and risk reduction benefits".*

The Council will formally review their holding of 'out of area' Commercial Assets during 2025/26 in advance of considering any future PWLB borrowing in compliance with the Code.

7 Treasury Management Indicators

The Council measures and manages its exposure to Treasury Management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating/credit score of its investment portfolio. The credit score is calculated by applying a value to each investment (AAA=1, AA+=2, …. A=6 etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating (score)	A (6)

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one-month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 1 months	£10m

Interest rate exposures: This indicator is set to control the Council's exposure to interest rate risk. The Council's debt portfolio is virtually all at fixed rate and therefore has no exposure to fluctuations in interest rates. As such, no specific limits are proposed on interest rate exposure but any new borrowing will be restricted to a maximum **30%** of the total portfolio exposed to variable interest rate.

Maturity structure of borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	10%	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	40%	10%
10 years and within 20 years	50%	10%
20 years and within 30 years	50%	10%
30 years and within 40 years	50%	10%
40 years and above	50%	10%

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2025/26	2026/27	2027/28
Limit on principal invested beyond year end		£40m	

8 Treasury Management Consultants

Arlingclose Ltd were appointed as the Council's external Treasury Management advisor for three years from April 2020, following a full tender process. An option to extend the term for a further two years was subsequently exercised by the Council. The current contract expires in April 2025, a full tender process will be undertaken in line with procurement regulations with the contract being awarded with effect from May 2025.

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

9 Reporting Arrangements and Management Evaluation

Members of the Audit Committee will receive the following reports for 2025/26 as standard in line with the requirements of the Code of Practice:

- Annual Treasury Management Strategy
- Mid-Year Treasury Management Review report
- Annual Treasury Management Outturn report

The Director of Finance, (CFO), will inform the Cabinet Member for Finance and Housing of any long-term borrowing or repayment undertaken or any significant events that may affect the Council's treasury management activities. The CFO will maintain a list of staff authorised to undertake treasury management transactions on behalf of the Council.

The Director of Finance is authorised to approve any movement between borrowing and other long-term liabilities within the Authorised Limit. Any such change will be reported to the next meeting of the Council.

The impact of these policies will be reflected as part of the Council's revenue budget and therefore will be reported through the quarterly budget monitoring process. The Council's management and evaluation arrangements for Treasury Management will be as follows:

- Monthly monitoring report to the Director of Finance (Chief Finance Officer);
- Quarterly monitoring report to the Cabinet Member for Finance and Housing;
- Quarterly meeting of the Director of Finance, Treasury Manager and Treasury Advisors to review previous quarter performance and plan future period activities;
- Ad-hoc meetings with the Council's treasury advisors as required;
- Regular Investment benchmarking against other local authorities

The Audit Committee is the governance body responsible for the scrutiny of Treasury Management, making any relevant recommendations and amendments through Cabinet and Full Council.

The CIPFA Code requires the Chief Finance Officer to ensure that members with responsibility for treasury management receive adequate training. In compliance with this, a comprehensive briefing, and training event, was held in December 2023, delivered by Arlingclose and the Director of Finance. A refresher training session will take place with Arlingclose to ensure that the members with responsibility for treasury management continue to have the required knowledge and skills.

The training needs of treasury management officers are periodically reviewed.

Appendix 1

Policy on Minimum Revenue Provision for 2025/26

The Minimum Revenue Provision (MRP) is a statutory charge that the Council is required to make from its revenue budget where the Council funds capital expenditure with debt.

Although there has been no statutory minimum since 2008, the Local Government Act 2003 requires the Council to have regard to the Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in April 2024

The MHCLG Guidance requires the Council to approve an Annual MRP Policy each year and provides a number of options for calculating a prudent amount of MRP, but does not preclude the use of other appropriate methods.

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

One of the aims of this legislation is to ensure that the repayment of principal owed for Capital expenditure is charged on a prudent basis. Central Government guidance says:

> "***the broad aim of prudent provision is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the Capital expenditure provides benefits***"

For Supported Borrowing, (borrowing funded by central government), the Council will charge MRP at 2% of the balance to clear the borrowing liability over a period of 50 years.

In relation to transferred debt from Devon County Council the Council deem it prudent to allocate a VRP, (voluntary revenue provision), calculated in line with the supported borrowing calculation, based on a total repayment period of 50 years.

For capital expenditure funded from unsupported borrowing the Council will make a MRP based on the cumulative expenditure incurred on each asset, (including investment fund properties), in the previous financial years using a prudent asset life, which reflects the estimated usable life of that asset.

The MRP for each asset will be calculated on the asset life method using an annuity calculation. MRP will be calculated on the total expenditure on that asset, in the financial year **after the asset becomes operational,** or 12 months after operational, or when there is an income stream in relation to that asset.

The Council will continue to charge services for their use of unsupported borrowing using a prudent asset life (or a shorter period) on an annuity calculation. Where possible the same asset life and borrowing interest rate will be used for both the charge to services and the calculation of the MRP.

To mitigate any negative impact from the changes in accounting for leases and PFI schemes the Council will include in the annual MRP charge an amount equal to the amount that has been taken to the balance sheet to reduce the balance sheet liability for a PFI scheme or a finance lease. The calculation will be based on the annuity method using the Internal Rate of Return (IRR) implicit in the PFI or lease agreement.

For Council Led development projects the council will select one of the methods detailed below

- **Method 1 -** Equal instalments of MRP over the life of the asset.

- **Method 2** - Annuity model, applicable to housing development schemes only. A lower amount of MRP will be applied in the early years with this increasing in future years based on forecasted uplift in rental income.

The decision on the applicable method will be determined by the S151 Officer and will be based on certainty / risk of future income streams and the level of exposure to long term debt.

For projects that are in nature are either office/retail/commercial development method 1 will be applied.

When applying the annuity model (method 2), schemes under consideration will have to, as a minimum, pay back the interest costs from day 1 and make at least a contribution towards repayment of principal (which will be increased over future years).

For Council led projects, which are considering applying the annuity model, the Council will consult with their external auditors on the proposed approach in advance of seeking formal Council approval.

Where relevant, the suggested asset lives for certain types of capitalised expenditure as detailed in the MRP statutory guidance issued by MHCLG will be used. The latest guidance issued suggests a maximum asset life of 50 years.

In terms of **Council led Housing developments**, the MRP charge can be based on the life of the housing assets developed. A life of more than 50 years can be applied if supported by an independent valuer's report.

Each asset life will be considered in relation to the asset being constructed (primarily to ensure the MRP period does not exceed asset life); however, as a guide the following are typical ranges for asset lives that will be used.

Asset Type	Range of Asset Life
Freehold Land (speciifed in MHCLG statutory gudiance)	50 years
Buildings	20-40 years
Investment Properties	25-50 years
Software	5-10 years
Vehicles & Equipment	5-8 years
Highway Network	25-40 years
Structural Enhancements	10-25 years
Infrastructure	25-50 years

For capital expenditure where land and buildings are not separately identified a blended asset life can be used.

Where **loans are given for capital purposes**, they come within the scope of the prudential controls established by the Local Government Act 2003 and the Local Authorities (Finance and Accounting) (England) Regulations 2008.

For capital expenditure on loans to third parties **which were made primarily for service purposes**, the Authority will make nil MRP except as detailed below for expected credit losses. Instead, the Authority will apply the capital receipts arising from the repayments of the loan principal to finance the expenditure in the year they are received.

For capital loans made on or after 7th May 2024 where an expected credit loss is recognised during the year, the MRP charge in respect of the loan will be no lower than the loss recognised. Where expected credit losses are reversed, for example on the eventual repayment of the loan, this will be treated as an overpayment.

For capital loans made before 7th May 2024 and for loans where expected credit losses are not applicable, where a shortfall in capital receipts is anticipated, MRP will be charged to cover that shortfall over the remaining life of the assets funded by the loan.

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

- Capital receipts arising on the repayment of principal on capital loans to third parties will be used to lower the MRP charge in respect of the same loans in the year of receipt, if any.
- Capital receipts arising on the repayment of principal on finance lease receivables will be used to lower the MRP charge in respect of the acquisition of the asset subject to the lease in the year of receipt, if any.
- Capital receipts arising from other assets which form an identified part of the Council's MRP calculations will be used to reduce the MRP charge in respect of the same assets over their remaining useful lives, starting in the year after the receipt is applied.
- Any other capital receipts applied to repay debt will be used to reduce MRP in equal instalments starting in the year after receipt is applied.

Appendix 2
Economic Commentary

(Provided by Arlingclose Ltd, November 2024)

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

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

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

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

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

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

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

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

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

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

Overall, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

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

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

Appendix 3
Creditworthiness Policy and Investment Limits

The Council may invest its surplus funds with any of the counterparty types in table 9, subject to the cash limits, (per counterparty), and the time limits shown. The Chief Finance Officer will exercise his delegated powers "to take any decisions, (including key decisions), and to exercise all legal powers relevant to the Council's borrowing, investments and financial management)" (s.7.1 of the Constitution – Officer Scheme of Delegation) to vary these limits at any time to ensure they remain viable and relevant during any market or political volatility.

Table 9: Approved investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£15m	Unlimited
Secured investments *	25 years	£15m	Unlimited
Banks (secured)*	25 years	£15m	Unlimited
Banks (unsecured) *	13 months	£6m	Unlimited
Building societies (unsecured) *	13 months	£6m	£18m
Registered providers (unsecured) *	3 years	£6m	£20m
Money market funds *	n/a	£15m	Unlimited
Strategic pooled funds	n/a	£10m	£30m
Real estate investment trusts	n/a	£10m	£20m
Other investments *	3 years	£6m	£15m

This table should be read in conjunction with the notes below

*** Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be considered.

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

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

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

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

Banks and building societies (unsecured): Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

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

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

Strategic pooled funds: Bond, equity and property funds, including exchange traded funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date but can be either withdrawn after a notice period or sold on an exchange, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

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

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

Operational bank accounts: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £15,000,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

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

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

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

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government or, on an exception basis, with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment limits: The Council's revenue reserves available to cover investment losses are forecast to be £86 million on 31st March 2025. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £15 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country since the risk is diversified over many countries.

Table 10: Additional investment limits

	Cash limit
Any group of pooled funds under the same management	£30m per manager
Foreign countries	£30m per country