NORTH AYRSHIRE COUNCIL

1 March 2023

Cabinet

Title:	**Treasury Management and Investment Strategy 2023/24**
Purpose:	To seek approval for the proposed Strategy for Treasury Management and Investment activities within the Council for the financial year 2023/24.
Recommendation:	That Council a) approves the Treasury Management and Investment Strategy for 2023/24 as attached at Appendix 1; and b) notes that updated performance in relation to the treasury management and prudential indicators will be reported Cabinet as part of the Revenue and Capital Monitoring arrangements throughout the year.

1. Executive Summary

1.1 The Council is required by regulations issued under the Local Government in Scotland Act 2003 and the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) to approve a Treasury Management Strategy before the start of each financial year. The Council is also required by regulation to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (2021) under Part 7 of the Local Government in Scotland Act 2003. In addition, the Consent by Scottish Ministers for the Investment of Money by Scottish Local Authorities, which came into force in April 2010, requires the Authority to approve an Investment Strategy before the start of each financial year.

1.2 The Treasury Management and Investment Strategy attached to this report complies fully with these requirements and provides:

- a summary of the Council's capital plans;
- an outline of the treasury management strategy in relation to borrowing and the impact of capital plans on this borrowing; and
- an outline of the investment strategy including the type of instruments available for investment and our permitted counterparties.

1.3 The strategy provides key prudential and treasury indicators to 2030/31 which clearly articulate the operational parameters associated with Treasury Management and Investment as well as offering assurance in relation to the affordability and sustainability of capital investment plans.

1.4 The key points highlighted in this report are;

- the continuation of an “under borrowed” position;
- interest rate forecasts predict that the UK Bank Rate will continue to rise in 2023, with rates rising to 4.25% by March 23 and then remaining at that level before beginning to decline in 2024;
- notes the introduction of International Financial Reporting Standard (IFRS)16 which from 1 April 2023 will see leases, which were previously off balance sheet, now being included. Although leases form part of the other long term liability figures which make up the Prudential Indicators, it is not currently anticipated that the Indicators will be exceeded. Once the detailed data gathering has been substantially completed, later in the 2023/24 financial year, an updated report may be required to inform the members of the detailed impact of IFRS 16 with amended Prudential Indicators for approval.

1.5 As recommended under the CIPFA Prudential and Treasury Management Codes, updated performance information in relation to the treasury management and prudential indicators will be reported to Cabinet on a quarterly basis as part of the regular Revenue and Capital Monitoring arrangements.

2. Background

2.1 CIPFA defines treasury management as:

‘The management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.’

2.2 The Local Government Scotland Act 2003 and the Prudential Code requires the Council to approve an annual Treasury Management and Investment Strategy which outlines the Council's strategy in relation to borrowing and the Council's strategy for managing investments giving priority to the security and liquidity of those investments.

2.3 The Treasury Management and Investment Strategy 2023/24 is attached at Appendix 1. The overall objectives of the strategy are as follows:

<u>Borrowing</u>

- to minimise the revenue cost of borrowings;
- to manage the Council’s cash flow;
- to manage the borrowing repayment profile;
- to assess interest rates’ movements and borrow/invest accordingly;
- to monitor and review the level of variable rate loans held in order to take advantage of interest rate movements; and
- to identify and evaluate opportunities for debt rescheduling.

Investments

- to protect capital security of the invested funds;
- to obtain the best market return whilst recognising that security and liquidity are key priorities;
- to specify criteria for identifying creditworthy counterparties; and
- to specify the types of investments permitted and appropriate limits for each.

2.4 The strategy provides detailed key prudential and treasury indicators to 2030/31, aligned to the Councils current capital investment programme, which clearly articulate the operational parameters associated with Treasury Management and Investment as well as offering assurances in relation to the affordability and sustainability of capital investment strategy, including;

- the General Services capital plan to 2030/31; and
- the one-year programme for the Housing Revenue Account, with investment requirements for future years outlined within the HRA 30-year Business Plan.

2.5 The strategy also links with the key objectives of the Prudential Code that capital investment programmes:

- should be set at a level that delivers the Council's strategic priorities; and
- are affordable in terms of the impact of the resultant debt repayments on revenue budgets.

2.6 The Treasury Management and Investment Strategy includes prudential indicators which are critical in assessing the affordability of capital investment plans and their impact on the Council's overall finances. The indicator used to demonstrate affordability is the proportion of financing costs to the net revenue stream (for both General Fund and Housing Revenue Account).

2.7 There are a number of other key indicators designed to ensure that the Council operates within well-defined limits. The strategy, therefore, specifies:

- limits we do not expect external debt to exceed;
- appropriate levels of fixed rate borrowing versus variable rate borrowing;
- upper and lower limits on the maturity of the debt portfolio, which reduces the Council's exposure to large sums falling due for refinancing at any one time; and
- limits on investments placed for more than 365 days.

2.8 In addition to the annual Treasury Management Strategy, the CIPFA Treasury Management Code recommends that authorities should have formal reporting arrangements which include performance against the treasury management and prudential indicators and the CIPFA Prudential Code recommends reporting as part of the authority's integrated revenue and capital monitoring arrangements. During 2023/24, updated performance information in relation to the indicators will be reported to Cabinet on a quarterly basis as part of the regular Revenue and Capital Monitoring arrangements.

2.9 The Council expects to hold an 'under-borrowed' position at 31 March 2023. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded by debt, due to the level of the Council's internal funds. The use of internal funds instead of borrowing will continue in order to minimise borrowing costs. This under-borrowed position will decline through time as internal funds reduce and borrowing is required to be undertaken to replace internal funding.

2.10 The Treasury Management and Investment Strategy includes details of the Council's policy on repayment of loans fund advances. The Council's policy complies with the options currently available under the Local Authority (Capital Financing and Accounting) (Scotland) Regulations 2016 and the asset lives and methodologies used have been reviewed to provide for the prudent repayment of advances.

3. Proposals

3.1 That Council a) approves the Treasury Management and Investment Strategy for 2023/24 as attached at Appendix 1; and b) notes that updated performance in relation to the Treasury Management and Prudential Indicators will be reported Cabinet as part of the Revenue and Capital Monitoring arrangements throughout the year.

4. Implications/Socio-economic Duty

Financial

4.1 Financial implications are detailed in the report attached at Appendix 1.

Human Resources

4.2 None.

Legal

4.3 The Local Government in Scotland Act 2003 and supporting regulations require the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. The Local Authority (Capital Financing and Accounting) (Scotland) Regulations 2016 require the Council to set a policy for the repayment of loans fund advances.

Equality/Socio-economic

4.4 None.

Environmental and Sustainability

4.5 None.

Key Priorities

4.6 The Treasury Management Strategy aligns with the Council Plan by maximising resources and providing value for money to support financially sustainable delivery models.

Community Wealth Building

4.7 None.

5. Consultation

5.1 The Council's treasury advisors, Arlingclose Ltd, were consulted in the preparation of the Strategy.

Mark Boyd
Head of Service (Finance)

For further information please contact **David Forbes, Senior Manager (Strategic Business Partner),** on **01294 324551**.

Background Papers
None

North Ayrshire Council
Comhairle Siorrachd Àir a Tuath

Treasury Management and Investment Strategy 2023/24

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1 Purpose

The Council is required by regulations issued under the Local Government in Scotland Act 2003 and the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) to approve a Treasury Management Strategy before the start of each financial year. The Council is also required by regulation to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (2021) under Part 7 of the Local Government in Scotland Act 2003.

In addition, the Consent by Scottish Ministers for the Investment of Money by Scottish Local Authorities, which came into force in April 2010, requires the Authority to approve an Investment Strategy before the start of each financial year.

This strategy meets these requirements fully.

Three main reports on Treasury Management activity are presented to Members each year, incorporating a variety of policies, estimates and actuals. These are:

- **Annual Treasury Management and Investment Strategy** (this report), which is submitted to full Council before the start of each financial year.

- **Mid-Year Treasury Management and Investment Report**, submitted to Cabinet as soon as possible following 30 September each year.

- **Annual Treasury Management and Investment Report**, submitted to full Council annually by the 30 June following the end of each financial year.

Responsibilities

Regulations place responsibility on Members for the review and scrutiny of treasury management policy and activities. The following Scheme of Delegation has been adopted by the Council:

<u>Full Council</u>

- to receive and review reports on treasury management policies, practices and activities;
- to approve the annual Treasury Management and Investment Strategy.

Cabinet

- to approve amendments to the treasury management policy statement and treasury management practices;
- to approve the division of responsibilities;
- to receive and review regular monitoring reports and act on recommendations.

Section 95 Officer

The Council's Section 95 Officer is responsible for the proper administration of the Council's financial affairs and is required:

- to recommend treasury management policies / practices, review these regularly and monitor compliance;
- to submit regular treasury management updates;
- to receive and review management information;
- to review the performance of the treasury management function;
- to ensure the adequacy of treasury management resources and skills and the effective division of responsibilities within the treasury management function; and
- to approve the appointment of external service providers.

External Treasury Advisers

The Council recognises that there is value in employing external providers of treasury management services, in order to access specialist skills and resources.

However, it recognises that the responsibility for treasury management decisions remains with the Council at all times and officers will ensure that undue reliance is not placed upon external advice.

The Council's current external treasury management advisors are Arlingclose Limited. The contract started on 5 April 2021 and is in place for an initial 3 year period. The Council will ensure that the terms of their appointment and the methods by which their value is assessed are properly agreed, documented and subject to regular review.

2 Executive Summary

The treasury management function ensures that the Council's funds are managed in accordance with the relevant professional codes, so that sufficient cash is available to meet service activity. This involves both the organisation of the cashflow and, where capital plans require, the organisation of approporiate borrowing facilities.

CIPFA defines treasury management as:

"The management of the organisation's borrowing, investments and cashflows, 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."

This document outlines the Council's Annual Treasury Management Strategy and Annual Investment Strategy providing:

- a summary of the Council's capital plans;
- an outline of the treasury management strategy in relation to borrowing and the impact of capital plans on this borrowing; and
- an outline of the investment strategy including the type of instruments available for investment and our permitted counterparties.

Key prudential and treasury indicators are provided throughout this strategy which clearly articulate the operational parameters in relation to Treasury Management and Investment, as well as providing assurances in relation to the affordability and sustainability of capital investment plans. Table 1 contains the key prudential and treasury indicators within the report.

Table 1

Prudential and Treasury Indicators	2022/23 Probable Outturn £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Capital Expenditure:				
General Services	51.938	115.931	92.308	72.782
HRA	41.286	172.316	75.825	28.379
Total	**93.224**	**288.247**	**168.133**	**101.161**
Loans Capital Financing Requirement (CFR):				
General Services	203.831	267.879	331.353	358.260
HRA	174.824	284.275	332.105	342.052
Total	**378.655**	**552.154**	**663.458**	**700.312**
Gross Borrowing	268.796	490.154	621.458	678.312
Operational Boundary for Borrowing	393.907	571.667	682.720	724.044
Authorised Limit for Borrowing	433.298	628.834	750.992	796.448
Total Operational Boundary (Including PPP/NPD)	486.293	659.399	766.014	802.634
Total Authorised Limit (Including PPP/NPD)	525.684	716.566	834.286	875.038
Investments	30.000	20.000	20.000	20.000

A summary of this is provided as follows, with more detailed information provided in the body of the report.

Capital Expenditure for the General Fund (GF) reflects the capital investment programme for 2023/24 to 2030/31 and Housing Revenue Account (HRA) reflects the capital investment programme for 2023/24 and the capital investment plans included in the latest business plan. To ensure the financial consequences of the new programme are fully transparent, all relevant indicators have been projected to 2030/31 and these can be found in Appendix 1.

The **Capital Financing Requirement (CFR)** is the underlying borrowing requirements of the Council.

Gross Borrowing reflects the actual borrowing which has been undertaken. This is projected to be lower than the CFR as the Council continues with its strategy to use internal funds.

The **Operational Boundary** is the maximum borrowing and other long-term liabilities to fund previous years' and the current year capital programme, building in flexibility for the timing of the different funding streams and principal repayments. The operational boundary includes any other long-term liabilities (e.g. PPP/NPD schemes, finance leases) however no borrowing is actually required against these schemes as a borrowing facility is included in the contract.

The **Authorised Limits** is set at 10% above the Operational Boundary to give some flexibility around raising funds for future year capital investment.

Affordability of borrowing is measured by the percentage of financial costs relative to the net revenue stream of the GF and HRA.

Full details of these can be found on page 11.

The **average investment** rate estimated for 2023/24 is 4.25% and is reflective of the Council's appetite for risk, the short term nature of investments and the permitted instruments and counterparties selected.

Other prudential and treasury indicators and supporting information can be found in the main body of this report.

Client Status

The introduction of the second Market in Financial Instruments Directive (MiFID II) in January 2018, classifies Local Authorities as "retail clients" unless they choose to opt-up to "professional client" status. This has the advantages of lower fees and access to a greater range of products and investment firms. The Council continues to opt-up to professional client status. In order to meet the professional client criteria, the Council must hold a £10m investment portfolio at all times and have at least one officer with the necessary level of experience and knowledge to understand the risks involved in the management of the investments.

3 Capital and Prudential Indicators 2023/24 – 2025/26

In exercising its power to borrow, the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 require the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code). The Prudential Code is a framework to ensure Councils demonstrate effective control over levels of, and decisions relating to, capital investment activity, including borrowing. The Treasury indicators are used to ensure that risk is managed and controlled effectively. Together the Prudential and Treasury Indicators consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework.

Capital Expenditure and Financing

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of the 2023/24 budget setting.

The 2023/24 budget proposes an updated Capital Investment Programme for General Services to 2030/31 and updated investment plans for the HRA for 2023/24 and the capital investment plans included in the latest business plan. All projects within the Capital Programme are linked to the Council's key strategic priorities. These are also covered in the Capital Investment Strategy, produced in line with the requirements of the Prudential Code. To ensure that the financial consequences of the new programme are fully transparent, all relevant indicators have been projected to 2030/31 and these can be found in Appendix 1. Table 2 shows the capital expenditure plans and how they are being financed by capital or revenue resources over the next three years. The borrowing figure in Table 2 is the difference between the estimates for total capital expenditure and the other funding sources.

Table 2

Estimates of Capital Expenditure and Income	2022/23 Probable Outturn £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
General Services Capital expenditure	51.938	115.931	92.308	72.782
Funded by:				
Borrowing	10.825	68.292	68.763	33.183
Receipts / Grants	41.055	47.639	22.310	39.599
Funded from Revenue	0.058	-	-	-
Funded from Reserves	-	-	1.235	-
Total	**51.938**	**115.931**	**92.308**	**72.782**
HRA Capital expenditure	41.286	172.316	75.825	28.379
Funded by:				
Borrowing	24.563	115.676	56.310	20.130
Receipts / Grants	1.767	44.979	12.804	1.337
Funded from Revenue	12.209	5.151	3.354	3.316
Funded from Reserves	2.747	6.510	3.357	3.596
Total	**41.286**	**172.316**	**75.825**	**28.379**

The Council's Overall Borrowing Need (the Capital Financing Requirement)

This indicator outlines the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not been paid from either a capital or a revenue resource and, therefore, needs to be funded from borrowing. It is essentially a measure of the Council's underlying borrowing need.

Part of the Council's treasury activity is to meet the funding requirements for this borrowing need. The treasury management section organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the Council.

The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. The Council is required to make an annual revenue charge, called the Loans Fund Principal Repayment. This is effectively a repayment of the borrowing need and it is charged to revenue over the life of the asset. This charge reduces the CFR each year. This differs from the treasury management arrangements, which ensure that cash is available to meet the payment of capital commitments on an ongoing basis. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- increasing the annual revenue charge.

The Council's CFR is shown below and is a key prudential indicator. The opening balances include the PPP/NPD schemes on the balance sheet, which increase the Council's borrowing need. This is shown to give a complete picture of the Council's debt. However, no borrowing is actually required against these schemes as a borrowing facility is included in the contract and, as such, this is subtracted from the total CFR to identify the Loans CFR. The Loans CFR is forecast to rise over the next few years as capital expenditure financed by borrowing increases.

Table 3

Capital Financing Requirement (CFR)	2022/23 Probable Outturn £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
General Services	296.217	355.611	414.647	436.850
HRA	174.824	284.275	332.105	342.052
Sub-total	**471.041**	**639.886**	**746.752**	**778.902**
Less PPP/NPD long-term liability	(92.386)	(87.732)	(83.294)	(78.590)
Loans Capital Financing Requirement (CFR)	**378.655**	**552.154**	**663.458**	**700.312**
Movement in CFR				
General Services		64.048	63.474	26.907
HRA		109.451	47.830	9.947
Annual Change		**173.499**	**111.304**	**36.854**

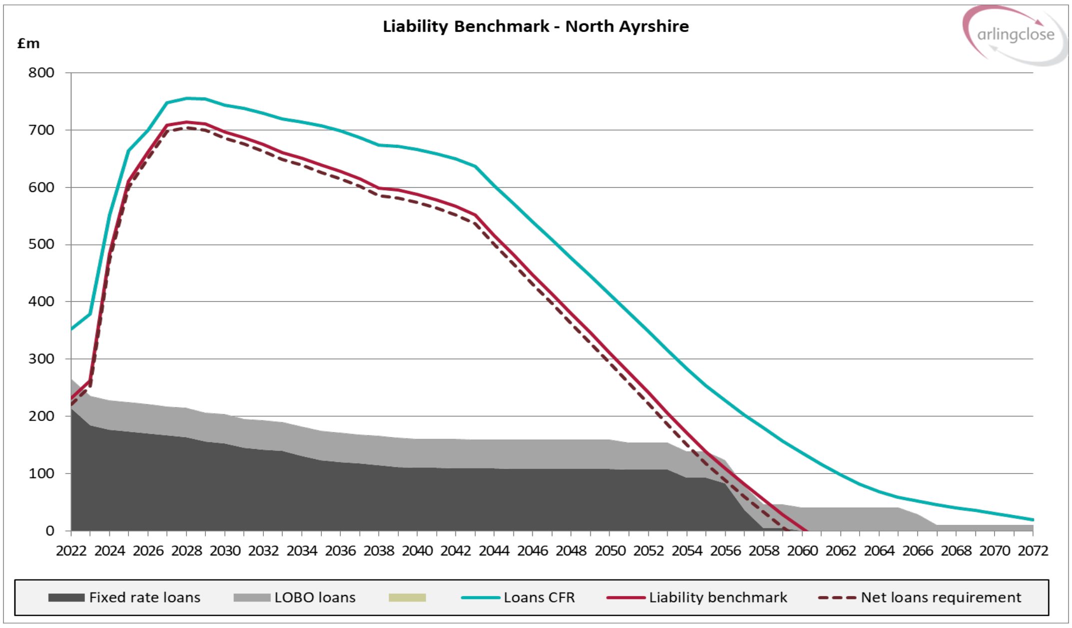
Liability Benchmark

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

Table 4

Liability Benchmark	2021/22 Actual £m	2022/23 Estimate £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m
Loans CFR	353.000	378.700	552.200	663.500	700.300
Less Balance sheet resources	(131.700)	(126.000)	(78.200)	(63.300)	(48.900)
Net loans requirement	**221.300**	**252.700**	**474.000**	**600.200**	**651.400**
Liquidity allowance	10.000	10.000	10.000	10.000	10.000
Liability Benchmark	**231.300**	**262.700**	**484.000**	**610.200**	**661.400**

Following on from the medium-term forecasts in the table above, the long-term liability benchmark assumes capital expenditure funded by borrowing will be in line with the 10 year capital plan and 30 year HRA business plan respectively, loans fund advances on new capital expenditure based on asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year with any specific adjustments made for planned use of reserves. This is shown in the chart below together with the maturity profile of the Council's existing borrowing:



The Liability benchmark graph above is used to inform the Council's borrowing strategy. The shaded grey area shows the Councils current debt and the gap between this and the Liability benchmark line is how much more borrowing the Council likely needs to undertake to support its current capital plans once taking into account its balance sheet resources. The above graph indicates that long term borrowing for the period of around 20 years would be most appropriate to meet the Councils borrowing needs and mitigate against interest rate risk.

Limits to borrowing activity

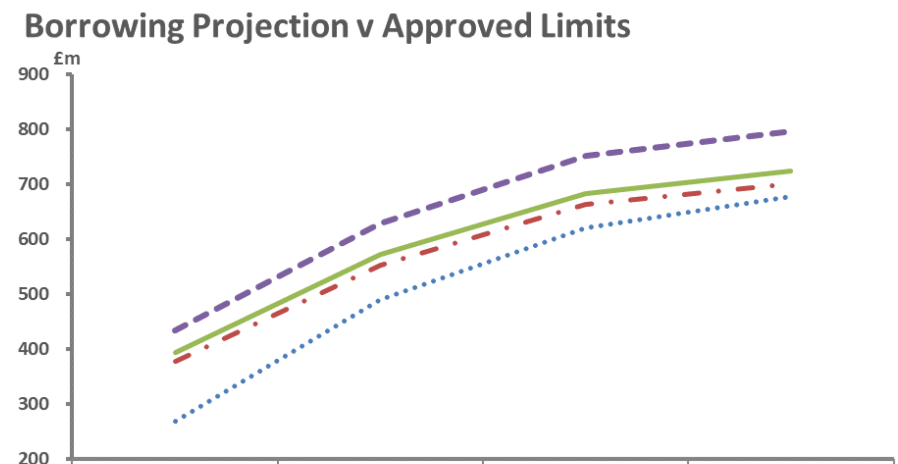
<u>The Operational Boundary</u>

The operational boundary is the expected maximum borrowing position of the Council during the year, taking account of the timing of various funding streams and the recharge of principal repayments from the revenue account. Periods where the actual position varies from the boundary are acceptable, subject to the authorised limit not being breached.

<u>The Authorised Limit</u>

The authorised limit represents a limit beyond which external debt is prohibited. This limit is set by Council and can only be revised by Council approval. It reflects the level of external borrowing which, while not desirable, could be afforded in the short term, but is not sustainable in the longer. The current limit is set at 10% above the Operational Boundary.

The following graph shows the projected levels of the Operational Boundary and Authorised Limit for Borrowing, compared with the Council's CFR and gross debt position. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should not exceed the highest forecast CFR over the next three years. This provides Councils with some flexibility to borrow to meet future capital investment requirements but provides a balance to ensure debt is not held for long periods of time without an underlying need to fund capital investment. The graph below confirms that the Council expects to comply with this recommendation.



	2022/23	2023/24	2024/25	2025/26
Gross Debt at 31 March	268.796	490.154	621.458	678.312
CFR (Borrowing need)	378.655	552.154	663.458	700.312
Operational Boundary	393.907	571.667	682.720	724.044
Authorised Limit	433.298	628.834	750.992	796.448

NB: Figures exclude PPP/NPD

Leasing – International Financial Reporting Standard (IFRS) 16

From 1 April 2023, leases which were previously off balance sheet will now be included. Although leases form part of the other long term liability figures which make up the Prudential Indicators above, it is not currently anticipated that the Indicators will be exceeded. Once the detailed data gathering has been substantially completed, later in the 2023/24 financial year, an updated report may be required to inform the members of the detailed impact of IFRS 16 with amended Prudential Indicators for approval.

Affordability Prudential Indicators

These Prudential Indicators assess the affordability of capital investment plans and provide an indication of the impact of capital investment plans on the Council's overall finances. The cost impact of borrowing decisions are reflected in the Council's budget as loan charges. These have been projected to 2030/31 in line with the capital plan.

Actual and estimates of the proportion of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long-term liabilities net of investment income) against the net revenue stream and reflects the profile of the loans fund advances together with future capital investment. The estimates of financing costs include current commitments and those arising from the capital programme. The HRA costs are aligned with the 30-year business plan.

Table 5

Proportion of financing costs to net revenue stream	2022/23 Probable Outturn %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %
General Services	2.9%	3.4%	4.6%	5.6%
HRA	20.9%	27.8%	36.8%	39.9%

Capital expenditure impacts on the revenue budget through financing charges, so it is essential that the Council ensures the financing costs remain affordable and do not constitute an excessive proportion of the revenue resources available. From a General Fund perspective, the draft CIPFA Directors of Finance Performance Indicators 2021/22 show a Scottish Local Authority average of 5.48%, therefore demonstrating a prudent borrowing policy. For the HRA, the indicative Scottish average in 2021/22 was 23.03%. The rising ratio within the HRA is indicative of the significant capital investment programme as outlined in the Strategic Housing Investment Plan. The level of loan charges is deemed prudent and affordable within the framework of the 30 year Housing business plan.

4 Treasury Management Strategy

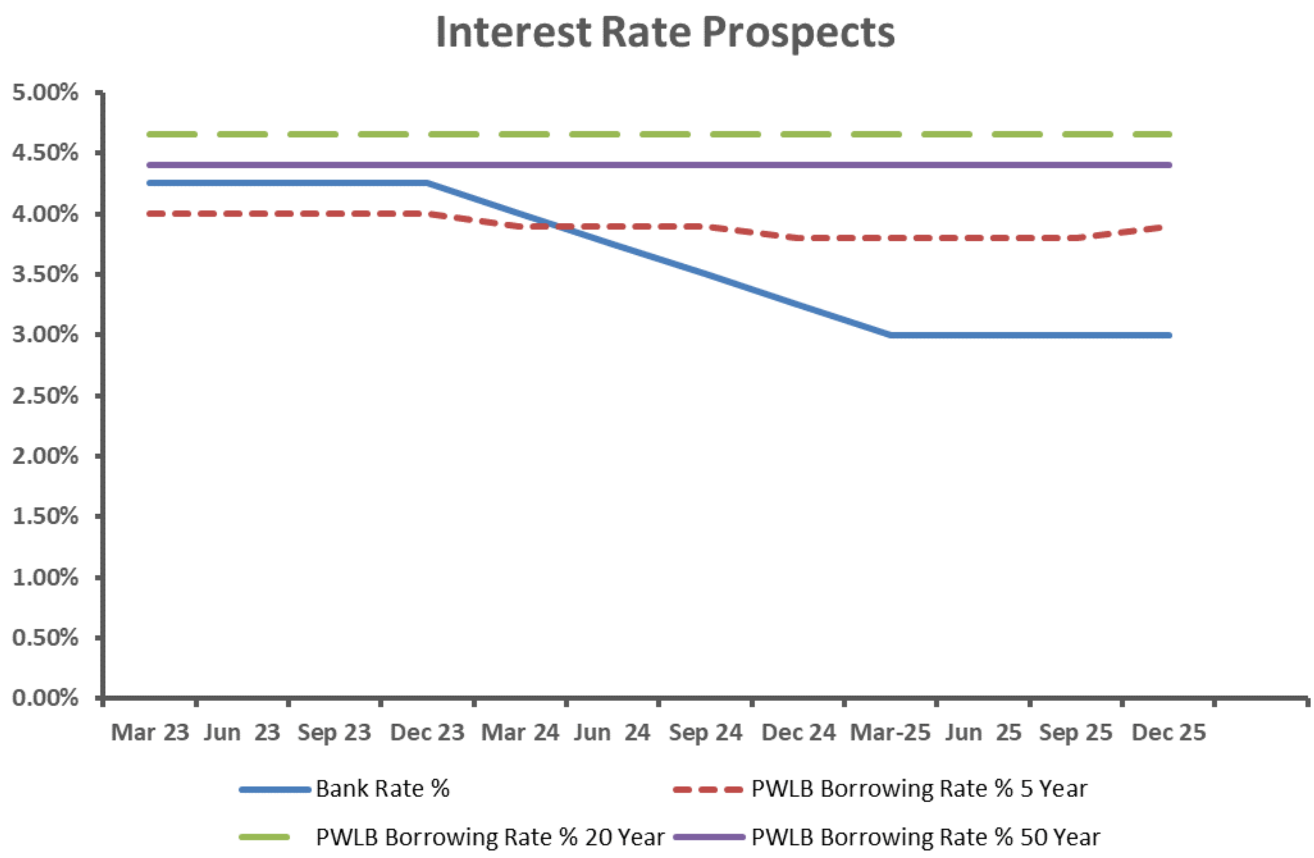
The treasury management function ensures that the Council's funds are managed in accordance with the relevant professional codes, so that sufficient cash is available to meet service activity. This involves both the organisation of the cashflow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy. The primary objectives of the Council's borrowing strategy is to minimise the revenue impact of borrowing and to effectively manage the repayment profile of the debt.

The treasury strategy aligns with the Council Plan by contributing to "an efficient Council that maximises resources and provides value for money as referred to under the objective of "A Council for the Future". The Council Plan can be found on the Council's website at: www.north-ayrshire.gov.uk.

Economic Outlook

<u>Interest rate forecast</u>

Interest rate forecasts are key to forecasting the costs of future borrowing. The Council's treasury management adviser Arlingclose is forecasting that the bank rate will continue to rise in 2023 with rates rising to 4.25% by March 23 and then remaining at that level before beginning to decline in 2024. The projected rates are shown in the following graph alongside an assessment of PWLB borrowing rates to December 2025:



Current Portfolio Position

The Council's projected treasury portfolio position at 31 March 2023, with future year estimates, is summarised below. Table 6 shows the actual external debt against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing. Both the external debt and CFR exclude the Council's liabilities in respect of the PPP/NPD schemes.

Table 6

Current Portfolio Position (excluding PPP/NPD)	2022/23 Probable Outturn £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Gross Debt at 31 March	268.796	490.154	621.458	678.312
CFR	378.655	552.154	663.458	700.312
(Under)/Over Borrowed Position	**(109.859)**	**(62.000)**	**(42.000)**	**(22.000)**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates within well-defined limits. One of these is that the Council's gross debt should not, except in the short term, exceed the total of the CFR. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes.

The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The Council is currently under-borrowed. This means that the capital financing requirement (CFR), has not been fully funded with loan debt because the cash supporting the Council's internal balances and cashflow is being used as a temporary measure. This strategy is currently prudent, as investment returns are low and counterparty risk is high. Where possible, the Council will continue to use internal funds but will balance this strategy against movements in interest rates as outlined above.

Against this background and the risks within the economic forecast, caution will be adopted within 2023/24 treasury operations. The Section 95 Officer will monitor interest rates and adopt a pragmatic approach to changing circumstances. For example:

- if it is anticipated that there is a significant risk of a sharp fall in long and short-term rates, then long-term borrowings will be postponed and potential rescheduling from fixed rate funding into short-term borrowing will be considered.

- if it is anticipated that there is a significant risk of a sharp rise in long and short-term rates than that currently forecast, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they are expected to be in the next few years.

Any such decisions will be reported to the Cabinet as part of the mid-year and annual treasury outturn report. A summary of treasury risks and mitigating controls can be found at Appendix 2.

Controls on Borrowing Activity

The purpose of these controls is to manage the risk and impact of any adverse movement in interest rates. However, if they are set to be too restrictive, they may impair opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates.

Table 7

	2022/23 Probable Outturn £m	2022/23 Limit £m	2023/24 Limit £m	2024/25 Limit £m	2025/26 Limit £m
Limits on fixed interest rates based on net debt	217.846	433.298	628.834	750.992	796.448
Limits on variable interest rates based on net debt	50.950	60.000	60.000	60.000	60.000

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large sums falling due for refinancing; both upper and lower limits are required.

Table 8

Maturity Profile of Borrowing	2022/23 Probable Outturn £m	2022/23 Probable Outturn %	Lower Limit %	Upper Limit %
Under 12 months	45.485	18%	0%	50%
12 months and within 24 months	2.888	1%	0%	50%
24 months and within 5 years	10.112	4%	0%	50%
5 years and within 10 years	24.439	10%	0%	75%
10 years and above	164.039	66%	25%	90%
Total Borrowing	**246.963**	**100%**		

* Note the Under 12 months figure in the above table includes £25.950m LOBOs which have call options in year.

The impact of a 1% rise in interest rates based on the Councils current debt portfolio is shown in the table below:

Table 9

Interest Rate Risk Exposure	2023/24 £m	2024/25 £m	2025/26 £m
Impact of a 1% increase in Interest rates	0.313	0.462	0.492
Impact of a 1% decrease in Interest rates	(0.105)	(0.202)	(0.233)

*Note there is a lower impact of a 1% reduction as the LOBO loans are unlikely to be called when the rate reduces.

LOBOs

The Council currently holds £50.950m of Lender's Option Borrower's Option (LOBO) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. Similar to other debt held by the Council we continue to work with treasury management advisers to identify financially beneficial opportunities to repay LOBO loans.

Policy on Borrowing in Advance of Need

The Council will not borrow more than, or in advance of, its needs purely to profit from the investment of the extra sum borrowed. Any decision to borrow in advance will be within forward approved CFR estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any advance borrowing activity will be subject to appraisal and subsequent reporting in either the mid-year or annual treasury report.

Debt Rescheduling

As short-term borrowing rates are considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the cost of any premiums incurred on early debt repayment.

Potential reasons for debt rescheduling include:

- the generation of cash savings and / or discounted cashflow savings; or
- the enhancement of the portfolio balance (amend the maturity profile and / or risk).

The recent rise in interest rates means that more favourable debt rescheduling opportunities may arise than in previous years. All debt rescheduling proposals will be reported to Cabinet / full Council as part of the annual or mid-year report.

Borrowing Sources

Approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board) and any successor body;
- Any institution approved for investments (see Appendix 3);
- Any other bank or buiding society authorised to operate in the UK;
- Any other UK public sector body;
- UK public and private sector pension fund (except Strathclyde Pension Fund);
- Capital market bond investors; or
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

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

- Leases;
- Hire purchase;
- Private Finance Initiatives (including PPP/NPD); or
- Sale and leaseback arrangements.

Alternatives to PWLB

North Ayrshire 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. The Council will also investigate the possibility of issuing bonds and similar instruments, which may offer lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. One example of such funding is the UK Municipal Bonds Agency, an organisation which plans to issue bonds on the capital markets and lend the proceeds to local authorities. As these will represent a more complex form of borrowing, any decision to borrow in this way will be the subject of a separate report to Council.

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

Policy on Use of Financial Derivatives

A financial derivative is a contract, which derives its value from the performance of an underlying entity. They are used for a number of purposes, including insuring against price movements. In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, future and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used and the risks that they present will be managed in line with the overall treasury risk management strategy.

Policy on Repayment of Loans Fund Advances

The prudent repayment of Loans Fund Advances are made under the provisions of The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016, which came into force on 1 April 2016.

These Regulations require North Ayrshire Council to outline its policy on the repayment of loans fund advances. The loans fund advance is effectively the repayment of the 'principal' linked to the capital expenditure which is funded from borrowing.

The statutory guidance identifies a number of options for the prudent repayment of advances, including basing the repayments on:

- the depreciation charges made against the assets;
- the life of the assets, using either the annuity or equal instalments methodology; or
- the funding or income streams attached to the assets.

For the majority of projects undertaken by the Council, the policy is to repay loans fund advances linked to asset life using the annuity methodology. However, where appropriate, the repayment of advances arising from projects with associated income streams will be matched to the profile of the income.

The Council will continue to consider the most appropriate repayment methods, which align to the benefits of the assets and ensure a prudent repayment, for existing and future advances.

The policy is outlined in full in Appendix 4.

5 Investment Strategy

The Council's investment strategy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular) and the 2021 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). 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 or of receiving unacceptably low investment income. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

The aim of the Investment Strategy is to provide security of investment and minimisation of risk by generating a list of high creditworthy counterparties which will enable diversification. Investment instruments identified for use in the financial year, along with their associated risks and controls can be found in Appendix 3.

Counterparty limits are set through the Council's Treasury Management Practices. The maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership, will be treated as a single organisation for limit purposes.

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's revenue budget and cash flow forecast.

Given the risk of bail-in (as defined on page 19) and continued low returns from short-term unsecured bank investments, the Council will take opportunities, as cash flows permit, to further diversify into more secure asset classes during 2023/24. This diversification will mitigate further risks associated with investments.

Current Portfolio Position

Table 10

Current Portfolio Position	2022/23 Probable Outturn £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Investments at 31 March	30.000	20.000	20.000	20.000
Net Debt at 31 March	**238.796**	**470.154**	**601.458**	**658.312**

Environmental, Social and Governance (ESG) Policy

Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code. A list of ESG Initiative signatories is updated quarterly by the Council's treasury advisor Arlingclose to support the Council's decision making process for investing.

Creditworthiness policy

In accordance with the above, and in order to minimise risk, the Council has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on its lending list. The Council uses Arlingclose's Approved Counterparties List (see Appendix 5) which takes full account of the ratings, outlooks and watches published by all three ratings agencies. Ratings are monitored on a real time basis with any changes notified electronically supplemented by weekly update.

Investment decisions are made by reference to the lowest published long-term credit rating and analysis from the Council's treasury management advisers. The Council considers high credit quality organisations and investments as those having a credit rating of A- or higher and which are domiciled in the UK or in a foreign country with a sovereign rating of AA+ or higher. For money market funds that are more diversified, "high credit quality" is defined as those having a credit rating of A- or higher. However, in addition to credit ratings, the Council will consider investments in organisations based on independent analysis from our treasury management advisors.

All credit ratings are monitored by the Treasury Team who are alerted to changes in ratings of the main rating agencies through Arlingclose's weekly updates and following credit developments. Where a downgrade results in the counterparty or investment scheme no longer meeting the Council's minimum criteria, any investment will be withdrawn immediately, where breakage costs are not excessive.

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.
.
The Council recognises that credit ratings are good, but not comprehensive, indicators of investment default. Full regard is therefore 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 government support, reports in the financial press and analysis from the Council's treasury management adviser. No investment will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

Bail-in Risk

Since the financial crisis, global authorities have embarked on a wide ranging review of the banking sector to ensure that the cost to the public purse of any future crises is contained. One of the most significant changes has arisen from the Financial Services (Banking Reform) Act 2013 which added the bail-in of certain unsecured creditors to the Special Resolution Regime (SRR) granted to the Bank of England under the Banking Act 2009. Bail-in is the opposite of bail-out and requires certain creditors to bail-in funds from existing investments if a bank requires it to remain financially sustainable.

Local authority deposits in banks are unsecured and because other previously unsecured creditors such as retail investors have become preferred under UK and EU Directives, it means that the risks associated with local authority unsecured investments in banks have risen.

The best solution to mitigating against bail-in risk is to invest with high quality and credit worthy institutions. The identification of these institutions remains a key objective of the investment strategy. Ensuring diversification of investment counterparties is also an effective risk management approach and is reflected in investment counterparty limits.

Investment Strategy and Permitted Investments

The Investment Regulations (Code on the Investment of Money by Local Authorities) require the Council to approve all types of investments to be used and to set appropriate limits for the amount that can be held in each investment type. In determining its permitted investments, the Council must identify the treasury risks associated with each type of instrument and the controls put in place to limit risk on each investment type. Full details can be found in Appendix 3.

Investment Returns Expectations

The Bank Rate is forecast to rise to 4.25% during the first half of 2023 and remain at this level until June 24 where gradual reductions are anticipated. Bank Rate forecasts for financial year ends (March) are:

- 2023/24 4.25%
- 2024/25 3.25%
- 2025/26 3.25%

The estimated rates for returns on investments placed for periods up to 100 days during each financial year for the next three years are as follows:

- 2023/24 4.25%
- 2024/25 3.25%
- 2025/26 3.25%

Investment Treasury Indicator and Limit

This is a control on the total principal funds invested for greater than 1 year. This limit is set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and is based on the availability of funds after each year-end.

Table 11

Maximum principal sums invested for more than 1 year	2022/23 Probable Outturn £m	2023/24 Limit £m	2024/25 Limit £m	2025/26 Limit £m
Principal sums invested for more than 1 year	-	10.000	10.000	10.000

For cashflow management, the Council will seek to utilise its 15 and 30 day notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

Summary of Material Investments, Guarantees and Liabilities

In line with the requirements in respect of the Council's Capital Investment Strategy information is provided on material Investments, Guarantees and Liabilities. Reporting of this fits better within the TMIS. Information is provided in the table below;

The Council has the current historic investments on the balance sheet as at 31st March 2022:

Category	**Value as at 31 March 2022 £m**
Long-term Debtors	0.104
Total	**0.104**

The long-term debtors represent loan finance provided by the Council to other parties which relates to Advances for House Purchases.

Monitoring of Investment Strategy

An update on the investment position of the Council will be reported to Cabinet in the 2023/24 Mid-Year Treasury report and the Annual Treasury Report will be submitted to the Council after the end of the financial year.

Appendix 1: Prudential Indicators 2027 to 2031

Estimates of Capital Expenditure and Income	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
General Services Capital expenditure	69.466	32.165	18.850	21.622	10.946
Funded by:					
Borrowing	50.474	13.173	1.219	(7.035)	0.353
Receipts / Grants	18.992	18.992	17.631	28.657	10.593
Funded from Revenue	-	-	-	-	-
Funded from Reserves	-	-	-	-	-
Total	**69.466**	**32.165**	**18.850**	**21.622**	**10.946**
HRA Capital expenditure	23.964	19.415	24.543	25.055	25.859
Funded by:					
Borrowing	14.014	10.572	13.972	12.596	13.212
Receipts / Grants	4.184	-	-	-	-
Funded from Revenue	5.156	8.843	10.571	12.459	12.647
Funded from Reserves	0.610	-	-	-	-
Total	**23.964**	**19.415**	**24.543**	**25.055**	**25.859**

Capital Financing Requirement (CFR)	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
General Services	476.515	477.540	466.542	447.217	434.630
HRA	344.929	345.835	349.926	352.558	353.899
Sub-total	**821.444**	**823.375**	**816.468**	**799.775**	**788.529**
Less PPP/NPD long-term liability	(73.717)	(68.023)	(62.547)	(56.667)	(50.841)
Sub-total	**747.727**	**755.352**	**753.921**	**743.108**	**737.688**
Movement in CFR					
General Services	44.538	6.719	(5.522)	(13.445)	(6.761)
HRA	2.877	0.906	4.091	2.632	1.341
Annual Change	**47.415**	**7.625**	**(1.431)**	**(10.813)**	**(5.420)**

* A negative annual change in CFR reflects a reduction in the need to finance capital investment from borrowing.

Proportion of financing costs to net revenue stream	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
General Services	6.0%	6.5%	6.7%	6.6%	6.8%
HRA	39.7%	36.1%	35.0%	33.4%	34.1%

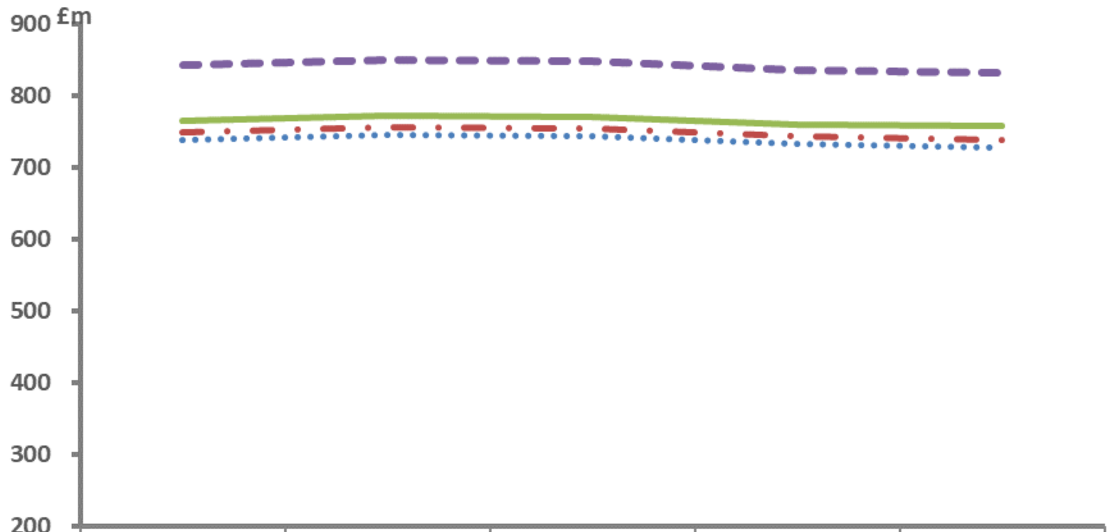
Current Portfolio Position (excluding PPP/NPD)	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
Gross Debt at 31 March	737.727	745.352	743.921	733.108	727.688
CFR	747.727	755.352	753.921	743.108	737.688
(Under)/Over Borrowed Position	**(10.000)**	**(10.000)**	**(10.000)**	**(10.000)**	**(10.000)**

Current Portfolio Position	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
Investments at 31 March	20.000	20.000	20.000	20.000	20.000
Net Debt at 31 March	**717.727**	**725.352**	**723.921**	**713.108**	**707.688**

Operational Boundary	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
Anticipated borrowing	765.410	771.472	770.543	759.482	756.673
PPP/NPD long-term liability	73.717	68.023	62.547	56.667	50.841
Operational Boundary	**839.127**	**839.495**	**833.090**	**816.149**	**807.514**

Authorised Limit	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
Operational Boundary + 10%	841.951	848.619	847.597	835.430	832.340
PPP/NPD long-term liability	73.717	68.023	62.547	56.667	50.841
Authorised Limit	**915.668**	**916.642**	**910.144**	**892.097**	**883.181**

Borrowing Projection v Approved Limits



	2026/27	2027/28	2028/29	2029/30	2030/31
Gross Debt at 31 March	737.727	745.352	743.921	733.108	727.688
CFR (Borrowing need)	747.727	755.352	753.921	743.108	737.688
Operational Boundary	765.410	771.472	770.543	759.482	756.673
Authorised Limit	841.951	848.619	847.597	835.430	832.340

Appendix 2: Treasury Risk Register

Risk Title	Description	Consequence of Risk	Current Controls	RAG Status
Credit and Counterparty Risk	This is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly due to the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have a very high level of creditworthiness.	That investment funds will not be returned in full to the Council as per the contractual obligation of the counterparty.	The Council sets minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to invest securely. The RAG status is Amber because this risk will never be fully eliminated.	Amber
Liquidity Risk	This is the risk that cash will not be available when it is needed. Whilst it could be said that all counterparties are subject to at least a very small level of liquidity risk, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. While some forms of investment e.g. gilts, Certificates of Deposit, corporate bonds can usually be sold immediately if the need arises, there are two caveats: - a) cash may not be available until a settlement date up to three days after the sale; and b) there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer.	That the Council has insufficient access to cash to enable it to carry out its activities.	The Council has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested. This has a high level of assurance around regular cash inflows and outflows. Some of the Council's cashflow related investments are invested in Money Market Funds which provide very high daily liquidity.	Green

Risk Title	Description	Consequence of Risk	Current Controls	RAG Status
Market Risk	This is the risk that, through adverse market fluctuations in the value of the sums that the Council borrows and invests, there is a detrimental impact on the Council.	That investment funds will not be returned in full to the Council as per the contractual obligation of the counterparty due to market variations.	Only a proportion of the Council's investments will be invested in instruments whose value are subject to market movements. The proportion will not exceed the maximum percentage the Council will invest in investments over 1 year	Green
Interest Rate Risk	This is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. The Council has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report	That the Council will be faced with unexpected higher interest costs due to market variations.	The Council manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.	Green
Legal and Regulatory Risk	This is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, including failure to comply with the CIPFA Codes and that the organisation suffers losses accordingly.	That investment funds will not be returned in full to the Council due to the failure of the counterparty to comply with their contractual obligations	The Council will not undertake any form of investing until it has ensured that it has all necessary powers and has complied with all regulations.	Green

Appendix 3: Permitted Investments, Risks and Mitigating Controls

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
Banks Unsecured	These are accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks, which are established by more than one country, e.g. European Investment Bank. 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.	Diversifying investments is crucial to managing bail-in risk, in addition to determining proportionate counterparty and maturity limits. Certificates of Deposit, which are tradable on the secondary market and which can be sold prior to maturity, will also assist in managing credit risk.	The combined secured and unsecured investments in any one bank will not exceed £10m.
Banks Secured	These are covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. Reverse purchase agreements involve the purchase of securities with the agreement to sell at a future date at a higher price. Collateralised arrangement are an investment with collateral such as properties or debt.	These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they 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 to determine cash and time limits.	The combined secured and unsecured investments in any one bank will not exceed £10m.

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
Operational Bank Accounts	The Council will incur operational exposures to its banking services provider, Clydesdale Bank, through current accounts. The bank is not currently on the Council's lending list as its credit ratings are below the investment credit rating criteria of A-. These balances are not classed as investments but are still subject to the risk of bail-in and balances will therefore be minimised.	The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion (which applies to Clydesdale Bank) are more likely to be bailed in than made insolvent, increasing the chance of the Council maintaining operational continuity. .	The Council monitors its operational accounts on a daily basis, transferring any surplus funds to investment accounts and there for minimising the amount held in the operational bank account at any time.
Government	These are loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. Includes the UK Debt Management Office.	These investments are not subject to bail-in, and there is an insignificant risk of insolvency.	Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
Corporates	These are loans, bonds and commercial paper issued by companies other than banks and registered social landlords. Loans to unrated companies will only be made if approved through a separate report to Council.	These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. This risk will be mitigated by taking independent external advice and diversifying investments over a number of counterparties.	Loans to unrated companies would be made as part of a diversified pool in order to spread the risk widely.

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
Registered Social Landlords	These are loans and bonds issued by, guaranteed by or secured on the assets of Registered Social Landlords (Housing Associations). These bodies are regulated by the Scottish Housing Regulator and by the Homes and Communities Agency for Registered Providers of Social Housing in England.	As providers of public services, they retain the likelihood of receiving government support if needed and are therefore considered low risk.	Policy driven, managing all associated risks.
Money Market Funds	These are diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a management fee.	Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts.	It is recommended that no more than 10% of the Council's total investments are invested in any one MMF and that the amount invested is no more than 0.5% of the size of a MMF used for liquidity purposes. For pooled investment vehicles that invest in bonds, equities and property, all of which operate on a variable net asset value (VNAV) it is recommended that no more than 10% of the Council's total investments are invested in each fund. These investments will be held for periods greater than 1 year.

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
Investment Properties	These are non-operational properties that are being held pending disposal, or for a longer-term rental income stream. They are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).	In larger investment portfolios, some small allocation of property-based investment may counterbalance/ complement the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams. Member approval required and each application must be supported by the service rationale behind the loan and the likelihood of partial or full default.	Policy driven, managing all associated risks.
Loans to third parties, including soft loans	These are service investments either at market rates of interest, or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application must be supported by the service rationale behind the loan and the likelihood of partial or full default. Interest payments and loan repayments will be monitored and the likelihood of partial or full default re-assessed regularly.	Policy driven, amount and loan maturity limit will be determined on a case-by-case basis.
Loans to a local authority company	These are service investments either at market rates of interest, or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each loan to a local authority company requires Member approval and each application must be supported by the service rationale behind the loan and the likelihood of partial or full default. Interest payments, loan repayments, and their timeliness will be monitored and the likelihood or partial or full default reassessed regularly.	Policy driven, amount and loan maturity limit determined on a case-by-case basis, managing all associated risks.

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
Shareholdings in a local authority company	These are service investments, which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application must be supported by the service rationale behind the investment and the likelihood of loss. Service investments will be subject to scrutiny by Financial Services on a regular basis and will include scrutiny of financial statements issued by the local authority company.	Policy driven, amount determined on a case-by-case basis, managing all associated risks.
Non-local authority shareholdings	These are non-service investments, which may exhibit market risk, will only be considered for longer term investments and are likely to be liquid.	Any non-service equity investment will require separate Member approval and each application must be supported by the service rationale behind the investment and the likelihood of loss. Non-service investments will be subject to scrutiny by Financial Services on a regular basis, reported to Members, and will include scrutiny of financial statements issued by the company.	Policy driven, amount and anticipated time frame for shareholding determined on a case-by-case basis, managing all associated risks.

Appendix 4: Policy on Repayment of Loans Fund Advances

Policy on Repayment of Loans Fund Advances

The purpose of the Loans Fund is to record advances from the loan fund for expenditure incurred, or loans made to third parties, which a local authority has determined are to be financed from borrowing as set out in Regulation 2 of The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 [“the Regulations”]. The Council is also statutorily required to repay Loans Fund advances and to prudently determine the periods over which it will repay Loans Fund advances and the amount of repayments in any financial year.

Loans Fund advances comprise several items and the estimated opening balances for 2023/24, where applicable for North Ayrshire Council, are:

- capital expenditure (£378.655m);
- grants to third parties and expenditure on third party assets which would be classified as capital expenditure by a local authority (£0m);
- loans to third parties (£0m); and
- expenditure for which a borrowing consent has been issued by the Scottish Government (£0m).

Prudent repayment of Loans Fund advances

The loans fund advance is effectively the repayment of the ‘principal’ linked to the expenditure classified above which is unfinanced and is required to be funded from borrowing. Repayment of loans fund advances are required to be made in line with Scottish Government statutory guidance on Loans Fund Accounting. The Council’s annual accounts require to include a disclosure of details of Loans Fund transactions. The HRA Loans Fund advances and associated annual repayments are identified separately from that of the General Fund.

The broad aim of prudent repayment is to ensure that the Council’s unfinanced capital expenditure is repaid over the period of years in which that expenditure is expected to provide a benefit and that each year’s repayment amount is reasonably commensurate with the period and pattern of the benefits.

The statutory guidance requires the Council to approve a policy on Loans Fund repayments each year and recommends a number of options for calculating prudent repayments. North Ayrshire Council’s policy is as follows:

For the majority of projects undertaken by the Council the policy is to use the asset life method to repay loans fund advances on an annuity basis, which is similar to the repayment of a mortgage where principal payments are lower at the start of the mortgage and build up to deliver full repayment over the term of the mortgage. As well as annuity, the asset life method has the option of equal instalments.

The Council will continue to consider the most appropriate repayment method which aligns to the benefits of the assets and ensures a prudent repayment.

In addition, there are some projects where income streams are attached to the project which can be reasonably associated with the borrowing which will be undertaken. In these circumstances it may be more appropriate for the advances to be repaid on a profile which matches this income. For these unique projects, loans fund advances may be profiled for repayment to match the income and not on the annuity basis.

These options comply with the statutory guidance and the Council will continue to consider all options available to it.

The repayment of Loans Fund advances will therefore be equal to the annual amount determined in accordance with the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016.

The above regulations state that Council's may vary the period and/or amount of the repayments if they consider it prudent to do so. As a result, officers continue to review existing loans fund advances for opportunities to ensure the most prudent repayment method is being used.

Estimates of prudent Loans Fund repayment

The Authority's latest estimates of its Loans Fund account information are as follows:

Year	Opening Balance £m	Advances to GF £m	Advances to HRA £m	Repayment by GF £m	Repayment by HRA £m	Closing Balance £m
2021/22 actual	319.890	16.656	24.354	-3.466	-4.445	352.989
2022/23	352.989	10.825	24.563	-4.350	-5.372	378.655
2023/24 - 27/28	378.655	233.886	216.700	-28.198	-45.691	755.352
2028/29 - 32/33	755.352	-5.464	63.927	-36.460	-58.445	718.910
2033/34 - 37/38	718.910	0.000	78.950	-42.076	-82.312	673.473
2038/39 - 42/43	673.473	0.000	118.549	-48.171	-106.788	637.064
2043/44 - 47/48	637.064	0.000	0.000	-54.943	-105.475	476.646
2048/49 - 52/53	476.646	0.000	0.000	-64.885	-95.871	315.890
2053/54 - 57/58	315.890	0.000	0.000	-50.363	-86.283	179.243
2058/59 - 62/63	179.243	0.000	0.000	-34.137	-63.068	82.038
2063/64 - 67/68	82.038	0.000	0.000	-32.359	-9.018	40.660
2068/69 & later	40.660	0.000	0.000	-40.661	0.000	0.000

Policy on Apportioning Interest to the HRA

Interest and expenses on all new borrowing is allocated to the HRA based on the share of total borrowing taken each year.

Appendix 5: Counterparty Limits

The status of counterparties is monitored regularly. The Council receives credit rating and market information from Arlingclose Limited, including when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately and, if required, new counterparties which meet the criteria will be added to the list. The list of local authorities in the table are those, which are credit rated; however, the Council may lend to rated and unrated UK local authorities.

The Council may invest its funds with any of the counterparties detailed below, subject to the cash limits (per counterparty) and time limits shown. This list reflects the current (December 2022) counterparty list and will be updated throughout the year based on information received by our Treasury Adviser.

		ARLINGCLOSE RECOMMENDS						AUTHORITY SPECIFIC LIMITS		
Counterparty	Country of Domicile	Maximum Deposit/CD Duration	Repo & Covered Bonds	Fitch Long-term	Moody's Long-term	S&P Long-term	Banking Group	Cash Limit (£/%)	Group Cash Limit (£/%)	Max Investment period
UNITED KINGDOM: BANKS										
BANK OF SCOTLAND PLC	GB	6 months	Yes	A+	A1	A+	Lloyds Banking Group		£10,000,000	6 months
LLOYDS BANK PLC	GB	6 months	Yes	A+	A1	A+				6 months
BARCLAYS BANK PLC	GB	100 days	-	A+	A1	A	Barclays Group			100 days
BARCLAYS BANK UK PLC	GB	100 days	Yes	A+	A1	A				100 days
HANDELSBANKEN PLC	GB	100 days	-	AA		AA-	Svenska HB			100 days
HSBC BANK PLC	GB	6 months	Yes	AA-	A1	A+	HSBC Group			6 months
HSBC UK BANK PLC	GB	6 months	-	AA-	A1	A+				6 months
NATIONAL WESTMINSTER BANK	GB	100 days	Yes	A+	A1	A	NatWest Group			100 days
NATWEST MARKETS PLC	GB	100 days	-	A+	A1	A-				100 days
ROYAL BANK OF SCOTLAND PLC/T	GB	100 days	-	A+	A1	A			£10,000,000	100 days
SANTANDER UK PLC	GB	100 days	-	A+	A1	A	Santander			100 days
STANDARD CHARTERED BANK	GB	6 months	-	A+	A1	A+				6 months
UK: BUILDING SOCIETIES										
NATIONWIDE BUILDING SOCIETY	GB	100 days	Yes	A+	A1	A+				100 days

		ARLINGCLOSE RECOMMENDS						AUTHORITY SPECIFIC LIMITS		
Counterparty	Country of Domicile	Maximum Deposit/CD Duration	Repo & Covered Bonds	Fitch Long-term	Moody's Long-term	S&P Long-term	Banking Group	Individual Cash Limit (£/%)	Group Cash Limit (£/%)	Max Investment period
UK: LOCAL AUTHORITIES										
ABERDEEN CITY COUNCIL	GB	2 years +	-		A1		-			2 years +
CORNWALL COUNCIL	GB	2 years +	-		Aa3		-			2 years +
GREATER LONDON AUTHORITY	GB	2 years +	-			AA	-			2 years +
GUILDFORD BOROUGH COUNCIL	GB	2 years +	-		A1		-			2 years +
LANCASHIRE COUNTY COUNCIL	GB	2 years +	-		A1		-			2 years +
NORTH LONDON WASTE AUTHORITY	GB	2 years +	-		A1		-			2 years +
SUTTON LONDON BOROUGH OF	EN	2 years +	-		Aa3		-			2 years +
WARRINGTON BOROUGH COUNCIL	GB	2 years +	-		A3		-			2 years +
UK: OTHER INSTITUTIONS										
LCR FINANCE PLC	EN	10 years	-	AA-	Aa3	AA				10 years
NETWORK RAIL INFRASTRUCTURE	GB	10 years	-	AA-	Aa3					10 years
UNITED KINGDOM	GB	50 years	-	AA-u	Aa3	AAu				50 years
WELLCOME TRUST FINANCE PLC	GB	15 years	-		Aaa	AAA				15 years
AUSTRALIA	AU		-	AAAu	Aaa	AAAu				
AUST AND NZ BANKING GROUP	AU	100 days	-	A+	Aa3	AA-				100 days
COMMONWEALTH BANK OF AUSTRAL	AU	100 days	Yes	A+	Aa3	AA-				100 days
NATIONAL AUSTRALIA BANK LTD	AU	100 days	Yes	A+	Aa3	AA-				100 days
WESTPAC BANKING CORP	AU	100 days	-	A+	Aa3	AA-				100 days
AUSTRIA	AS		-	AA+u	Aa1	AA+				
OESTERREICHISCHE KONTROLLBAN	AS	10 years	-		Aa1	AA+				10 years
CANADA	CA		-	AA+u	Aaa	AAA				
BANK OF MONTREAL	CA	100 days	Yes	AA	Aa2	A+				100 days
BANK OF NOVA SCOTIA	CA	6 months	Yes	AA	Aa2	A+				6 months
CAN IMPERIAL BK OF COMMERCE	CA	6 months	Yes	AA	Aa2	A+				6 months
EXPORT DEVELOPMENT CANADA	CA	10 years	-		Aaa	AAA				10 years
NATIONAL BANK OF CANADA	CA	100 days	-	AA-	Aa3	A				100 days

ROYAL BANK OF CANADA	CA	6 months	Yes	AA	Aa1	AA-				6 months
TORONTO-DOMINION BANK	CA	6 months	Yes	AAu	Aa1	AA-				6 months
DENMARK	DE		-	AAA	Aaa	AAAu				
KOMMUNEKREDIT	DE	10 years	-		Aaa	AAA				10 years
FINLAND	FI		-	AA+	Aa1	AA+				
MUNICIPALITY FINANCE PLC	FI	10 years	-		Aa1	AA+				10 years
NORDEA BANK ABP	FI	100 days	-	AA	Aa3	AA-				100 days
OP CORPORATE BANK PLC	FI	100 days	-		Aa3	AA-				100 days

								AUTHORITY SPECIFIC LIMITS		
Counterparty	Country of Domicile	Maximum Deposit/CD Duration	Repo & Covered Bonds	Fitch Long-term	Moody's Long-term	S&P Long-term	Banking Group	Individual Cash Limit (£/%) £10m unless Specified	Group Cash Limit (£/%)	Max Investment period
NETHERLANDS	NE		-	AAA	Aaa	AAAu				
COOPERATIEVE RABOBANK UA	NE	100 days	-	AA-	Aa2	A+				100 days
SINGAPORE	SI		-	AAA	Aaa	AAAu				
DBS BANK LTD	SI	100 days	-	AA-	Aa1	AA-				100 days
OVERSEA-CHINESE BANKING CORP	SI	100 days	Yes	AA-	Aa1	AA-				100 days
UNITED OVERSEAS BANK LTD	SI	100 days	Yes	AA-	Aa1	AA-				100 days
UNITED STATES OF AMERICA	US		-	AAA	Aaa	AA+u				
SUPRANATIONAL										
COUNCIL OF EUROPE DEVELOPMENT BANK (CEDB)	FR	15 years	-	AA+	Aa1	AAA				15 years
EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)	GB	25 years	-	AAA	Aaa	AAA				25 years
EUROPEAN INVESTMENT BANK (EIB)	LX	25 years	-	AAA	Aaa	AAA				25 years
INTER-AMERICAN DEVELOPMENT BANK (IADB)	US	25 years	-	AAA	Aaa	AAA				25 years
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (THE WORLD BANK)	US	25 years	-	AAA	Aaa	AAA	World Bank Group			25 years
NORDIC INVESTMENT BANK (NIB)	FI	25 years	-		Aaa	AAA				25 years

Appendix 6: Economic Background – Arlingclose's View January 2023

Economic Outlook

The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2%

(revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

Credit outlook

Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

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