Treasury & Investment Strategies 2025/26

Overview Select Committee: 30 January 2025

Council: 19 February 2025

Lead director: Amy Oliver, Director of Finance

Useful information

- Ward(s) affected: All
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- Report version number: 1

1. Summary

1.1 This report proposes:

- A Treasury Policy framework. (Appendix 1)
- A Treasury Management Strategy for the governance of the Authority's borrowing and cash balances during 2025/26. (Appendix 2)
- The Investment Strategy defining the Authority's approach to making and holding investments, other than those made for normal treasury management purposes. (Appendix 3)

1.2 The Capital Strategy and relevant prudential indicators form part of the 2025/26 Capital Programme report found elsewhere on the Council's agenda.

2. Recommended actions/decision

2.1 The Overview Select Committee is recommended to note the report and make comments to the Director of Finance and the Executive as they wish, prior to Council consideration.

2.2 The Council is recommended to approve:

- The Treasury Policy at Appendix 1, including the 12 treasury Management Practices.
- The Treasury Management Strategy at Appendix 2 (including Treasury Limits at Appendix 2a, and Treasury Investment Strategy at Appendix 2b).
- The Investment Strategy at Appendix 3.
- Delegation of authority to the Director of Finance to revise the authorised limit and operational boundary, if required once work on implementing IFRS 16 leases is completed during the year end process.

3. Scrutiny / stakeholder engagement

3.1 This report and associated strategies will go to Overview Select Committee prior to being presented to Council for approval.

4. Background and options with supporting evidence

Background

4.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. The Council is required to approve an annual MRP statement and set prudential and treasury indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

4.2 The legislation requires the Authority to set its treasury strategy for borrowing and to prepare an annual investment strategy (for treasury management investments). This strategy sets out the Authority's policies for managing its treasury management investments and for giving priority to the security and liquidity of those investments. The Treasury Management Strategy (Appendix 2) should be read in conjunction with the Capital Strategy which is included in the 2025/26 Capital Programme Report elsewhere on the Council's agenda.

4.3 The Treasury Limits are included at Appendix 2a, whilst the relevant prudential indicators are included with the 2025/26 Capital Programme Report.

4.4 The Council are required annually to approve the Treasury Management Strategy and the Investment Strategy, and any updates to the Treasury Policy.

4.5 The Treasury Policy, the Treasury Management Strategy and the Investment Strategy will become effective as soon as they are approved at Council.

4.6 The strategy for balancing the revenue budget in 2025/26 and the subsequent two years by utilising the Capital Fund reserve will result in prudential borrowing to fund the 2024/25 and 2025/26 capital programmes. This impacts the treasury and prudential limits as capacity within the Authorised and Operational boundaries is needed. The budget strategy also envisages the sale of assets to the value of £60m over the next 3 years, for which we may seek a Government direction to use for revenue purposes in due course. Resultant cash receipts in 2025/26 are reflected in the treasury strategy indicators.

IFRS 16 Leases

4.7 There is one significant change affecting the calculation of treasury and prudential limits, this is the implementation of International Financial Reporting Standard (IFRS) 16. Under IFRS 16, leases that were previously classified as operating leases for lessees under IAS 17 will be reclassified as finance leases. This will result additional assets on the balance sheet which increases the Capital Financing Requirement (CFR).

4.8 The full impact of changes will not be known until the end of the financial year and the financial accounts as decisions on leases could be taken up to the end of the year. Capacity has been included within the limits, but a recommendation to delegate amendments, if needed, to the Director of Finance is included in this report.

4.9 Fundamentally this is an accounting adjustment.

5. Financial, legal, equalities, climate emergency and other implications

5.1 Financial implications

The report is exclusively concerned with financial issues.
Signed: Kirsty Cowell
Dated: 13 January 2025

5.2 Legal implications

The report proposes a treasury policy (appendix 1), a treasury management strategy (appendix 2) and an investment management strategy (appendix 3) to be adopted. The proposals are in accordance with the Council's statutory duties under the Local Government Act 2003 and statutory guidance. This includes each of the policies and strategies having regard to the CIPFA Prudential Code and those in appendices 1 and 2 having regard to the CIPFA Code of Practice on Treasury Management as well.
Signed: Kevin Carter Head of Law - Commercial, Property & Planning
Dated: 16th January 2025

5.3 Equalities implications

Under the Equality Act 2010, public authorities have statutory duties, including the Public Sector Equality Duty (PSED) which means that, in carrying out their functions they have to pay due regard to the need to eliminate unlawful discrimination, harassment and victimisation, to advance equality of opportunity between people who share a protected characteristic and those who don't and to foster good relations between people who share a protected characteristic and those who don't.

Protected characteristics under the Equality Act 2010 are age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex, sexual orientation. There are no direct equality implications arising from this report. However, there might be implications associated with how we invest and spend our money and the equality implications should be considered individually at that point.
Signed: Equalities Officer, Surinder Singh
Dated: 16 January 2025

5.4 Climate Emergency implications

It is widely recognised that investment has implications for global, national and local efforts to address the climate emergency. Decisions by investors over where to place their investments can, for example, help to fund solutions to climate change but they can also lead to funding of projects and activities – such as new fossil fuel exploration and extraction – which increase carbon emissions. In addition, the growing impacts of climate change such as increasingly extreme weather events can affect the risks associated with some investments. To the extent that it is relevant to the types of investment made by the council, and subject to meeting the policy objectives set out in the Treasuring Investment Strategy and the Investment Strategy, consideration should be given to: a. Seeking information about the climate implications of potential investments before making decisions; b. Investing positively to help finance action which helps tackle the climate emergency; c. Avoiding making investments which would/could fund damaging activities.
Signed: Duncan Bell, Change Manager (Climate Emergency). Ext. 37 2249.
Dated: 15th January 2025

5.5 Other implications (You will need to have considered other implications in preparing this report. Please indicate which ones apply?)

N/A

6. Background information and other papers:

Treasury Policy 2024/25, presented to Council 21 February 2024

Treasury Management Strategy 2024/25, presented to Council 21 February 2024

Investment Strategy 2024/15, presented to Council 21 February 2024

CIPFA Treasury management in the public services - Code of practice and cross-sectoral guidance notes (2021 edition)

7. Summary of appendices:

Appendix 1 – Treasury Policy

Appendix 2 – Treasury Management Strategy

Appendix 2a – Treasury Limits

Appendix 2b – Treasury Investment Strategy

Appendix 3 – Investment Strategy

8. Is this a private report (If so, please indicate the reasons and state why it is not in the public interest to be dealt with publicly)?

No

9. Is this a “key decision”? If so, why?

No – a decision for Council.

Appendix 1

Treasury Policy 2025/26

Treasury Management Policy Statement (TMPS)

1.1 The overall aim of the Authority's treasury activity is to minimise the Authority's net financing costs, whilst maintaining an appropriate level of liquidity and taking a prudent approach to risk.

1.2 The Authority defines the policies and objectives of its treasury management activities as follows:-

"The management of the authority's borrowing, investments and cash flows, including 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".

1.3 The Authority 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 Authority and any financial instruments entered into to manage these risks.

1.4 This Authority 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.

1.5 The Authority will create and maintain, a Treasury Policy (i.e. this document), which is approved by full Council when revised. This will be supported by suitable Treasury Management Practices (TMPs, shown below), setting out the manner in which the Authority will seek to achieve these policies and objectives, and prescribing how the Authority will manage and control those activities.

1.6 The Council will receive a report on an annual strategy in advance of each year, and the Overview Select Committee (OSC) will receive twice yearly reports on performance and quarterly prudential indicator updates.

1.7 The Council delegates responsibility for the execution and administration of treasury management decisions to the Director of Finance (DoF) who will act in accordance with this policy statement and TMPs; and CIPFA's Standard of Professional Practice on Treasury Management. Monitoring of the function will be undertaken by the OSC.

1.8 In practice the following matters are delegated to the DoF:

- Decisions on borrowing, investments, leasing and other forms of finance;
- Renegotiation and premature repayment of loans;
- Entering into associated contracts;
- Selection of treasury advisors;

- Selection of the money market brokers;
- Selection of leasing brokers used, if any;
- Selection of counterparties required for treasury purposes;
- The allocation of responsibilities and organisation of staffing;
- Determining the procedures to be followed by staff involved in treasury management, including internal controls and safeguards;
- Determining the accounting treatment of treasury decisions;
- Determining a list of institutions from whom the Authority may borrow money;
- Negotiating the terms of loan agreements and other capital finance arrangement (as specified in TMP 4);
- The preparation of schedules to TMPs, to serve as working documents for day-to-day use;
- Determining the list of institutions (the "lending list") to whom the Authority will lend or invest, and for what period, applying the criteria established by the Authority's Treasury Management Strategy.

2. **Treasury Management Practices**

2.1 As part of the Treasury Policy, the Council is asked to approve 12 Treasury Management Practices.

TMP1	-	Risk Management
TMP2	-	Best Value and performance measurement
TMP3	-	Decision making and analysis
TMP4	-	Approved instruments, methods and techniques
TMP5	-	Organisation, clarity and segregation of responsibilities and reporting arrangements
TMP6	-	Reporting arrangements and management information arrangements
TMP7	-	Budgeting accounting and audit arrangements
TMP8	-	Cashflow management
TMP9	-	Money laundering
TMP10	-	Staff training and qualifications
TMP11	-	Use of external service providers
TMP12	-	Corporate Governance

3. **TMP1 – Risk Management**

3.1 The DoF will have paramount regard to the risk associated with treasury management decisions and will ensure systems exist to control this risk.

3.2 The DoF will make sure we have enough money available immediately to meet day-to-day obligations.

3.3 Borrowing and investment strategy will be undertaken with regard to the implications for the Authority's budget, whilst not missing opportunities to save money over the longer term.

3.4 The DoF will keep a list of the organisations the Authority will invest with (mainly by lending money), and limits for each. These "counterparty lists" will reflect a prudent attitude towards organisations with whom funds may be deposited. The counterparty policy will be established within the annual treasury strategy.

3.5 The DoF will ensure the Authority complies with legal requirements. We will demonstrate such compliance, if required to do so, to all parties with whom the Authority deals. In framing the counterparty policy, the DoF will ensure that there is evidence of counterparties' powers, authority and compliance with regulatory requirements.

3.6 The DoF will use systems to prevent the risk of fraud or loss and will maintain contingency management arrangements.

3.7 The DoF will look to mitigate any losses to the Authority if interest rates move the wrong way.

3.8 The DoF will make sure that borrowing is phased so we don't have to borrow too much all at once and will refinance maturing loans and other financing arrangements as necessary.

3.9 The DoF will manage exposure to exchange rate risk, inflation risk and price risk.

3.10 Members are asked to note that the avoidance of all risk is neither appropriate nor possible and a prudent balance will need to be struck between mitigating risk and maximising returns.

4. TMP2 – Performance Measurement

4.1 The Authority will continually monitor treasury management performance.

4.2 We will evaluate borrowing and investment decisions by reference to external data, which may include:-

i) Benchmarks derived from financial market data;

ii) Benchmarks provided by the Authority's treasury advisors.

4.3 The DoF will obtain a comprehensive annual review of the Authority's treasury position, prepared by independent treasury advisors.

4.4 The main vehicle for such reviews to be reported to elected members are the six-monthly reviews of treasury management activities reported to OSC. Prudential Indicator updates are included within the Capital Programme Monitoring every quarter.

5. **<u>TMP3 – Decision-making and analysis</u>**

5.1 The DoF will maintain full records of treasury management decisions, and of the processes and practices applied in reaching those decisions.

6. **<u>TMP4 – Approved instruments, methods and techniques</u>**

6.1 The Authority may raise new loans or other capital finance. It may also repay existing borrowing instruments or transfer these to third parties. It may use borrowing instruments from the approved list below.

Loans

1. Public Works Loans Board Loans
2. Municipal Bond Agency Loans
3. UK Infrastructure Bank
4. Loans from other local authorities
5. European Investment Bank Loans
6. Commercial Bank Loans
7. Stock Issues
8. Market Loans
9. Local Temporary Loans
10. Local Bonds
11. Negotiable Bonds
12. Commercial Paper
13. Medium Term Notes
14 Bank Overdraft

Other Capital Finance

1. Operational Leases
2. Finance Leases
3. Sale and lease back
4. Construction and lease back / income strips

6.3 Borrowing instruments are permitted to be contracted for in advance - for example to lock into cheap interest rates. Where they are complex our decisions will be informed by independent, expert advice.

6.4 The DoF may determine that other instruments can be used when, in substance, they are similar to those already authorised.

6.5 Permitted **investment instruments** will be specified in the annual Treasury Investment Strategy (Appendix 2b).

6.6 The Authority is classified as a “professional investor” for the purposes of the regulatory framework of “MIFID II”. This means that it has access to a wider range of investments than “retail investors”.

7. **TMP5 – Organisation, clarity and segregation of responsibilities, and dealing arrangements**

7.1 The DoF will make sure the duties of staff are properly organised and written down.

7.2 The principle on which this will be based is a clear distinction between those charged with setting treasury and management policies, and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds.

7.3 If the DoF intends to depart from these principles (for example due to staff sickness) additional monitoring and reporting arrangements will be put in place.

7.4 The DoF will ensure that there are clear written and communicated statements of the responsibilities of each role, and the arrangements for absence cover. Delegation arrangements will also be documented.

7.5 The DoF will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds.

8. **TMP6 – Reporting requirements and management information arrangements**

8.1 Regular reports will be taken to members. As a minimum, the following reports will be prepared:-

i) An annual report to the City Mayor and Council on the strategy to be pursued in the coming year;

ii) A twice annual report to OSC on the performance of the treasury management function, on the effects of the decisions taken in the past year, and on any circumstances of non-compliance with the Authority's treasury management policy or strategy.

9. **TMP7 – Budgeting, accounting and audit arrangements**

9.1 The costs of treasury management will be reflected in the Authority's normal budgeting arrangements.

10. **TMP8 – Cash Management**

10.1 The DoF will manage the Authority's cash holdings in their entirety. Cash flow projections will be prepared regularly and the DoF will ensure that these are adequate to ensure that the Authority always has sufficient funds to meet its obligations.

11. **TMP9 – Money Laundering**

11.1 The Authority may become the subject of an attempt to involve it in the laundering of money. The DoF will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions and will ensure that staff are properly trained.

11.2 A policy to prevent the Authority's unwitting involvement in money laundering has been established.

12. **TMP 10 – Staff training and qualifications**

12.1 The DoF will use properly trained staff.

12.2 The core professional requirement for senior staff leading the treasury function is a professional accountancy qualification. Officers dealing with treasury and cash management will receive ongoing training and development on specific matters which will be provided by an appropriate blend of direct study of briefing notes etc; and organised courses, conferences and seminars.

12.3 Elected members will be offered training and development.

13. **TMP11 – Use of external service providers**

13.1 The Authority will use external experts, where this is sensible. When external experts are used, the DoF remains responsible for the treasury management function.

14. **TMP12 – Corporate Governance**

14.1 Treasury management activity will comply with our usual corporate governance principles. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

14.2 The Authority places high value on the use of independent treasury advisors. It looks to such advisors to present an independent view of the Authority's treasury investments and borrowings.

Appendix 2

Treasury Management Strategy 2025/26

Summary

1. Treasury management is the process by which our borrowing is managed, and our cash balances are invested. Whilst there are links to the budget process, the sums in this report do not form part of the budget. To the extent that the Authority has money it can spend, this is reflected in the budget report. Cash balances reported here cannot be spent, except to the extent already shown in the budget report or the accounts.

2. The Authority has incurred debt to pay for past capital expenditure.

3. The Authority also has cash balances. These are needed for day-to-day expenditure (e.g. to pay wages when they are due) although some form our reserves. Historically we have used our cash balances to reduce the need to undertake new borrowing. However, as our earmarked capital resources for the capital programme are spent and reserves are used up and with limited capital resources for the capital programme, our cashflow analysis suggests the need for prudential borrowing.

4. This strategy comes into immediate affect once approved at Council and will cover 2025/26 and the remaining period of 2024/25.

Background

5. The authority follows requirements under the Treasury Management Code and the Prudential Code, both published by CIPFA. The codes were revised in 2021.

6. The Authority must ensure it is able to meet its budgeted annual expenditure. The first main function of the treasury management operation is to ensure that cash flow to meet this expenditure is adequately planned, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Authority's low risk appetite, providing adequate liquidity initially before considering investment return.

7. The second main function is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing needs of the Authority, essentially the longer-term cash flow planning, to ensure that it 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 risk or cost objectives.

8. The contribution the treasury management function makes to the Authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

Economy

9. Interest rates had been very low since the financial crisis of 2007/08, though during the last 2 years they have risen with an increase in bank base rate from 0.1% in December 2021 to 4.75% at the time of writing. As our loans are at fixed rates, current interest rates only affect the interest earned on our cash balances or future loans. The expectation is that the Bank of England Monetary Policy Committee will slowly lower interest rates during in 2025. It seems very unlikely that rates would fall back to 0.5% and below.

Reporting

10. A twice-yearly report is submitted to Overview Select Committee reviewing the treasury activities undertaken in the year. The prudential indicators are included with the Capital Programme Monitoring and reported to Overview Select Committee quarterly.

Borrowing

11. The Authority currently has £174m of long-term debt. This comprises £134m borrowed from the Public Works Loans Board (PWLB) (a Government quango), £20m from Unitary Status with Leicestershire County Council and £20m from the financial markets.

12. In years prior to 2011, the Government usually supported our capital programme by means of “supported borrowing approvals.” The Government allowed us to borrow money and paid us to service the debt through our annual revenue support grant. This is similar to someone supporting a family member to buy a house, by paying the mortgage instalments.

13. The Government no longer does this, choosing instead to support our capital programme by means of capital grants (i.e., lump sums). Consequently, our debt levels have been largely static (until the Barclays loan repayment in 2023) for 15 years. All of our current debt is long term, with repayments due 23 to 32 years from now.

14. Early repayment of debt used to be a tool at our disposal, but Government rule changes and very low interest rates made this prohibitively expensive for PWLB debt. However, as long-term interest rates have risen this has become an option to consider.

15. The Authority has two LOBO (Lender Option Borrower Option) loans with Dexia totalling £20m at 4.6% p.a. (referred to as financial markets above). These loans allow the lender at periodic three year intervals the option to propose a higher interest rate for the rest of the term. With interest rates being so low for the last 15 years this option has previously only been theoretical. However, with the rise in interest rates it is currently considered about an even chance that Dexia will ask for a higher interest rate at its next option date of January 2025. If that option is

exercised, we will be able to update the position prior to the report going to Council in February. We have the right to refuse the option and repay the loans.

16. Best practice requires the Authority to set certain limits on borrowing and investments, and these are provided at Appendix 2a.

17. Given our high cash balances in the past, the Authority has not needed to borrow long term for many years. However, as earmarked capital resources for the capital programme are spent and reserves are used up, our cashflow analysis suggests this is likely to change over the next year.

18. For 2024/25, 2025/26 and future years the Authority is proposing to change the policy (included within the Council's other agenda papers) on financing the capital programme, moving to financing by prudential borrowing rather than using the capital fund. from utilising the capital fund to support the revenue budget, and financing by prudential borrowing.

19. For many years the PWLB has been the dominant lender to local authorities, which seems likely to continue. The Authority has raised the majority of its borrowing in the past from the PWLB but will consider long term loans from other sources such as banks, pension funds and other local authorities if that reduces costs. The Authority will also consider borrowing from the UK Infrastructure Bank which can offer loans at 0.4% p.a. cheaper than the usual PWLB rate for certain approved schemes. PWLB loans are no longer available to local authorities planning to buy investment properties primarily for yield, although the Authority intends to avoid that activity. The Strategy also grants sufficient delegated power to the Director of Finance to access new lenders if required.

20. The Housing Revenue Account operates under separate rules (though within the same legal regime) whereby interest has to be accounted for but the principal does not have to be repaid through the application of Minimum Revenue Provision (MRP) from the revenue account. Our general approach is that for the HRA we will not repay principal for historic debt, but we will do so for new borrowing. New borrowing for the HRA will also be allowed for when a new income stream is created such as acquisitions of rental properties or new build but will not be used for general maintenance.

21. The PWLB allows borrowing for HRA capital expenditure at 0.4% cheaper than usual rates. The government has announced that this concessionary rate will be extended until June 2025, and as much of our capital expenditure undertaken through borrowing is HRA related, we may wish to use this facility if we need to borrow.

22. The Authority previously managed funds on behalf of the Combined Fire Authority and the Leicester and Leicestershire Enterprise Partnership (LLEP). This is no longer the case.

Investments

23. The effort involved in treasury management has previously revolved mainly around management of our cash balances. These fluctuate during the course of a year, and in previous years generally ranged from £250m to £350m dependent on circumstances (e.g. closeness to employees' pay day). However, these balances have been falling recently and were just over £133m at the beginning of December. With the pressure on local government funding, and the use of reserves, we expect cash balances to decline further. We have recently only been lending out cash balances to other Local Authorities over short timescales of no more than 6 months to ensure that we have enough liquidity with our balances.

24. The Authority has substantial investments, but this is not "spare cash". There are three reasons for the level of investments:-

    a. Whilst the Government no longer supports capital spending with borrowing allocations, we are still required to raise money in the budget each year to repay debt, technically known as the Minimum Revenue Provision or MRP. Because of the extra costs of repaying PWLB debt, we are not usually able to repay any actual debt, and therefore have to invest the cash.

    b. We have working balances arising from our day-to-day business (e.g. council tax received before we have to pay wages, and capital grants received in advance of capital spending).

    c. We have reserves, which are held in cash until we need to spend them. We expect reserves to fall over the next few years (as they are required to balance both the 2024/25 and 2025/26 budgets, as reported elsewhere on your agenda).

25. The key to investment management is to ensure our money is safe, whilst securing the highest possible returns consistent with this.

26. In terms of **security**, the key issues are:-

    a. The credit worthiness of bodies we lend money to;

    b. The economic environment in which all financial institutions operate;

    c. What would happen if a financial institution did, in fact, run into trouble?

27. The world economic situation appears fragile, and growth remains slow. Many commentators see a possibility that the position could deteriorate.

28. Inflation had fallen to a low of 1.70% in September 2024 and risen slightly to 2.30% in October 2024 before rising further to 2.6% in November. CPI is expected to rise in January 2025, but expected to be back at close to target in December 2025. Most commentators expect interest rates to fall further in 2025 but only slowly and dependent upon inflation data in the second half of 2025.

29. Following the financial crisis of 2008, banks if they got into trouble could be subject to “bail in” whereby large investors could lose some or (even in extremis all) of their capital. The Authority has accordingly been very cautious regarding lending unsecured to banks.

30. A linked measure has been to split major UK high street banks into “ring-fenced banks used by individuals and small to medium businesses; and “non-ring-ringfenced” banks for larger businesses (including most councils) and for other non-core banking activities, such as those involving financial institutions.

31. The upshot is that we cannot regard any financial institution as a safe haven over the medium term – we need to keep watch for any signs of trouble.

32. The key to our treasury investment strategy is therefore to diversify our investments (so we don’t “keep all our eggs in one basket”), invest with local authorities, or with public sector bodies that <u>are</u> backed by the Government, or seek additional security for our money.

33. In respect of <u>**return**</u>, the Bank of England base rate has fallen by 25bps in August and November 2024, taking the official Base Rate to 4.75%. The prospects for base rates in 2025 and beyond are uncertain, with a reasonable chance of further rate cuts, especially if inflation reduces in the second half of 2025 to around the 2% Bank of England target.

34. Greater returns can sometimes be achieved by lending for longer periods, but this starts to increase the risks described above.

35. The details of our treasury investment strategy are described in Appendix 2b, but in summary:-

    a) We will lend on an <u>unsecured</u> basis to the largest UK banks and building societies for periods not exceeding one year, subject to our treasury advisors’ advice, though currently our advisors have recommended that we should limit our lending to a maximum of 35 days. Bail-in rules mean lending for long periods on an unsecured basis is too great a risk;

    b) We will lend for longer periods, and to smaller banks or building societies, if our money is <u>secured</u> (i.e. if we can take possession of the bank’s assets in the event of failure to repay);

    c) Lending to other local authorities has long been a cornerstone of our investment strategy, and this will continue. No local authority has ever defaulted on a loan. We are able to lend to local authorities for up to 3 years, enabling us to secure greater returns. We will seek advice from our advisors for any loan in excess of 24 months though in practice we are unlikely to lend so long next year;

    d) We will place money with pooled investments, such as money market funds. These are professionally managed funds, which place money in a range of financial assets, some based overseas. This helps achieve diversification. In cases where money is not secured, we will make sure funds can be returned very quickly. Interest rates on money market funds are low because we can get our money back quickly (we need to have funds available at “instant" access); and

e) We will lend to the Government and other public sector bodies.

36. In addition to the above, we will allow investment up to £30m in commercial property funds. These are pooled investments similar to “unit trusts”. This continues the current strategy. Such funds are expected to pay dividends at a rate of approximately 3.0%. Current investments are valued at £4.6m. However, with such funds there is always a risk that values will decrease, though it is hoped that capital values will rise over the long term. Performance has been disappointing since we invested in these funds in 2018, though the capital losses have been outweighed by the income received to date.

37. One of our property funds, Lothbury had suffered a large number of redemption requests, which resulted in withdrawals from the fund being suspended. The fund terminated on 30 April 2024. Following the funds termination, the properties held within the fund have been marketed and 29 properties have sold. 10 properties have still to be sold, 3 exchanged, 6 under offer and 1 being auctioned. The original investment in the fund was £3,292k. To date £2,106k has been repaid to the Authority, further repayments of investment are expected with further completion of property sales. Income is also being received from property rents and will continue until all properties are sold.

38. We also allow investment of up to £20m in diversified asset investment funds. These funds invest in a mixture of shares, property and Government investments and are pooled with other investors’ funds. These investment funds are professionally managed and typically have produced an income of between 3% and 5%. Risk is higher than cash and we have not made any investments in this category to date and do not expect to make any such investments of this type in the next year. The Authority has a smaller proportion of its treasury investments in non-cash deposits than most other authorities.

39. There is a market for investment with environmental and socially responsible objectives, and we will evaluate opportunities presented to us. Whilst there are established investments suitable for long term investors such as pension funds, these tend not to be suitable for us. Our investment time horizon is 5 years at most.

40. A maximum of £20m would be invested in all such environmental and socially responsible investments that do not meet any investment criteria above.

Commercial Investments

41. As part of the Government’s response to concerns about some authorities’ property investments, separate commercial investment strategies are now required. Our proposed strategy is elsewhere on your agenda.

42. The Treasury Strategy does not deal with matters covered by this separate strategy, though there is a relationship between the strategies. Members are asked to note that the property funds discussed above (which are covered by the Treasury Strategy) are pooled funds in which risks and rewards of owning a large portfolio of properties is shared between many investors. The commercial strategy covers specific investments.

Credit Rating Requirements for Investments

43. Credit ratings are a key element of our treasury investment strategy, being used to help us determine the financial strength of the borrower.

44. The credit rating of UK borrowers will rarely exceed that of the UK Government and consequently a reduction in the credit rating of the UK Government may result in credit rating downgrades for a large number of borrowers. Fitch has in December 2024 maintained the outlook for the UK Government as AA-.

45. However, if the UK Government is downgraded further there are two scenarios. One is that the financial operating environment of the UK becomes weaker, and this weakens the strength of UK borrowers. The second is that the rating of the UK Government caps the rating of domestic borrowers, but that the strength of the borrowers is unchanged. Intermediate positions are possible. Our actions will be based on an assessment of the actual situation, and we shall take advice from our treasury advisors. The Director of Finance may present a report to the City Mayor for his approval recommending any revisions to the Treasury Investment Strategy at Appendix 2b. All interest paying investments on such a revised lending list will have a minimum credit rating of BBB+ or (if unrated) be judged to be of equivalent standing. In this event, a revised Treasury Strategy will be presented to the Council at the earliest reasonable opportunity.

46. There is no legal mechanism for a local authority to go bankrupt or otherwise avoid paying money on loans that were lawfully incurred and there is a legal mechanism to recover loan payments. Irrespective of legalities, the practical issue is what would happen if, say, an authority simply did not have the cash to both pay its staff and its loans. In practice, this has never happened.

47. Our treasury advisors provide advice on lending to local authorities. They believe that the credit worthiness of most local authorities remains very strong.

Premature Repayment of Debt

48. One tool of treasury management is the premature repayment of debt to achieve savings. This is something we used to do routinely, but (as discussed above) has until recently been non-viable for PWLB loans. We will take such opportunities if they present themselves at a sensible cost. Any capital premium (i.e. additional cost) usually has to be charged to the revenue account over the life of the old loan, the life of any replacement loan or any shorter period.

49. The reasons why our debt has 23 to 32 years to run are historic and reflect past circumstances and Government policies at that time. In current circumstances, we would prefer a more even spread of repayment dates and may use premature repayment to achieve this if possible. Another option is to repay using our cash balances though as reserves are expected to be depleted this option has become less likely.

50. We would currently expect to pay a premium on any premature repayment of debt. This is because interest rates have increased recently, premium costs have gone down.

51. In practice, we are unlikely to repay any PWLB loans in 2024/25 or 2025/26. We would evaluate options that became available.

Management of Interest Rate Exposure

52. Whilst the Treasury Management Strategy is based on a view of future movements in interest rates, all interest rate forecasts carry uncertainty. This strategy seeks to manage that risk.

53. For the foreseeable future the main risk arises from uncertainty around the interest earned on investments rather than interest paid on existing borrowing. If we need to borrow in the medium term though, there will be an interest rate risk depending on the timing of such borrowing. Unlike recent years, interest earned on investments has risen significantly.

Leasing

54. The Authority owns some properties on lease, but other than this we do not generally use leasing as a method of financing, preferring instead to use our cash balances.

55. However, the Authority is required to follow IFRS16 for accounting purposes for the first time, which means that operating leases will now appear on the balance sheet as assets. This impacts the Capital Financing Requirement (CFR) and enough headroom is built into treasury limits as the value of leases will change before the end of each year.

Treasury Advisors

56. The Authority uses Link Group, Link Treasury Services Limited as its external treasury management advisors.

57. The Authority 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 regards to all available information, including, but not solely, our treasury advisers.

58. It also recognises that there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. The Authority 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.

Appendix 2a

Treasury Limits for 2025/2026

1. The Treasury Strategy includes a number of prudential indicators required by CIPFA's Prudential Code for Capital Finance, the purpose of which are to ensure that treasury management decisions are affordable and prudent. The recommended indicators and limits are shown below. One of these indicators, the "authorised limit" (para 3 below), is a statutory limit under the Local Government Act 2003. We are not allowed to borrow more than this.

2. The first indicator is that over the medium-term net borrowing will only be for capital purposes – i.e. net borrowing should not, except in the short-term, exceed the underlying need to borrow for capital purposes (the "capital financing requirement").

3. The authorised limits recommended for 2025/26 and for the remainder of 2024/25 are:-

	£m
Borrowing	650
Other forms of liability	500
Total	**1,150**

4. "Other forms of liability" relates to loan instruments in respect of PFI schemes and to pre-unitary status debt managed by the County Council (and charged to the City Council). This also includes the estimated impact of IFRS16 leases.

5. The Authority is also required to set an "operational boundary" on borrowing which requires a subsequent report to scrutiny committee if exceeded. The approved limits recommended for 2025/26 and for the remainder of 2024/25 are:

	£m
Borrowing	550
Other forms of liability	450
Total	**1,000**

6. The boundary proposed is based on our general day to day situation and is not absolute as there may be good, usually temporary, reasons to breach it. Its purpose is to act as a warning signal to ensure appropriate scrutiny.

7. The Authority has also to set upper and lower limits for the remaining length of outstanding loans that are fixed rate. This table excludes other forms of liability. Recommended limits are:

Upper Limit

	£m
Under 12 months	50
12 months and within 24 months	100
24 months and within 5 years	150
5 years and within 10 years	200
10 years and within 25 years	250
25 years and over	350

We would not normally borrow new loans for periods in excess of 50 years.

Lower Limit

	£m
All maturities	0

8. The Authority has also to set upper limits on the periods for which principal sums are invested. Recommended upper limits are:

	Up to 1 year £m	**Over 1 years £m**	**Over 2 Years £m**
Upper limit on maturity of principal invested	All investments	170	100

9. The central assumption of this Treasury Strategy is that the value of external borrowing will be as shown.

	31/03/2023 Actual £m	**2023/24 Estimated Average £m**	**2024/25 Estimated Average £m**	**2025/26 Estimated Average £m**	**2026/27 Estimated Average £m**
External debt	174	175	280	320	340

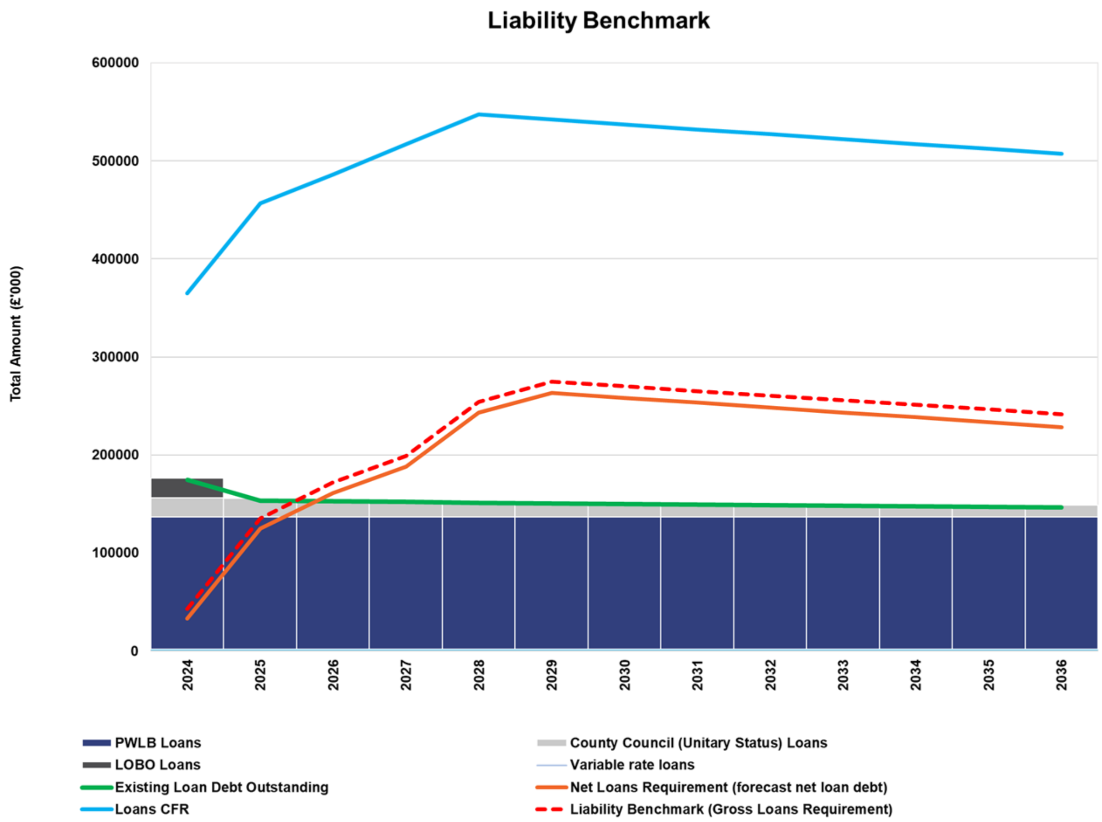
10. Liability Benchmark

The Treasury Management Strategy is required to include the Liability Benchmark. This compares the underlying need to borrow for capital purposes with the external loans profile over the next 50 years, for existing and approved future expenditure.

The underlying need to borrow for capital purposes is called the Capital Financing Requirement (CFR). The CFR falls over time as loans are gradually repaid and rises with new borrowing. The historic Housing Revenue Account debt does not have to be repaid and will therefore remain in the CFR. The Authority is required to estimate and measure the Liability Benchmark for the forthcoming financial year and the following two financial years, as a minimum. We have presented at least 10 years as recommend by CIPFA.

There are four components to the LB: -

- Existing loan debt outstanding: the Authority's existing loans that are still outstanding in future years.
- 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 MRP.
- 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 MRP and any other major cash flows forecast.
- Liability benchmark (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.



After revenue and other balances have been considered, the liability benchmark (the underlying need to borrow for <u>all</u> purposes), is less than the CFR which is the maximum amount that can be borrowed except for very short term cashflow requirements.

In terms of risks, the Authority is exposed to rising interest rates increasing the cost of future borrowing, but this is offset by an exposure to falling interest rates, which would reduce the return received on investments. The Authority is also exposed to credit risk on its investments, that is the risk that loans or investments are not repaid although the great majority of its treasury balances are in low-risk investments.

Statutory guidance is that debt should remain below the capital finance requirement, except in the short term. The authority has complied and expects to continue to comply with this requirement. The total debt including PFI and finance leases is £245m whereas our capital finance requirement was £595m.

11. Potential Effect of interest rate changes

Interest rates are subject to change and are expected to reduce marginally over the next 12 months. The approximate effect (which could be either a rise or reduction of income) of a rise or fall in interest rates of 1% more than anticipated would be.

	Effect of 1% change in interest rates	Effect of 1% change in interest rates as percentage of Net Revenue Budget
2025/26	£1.5m	0.4%
2026/27	£1.0m	0.2%
2027/28	£0.5m	0.1%

As our borrowings are mostly fixed, we do not anticipate any changes on our borrowing costs in the event of interest rate changes on our existing loans. However, interest rates associated with any new borrowings could impact on costs in future years.

12. MIFID 11 Professional Client Status.

The Authority has Professional Client Status under MIFID 11 (a European regulatory framework for investor protection) and expects to maintain that status including keeping a minimum of £10m invested.

13. Use of Derivatives

A derivative is a financial instrument which in the context of the Authority would usually be used to mitigate the risk of future interest rate changes.

In line with the CIPFA prudential code, the Authority will seek external advice and consider that advice before entering into any derivatives to ensure that the implications are fully understood.

Our use of derivatives is expected to be limited to fixing the interest rate for:

a) borrowing that may be required at a future date, for example to finance a significant development; or
b) lending to another organisation such as an Authority at a defined future date (usually no more than four months ahead).

The Authority will only use financial derivatives where they can clearly be demonstrated to reduce the overall level of financial risks to which we are exposed.

Embedded risks such as those present in pooled funds and forward starting positions will not be subject to this policy.

Appendix 2b

Treasury Investment Strategy 2025/26

1. Introduction

1.1 This Treasury Investment Strategy complies with the DLUHC's Guidance on Local Government Investments and CIPFA's Code of Practice.

1.2 It states which investments the Authority may use for the prudent management of its treasury balances. It also identifies other measures to ensure the prudent management of investments.

1.3 Appendix 2a (above) limits the periods for which principal sums can be invested. This is to be assessed on our intentions with regard to each investment rather than its legal form.

2. Investment Objectives & Authorised Investments

2.1 All investments will be in sterling.

2.2 The Authority's investment priorities are:

(a) The **security** of capital; and

(b) **Liquidity** of its investments; and

(c) The **yield** (the return on investments)

2.3 The Authority will aim to achieve the **optimum return** on its investments commensurate with proper levels of security and liquidity. Liquidity is assessed from the perspective of the overall investment portfolio and will take account of the Authority's ability to borrow for cashflow purposes. The security of capital is the most important priority.

2.4 The following part of this appendix specifies how the Authority may invest, with whom and the credit worthiness requirements to be applied. Our treasury advisors provide daily updates to our counterparty list and we are able to utilise this for any new investments.

3. Approved Investments

3.1 UK Banking Sector: Credit Rated Institutions			
Type	**Description**	**Investment Period**	**Controls**
General	Covers the largest UK banks and building societies. Covers non-UK banks operating in the UK and regulated in the UK.		No more that £100m will be invested in total with these institutions. Other than our bankers (Barclays) no more than £20m will be invested with one institution of which no more than £10m will be unsecured. £25m may be lent to Barclays, of which no more than £15m will be unsecured. New investments may be agreed up to 4 months advance. A list of approved counterparties will be maintained by our treasury advisors (Link). New bodies will not be added to the list without the written approval of the Director of Finance. Minimum ratings as below. Other market intelligence will also be considered.
Unsecured deposits	Banks and building societies regulated within the UK Covers non-UK banks operating in the UK and regulated in the UK.	Up to 366 days or such lesser period our advisors recommend	Our advisors produce a credit matrix with maximum duration analysis for all unsecured bank deposits. We will invest in line with our advisor's recommendations.
		Up to 366 days	Long-term rating of A & short-term rating of F1
		Up to 6 months	Long-term rating of A- & short-term rating of F2
		100 days or less	Long-term rating of BBB+ & short-term rating of F2

Type	Description	Investment Period	Controls
Covered Bonds	This is a deposit with a bank or building society, which is secured on assets such as mortgages. These assets are not immediately saleable but the value of the assets exceeds loans secured upon them. If the deposit is not repaid the assets are sold and the proceeds used to repay the loan.	Maximum 5 years	Bond is regulated under UK law and majority of assets given as security are UK based. Minimum long-term bond rating of A+
Secured Deposits	These are deposits with a bank which are then secured on other assets which can be reclaimed if the bank fails.	Maximum 3 years	Any form of security (even if low grade) is better than none as secured deposits are much less likely to be subject to any bank bail in. The Authority would look to use high grade security such as government gilts. We may use a third party to facilitate these transactions, but the underlying assets would be owned by the Authority and not the third party.
REPOs/ Reverse REPOs	This is a deposit with a bank or other financial institution, which is secured on bonds and other readily saleable investments and which will be sold if the deposit it not repaid.	Maximum 1 year	Judgement that the security is equivalent to, or better than, the credit worthiness of unsecured deposits. REPO/Reverse REPO is accepted as a form of collateralised lending. One acceptable basis is the GMRA 2000 (Global Master REPO Agreement) but other documentation may be accepted. Should the counterparty not meet our senior unsecured rating then a 102% collateralisation would be required. The acceptable collateral is as follows:- • Index linked Gilts (including delivery by value) • Conventional Gilts (including delivery by value) • UK Treasury bills • Corporate bonds (subject to additional due diligence)

3.2 UK Public Sector & Quasi Public Sector			
Type	**Description**	**Investment Period**	**Controls**
General	The UK Government. UK local authorities, including Transport for London (TFL), and bonds issued by the UK Municipal Bonds Agency. Bodies that are very closely linked to the UK Government or to local government such as Cross Rail.	Up to 6 years for the UK Govt. and up to 3 years for LA's	No more than £40m to be lent to bodies very closely linked to the UK Government and no more than £20m to be lent to any one body. No limit on amounts lent to the UK Government. New investments may be agreed up to 4 months in advance (these may be classed as derivatives). In practice, we will be guided by our treasury advisors' views on appropriate investment periods.
Deposits	Deposits with Local Authorities and the UK Government.	Up to 6 years for the UK Govt. and up to 3 years for LA's	No more than £300m to be lent to local authorities (as defined in the first column). No more than £20m to be lent to any one local authority. Our judgement is that most local authorities are of high credit worthiness and that the law provides a robust framework to ensure that all treasury loans are repaid. However, should the occasion arise, we would have regard to adverse news or other intelligence regarding the financial standing of an individual local authority, including information which is provided by the Authority's Treasury Advisors. Maximum periods for loans to local authorities will not exceed limits recommended by our treasury advisors.
Bonds – Local Authority	Bonds issued by local authorities.	Up to 3 years	
Bonds – UK Municipal Bond Agency	Bonds issued by local authorities collectively through the UK Municipal Bonds Agency.	Up to 6 years	Minimum A+ credit rating. The agency has had very limited success in lending though that may change in the future and until established the number of underlying borrowing local authorities will be low. When investing with the agency we will look at the underlying exposure to individual authorities when these are material and take into account existing exposures to those authorities.

Type	Description	Investment Period	Controls
Bonds – Bodies Closely Linked to UK Government		Up to 6 years	Minimum A+ credit rating. A list of approved counterparties will be maintained. Approval by Director of Finance to the body being added to the lending list on the basis of a written case, including advice from the Authority's treasury advisors.
Bonds and Deposits to UK Housing Associations		Up to 3 years	No more than £20m in total may be lent to UK Housing Associations. All lending to require approval by the Director of Finance in consultation with the City Mayor on the basis of a written case, including advice from the Authority's treasury advisors.

3.3 International Development Banks			
Type	**Description**	**Investment Period**	**Controls**
Bonds	International Development Banks which are backed by the governments of the world's largest and strongest economies. The funding obligations are established by treaties or other binding legal agreements. Examples are the European Investment Bank and the World Bank.	Up to 6 years	No more than £40m to be lent in total and no more than £10m to be lent to any one bank. A list of approved counterparties will be maintained. Approval by the Director of Finance, in consultation with the City Mayor, to the body being added to the lending list on the basis of a written case, including advice from the Authority's treasury advisors. A minimum credit rating of AA- plus backing of one or more G7 country.

<table>
<tr><th colspan="4">3.4 Environmentally and Socially Responsible Investments</th></tr>
<tr><th>Type</th><th>Description</th><th>Investment Period</th><th>Controls</th></tr>
<tr><td></td><td>Investments which facilitate environmental and social objectives. Encompasses a range of legal structures including:

• Company shares (equity)
• Loans and other interest bearing investments
• Trust structure including the above and including ownership of land, buildings, plant, equipment and contractual rights (for example, the right to sell electricity)
• Pooled investments
• Specialist Real Estate Investment Trusts (REITS) such as those investing in supported housing.
• Other investment types

Where an investment is better described elsewhere in this appendix (for example a regular money market fund that only contained ethical investments) that section of this appendix shall govern that investment.</td><td>Up to 10 years</td><td>No more than £20m in all such investments.

For investments which can be sold to others in a financial market or which can be redeemed by the fund manager - approval by the Director of Finance, in consultation with the City Mayor, to the investment being added to the lending list of approved counterparties based on a written case, including specialist advice.

For other investments approval by the Director of Finance in consultation with the City Mayor to the individual investment, on the basis of a written case, including specialist advice.

Investments will only be made when it is assessed that there is a reasonable prospect that after 10 years the Authority would be able to have its initial investment returned plus the return that it would have gained on a cash investment.

We will look for strong evidence of expertise from those who manage the pooled fund or who are otherwise involved in the management of the investment.

Such investments need not be rated.

Where the legal structure of the investment is not a widely used one appropriate due diligence will be undertaken.</td></tr>
</table>

3.5 Other Pooled Investments (General)			
Type	**Description**	**Investment Period**	**Controls**
General	A structure where a wide base of investors share a common pool of investments. The most common legal form involves an intermediate company. The company has legal title to a pool of investments. The underlying investors own the company with a claim to their share of the assets proportional to their investment in the company.		We will only invest in funds where there is evidence of a high level of competence in the management of the investments, and which are regulated. A list of approved counterparties will be maintained. Approval by Director of Finance to the body being added to the lending list on the basis of a written case, including advice from the Authority's treasury advisors. The investment period will reflect advice from our Treasury Advisors on a fund by fund basis. We will be alert to "red flags" and especially investments that appear to promise excessive returns. We look for diversification away from the banks permitted elsewhere in this lending list (though some overlap is unavoidable). No more than £180m to be invested in aggregate in all type of pooled investments (short term, long term, property and diversified investment funds).
3.5.1 Pooled Investments – Shorter Dated Investments			
Type	**Description**	**Investment Period**	**Controls**
General	Investments of up to eighteen months.		There is no upper limit on shorter dated investments, other than the global limit for pooled investments above (£180m).
Money market funds	The underlying pool of investments consists of interest paying investments, for example deposits. The underlying borrowers include banks, other financial institutions and non-financial institutions of good credit worthiness. Banks may be UK or overseas.	Must have access to funds within one week	Fitch rating of AAf (or equivalent). No more than £25m in any one fund except where our advisors recommend a lower figure. No more than £130m to be held in money market funds in total, this excludes money market plus funds.

Type	Description	Investment Period	Controls
Short Dated Government Bond Funds	Similar to money market funds but mainly concentrated in highly credit rated government bonds.	Must have access to funds within one week	Whilst these are very safe the interest returned is very low. We may use these in times of market turmoil. Fitch rating of AAf (or equivalent). No more than £20M in any one fund.
Money market plus funds / cash plus funds / short dated bond funds	Similar to money market funds but the underlying investments have a longer repayment maturity. We would use these to secure higher returns.	Must have access with one month's notice but normally would wish to hold for 12-18 months	Fitch rating of AAf (or equivalent). No more than £20m in any one fund. No more than £50m in total in money market plus/cash plus funds/short dated bond funds. We will "drip feed" money that we invest rather than investing it all at once.

3.5.2 Pooled Investments – Longer Dated Investments

Type	Description	Investment Period	Controls
General	Longer dated investments expose us to the risk of a decline in value, but also provide an opportunity to achieve higher returns. Consequently, controls involve both the personal authorisation of the Director of Finance and consultation with the City Mayor.		No more than £50m to be invested in all fund types listed in this table section 3.5.2. This limit applies within the global limit for pooled investments (£180m). Investment amounts and timing to be approved by the Director of Finance, in consultation with the City Mayor. This applies to all the longer dated investments in this section.
Longer-dated Bond Funds.	Similar to money market funds but the underlying investments are now mainly bonds, typically, with an upper average maturity of up to 8 years.	Must have access with one month's notice but normally would wish to hold for two to three years	We may consider unrated funds on the recommendation of our Treasury Advisors. No more than £10m to be invested in any one fund.

Type	Description	Investment Period	Controls
Asset Based Securities	The base investments are “securitised investments” which pool consumer debt (mortgages, car loans and credit cards) and loans to small businesses. The base investments are loans to borrowers of good credit worthiness. The investment we would make would be in a pooled investment containing a number of such securitised investments. They are normally issued by banks (UK or overseas).	Must have access with one month’s notice but normally would wish to hold for two to three years	We look for particularly strong evidence of expertise both from the organisations that issue the securitised investments and also from the managers of the pooled fund. We look for clear evidence of financial and operational independence between the fund managers and the banks that made the consumer loans in the first place. No more than £10m to be invested in any one fund.
Property Funds	The underlying investments are mainly direct holdings in property, but our investment is in a pool of properties. Whilst the funds normally have a small cash balance from which to fund redemptions the bulk of the funds are held in direct property investments. On occasions redemptions will not be possible until a property has been sold. Funds may have the power to borrow.	Generally have access with three months’ notice but normally would wish to hold for at least five years	No more than £30m to be invested in property funds. This limit applies within the global limit for pooled investments (£180m).
Diversified Investment Funds	The underlying investments are a mixture of mainly equities, government gilts, corporate bonds and property which are also diversified geographically. Whilst the funds normally have a small cash balance from which to fund redemptions.	Generally have access with three months’ notice but normally would wish to hold for at least five years	No more than £20m to be invested in diversified investment funds. This limit applies within the global limit for pooled investments (£180m).

4. **Business Models**

4.1 The Authority has a “buy and hold” strategy for its investments that are bought and sold in financial markets. That is, it seeks to achieve value for money from its investments by collecting the sums contractually due. It does not aim to achieve additional value by selling them on although there may be occasions when investments may be sold for the purposes of managing or mitigating risk.

Appendix 3

Investment Management Strategy 2025/26

Summary

1. The Authority will facilitate investment which benefits the people of Leicester and at the same time makes a return. All such investment is required to meet a service need or promote regeneration as the main objective, although making a financial return on investments would be a positive secondary objective.

2. The Government's debt management office forbids lending to authorities which have recently invested or intend to invest in schemes "primarily for yield." The Authority does not invest primarily for yield and all schemes supported will have a service or regeneration main reason for investment.

3. The Authority is prepared to take greater risks in the furtherance of this Investment Strategy than it would be with the Treasury Management Strategy. This is because investments here are principally for service purposes such as regeneration, not primarily to generate a financial yield.

4. This strategy comes into immediate affect once approved at Council and will cover 2025/26 and the remaining period of 2024/25.

Introduction

5. Government guidance requires the Authority to approve an Investment Strategy. This requirement has arisen because of Government concerns about some authorities borrowing substantial sums of money to invest in commercial property or other assets (sometimes a considerable multiple of their net revenue budget). Additionally, the Government's debt management office now forbids lending to authorities which have recently invested or intend to invest in schemes "primarily for yield." This is regardless of the funding source for the investment and the stated reason for the authority seeking the lending. The Authority does not invest primarily for yield and all schemes have a service or regeneration focus as the main reason for investment.

6. For the purposes of this strategy, an investment means any spending, or any interest-bearing loan to a third party which is (at least in part) intended to achieve a return for the Authority. It has included advances in the past made to the Leicester and Leicestershire Enterprise Partnership (LLEP) for their purposes if the Authority expected to make a return on the money. The LLEP was disbanded at the end of March 2024, following the Government's decision that its functions should transfer to the City and County Councils as part of national reforms.

7. The strategy excludes capital investment in social housing for both permanent and temporary accommodation, which is not done to achieve an investment return.

Investments

8. The Authority's financial priorities for investment are:-

   a) Security of capital – notwithstanding the above, this is the paramount consideration.

b) Yield (the return on investments) - this is important, but secondary to ensuring our capital is protected.

c) Liquidity (ability to get money back when we want it). We have traditionally regarded this as less important because individual investments are small scale compared to the overall size of the Authority. However, in future years with the expected depletion of cash balances, liquidity is expected to become more important to manage.

9. Property acquired under this investment strategy will be located:-

a) In the case of the Corporate Estate, within the boundary of the Leicester, Leicestershire, and Rutland area. (Usually, within the city).

b) If acquired for economic regeneration purposes, within or at the perimeter of the Leicester, Leicestershire, and Rutland area.

c) Potentially further afield to better meet wider service objectives, such as low-carbon assets. We have made no such investments in recent years.

10. Individual investments can be funded by any of the following (or combination of the following):-

a) Grants/contributions from third parties where the funding is provided at the third party's risk.

b) Capital or revenue monies held by the Authority.

c) Prudential borrowing, and contributions from third parties where the Director of Finance deems the substance of the investment to be at the Authority's risk (e.g. "income strips"). In practice, "prudential borrowing" has not in the past required genuine external borrowing as we have had sufficient cash balances (as described in the Treasury Management Strategy Appendix 2). Prudential borrowing is best seen as a permission to borrow externally, should we need to, with revenue costs in future years. This category includes prudential borrowing in anticipation of future business rates growth in Enterprise Zones. It should be noted that significant increases in interest rates over recent years have made it much more difficult for new schemes to make a surplus unless significant Government grant is included within the financing.

11. Items (b) and (c) together represent the Authority's <u>capital invested.</u> Item (c) represents the risk of the Authority requiring further capital or revenue resources if an investment fails; it may or may not represent any actual external debt. The amount of prudential borrowing outstanding may fall over the life of an investment. The totality of prudential borrowing, or other funding provided at the Authority's risk, outstanding at any one time is a key control over the Authority's investment activity and is termed "<u>exposure</u>."

12. The Authority will not, at any one time, have exposure in excess of the following:-

	£m
On commercial or industrial property, it already owns or will own.	100
For loans to third parties	20
To fund Enterprise Zone projects	40
For other investments	40

13. The Authority will not have more than £130m of exposure in respect of <u>all</u> activity covered by this strategy. Therefore, it is not possible to reach the maxima in all the above categories.

14. Limits on total external debt are included in the Treasury Management Strategy (Appendix 2).

15. The Authority can reduce its exposure, particularly if an investment is performing poorly, by writing down prudential borrowing using capital or revenue resources.

16. Where the Authority has an option of utilising third party contributions at the Authority's risk, the Director of Finance will determine if this represents value for money as an alternative to prudential borrowing.

What we invest in and how we assess schemes

17. Decisions to invest will be taken in accordance with the usual requirements of the Constitution. Executive decisions will be subject to normal requirements regarding notice and call-in. All decisions to use prudential borrowing require the approval of the City Mayor, unless previously approved by full Council. The criteria below set normal expectations for investment decisions, but it is impossible to provide a framework for all potential opportunities: we do not know what might be available in the future. The City Mayor may approve investments which do not meet the criteria within paragraphs 14 to 28 (the limits contained in paragraphs 8 and 9 will not be exceeded), but if he does so:-

    a) The reason will be reflected in the decision notice;
    b) The decision will be included in the next refresh of this strategy.

18. All proposals will be subject to a financial evaluation, and approval by the Director of Finance must be obtained. This will calculate expected return (see below), assess risk to the Authority's <u>capital invested,</u> and ability to repay any prudential borrowing. The evaluation must therefore give evidence of a financially robust proposal, regardless of the other merits. The results of the evaluation will be set out in the decision report. For small purchases of property within the Corporate Estate, a more streamlined evaluation can be prepared. Where the use of third-party contributions at the Authority's risk is recommended, as an alternative to prudential borrowing, the assessment of this method of financing will be included in the evaluation. All proposals for investment will explicitly describe what the main purpose the investment is being made, which cannot be primarily for yield.

19. Any investment for economic development purposes will accord with the Authority's adopted strategies, except for early-stage expenditure in contemplation of a new strategy.

20. The maximum prudential borrowing permitted for any given capital scheme by way of an Executive Decision is determined by Council when considering the capital programme and is currently £10m. Any proposals to borrow more than £10m on a particular scheme would be subject to specific approval by full Council.

21. Advances to third parties will normally require additional security where the total capital invested by the Authority exceeds £2m, e.g. the underwriting of risk by a third party, or a charge on property with a readily ascertainable value and a number of potential purchasers.

22. The Authority will look for a return on its capital invested, although this can be lower than a bank would seek (reflecting our cost of funds, and the expected service benefits).

    a) The usual yardstick for investment is that, on a prudent estimate of costs and income, investments must make a positive return when discounted at 5% per annum. A higher return may be sought where a project is riskier than normal;

    b) Where reasonably certain, growth in retained business rates can be included in the calculation of Net Present Value (NPV) until the date of the next national reset (although rates growth will continue to be accounted for as rates income, and not earmarked);

    c) Resultant savings in departmental budgets cannot be included in the calculation.

23. The City Mayor may take a conscious decision to accept lower returns for service or environmental reasons; an alternative way of looking at this is to say that the Authority will sometimes choose to accept modest returns instead of providing something at its own expense for service and/or environmental reasons. Such a decision will be transparent and recorded in the decision notice.

24. The following are deemed to be suitable investments, although not primarily for yield:-

    a) Acquisition of commercial or industrial property for regeneration.

    b) Construction or development of commercial or industrial property for regeneration.

    c) Construction or development of non-HRA housing (noting that any housing acquired for permanent or temporary social housing is outside the scope of the Investment Strategy).

    d) Acquisition of land for development.

    e) Infrastructure provision at key development sites.

    f) Loans to businesses to support economic development.

    g) Acquisition or construction of low carbon energy investments.

h) Arrangements to support provision of services. Including loans to support provision of temporary accommodation or children's residential care.

25. All investments and loans must be compliant with Government's subsidy control rules. Investments must not be made primarily for an income return (though a decent income return is to be encouraged) but must have an alternative primary purpose such as promoting economic development. The Authority will also not try to rely on investment income which is disproportionate to the overall budget.

26. Acquisition of commercial or industrial property can be considered where there are either economic development or service reasons why the city would benefit from the Authority's ownership. An example of economic development reasons might be to facilitate a significant business relocation to the city or surrounding area.

27. <u>Construction or development of commercial or industrial property</u> can be considered for regeneration purposes where the asset constructed or developed would generate a continuing income stream and have a readily realisable capital value. Whilst a pre-let is regarded as highly desirable, a benefit of Authority involvement is that strategically important development can be secured which would not attract normal commercial finance. New grade A office space is a key example. It is, however, essential that the Authority can be confident of a return on its capital invested, and an NPV shall be calculated using prudent assumptions of any void periods. It should be noted though that any such scheme needs to have a main objective of regeneration (or service provision) and although financial gain is desirable it must not be the main driver of such investment.

28. <u>Acquisition of land for development</u> can be considered for strategic regenerative land assembly schemes, subject to the proviso that future development is planned and fundable:-

a) The Authority's return will usually arise from an appreciation in land values and this must be reasonably assured with a ready market;

b) This type of investment is riskier than the acquisition of tenanted property, and a higher return would normally be sought.

29. The availability of other public funding to secure development will improve the acceptability of such proposals, as this will increase the return on the Authority's capital invested.

30. <u>Infrastructure provision at key development sites</u> can be considered where development can be catalysed by provision of site infrastructure:-

a) Investment can be considered where future disposals can be assumed with a reasonable degree of confidence; and

b) Developments that unlock strategic housing or commercial development on economic growth sites or contribute towards bringing forward linked developments.

31. <u>Loans to businesses</u> can be made at attractive rates (when compared to bank finance) for proposals which facilitate economic development, and where the

Authority can be confident that the money will be repaid. The following criteria will be applied:-

a) Loans would normally be repayable within 10 years (or the Authority has an asset which is readily realisable within that period, whether we choose to realise it or not);

b) A minimum loan value of £100,000 will apply;

c) Proposals must demonstrate that they are viable, i.e. there is a reasonable expectation that the capital and interest will be repaid;

d) Security will usually be obtained (and always for higher value loans).

32. Low Carbon Energy Investments which help to reduce climate change can be considered. Any such investment will still be expected to make a positive return, though in making the investment the Authority will consider the environmental and social benefits as well as the financial return.

33. Arrangements to support provision of services. Where an arrangement such as a partnership or a loan result in a value for money solution to support provision of services, especially in relation to temporary accommodation or children's residential care.

Monitoring of Investments

34. The performance of investments will be reported annually. Investments within the Corporate Estate will be monitored as part of the Corporate Estate Annual Report.

Capacity, Skills and Culture

35. The Authority employs professional accountants who are skilled in carrying out investment appraisals, as well as regeneration, economic development and property specialists. Nonetheless, the more complex schemes will require external support to enable thorough due diligence to be undertaken and business cases to be developed and assessed. External specialists will work with Authority officers to ensure they understand the public service dimension of the Authority's business.

36. The Authority will use whatever presentation techniques are appropriate when decisions on individual investments are sought; these will in particular focus on the risk assessment.

Appendix 3a

Current Investments

The Council has approved the following investments which fall within the remit of this strategy.

a) **The Corporate Estate.** The purpose of holding the portfolio includes income generation, but also with an eye to providing a range of accommodation for businesses across the city and for ensuring a presence in city centre retail. The properties in the fund are not held to provide accommodation or services to/for the Authority. Accounting rules do not require us to treat the properties as investment properties for reporting purposes; however, they are held in part for return and thus fall within the ambit of this strategy. Details are available in the Corporate Estate annual report. Much of the estate has been owned by the Authority for decades and the income generated is a contribution to the General Fund.

It should be noted that guidance from MHCLG (Ministry of Housing, Communities & Local Government) and CIPFA (Chartered Institute of Public Finance and Accountancy) warns against investment activity which is disproportionately large in relation to an authority's finances. However, with net land and property investment income from the Corporate Estate accounting for less than 2% of the Authority's net revenue budget in 2024/2025, this continues to represent a manageable risk in relation to the overall revenue budget.

b) Loans to local businesses and organisations. A number of loans have been made.

- A loan to Leicestershire Cricket Club of £2.45m, to enable the Club to improve its facilities at an interest rate of 5%. The loan is supported by guarantees from the English Cricket Board.

- A loan of £1.5m to Ethically Sourced Products Ltd (of which just under £1.0m remains outstanding). This loan carries a return equivalent to 4% per annum. It is expected that this loan will be fully paid off with a lump sum in December 2025.

- A loan of £450k in 2023 to Leicester Hockey Club (of which £422k has been drawn down to date), to improve sporting facilities at St Margaret's Pastures. The interest rate is 5% p.a.

- A loan of £1.5m to Leicester Community Sports Arena Ltd in 2023, to assist funding of expanded facilities at the (now) Mattioli Arena. The rate of interest is 5% p.a.

- A loan of £0.95m (of which £0.82m has been drawn down to date) to the Chapter of Leicester Cathedral to assist funding of the repair and restoration of Leicester Cathedral and the construction of a new Heritage Learning Centre. The interest rate is 5% p.a.

(c) Regeneration schemes with an element of Prudential Borrowing:

- Expenditure of £5.4m was incurred to deliver 26,400 square feet of workspace at Dock 2 Pioneer Park, which was completed in March 2021. The scheme attracted £2.15m of external funding. Prudential borrowing was £1.7m.

- Work is nearing completion on a £13.3m scheme to redevelop Pilot House to provide modern small scale office accommodation. This is partly funded by £8.6m Government grant and is expected to be completed in 2025.

- A major regeneration scheme of £24.7m (plus a £1.5m inflation contingency) including £19.4m of Government grant for Pioneer Park is underway. This incorporates schemes at Dock 3, Abbey Court and the Ian Marlow Centre. These schemes are expected to provide a significant net revenue surplus to the Authority after borrowing costs.

- Expenditure on Land south of Phoenix of £0.4m will be included here if the approval of the change of financing the 2024/25 capital programme in approved at this Council meeting.