NORTH AYRSHIRE COUNCIL

2 March 2022

Cabinet

Title:	**Treasury Management and Investment Strategy 2022/23**
Purpose:	To seek approval for the proposed Strategy for Treasury Management and Investment activities within the Council for the financial year 2022/23.
Recommendation:	That Council approves the Treasury Management and Investment Strategy for 2022/23 as attached at Appendix 1.

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 (CIPFA) Code of Practice on Treasury Management (revised 2017) 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 (revised 2017) 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 Regulation (April 2010) requires the Council to approve an Investment Strategy before the start of each financial year.

1.2 In December 2021 CIPFA published a revised Prudential Code and a revised Treasury management Code. It should be noted that the 2021 Prudential Code applies with immediate effect. However, Councils may defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. Due to the timing of these publications and their associated guidance, which was published in February 2022, this Strategy has been developed in compliance with the 2017 versions of the codes.

1.3 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;
- outlines the Treasury Management Strategy in relation to borrowing and the impact of council plans on borrowing;
- outlines the Investment Strategy including the instruments available for investments and permitted counterparties.

1.4 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.

1.5 The key points highlighted in this report are;

- the continuation of an “under borrowed” position;

- interest rates forecasts predict that the UK Bank Rate will rise to 1.0% in the first half of 2022 and remain at that level until December 2024;

- notes the introduction of International Financial Reporting Standard (IFRS)16 which from 1 April 2022 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 2022/23 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.

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 2022/23 is attached at Appendix 1. The overall objectives of the strategy are as follows:

Borrowing

- 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 The Council expects to hold an 'under-borrowed' position at 31 March 2022. 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 due to the low level of investment rates in the market and the saving which can be made in 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.

2.9 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 approves the Treasury Management and Investment Strategy for 2022/23 as attached at Appendix 1.

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

2022/23

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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 (CIPFA) Code of Practice on Treasury Management (revised 2017) 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 (revised 2017) 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.

In December 2021 CIPFA published a revised Prudential Code and a revised Treasury management Code. It should be noted that the 2021 Prudential Code applies with immediate effect. However, Councils may defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. Due to the timing of these publications and their associated guidance, which was published in February 2022, this Strategy has been developed in compliance with the 2017 versions of the codes.

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:

Full Council

- 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 local authority's investments and cashflows, 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	2021/22 Probable Outturn £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Capital Expenditure:				
General Services	59.442	124.152	89.262	75.469
HRA	43.885	114.507	76.000	71.543
Total	**103.327**	**238.659**	**165.262**	**147.012**
Loans Capital Financing Requirement (CFR):				
General Services	208.941	298.935	347.256	371.678
HRA	148.986	229.034	269.132	309.582
Total	**357.927**	**527.969**	**616.388**	**681.260**
Gross Borrowing	289.884	517.969	606.388	671.260
Operational Boundary for Borrowing	378.057	547.562	632.803	701.072
Authorised Limit for Borrowing	415.863	602.318	696.083	771.179
Total Operational Boundary (Including PPP/NPD)	470.396	635.952	716.653	780.586
Total Authorised Limit (Including PPP/NPD)	508.202	690.708	779.933	850.693
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 2022/23 to 2030/31 and Housing Revenue Account (HRA) reflects the capital investment programme for 2022/23 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 10.

The **average investment** rate estimated for 2022/23 is 0.50% 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 it chooses 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 2022/23 – 2024/25

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.

(a) 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 2022/23 budget setting.

The 2022/23 budget proposes an updated Capital Investment Programme for General Services to 2030/31 and updated investment plans for the HRA for 2022/23 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 2017 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	2021/22 Probable Outturn £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
General Services Capital expenditure	59.442	124.152	89.262	75.469
Funded by:				
Borrowing	28.582	94.515	53.739	30.473
Receipts / Grants	28.982	24.318	35.523	42.626
Funded from Revenue	0.162	0.600	-	-
Funded from Reserves	1.716	4.719	-	2.370
Total	**59.442**	**124.152**	**89.262**	**75.469**
HRA Capital expenditure	43.885	114.507	76.000	71.543
Funded by:				
Borrowing	17.707	85.376	47.265	49.211
Receipts / Grants	13.784	14.175	15.190	10.260
Funded from Revenue	10.599	12.209	10.067	10.242
Funded from Reserves	1.795	2.747	3.478	1.830
Total	**43.885**	**114.507**	**76.000**	**71.543**

(b) 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)	2021/22 Probable Outturn £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
General Services	301.280	387.325	431.106	451.192
HRA	148.986	229.034	269.132	309.582
Sub-total	**450.266**	**616.359**	**700.238**	**760.774**
Less PPP/NPD long-term liability	(92.339)	(88.390)	(83.850)	(79.514)
Loans Capital Financing Requirement (CFR)	**357.927**	**527.969**	**616.388**	**681.260**
Movement in CFR				
General Services		89.994	48.321	24.422
HRA		80.048	40.098	40.450
Annual Change		**170.042**	**88.419**	**64.872**

(c) Limits to borrowing activity

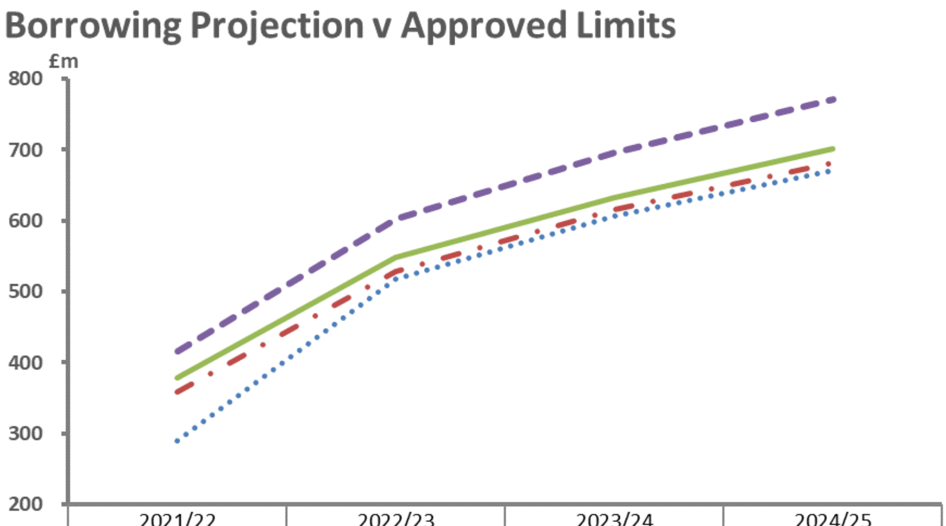
The Operational Boundary

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.

The Authorised Limit

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 Authority's 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.



	2021/22	2022/23	2023/24	2024/25
Gross Debt at 31 March	289.884	517.969	606.388	671.260
CFR (Borrowing need)	357.927	527.969	616.388	681.260
Operational Boundary	378.057	547.562	632.803	701.072
Authorised Limit	415.863	602.318	696.083	771.179

NB: Figures exclude PPP/NPD

Leasing – International Financial Reporting Standard (IFRS) 16

From 1 April 2022, 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 2022/23 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.

(d) 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 4

Proportion of financing costs to net revenue stream	2021/22 Probable Outturn %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %
General Services	3.0%	3.7%	4.6%	5.1%
HRA	18.7%	21.7%	26.9%	30.2%

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 Scottish Local Authority average in 2020/21 was 5.86%, therefore demonstrating a prudent borrowing policy. For the HRA , the Scottish average in 2020/21 was 21.62%. 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

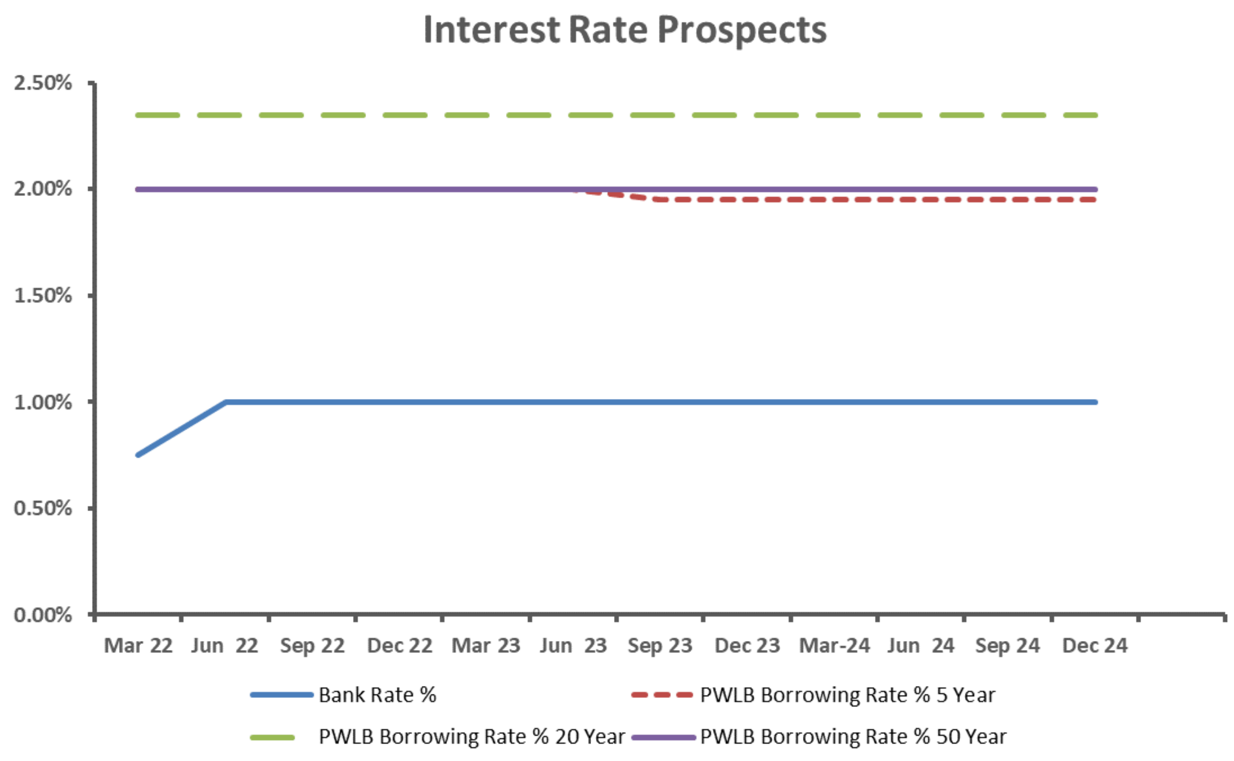
The treasury management function ensures that the Council's funds are managed in accordance with the relevant professional codes, so that sufficient cash is available to meet service activity. This involves both the organisation of the cashflow and, where capital plans require, the organisation of approporiate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

Interest rate forecast

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 during 2022 with rates rising to 1% from June 22 and then remaining at that level. The projected rates are shown in the following graph alongside an assessment of PWLB borrowing rates to December 2024:



Current portfolio position

The Council's treasury portfolio position at 31 March 2022, with forward projections, are summarised below. Table 5 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 5

Current Portfolio Position (excluding PPP/NPD)	2021/22 Probable Outturn £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Gross Debt at 31 March	289.884	517.969	606.388	671.260
CFR	357.927	527.969	616.388	681.260
(Under)/Over Borrowed Position	**(68.043)**	**(10.000)**	**(10.000)**	**(10.000)**

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 2022/23 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 6

	2021/22 Probable Outturn £m	2021/22 Limit £m	2022/23 Limit £m	2023/24 Limit £m	2024/25 Limit £m
Limits on fixed interest rates based on net debt	238.934	415.863	602.318	696.083	771.179
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 7

Maturity Profile of Borrowing	2021/22 Probable Outturn £m	2021/22 Probable Outturn %	Lower Limit %	Upper Limit %
Under 12 months	68.901	28%	0%	50%
12 months and within 24 months	2.888	1%	0%	50%
24 months and within 5 years	10.175	4%	0%	50%
5 years and within 10 years	24.439	10%	0%	75%
10 years and above	143.927	57%	25%	90%
Total Borrowing	**250.329**	**100%**		

* Note the Under 12 months figure in the above table includes £48.600m LOBOs which have call options in year.

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).

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 2017 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 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 18) 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 2022/23. This diversification will mitigate further risks associated with investments.

Current Portfolio Position

Table 8

Current Portfolio Position	2021/22 Probable Outturn £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Investments at 31 March	30.000	20.000	20.000	20.000
Net Debt at 31 March	**259.884**	**497.969**	**586.388**	**651.260**

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.

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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

Bank Rate is forecast to rise to 1% in the first half of 2022 and remain at this level until December 2024. Bank Rate forecasts for financial year ends (March) are:

- 2022/23 1.00%
- 2023/24 1.00%
- 2024/25 1.00%

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:

- 2022/23 0.50%
- 2023/24 1.00%
- 2024/25 1.00%

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 9

Maximum principal sums invested for more than 1 year	2021/22 Probable Outturn £m	2022/23 Limit £m	2023/24 Limit £m	2024/25 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 2021:

	Value as at 31 March 2021 £m
Long-term Debtors	0.439
Total	**0.439**

The long-term debtors represent loan finance provided by the Council to other parties which currently consists of the loans to North Ayrshire Ventures Trust Ltd (£0.292m) and Advances for House Rents (£0.147m).

Monitoring of Investment Strategy

An update on the investment position of the Council will be reported to Cabinet in the 2022/23 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 2024 to 2031

Estimates of Capital Expenditure and Income	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
General Services Capital expenditure	33.784	22.720	22.997	14.373	14.407	12.478
Funded by:						
Borrowing	9.172	3.514	5.705	0.514	0.630	-
Receipts / Grants	24.612	19.206	17.292	13.859	13.777	12.478
Funded from Revenue	-	-	-	-	-	-
Funded from Reserves	-	-	-	-	-	-
Total	**33.784**	**22.720**	**22.997**	**14.373**	**14.407**	**12.478**
HRA Capital expenditure	40.774	27.456	22.535	22.690	22.044	23.479
Funded by:						
Borrowing	24.597	12.080	8.061	6.927	4.646	6.384
Receipts / Grants	4.297	3.700	-	-	-	-
Funded from Revenue	10.129	11.066	14.474	15.763	17.398	17.095
Funded from Reserves	1.751	0.610	-	-	-	-
Total	**40.774**	**27.456**	**22.535**	**22.690**	**22.044**	**23.479**

Capital Financing Requirement (CFR)	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
General Services	449.228	441.942	435.852	424.550	413.322	400.584
HRA	323.690	324.265	322.305	319.048	313.626	308.270
Sub-total	**772.918**	**766.207**	**758.157**	**743.598**	**726.948**	**708.854**
Less PPP/NPD long-term liability	(74.973)	(70.264)	(64.742)	(59.411)	(53.684)	(47.883)
Sub-total	**697.945**	**695.943**	**693.415**	**684.187**	**673.264**	**660.971**
Movement in CFR						
General Services	2.577	(2.577)	(0.568)	(5.971)	(5.501)	(6.937)
HRA	14.108	0.575	(1.960)	(3.257)	(5.422)	(5.356)
Annual Change	**16.685**	**(2.002)**	**(2.528)**	**(9.228)**	**(10.923)**	**(12.293)**

Proportion of financing costs to net revenue stream	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
General Services	5.4%	5.2%	5.3%	5.3%	5.2%	5.4%
HRA	32.3%	32.3%	29.0%	28.3%	27.1%	28.4%

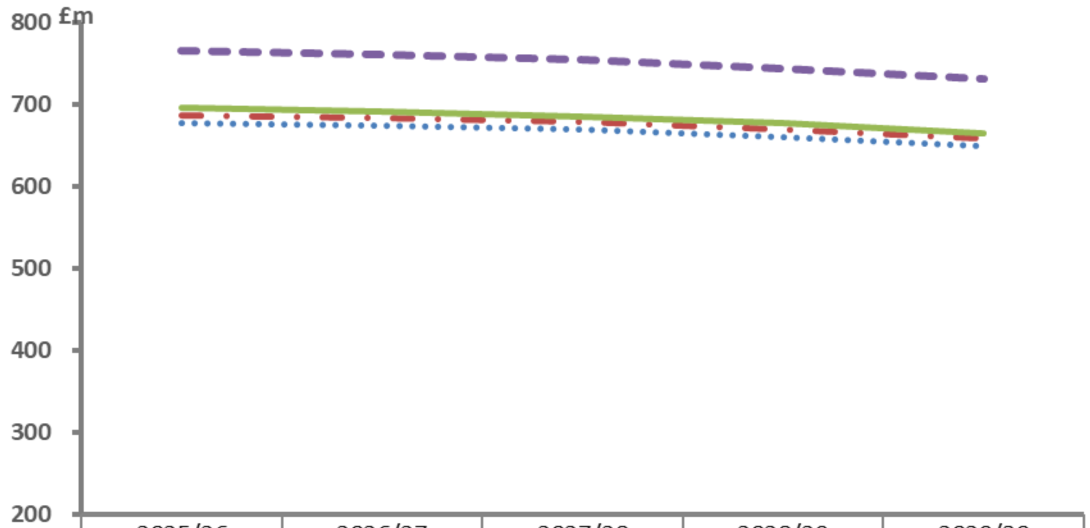
Current Portfolio Position (excluding PPP/NPD)	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
Gross Debt at 31 March	687.945	685.943	683.415	674.187	663.264	650.971
CFR	697.945	695.943	693.415	684.187	673.264	660.971
(Under)/Over Borrowed Position	**(10.000)**	**(10.000)**	**(10.000)**	**(10.000)**	**(10.000)**	**(10.000)**

Current Portfolio Position	2025/26 Estimate £m	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	20.000
Net Debt at 31 March	**667.945**	**665.943**	**663.415**	**654.187**	**643.264**	**630.971**

Operational Boundary	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
Anticipated borrowing	706.780	704.149	699.709	690.856	679.463	671.733
PPP/NPD long-term liability	74.973	70.264	64.742	59.411	53.684	47.883
Operational Boundary	**781.753**	**774.413**	**764.451**	**750.267**	**733.147**	**719.616**

Authorised Limit	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m	2028/29 Estimate £m	2029/30 Estimate £m	2030/31 Estimate £m
Operational Boundary + 10%	777.458	774.564	769.680	759.942	747.409	738.906
PPP/NPD long-term liability	74.973	70.264	64.742	59.411	53.684	47.883
Authorised Limit	**852.431**	**844.828**	**834.422**	**819.353**	**801.093**	**786.789**

Borrowing Projection v Approved Limits



	2025/26	2026/27	2027/28	2028/29	2029/30
Gross Debt at 31 March	677.341	673.711	669.521	660.027	648.811
CFR (Borrowing need)	687.341	683.711	679.521	670.027	658.811
Operational Boundary	696.155	691.851	685.719	676.569	664.871
Authorised Limit	765.771	761.036	754.291	744.226	731.358

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
Other types of investments			
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.

Type of Investment	Description and Risk	Mitigating Controls	Council Limits
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.
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 2022/23, where applicable for North Ayrshire Council, are:

- capital expenditure (£357.927m);
- 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
2020/21 actual	309.449	3.591	15.003	-4.662	-3.832	319.549
2021/22	319.549	28.582	17.707	-3.466	-4.445	357.927
2022/23 - 26/27	357.927	191.413	219.405	-28.677	-43.250	696.818
2027/28 - 31/32	696.818	6.849	31.282	-33.527	-54.194	647.228
2032/33 - 36/37	647.228	0.000	71.890	-40.410	-74.564	604.143
2037/38 - 41/42	604.143	0.000	141.789	-45.637	-99.197	601.098
2042/43 - 46/47	601.098	0.000	43.007	-51.247	-102.043	490.815
2047/48 - 51/52	490.815	0.000	0.000	-60.720	-92.330	337.765
2052/53 - 56/57	337.765	0.000	0.000	-45.750	-93.724	198.291
2057/58 - 61/62	198.291	0.000	0.000	-34.509	-73.458	90.324
2062/63 - 66/67	90.324	0.000	0.000	-33.191	-23.598	33.535
2067/68 & later	33.535	0.000	0.000	-33.535	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 (January 2022) counterparty list and will be updated throughout the year based on information received by our Treasury Adviser.

								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
UNITED KINGDOM: BANKS										
BANK OF SCOTLAND PLC	GB	100 days	Yes	A+	A1	A+	Lloyds Banking Group		£10,000,000	100 days
LLOYDS BANK PLC	GB	100 days	Yes	A+	A1	A+				100 days
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	100 days	Yes	AA-	A1	A+	HSBC Group			100 days
HSBC UK BANK PLC	GB	100 days	-	AA-	A1	A+				100 days
NATIONAL WESTMINSTER BANK	GB	100 days	Yes	A+	A1	A	NatWest Group			100 days
NATWEST MARKETS PLC	GB	100 days	-	A+	A2	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	100 days	-	A+	A1	A+				100 days
UK: BUILDING SOCIETIES										
NATIONWIDE BUILDING SOCIETY	GB	100 days	Yes	A+	A1	A+				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
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 +	-		Aa3					2 years +
LANCASHIRE COUNTY COUNCIL	GB	2 years +	-		A1					2 years +
SUTTON LONDON BOROUGH OF	GB	2 years +	-		Aa3					2 years +
TRANSPORT FOR LONDON	GB	2 years	-	A+	A3	A+				2 years
WARRINGTON BOROUGH COUNCIL	GB	2 years +	-		A2					2 years +
UK: OTHER INSTITUTIONS										
LCR FINANCE PLC	GB	10 years	-	AA-	Aa3	AA				10 years
NETWORK RAIL INFRASTRUCTURE	GB	10 years	-	AA-	Aa3					10 years
UNITED KINGDOM	GB	50 years	-	AA-	Aa3	AAu				50 years
WELLCOME TRUST FINANCE PLC	GB	20 years	-		Aaa	AAA				20 years
AUSTRALIA	AU		-	AAA	Aaa	AAAu				
AUST AND NZ BANKING GROUP	AU	100 days	Yes	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
CANADA	CA		-	AA+	Aaa	AAA				
BANK OF MONTREAL	CA	100 days	Yes	AA	Aa2	A+				100 days
BANK OF NOVA SCOTIA	CA	100 days	Yes	AA	Aa2	A+				100 days
CAN IMPERIAL BK OF COMMERCE	CA	100 days	Yes	AA	Aa2	A+				100 days
NATIONAL BANK OF CANADA	CA	100 days	-	AA-	Aa3	A				100 days
ROYAL BANK OF CANADA	CA	100 days	Yes	AA	Aa2 *+	AA-				100 days
TORONTO-DOMINION BANK	CA	100 days	Yes	AA	Aa1	AA-				100 days
FINLAND	FI		-	AA+	Aa1	AA+				
NORDEA BANK ABP	FI	100 days	-	AA	Aa3	AA-				100 days
OP CORPORATE BANK PLC	FI	100 days	-		Aa3	AA-				100 days
GERMANY	GE		-	AAA	Aaau	AAAu				
BAYERISCHE LANDESBANK	GE	100 days	-	A	Aa3	NR				100 days
DZ BANK AG DEUTSCHE ZENTRAL-	GE	100 days	-	AA-	Aa2	A+				100 days
KREDITANSTALT FUER WIEDERAUFBRAU (KFW)	GE	25 years	-	AAA		AAA				25 years
LANDESBANK BADEN-WUERTTEMBER	GE	100 days	-	A	Aa3	NR				100 days
LANDESBANK HESSEN-THURINGEN	GE	100 days	-	A+	Aa3	A-				100 days

Counterparty	Country of Domicile	Maximum Deposit/CD Duration	Repo & Covered Bonds	Fitch Long-term	Moody's Long-term	S&P Long-term	Banking Group	AUTHORITY SPECIFIC LIMITS 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 2022

Economic Outlook

The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

The Bank of England's (BoE) increased Bank Rate to 0.25% in December 2021 and again in February 2022 to 0.5% and also announced a tailing down of its erstwhile Quantitative Easing programme. The Monetary Policy Committee (MPC) voted 5-4 to raise rates by 0.25% at the February meeting, the four dissenters had voted for an 0.5% rise at this meeting which means a very high likelihood of further rate rises in 2022.

At the time of the MPC meeting in November 2021, the economic uncertainty surrounding the Omicron variant of coronavirus was much more prevalent and the forecast for growth was depressed as a result. Since then, the uncertainty surrounding this variant had declined and the negative effects that it might have had on the global economy were shown to be less damaging and more short lived than previously expected. On the other hand, exceptionally strong demand for goods combined with supply chain disruptions and rising energy prices have weighed on activity throughout the early parts of Q1 2022.

In its February 2022 Monetary Policy Report the Bank of England noted 12-month CPI inflation for December was 5.4% which is 1% above the expectations set out in its previous Report in November 2021. Rising energy prices and core goods prices are the leading drivers of this inflation.

The MPC projects CPI inflation will continue its upward trajectory in the coming months to around 6% in February and March before peaking at 7.25% in April. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

The most recent Labour Force Data for the period to November 2021 shows that the labour market continues to recover. The number of job vacancies in Q4 2021 rose to a new record of 1,247,000, and the unemployment rate fell to 4.1%.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. Looking ahead, Q4 growth (data for which will be released in February) is expected to be soft.

According to a first estimation of annual growth for 2021, GDP increased by 5.2% in both the euro area and the EU. Core CPI inflation was 5.1% y/y in December. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 6.9% in Q4 2021. CPI rose 7% in 2021, the largest 12-month increase since June 1982. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Credit outlook

Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.