SURREY HEATH BOROUGH COUNCIL

APPENDIX 3

TREASURY MANAGEMENT STRATEGY 2024/25

(APPENDIX 3 TO THE MEDIUM TERM FINANCIAL STRATEGY 2024/25 TO 2027/28)

February 2024

Surrey Heath Borough Council
Knoll Road, Camberley GU15 3HD

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Annex A

Part 1 - Treasury Investment Strategy

1.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. This is expected to remain at an average between £12 million and £15 million over 2024/25.

Objectives:

1.2 The CIPFA Code requires the Council to invest its treasury funds prudently, and with regard to the security and liquidity of its investments before seeking the highest return 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.

Strategy:

1.3 The majority of the Council's surplus cash is currently invested in money market funds and the UK Government. On the advice of our retained advisors, the public sector treasury arm of Link Group, no changes are proposed to the 2024/25 investment strategy from that adopted and approved in February 2023**.**

Business Models:

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

Approved Counterparties:

1.5 The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the limits shown:

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£3m	Unlimited
Secured investments *	25 years	£3m	Unlimited
Banks (unsecured) *	13 months	£2m	Unlimited
Building societies (unsecured) *	13 months	£2m	£5m
Registered providers (unsecured) *	5 years	£2m	£5m
Money market funds *	n/a	£3m	Unlimited
Strategic pooled funds	n/a	£3m	£5m
Real estate investment trusts	n/a	£3m	£3m

This table must be read in conjunction with the notes below.

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

1.7 Lowest published credit rating is the lowest from those published by either Fitch, Moody's or Standard and Poors.

1.8 For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £2 million per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

1.9 **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.

1.10 **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 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.

1.11 **Government**: 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. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

1.12 **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.

1.13 **Money Market Funds (MMF)**: 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. Due to the diversity of the fund elements, the low volatility and the ringfencing of assets to the fund subscribers, money market funds are normally granted a AAA rating.

1.14 **Strategic Pooled Funds**: Bond, equity and property 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 are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

1.15 **Real Estate Investment Trusts (REITs)**: 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.

1.16 **Operational/Transactional 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 £3 million 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. Deposits with the Council's current account are restricted to overnight deposits.

1.17 **Risk Assessment and Credit Ratings**: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

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

1.19 **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.

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

1.21 **Investment Limits**: The maximum that will be lent to any one organisation (other than the UK Government) will be £3 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

1.22 Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £3 million in operational bank accounts count against the relevant investment limits.

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

	Cash limit
Any single organisation, except the UK Central Government	£3m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£3m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£2m per country
Registered Providers	£5m in total

Unsecured investments with Building Societies	£5m in total
Loans to unrated corporates	£2m in total
Money Market Funds	Unlimited

Part 2 - Borrowing Strategy

2.1 The Council currently holds £174.0 million of loans (forecast as at 31 March 2024), which it is using to fund its property acquisitions. The Council may borrow in advance to pre-fund future years' requirements in order to access better rates, providing this does not exceed the authorised limit for borrowing of **£237 million**; however the Council will incur a net cost of carry until the funds are utilised and must not borrow purely for investment purposes.

2.2 **Objectives**: The Council's main 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 or repay loans should the Council's long-term plans change is also an objective.

2.3 **Strategy**: Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently slightly lower than long-term rates, it is likely to continue to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. This also provides liquidity for repayment of debt should funds become available through sale of assets.

2.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Link Group will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2024/25 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

2.5 The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. Access to PWLB loans is no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

2.6 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

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

2.8 **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)
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Surrey County Council Pension Fund)
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
- Local Enterprise Partnerships
- Any other UK public sector body

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

- Leasing
- Hire Purchase
- Private Finance Initiative
- Sale and Leaseback

2.10 **Annual Minimum Revenue Provision (MRP) statement**: When a Council borrows, it is required to indicate how it intends to fulfil its duty to make prudent provision for the repayment of the capital borrowed from revenue. This provision is called the Minimum Revenue Provision or MRP. Best practice guidance recommends that authorities prepare a statement of policy on making MRP in respect of the forthcoming financial year. The Council's MRP statement will be recommended to Council by the Executive on 21 February 2024 as part of the annual budget for 2024/25 and the Medium Term Financial Strategy.

2.11 The recommended policy is attached in **Annex F** and the forecast MRP in £million is shown in the table below:

£ million	2023/24 estimate	2024/25 budget	2025/25 budget	2026/27 budget	2027/28 budget
MRP Payment	2,740	2,974	3,156	3,328	3,444

2.12 On 31 December 2023, the Council held £165.1 million of borrowing and £17.4 million of treasury investments.

2.13 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing below their underlying levels, sometimes known as internal borrowing subject to holding a minimum of £5 million.

Annex B

Treasury Management Strategy – other items
2023/24

Other Items
There are a number of additional items that the Council is obliged by CIPFA or DLUHC to include in its Treasury Management Strategy.

1. **Financial Derivatives**

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

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

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

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

At the moment the Council does not hold any Financial Derivatives.

2. **Investment Advisers**

The Council has appointed Link Group as treasury management advisers and receives specific advice on investment, debt and capital finance issues. This is monitored by holding regular meetings with the advisers to ensure that they continue to meet the Council's treasury management objectives. In addition, the Council's tender process for treasury management advice ensures value for money.

3. **Investment of Money Borrowed in Advance of Need**

The total amount borrowed will not exceed the authorised borrowing limit of £237 million. The maximum period between borrowing and expenditure is not expected to exceed two years, although the Council is not required to link particular loans with particular items of expenditure. At the moment there are no plans to borrow in advance.

4. **Other Options Considered**

The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Strategic Director Finance and Customer Services, having consulted the Portfolio Holder, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-

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

Markets in Financial Instruments Directive (MIFID II)

The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, The Strategic Director Finance and Customer Services (Chief Finance Officer) believes this to be the most appropriate status.

Annex C

Treasury Management Indicators 2024/25

The Council measures its exposure to treasury management risks using the following indicators. The Council is asked to approve these indicators:

1. Security – Average Credit Rating

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

Credit Risk Indicator	Target
Portfolio average credit rating	A

This is calculated by applying a score to each investment (AAA = 1, AA+=2, etc.) and taking the arithmetic average weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

2. Liquidity: cash available within three months

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 three-month period, without additional borrowing.

Liquidity Risk Indicator	Target
Total cash available within 3 months	£5m

3. Interest Rate Exposures:

This indicator is set to control the Council's exposure to interest rate risk. The Council holds investments of £17 million and variable rate borrowing of £165 million which equates to net borrowing of £148 million. The limit on one-year revenue impact of a 1% rise in interest rates has been set at £1 million. The Council has sufficient reserves in an Interest Equalisation Reserve to mitigate the impact of an interest rate rise for 2024/25.

4. Maturity Structure of Borrowing:

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

Refinancing rate risk indicator	Upper	Lower
Not over 1 year	100%	0%
Over 1 but not over 2 years	100%	0%
Over 2 but not over 5 years	100%	0%
Over 5 but not over 10 years	100%	0%
Over 10 but not over 15 years	100%	0%
Over 15 but not over 20 years	100%	0%
Over 20 but not over 30 years	100%	0%
Over 25 but not over 30 years	100%	0%
Over 30 but not over 40 years	100%	0%
Over 40 years	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. This table means there is total flexibility on borrowing periods to achieve the most cost-effective option.

5. 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	2024/25	2025/26	2026/27
Limit on principal invested beyond year end	£2.5m	£2.5m	£2.5m

Annex D

INVESTMENTS as of 31st December 2023

	£
Debt Management Office	7,000,000
Other Local Authorities Short Term	0
Total Government	**7,000,000**
Aberdeen Standard	500,000
Aviva	300,000
CCLA Public Sector Deposit Fund	500,000
Federated	3,000,000
Legal and General	2,500,000
Total Money Market Funds	**6,800,000**
CCLA Property Fund	2,000,288
Total Longer-Term Investments	**2,000,288**
Total Invested (excluding the NatWest Business Reserve)	**15,800,288**
NatWest Business Reserve	1,562,273
NatWest Transactional Account	35,807
Total Invested	**£17,398,368**

Annex E

Existing Investment & Debt Portfolio

	31 Dec 23 Actual Portfolio £m
External Borrowing:	
Public Works Loan Board - Long Term	50.00
Phoenix Loan	48.62
Local authorities - Short Term	66.50
Total Gross External Debt	**165.12**
Investments:	
Banks & Building societies	1.60
Government – DMO	7.00
Government - Other Local Authorities	-
Money Market Funds	6.80
Other Pooled Funds	2.00
Total Treasury Investments	**17.40**
Net Debt	**147.72**

Annex F

Minimum Revenue Policy (MRP) Statement

1. Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, where the local Authority has financed Capital expenditure by borrowing it is required to make a provision each year through a revenue charge (MRP).

2. The Authority is required to calculate a prudent provision of MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the Authority can use any other reasonable basis that it can justify as prudent

3. For capital expenditure incurred and funded through borrowing the Council will calculate MRP using the annuity method.

4. MRP is the principal element for the year of the annuity required to repay over the asset's useful life the amount of capital expenditure financed by borrowing or credit arrangements. The authority will use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during repayment period (e.g. by the application of capital receipts) should be made as necessary.

5. As summarised in the table below, MRP will be based on the estimated useful life of the assets purchased by prudential borrowing.

Asset class	Estimated useful economic life
Land and heritage assets	50 years
Buildings and services	50 years
Vehicles and plant	10 years
ICT equipment	5 years
Investment property	50 years
Assets under construction/pending regeneration	0% until development complete

6. The Council will aim to minimise the impact of MRP on the General Fund by only acquiring assets with a longer rather than shorter economic life through borrowing.

7. In accordance with provisions in the guidance MRP will be charged starting in the year following the date an asset becomes operational.

8. The forecast MRP in £million is shown in the table below:

£ million	**2023/24 estimate**	**2024/25 budget**	**2025/25 budget**	**2026/27 budget**	**2027/28 budget**
MRP Payment	2,740	2,974	3,156	3,318	3,444

Annex G

Treasury Management Policy Statement

The Council's financial regulations require it to create and maintain a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

Definition

1. The Council defines its treasury management activities as: The management of the Council'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.

Risk management

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

Value for money

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy

4. The Council greatly values revenue budget stability. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

5. The Council will set an affordable borrowing limit each year in compliance with the Local Government Act 2003, and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit. It will also set

limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

6. The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local Council services is an important, but secondary, objective.

7. The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.