Report

Governance & Audit Committee

Part 1

Date: 25 January 2024

Subject **2024/25 Capital Strategy and Treasury Management Strategy**

Purpose The purpose of this report is to gather the Committee's views and responses to the Council's draft Capital and Treasury Management strategies. These views and responses will then be reported to both Cabinet and Council, to inform their respective considerations of these documents. Both strategies are appended to this report.

To aid the Committee's deliberations, the covering report summarises the key aspects to both strategies, as well as well as highlighting the main implications and risks arising from them. In addition, to assist Committee in navigating the strategies, paragraph 8 includes a series of questions that the Committee may wish to use as a guide for their deliberations and to enable focus on the strategic aspects of Capital and Treasury Management.

Author Assistant Head of Finance

Ward General

Summary As set out within the Corporate Plan, the Council has ambitious plans for the city, with the Capital Programme a key enabler in delivering this ambition. The current programme runs from 2023/24 to 2027/28. In line with the rolling programme management approach, the next iteration of the five-year programme will run from 2024/25 to 2028/29. The next iteration of the programme will predominantly comprise of annual recurring allocations and a number of ongoing schemes from the existing programme.

This report includes both the Capital and Treasury Management Strategies which, at their core, (i) confirm the Capital Programme, as part of the Capital Strategy and (ii) the borrowing limits and other indicators which govern the management of the Council's borrowing and investing activities, as part of the Treasury Management Strategy.

The Capital Strategy also sets out the long-term context (10 years) in which capital decisions are made. It demonstrates that the Council's approach to taking capital and investment decisions is in line with service objectives, whilst giving consideration to risk, reward and impact. It also demonstrates that these decisions are taken whilst having proper regard to stewardship of public funds, value for money, prudence, sustainability and affordability.

The capital plans of the authority are inherently linked with the treasury management activities it undertakes and, therefore, the Treasury Management Strategy is included alongside the Capital Strategy.

The main recommendations arising from the two strategies are outlined in this covering report.

Proposal Governance & Audit Committee is asked:

- To provide comment on the Capital Strategy (Appendix 2), including the draft Capital Programme within it (shown separately in Appendix 1), and the borrowing requirements/limits needed to deliver the new programme.

- To provide comment on the Treasury Management Strategy and Treasury Management Indicators, the Investment Strategy and the Minimum Revenue Provision (MRP) policy for 2024/25. (Appendix 3)

- As part of the above:

  - To note, and comment as needed, on the increasing debt, and corresponding revenue cost of this, in delivering the Capital Programme, and the implications of this over both the short and medium to long term with regard to affordability, prudence and sustainability.

  - To note and comment on the Head of Finance recommendation to Cabinet and Council that borrowing needs to be limited to the extent that it meets the objective of stabilising, and ideally reducing, the Council's Capital Financing Requirement, and the recommended prudential indicators on borrowing limits to achieve this.

Action by Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Leader of the Council
- Chief Executive
- Strategic Directors
- Head of Finance
- The Council's Treasury Advisors

Signed

Background

Governance and requirement of councils

1. In November 2022, the Cabinet approved the Council's new Corporate Plan, which set out how it would achieve the ambition of an *Ambitious, Fairer, Greener Newport for everyone*. This mission is underpinned by four wellbeing objectives and supported by a transformation plan. Achievement of the four wellbeing objectives will be pursued via a series of actions and individual service plans. In some instances, these actions will involve activity and projects of a capital nature.

2. Whilst Cabinet makes decisions regarding the capital projects to be included in the programme, it is full Council that approves the borrowing limits that the overall programme must remain within. Many projects are funded from capital grants, capital receipts and specific reserves, which do not impact on borrowing levels, but, where borrowing is required, it is important that those limits are not exceeded. This is an important area of overall financial management governance in that debt funded capital expenditure, and the external borrowing that results, lock the Council in to a long-term liability for the associated revenue costs. These costs, known as 'Capital Financing Costs' are comprised of the external loan interest costs and the provision for financing the debt funded capital expenditure, known as Minimum Revenue Provision (MRP).

3. As in previous years, the Council continues to work within a constrained financial situation. This is particularly evident within the revenue budget, where high inflation and increasing demand for services has created significant budget pressure, but also within the capital budget and programme. This is evidenced by the relatively low level of capital resources available, considering the demand for capital resources, and the fact that the existing capital programme does not contain any provision for expenditure funded through new borrowing. The constraint on the availability of capital resources has been heightened by the high interest rate environment which, in effect, means that the Council's capital financing budget, which forms part of the overall revenue budget, does not stretch as far, due to more of it having to be used to meet external interest costs. Whilst interest rates appear to have now settled, and may start to reduce, they are still much higher than in recent years and will continue to limit the amount of new borrowing that can be committed to.

4. In light of the scarcity of capital resources, but ever-present demand for them, the Council has taken steps to strengthen its capital programme governance arrangements, by introducing a Capital Assurance Group (CAG). The CAG is comprised of senior officers, who periodically review the delivery of the capital programme and hold Heads of Service to account, where delays in delivery or rising costs of schemes are being experienced. Through this new arrangement, it is hoped that the levels of slippage seen in previous years will be reduced, thus reducing the risk that unnecessary external borrowing will be undertaken. As well as this, the group is also responsible for undertaking the initial review of new capital bids, both internally and externally funded, prior to formal consideration by Cabinet. This process will ensure that the Council's overall capital programme remains manageable by not committing to an undeliverable number of schemes, but also that Council capital resources are only committed to the highest priorities.

5. In addition to the continuation of a challenging financial environment, the introduction of a new accounting standard, IFRS16 Leases, will impact upon the Capital and Treasury Management Strategy. This standard will take effect from 1st April 2024 and will require all councils to treat leasing arrangements as capital expenditure, rather than revenue expenditure. As a result of this, the previous revenue cost of leasing arrangements, met from service area budgets, will be replaced by an MRP charge. Overall, in broad terms, this change is expected to have a neutral financial impact, as the charges against the revenue budget will be of equivalent value to current leasing charges. However, by treating the full cost of the lease as capital expenditure, it will increase the Council's Capital Financing Requirement (CFR) and impact upon the prudential indicators, especially the Operational Boundary and Authorised Limit. The estimated financial impact of this change is reflected throughout the report and the figures contained within it.

6. The key governance documents that underpin this area of local authority finances are:

Capital Strategy

This, at its core:

i) Sets out the long-term context (10 years) in which capital decisions are made and includes the medium-term Capital Programme;

ii) Demonstrates that the local authority takes capital / investments decisions in line with service objectives, giving consideration to risk, reward and impact;

iii) Shows how the Council takes account of stewardship of public funds, value for money and affordability, sustainability and prudence in its decisions and plans.

Treasury Management Strategy

This, at its core:

(i) Sets out the Council's longer term borrowing requirement and approach, which is driven mainly by the Capital Programme requirements and, in Newport specifically, the reducing 'internal borrowing' capacity;

(ii) Outlines how the Council will manage and invest any surplus cash;

(iii) Includes additional guidance, namely the Welsh Government Investment Guidance and the MRP Policy.

Both these strategies are a requirement of CIPFA's Prudential Code, which ensures, within the frameworks that these documents set, and a suite of prudential indicators, that capital expenditure plans are:

- **Affordable –** there must be sufficient resources to be able to meet the capital financing consequence of debt-funded capital expenditure within the overall revenue budget. There must also be sufficient capital resources for any non-debt funded capital expenditure. In addition, total capital expenditure is to be within **sustainable** limits. Councils are required to consider their current and estimated future resources available, together with the totality of their capital expenditure and income forecasts in assessing affordability.

- **Prudent –** it is important that whilst capital expenditure and capital financing costs are affordable, they are also proportionate. I.e. it is important that an appropriate proportion of the revenue budget is allocated for the purpose of financing past capital expenditure and that this is **sustainable**. Consideration as to overall financial **sustainability** is a key aspect to this. The operational borrowing limit should provide for the most likely level of borrowing, not the worst case, with the authorised limit providing sufficient headroom to enable day to day cash management. There should be alignment with the treasury management policy statement and practices and investing activities should strike an appropriate balance between security, liquidity and yield, in that order.

- **Sustainable –** sustainability is a key theme when considering both affordability and prudence and is something that should be assessed in terms of the long-term financial picture.

7. The Capital Strategy and Treasury Management Strategy are inherently linked and the main recommendations and observations arising from these are summarised in the following sections. In light of the requirement for full Council to ultimately provide approval of these strategies, the Governance & Audit Committee are asked to review and provide comments on both strategies, and the limits and prudential indicators contained within them, as necessary, to enable Cabinet, and then Council, to appropriately consider and then approve each strategy as required.

8. To assist the committee in their deliberations, and retain focus on the aspects that pertain to the committee's terms of reference, the following questions are provided as a guide:

   i. The borrowing strategy proposes that no additional borrowing for the next three financial years, over and above that already approved, will be included within the Capital Programme because of affordability challenges. Does the committee feel that is an appropriate position to take?
   ii. As outlined in the document, new borrowing of circa £7m per year could be affordable from 2027/28 and the proposed Capital Programme indicatively includes this. The proposal to potentially introduce new borrowing from 2027/28, and not earlier, is aimed at stabilising the Capital Financing Requirement over the long term. Does the committee feel as though the desire to stabilise the CFR is an appropriate one?
   iii. The report outlines the Council's borrowing approach, where available cash balances and investments are used in lieu of external borrowing (known as internal borrowing), thus deferring the need to undertake external borrowing and incur interest payable costs for as long as possible. Does the committee feel as though that this is the appropriate approach to take?
   iv. The report outlines the new governance arrangements that the Council has introduced regarding the Capital Programme. Does the committee feel as though the new arrangements are adequate and sufficiently robust?

Capital Strategy 2024/25 to 2034/35

Capital Programme to 2028/29

9. The Council's current capital programme, which covers the period 2023/24 to 2027/28, amounts to £248m, with £93m allocated in 2023/24 alone. Current forecasts suggest slippage £9m against this financial year, which will be transferred into future years. As mentioned previously, the current programme includes a very limited amount of borrowing headroom, due to the funding challenges already outlined over the medium-term period. However, whilst borrowing headroom is limited, some capital headroom exists via the Capital Expenditure Reserve and Capital Receipts Reserve and can be used to meet the costs of new schemes or the increasing costs of existing schemes.

10. The proposed programme for the period covering 2024/25 to 2028/29 largely comprises ongoing or previously approved schemes, including slippage from 2023/24, as well as annual sums for activities such as asset maintenance and fleet renewal. However, whilst the current programme only includes a limited amount of approved borrowing headroom, the new programme does, indicatively, reflect the potential for new borrowing capacity from 2027/28 onwards, amounting to £7m per year. These new allocations will only be approved closer to the years in question, once it is clear that they are affordable, prudent and sustainable. However, their inclusion does allow for some preliminary planning to take place around potential future schemes. Because of the high level of slippage forecasted in 2023/24, it means that the new programme will still be significant in scale and, because of this, remains a challenge in terms of deliverability.

11. The proposed programme is set out in the table that follows. It shows a total programme of £125.6m, comprising annual sums of £30.5m and ongoing schemes totalling £80.0m. Borrowing headroom stands at £15.057m, comprising £57k of unallocated existing headroom, £1m of existing headroom that is ringfenced specifically in relation to the Council's Levelling Up bid and £14m of indicative future borrowing. Significant schemes included within the proposed programme include the completion of the Council's Sustainable Communities for Learning Band B programme, the new leisure and wellbeing

provision, the Transporter Bridge refurbishment and the Council's contribution towards the Cardiff Capital Region City Deal (CCRCD). The total value of the programme in 2024/25 stands at £66.2m, which is significantly more than has been spent in previous years and could be a challenge to deliver without any slippage occurring. It should be noted that the Council will be required to meet CCRCD beyond 2028/29. These previously approved commitments will represent the first call upon any new borrowing capacity.

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

	5-YEAR CAPITAL PROGRAMME					Total programme
	2024/25 Budget £m	2025/26 Indicative £m	2026/27 Indicative £m	2027/28 Indicative £m	2028/29 Indicative £m	£m
Annual Sums	7.4	5.8	5.8	5.8	5.8	**30.5**
Ongoing Schemes	58.7	17.2	2.9	0.0	1.1	**80.0**
Uncommitted borrowing*	0.0	1.1	0.0	7.0	7.0	**15.1**
TOTAL EXPENDITURE	**66.2**	**24.1**	**8.7**	**12.8**	**13.9**	**125.6**

Affordable borrowing limit

12. Capital Expenditure funded by debt increases the need to undertake external borrowing, unless it is possible to bridge this need via 'internal borrowing', which is the use of existing cash resources which are underpinned by the overall level of earmarked reserves. As the capacity to internally borrow reduces, as reserves are utilised as intended, the need for external borrowing increases. This is particularly the case for this Council, which has had a high level of internal borrowing in the past, but is now seeing that capacity reducing over the medium-long term. Because of this, coupled with an increased level of unfunded capital expenditure, the Council is committed to be a net borrower for the long term. To ensure this borrowing is affordable and sustainable, Council is required to set an affordable borrowing limit each year.

13. The affordable borrowing limit, also termed the 'Authorised Limit' for external debt, is the absolute maximum amount of borrowing that can be undertaken, in order to manage the overall, day to day, cash requirements of the Council. It also allows for a level of borrowing in advance of need to be undertaken, where appropriate and affordable. In addition, the Council needs to set an 'Operational Boundary', which is the expected level of borrowing required to finance the current Capital Programme. Any increase required to the Operational Boundary needs to be approved by full Council.

Table 2: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2023/24 limit	2024/25 limit	2025/26 limit	2026/27 limit
Authorised limit – borrowing	246	251	248	238
Authorised limit – PFI and leases	39	51	49	47
Authorised limit – total external debt	**285**	**302**	**297**	**285**
Operational boundary – borrowing	150	157	161	155
Operational boundary – PFI and leases	39	51	49	47
Operational boundary – total external debt	**189**	**208**	**210**	**202**

14. Over the medium term, it is anticipated that the level of borrowing required to facilitate the capital programme will be substantial. As outlined in Table 2, it is projected that long-term borrowing will reach £161m, excluding PFIs, compared with the £135.6m that is currently held. It can also be seen that there is a significant difference between the Authorised Limit and the Operational Boundary. This is because of the level of internal borrowing available, underpinned by the level of cash backed reserves, which have increased significantly over recent years. However, the level of reserves will reduce over the medium-long term, in particular the PFI reserves, and, therefore, it will become necessary to undertake external borrowing in lieu of this reducing capacity. This will have a revenue impact because of the interest costs that will be incurred as a result of the external borrowing, compared to the lower cost of internal borrowing, which, in essence, is represented by interest income foregone.

15. It should be noted that the two limits described above only place a theoretical limit on borrowing that can be undertaken to fund new capital expenditure. This is particularly relevant where there is evidence of slippage occurring across the programme. As a consequence, in theory, additional borrowing could be undertaken over and above that budgeted in the existing Capital Programme, because the slippage means that the operational boundary, for example, would not be reached. This would present a risk that, ultimately, the cumulative level of borrowing could exceed that which is deemed affordable. Therefore, to ensure a measure of control on borrowing undertaken to fund new capital expenditure, a local indicator was introduced for 2022/23, which is directly linked to the level of borrowing headroom within the Capital Programme. The limit amounts to only £1.057m in 2024/25, with only £57,000 not earmarked already, and will apply until the new borrowing headroom is formally agreed.

16. The commitment to increase external borrowing leads to increasing capital financing costs. Because the financial impact of the current borrowing commitments was funded up front in the 2021/22 revenue budget, the existing revenue budget is already sufficient. The current and planned future budgets are set out in Table 3, below. The table also shows the value of capital financing costs as a proportion of the total revenue budget. The percentages quoted are lower than in previous years, largely because of the capital financing budgets remaining stable at a time when the overall revenue budget is increasing, due to funding increases to cover pressures in key services. There remains uncertainty regarding local authority settlements beyond 2024/25 and, therefore, affordability of new borrowing and corresponding capital financing increases could remain a challenge.

Table 3: Capital Financing Budgets

	2024/25 budget	**2025/26 budget**	**2026/27 budget**	**2027/28 budget**	**2028/29 budget**
Provision for repayment of debt (MRP)*	10.0	10.8	10.8	10.8	10.8
Net interest cost	6.9	7.0	7.0	7.0	7.0
Total capital financing (exc PFI)	**16.9**	**17.8**	**17.8**	**17.8**	**17.8**
PFI & Leases	6.5	6.5	6.7	6.7	6.7
Total Financing costs* (£m)	**23.4**	**24.3**	**24.5**	**24.5**	**24.5**
Proportion of net revenue stream	5.9%	6.0%	6.0%	6.0%	6.0%

*includes charges direct to service areas

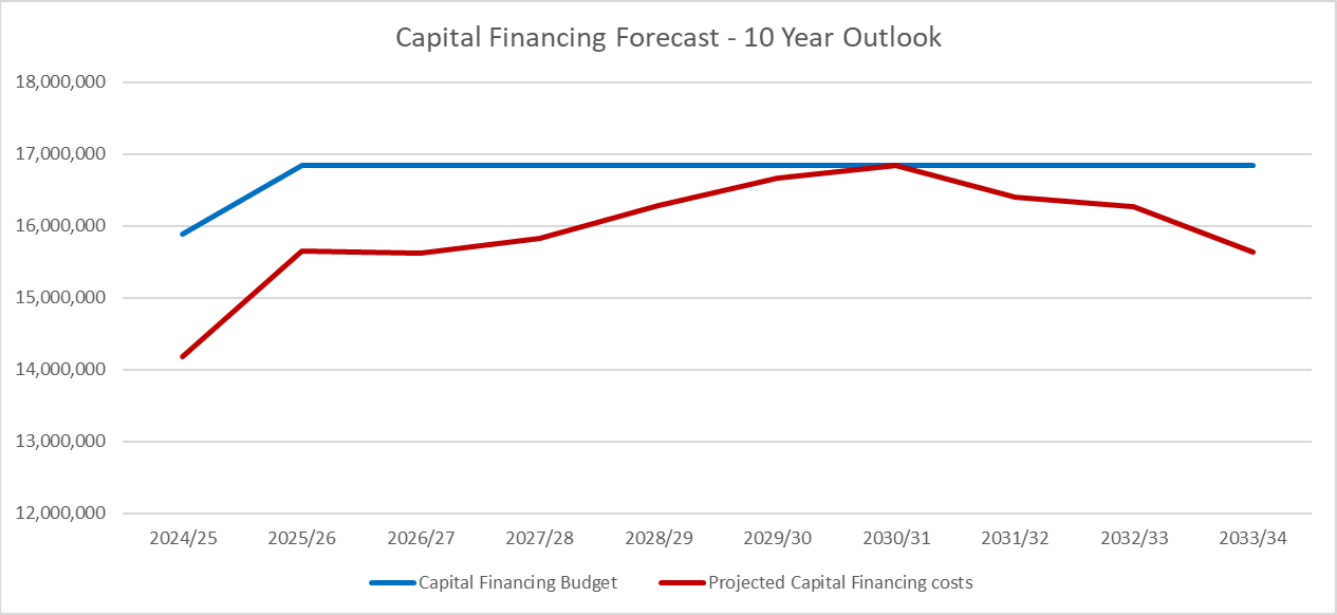
Longer term outlook

17. As well as considering the medium-term outlook, there is a need to look beyond this timeframe. This is particularly relevant when considering the long-term implications that capital financing decisions have. As outlined earlier, the overriding objective is to ensure that capital expenditure plans are affordable, prudent and sustainable, requiring a limit to be placed upon debt funded capital expenditure over that period. When looking longer term, the following points will need to be considered:

    - the high level of forecast borrowing and corresponding higher level of capital financing cost over the next few years.
    - the anticipated reduction in reserves and consequent capacity to be internally borrowed, requiring a continuing increase in external borrowing to replace it.
    - the need to refinance existing maturing borrowing, which could incur a higher interest cost than currently being incurred.
    - the Council's methodology for charging MRP, which realised a budget saving when changed in recent years, but which increases the charge each year from that point and will continue to do so going forward.
    - the challenging medium-term outlook driven by inflationary pressures, increasing demand for services and external funding constraints.

18. In light of the points above, the proposed programme does not include any provision for new borrowing in the short to medium term. However, at the point at which the existing new borrowing commitments subside (2027/28 onwards), indicative new borrowing capacity totalling £7m per year is included. It is important to note that these allocations will remain indicative until the point at which there is comfort that such commitments would meet the test of being affordable, prudent and sustainable, which would not be possible until closer to the years in question. Current assumptions and calculations would suggest that new borrowing from 2027/28 would be affordable and this is demonstrated in the graph that follows. As well as this, it would also achieve the aim of stabilising the Capital Financing Requirement and reducing it over a sustained period of time.

    Chart 1: Capital Financing Cost Forecast, excluding PFI



19. The above graph demonstrates the impact that the existing programme, coupled with new indicative borrowing capacity from 2027/28, has on the capital financing requirements, denoted by the sharp increase in costs over the short term. Beyond that, there is a levelling off before a more gradual

increase over the middle years. There is then a drop-off, largely because of some current significant MRP commitments coming to an end. Whilst this could, theoretically, release budget to allow further borrowing to be undertaken, it wouldn't necessarily achieve the aim of stabilising the underlying need to borrow (CFR). Alternatively, any headroom created within the capital financing budget could be released as a budget saving for the purposes of assisting with balancing the revenue budget at that point in time.

Accountability and Responsibility for delivery of the Capital Programme

20. As outlined in the main strategy report, and capital monitoring reports throughout recent years, there has been a general challenge in relation to slippage. A part of this was caused by the COVID-19 pandemic, which led to delays in scheme delivery, amongst other challenges. However, there are also instances of other issues, such as overly optimistic profiling and a degree of placeholding each time a new programme is developed, which have had an impact. As a consequence of slippage, there is a risk that revenue budget is provided in advance of need and external borrowing is undertaken before required. This is an issue that has been recognised as needing addressing and, as a result, the Council has taken steps to introduce new governance arrangements with the aim of ensuring closer management and oversight of the Capital Programme.

21. To address this issue, a new Capital Assurance Group has been introduced, comprising senior management representatives and senior finance officers. This group provides assurance to the Council's Executive Board and, ultimately, Cabinet. It has a remit to scrutinise progress in scheme delivery and hold Heads of Service and Project Managers to account for the schemes for which they are responsible. The introduction of this group has not diminished the responsibilities of Cabinet, who remain responsible for approving the overall programme and subsequent additions and amendments, but should improve internal control and reduce the scale of slippage experienced in recent years. In addition, the group is responsible for reviewing new bids for capital resources, whether that be internal or external resources. By introducing this additional step in the process for securing capital resources, it is intended to ensure that only those schemes with a realistic prospect of being delivered, both within budget and timeframe, are added to the capital programme. This should result in a more manageable programme and, again, reduce the instances of slippage and overspending.

Treasury Management Strategy

22. The Council's detailed Treasury Management Strategy for 2024/25 and beyond is included as Appendix 3, as are the various treasury management indicators. Key points of interest are summarised below.

Borrowing Strategy

23. As outlined in earlier sections of this report, the Council is committed to being a net borrower over the life of the proposed Capital Programme. In particular, a significant increase in the need to borrow is being projected to the 2025/26 financial year. However, the Council's preferred strategy is to maximise the level of internal borrowing, facilitated by the level of cash-backed earmarked reserves held. Therefore, whilst the overall Capital Financing Requirement is set to increase, the need to undertake new borrowing will be deferred for as long as possible.

24. However, the capacity to internally borrow is planned to reduce over the medium to long term. In addition, some existing sizeable loans are due to mature within the next two years. These two factors, will mean that some new borrowing will be required simply to maintain the status quo, before considering any overall increase in the CFR. As well as this, in light of the Council's position as a committed long-term borrower, the decision could be taken to undertake borrowing in advance of need. This would only be done in consultation with the Council's treasury advisors and where it was felt to be appropriate, and affordable, in order to mitigate against future interest rate rises. This is especially

relevant considering the known need to refinance existing loans by the end of 2024/25 and the relatively uncertain interest rate market.

25. When the need to undertake borrowing arises, the Council will need to give consideration as to the time period over which to borrow. The guiding principle will be to achieve a low, but certain cost of finance. This will generally mean long term borrowing, as this can provide certainty for periods of more than 50 years, if desired. However, there is currently little difference between long and short-term borrowing rates and, therefore, with there being potential for long-term borrowing interest rates to reduce over the medium term, the Council could decide to undertake a degree of short-term borrowing as a way of buying time before rates reduce. Also, this would achieve a more balanced borrowing portfolio, but also assist with mitigating the risk of locking into high long-term borrowing rates prior to rates dropping. Again, individual borrowing decisions would only be taken in consultation with the Council's treasury advisors, but also whilst considering the maturity profile of the current borrowing portfolio, as well as overall affordability.

Investment Strategy

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

27. In line with the intention originally outlined in the 2021/22 Capital Strategy, the Council has recently diversified its investment portfolio by investing £10m into a product known as covered bonds. These bonds have been committed to for periods of up to six years and, in doing so, has secured a reasonable yield, when compared to current interest rates, whilst ensuring the highest level of security available. By investing in these bonds, the Council has also ensured that it meets its MIFID II requirements and retains it professional client status for the purpose of accessing external finance. Over and above the minimum £10m investment requirement, the Council will continue to invest any surplus cash balances with secure investors, such as the Debt Management Office and other local authorities, both of which are currently providing competitive rates of return. The detail regarding the approved counterparty list and limits is shown in Appendix 3.

Head of Finance Summary

28. The Council's Capital Strategy, and in particular the Capital Programme itself, are, from a financial perspective, decisions with long term implications and where decisions today 'lock-in' the impact on budgets once projects have progressed and borrowing taken out. As explained in the first part of this report, the core requirement for councils is to make decisions whilst taking into account affordability, prudence and sustainability:

29. In terms of the Council's proposed Capital Programme to 2028/29:

Affordability

- There is a significant increase in the Council's projected level of external borrowing and the associated capital financing costs over the next two to three years, in particular. As has been reported in previous years, adequate revenue budget has been in place since 2021/22 to meet the anticipated costs of the full programme as it was at that point. As no new borrowing headroom has been introduced since then, this remains the case. The current capital programme is therefore affordable, in totality, as a result of this. In addition, based on current assumptions, indicative new borrowing capacity of £7m per year from 2027/28 would also be

affordable from within the planned capital financing budget. This is an important position because the Council has an unbalanced medium term financial position currently, due to high inflation driving up costs and increased demand for services. There is also a risk that funding constraints could arise over the medium term. Having already fully funded the revenue impact of the existing programme means that there is one less pressure on an already challenging outlook.

Prudence

- Prudent operational limits on the level of capital expenditure funded by borrowing have been recommended, which align with the proposed programme requirement and, therefore, the Council's priorities. These operational limits increase over the course of the programme and will result in the Council taking on more debt. Therefore, the Capital Programme needs to be strictly managed within those limits to ensure that the need to externally borrow does not increase and expose the Council to any further risk or interest costs.

Sustainability

- As outlined above, the revenue costs arising from the proposed Capital Programme have been fully funded within the overall revenue budget. Providing that the Council is able to meet the challenge of balancing its budget over the medium term, then the costs of borrowing are sustainable. In addition, current indications suggest that it will be possible to introduce new borrowing capacity from 2027/28. There is, however, a risk to this position, should funding constraints emerge over the medium term, which could present the need for the Council to take steps to balance its budget, one of which may be to review its capital financing budget and potentially scale back its capital programme aspirations. It is for this reason that this new headroom can only be introduced once there is greater certainty around the longer-term affordability of such a commitment.

30. It is recognised that whilst there are financial constraints to work within, there is also a need to invest in the Council's assets. It is therefore important that an appropriate balance is struck between financial restraint and the requirement to maintain and enhance the asset base. Therefore, whilst opportunities to introduce new borrowing capacity will be sought, it is also critical that all opportunities to increase the capital headroom via one-off sums need to be taken when available and potentially prioritised over other emerging pressures. This will assist with mitigating the impact of the maintenance backlogs and potentially avoiding the high-cost impact of asset failure. The absence of significant capital headroom will mean that other funding sources will need to be pursued for any new schemes, as well as maximising the ability to self-fund schemes. The new, strengthened, governance arrangements, will be a crucial part of managing the challenging situation over the medium to long term.

31. The Committee is asked to note the above confirmations and key messages as the Capital and Treasury Management strategies are reviewed, and provide comments to Cabinet and Council, including on the prudential indicators and limits contained within these strategies.

Risks

Risk Title / Description	**Risk Impact score of Risk if it occurs* (H/M/L)**	**Risk Probability of risk occurring (H/M/L)**	**Risk Mitigation Action(s)** What is the Council doing or what has it done to avoid the risk or reduce its effect?	**Risk Owner** Officer(s) responsible for dealing with the risk?
Increased need to borrow beyond	High*	Medium	Regular monitoring and reporting of available headroom should identify any issues at an early stage and	Members, Executive Board, Heads of Service

Risk Title / Description	Risk Impact score of Risk if it occurs* (H/M/L)	Risk Probability of risk occurring (H/M/L)	Risk Mitigation Action(s) What is the Council doing or what has it done to avoid the risk or reduce its effect?	Risk Owner Officer(s) responsible for dealing with the risk?
currently assumed levels.			keep Cabinet / Council updated. A mechanism exists for increasing borrowing limits and this should only be done where affordable, prudent and sustainable.	and Head of Finance.
Undertaking borrowing that is not ultimately required.	High	Low	Regular monitoring of schemes, and strengthened governance arrangements, means that potential for slippage should be identified at an early stage. Continued reprofiling to be undertaken to guard against slippage not being identified. Regular contact with WG regarding potential grant funding, which could negate the need to undertake borrowing.	Executive Board, Heads of Service and Head of Finance.
Investment counterparty not repaying investments.	High*	Low	The Council only invests with institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds/duration available for relatively higher risk investment as measured by credit ratings will also alleviate the risk.	Members, Head of Finance, Treasury staff, based on advice from treasury advisors.
Interest Rates moving adversely against expectations.	Medium*	Medium	The interest rate climate has stabilised compared with the volatility shown over the last 12 months. Interest rate forecasts are regularly received from external treasury advisors and the Council is prudent when forecasting future interest payable. In addition, the Treasury Strategy provides for a balance between short and long-term borrowing as a means of managing this particular risk.	Head of Finance, Treasury staff, based on advice from treasury advisors.

** Impact is ultimately determined by the values involved, with the impact reducing as the values decrease.*

Links to Council Policies and Priorities

The Capital Strategy sets out the Capital Programme over a long-term context and demonstrates that the Capital Programme supports a number of the Council's aims and objectives.

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

To note and provide comment on both the Capital Strategy and the Treasury Management Strategy for 2024/25, including the prudential indicators contained within both documents.

Preferred Option and Why

The committee is asked to note and provide comment and, therefore, there are no alternative options.

Comments of Chief Financial Officer

This report, and the Capital and Treasury Management Strategies appended, both highlight the revenue implications from capital expenditure, and the need for the capital plans of the authority to be affordable, prudent and sustainable. The main financial implications are captured within the report and all appendices. However, it is important to note the following comments.

The Capital Strategy highlights the anticipated increase in borrowing and the revenue costs resulting from the proposed Capital Programme, which is largely comprised of ongoing schemes from the current programme. Whilst the short to medium term increase in borrowing is currently affordable from within the capital financing budget, over the longer-term, a position needs to be reached whereby debt funded capital expenditure is no greater than the annual MRP charge, allowing the CFR to stabilise or, ideally, reduce. This will be a key issue over the medium to long term, mainly due to the challenging financial outlook being faced by the Council. At a time when demand for revenue resources is high, due to rising costs and demand for services, it will be important that demand for capital financing is proportionate and, ideally, kept to a minimum.

The strategy includes indicative allocations of new borrowing capacity from 2027/28 onwards. Whilst this would currently appear to be affordable, based on current assumptions, it is important to note that this is included for indicative purposes only. Only once there is greater certainty regarding the affordability and sustainability of such a commitment can this be approved. However, it is also recognised that there is a pressing need for new capital resources and, therefore, an appropriate balance will need to be struck between prudence and investment. Because of this demand for capital resources, it will be vital that opportunities to increase capital headroom are taken and that issues surrounding asset maintenance are prioritised. This will assist the Council with being able to react to emerging needs and mitigate the chance of asset failure.

The Treasury Management Strategy confirms that there is a long-term net borrowing commitment, but also a short-term refinancing requirement due to loans maturing over the coming financial year. It is almost certain, therefore, that the Council will need to take on new external borrowing during the year. Consideration will be given as to whether this can be done early, to mitigate the risk of interest rate rises and remain within current set budgets. As ever, such decisions will be taken in light of advice received from the Council's treasury advisors and with the aim of securing a low but certain cost of finance.

Comments of Monitoring Officer

There are no specific legal issues arising from the report. The Capital Strategy will provide a framework for future capital and investment decisions, having regard to principles of affordability, prudence,

sustainability and risk/reward. The Treasury Management Strategy sets out the financial management principles that will underpin the Capital Strategy. As such, both strategies will form part of the Council's overall budget framework and are required to be formally approved and adopted by full Council. Governance & Audit Committee have been asked to comment on the draft Capital Strategy and Treasury Management Strategy as part of its responsibility for reviewing and monitoring the effectiveness of the Council's system of internal controls and the proper administration of its financial affairs.

Comments of Head of People, Policy & Transformation

The Capital Strategy described within this report is considerate of, and meets the requirements of, the Wellbeing of Future Generations Act with a focus on long term planning and sustainability as part of the sustainable development principle. The Fairness and Equality Assessment completed and summarised below reinforces this element, along with the broadly positive/neutral impacts on protected groups.

Financial governance is a vital part of meeting the sustainable development principle and corporate objectives and it is noted that in light of scarce capital resources, despite demand for them, the Council has taken steps to strengthen governance, by introducing a Capital Assurance Group (CAG).

The report supports the Corporate Plan objectives which are ambitious and focused on working collaboratively with our staff, residents, and partners to improve service delivery across the city whilst supporting other related plans and strategies.

There are no direct human resources implications, however as the Council works towards the Corporate Plan and Capital Strategy, it will be necessary to consider the workforce requirements needed to achieve the objectives as set out. Any staffing impact will be considered, and consultation will take place as and when necessary.

Scrutiny Committees

N/A

Fairness and Equality Impact Assessment:

- **Wellbeing of Future Generation (Wales) Act**
- **Equality Act 2010**
- **Socio-economic Duty**
- **Welsh Language (Wales) Measure 2011**

The Council has a number of legislative responsibilities to assess the impact of any strategic decision, proposal or policy on people that may experience disadvantage or inequality. In relation to this strategy document, a Fairness and Equality Impact Assessment has been undertaken. The FEIA has been undertaken in light of this strategy being an overarching financial strategy, rather than a policy decision relating to one specific initiative or service. Therefore, there are elements to the assessment that don't lend themselves to this particular strategy. It should also be noted that there is a clear link between this strategy and the Council's revenue budget setting process, with the ultimate impact of debt-funded capital expenditure being felt within the revenue budget. Therefore, any consultation required will have been undertaken as part of the revenue budget setting process. Also, specific schemes within the Capital Programme will have been subject to an FEIA, where relevant.

The main conclusions to be drawn from the FEIA undertaken is that there is a clear link between the long-term nature of the Capital Strategy and the sustainable development principle of the Wellbeing of Future Generations Act. This is evidenced through the focus on ensuring affordability, prudence and, most relevantly, sustainability. Therefore, there is potentially a positive impact from the perspective of the younger age groups. In the case of the other protected characteristics, it is not felt that there is a specific impact, however this may not necessarily be the case for the individual schemes within the programme, which should have been subject to separate FEIAs. However, there are a variety of schemes within the

programme that will, collectively, have had a positive impact upon groups with protected characteristics such as disability, language preference and socio-economic background.

Consultation

N/A

Background Papers

Report on Treasury Management for the period to 30 September 2023
Capital Monitoring and Additions Report – November 2023

Dated: 18th January 2024

Appendix 1 – Detailed breakdown of the proposed Capital Programme (excluding borrowing headroom) (£000)

	Budget 2024/25 (including slippage)	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Indicative Budget 2028/29	Total
Annual Sums:						
People, Policy & Transformation:						
Asset Maintenance (including schools)	1,371	1,500	1,500	1,500	1,500	7,371
IT Replacement Schemes	289	202	150	150	150	940
Prevention & Inclusion:						
Disabled Facilities Grants	1,153	1,000	1,000	1,000	1,000	5,153
Safety at Home	283	300	300	300	300	1,483
Social Services:						
Disabled Equipment (GWICES)	165	165	165	165	165	825
Telecare	62	30	30	30	30	182
Infrastructure:						
Fleet Replacement	2,663	2,141	2,141	2,141	2,141	11,227
Highways Asset Maintenance	1,432	500	500	500	500	3,432
Annual Sums Total	**7,418**	**5,838**	**5,786**	**5,786**	**5,786**	**30,614**
Ongoing and Previously Approved Schemes:						
Education:						
Sustainable Communities for Learning - Band B	15,373	9,185	1,939	0	0	26,496
Welsh Medium Primary School (Pillgwenlly / Nant Gwenlli)	1,286	2,659	0	0	0	3,944
Pentrepoeth Primary School Accessibility Works	8	0	0	0	0	8
St Mary's Primary School	4,759	0	0	0	0	4,759
Education Maintenance Grant 2020/21	558	0	0	0	0	558
Education Maintenance Grant 2022/23	372	0	0	0	0	372
Capital Maintenance and Energy Works across the school estate	350	0	0	0	0	350
Education Accessibility Works - Phase 2	609	0	0	0	0	609

	Budget 2024/25 (including slippage)	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Indicative Budget 2028/29	Total
Millbrook Primary School Demolition	550	0	0	0	0	550
Ysgol Gwent Is Coed Sports Hall	3,284	0	0	0	0	3,284
Education Total	**27,149**	**11,843**	**1,939**	**0**	**0**	**40,931**
Environment & Public Protection:						
Refit	226	0	0	0	0	226
Local Places for Nature	467	0	0	0	0	467
Parks Improvements	635	0	0	0	0	635
Cemeteries Improvements	275	0	0	0	0	275
Community Building Decarbonisation	250	0	0	0	0	250
Mon & Brecon Canal Works (SPF scheme)	994	0	0	0	0	994
Tredegar Park (SPF scheme)	1,665	0	0	0	0	1,665
Environment & Public Protection Total	**4,512**	**0**	**0**	**0**	**0**	**4,512**
Housing & Communities:						
Food Resilience Programme (SPF scheme)	60	0	0	0	0	60
Housing & Communities Total	**60**	**0**	**0**	**0**	**0**	**60**
Infrastructure:						
Carnegie Court Emergency River Works	19	0	0	0	0	19
Placemaking Capital Projects (Hostile Vehicle Mitigation)	962	0	0	0	0	962
Herbert Road Highway Works	88	0	0	0	0	88
Infrastructure Total	**1,070**	**0**	**0**	**0**	**0**	**1,070**
People, Policy & Transformation:						
Central Library Structural Works	490	0	0	0	0	490
People, Policy & Transformation Total	**490**	**0**	**0**	**0**	**0**	**490**

	Budget 2024/25 (including slippage)	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Indicative Budget 2028/29	Total
Regeneration & Economic Development:						
Cardiff Capital Region City Deal – NCC Contribution	1,238	1,294	978	0	1,078	4,588
Mill Street Loan	261	0	0	0	0	261
Clarence House Loan	202	0	0	0	0	202
Transforming Towns	332	0	0	0	0	332
Transporter Bridge	5,651	0	0	0	0	5,651
Placemaking Capital Projects (Lighting Strategy)	500	0	0	0	0	500
New Leisure Centre	12,458	4,086	0	0	0	16,543
Newport Museum & Art Gallery	39	0	0	0	0	39
Regeneration SPF Schemes	4,093	0	0	0	0	4,093
Regeneration & Economic Development Total	**24,774**	**5,380**	**978**	**0**	**0**	**32,210**
Social Services:						
Cambridge House	681	0	0	0	0	681
Social Services Total	**681**	**0**	**0**	**0**	**0**	**681**
Total Capital Programme	**66,154**	**23,061**	**8,703**	**5,786**	**6,864**	**110,567**

	Budget 2024/25 (including slippage)	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Indicative Budget 2028/29	Total
Financed by:						
General Capital Grant	4,286	4,286	4,286	4,286	4,286	21,430
Supported Borrowing	4,160	4,160	22	0	0	8,342
Unsupported Borrowing	11,179	1,863	978	0	1,078	16,155
External Grants	35,219	9,189	650	0	0	45,058
S106	701	2,062	0	0	0	2,763

	Budget 2024/25 (including slippage)	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Indicative Budget 2028/29	Total
Other Contribution	276	0	0	0	0	276
Capital Receipts	2,461	0	0	0	0	2,461
Revenue Contribution	1,542	1,500	1,500	1,500	1,500	7,542
Reserves	6,329	0	1,267	0	0	7,596
Total Capital Programme Financing	**66,154**	**23,061**	**8,703**	**5,786**	**6,864**	**110,567**

Appendix 2

NEWPORT CITY COUNCIL
CAPITAL STRATEGY
2024/25 TO 2033/34

CONTENTS

EXECUTIVE SUMMARY

This Capital Strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services, along with an overview of how associated risk is managed and a summary of the implications for future financial sustainability.

Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and local policy framework, summarised in this report.

The report highlights that expenditure on capital needs to remain within affordable, prudent and sustainable limits. Demand for capital resources remains high and therefore, inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners are required to address this.

The strategy highlights the key risks and recommendations:

- The Council's new rolling capital programme, a large proportion of which relates to ongoing and previously approved schemes, requires a substantial amount of borrowing to 2025/26, in particular. Whilst this is affordable, due to the revenue budget requirement being forward funded in the 2021/22 budget, it is necessary to exercise caution in introducing new borrowing capacity thereafter, especially given the current economic climate and pressures upon the Council's revenue budget.

- The Council's Medium Term Financial Plan does not reflect any provision for new borrowing over and above that already funded within the existing revenue budget. Therefore, any new borrowing capacity, which is indicatively included in the Capital Programme from 2027/28, needs to be afforded from within the existing capital financing budget. This position will be kept under review as certainty regarding the medium-term outlook increases.

- As per the agreed framework (detailed in the report), the programme needs to be maintained within the agreed limits and not result in a medium-term increase in the Capital Financing Requirement. This is to be achieved by limiting new borrowing capacity to that affordable from within existing revenue resources. Any required increase in the level of capital expenditure to be specifically funded by borrowing would need approval by full Council.

- Due to the pressure for additional capital resources, partly driven by the need for investment in existing assets (e.g. buildings and highways), there is a requirement to supplement the capital headroom with one-off resources, wherever possible. To achieve this, consideration should be given to using any revenue underspends over the medium term for increasing the capital headroom, as well as a focussing on generating additional capital receipts, via the Council's Asset Programme.

- The pressure upon the Capital Programme and the historic challenges in relation to programme delivery and slippage, necessitates the need for clear, robust, governance structures around the programme. This requirement has been addressed by the introduction of the Capital Assurance Group, which is responsible for holding Heads of Service and their project managers to account for capital project delivery, as well as acting as a gateway for all new capital bids.

- The prudential indicators, including borrowing limits, are in line with the Council's agreed Medium Term Financial Plan.

The strategy will be reviewed and updated on an annual basis alongside the Treasury Management Strategy.

OVERVIEW OF THE STRATEGY

1.1. INTRODUCTION

Capital expenditure can be defined as expenditure on assets, such as property or vehicles, that will be used for more than one year. In local government, this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to acquire assets. It is the Council's policy not to treat any expenditure under £10,000 as capital, and therefore anything under this value will be charged as revenue in the year of expenditure.

The Prudential Code for Capital Finance in Local Authorities (2017) placed a requirement on local authorities to determine a Capital Strategy, in order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives, and properly takes account of stewardship, value for money, prudence, sustainability and affordability.

This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services, along with an overview of how associated risk is managed and the implications for future financial sustainability.

Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and a local policy framework, summarised in this report.

The report sets out:

- The key objectives outlined in the Prudential Code and the governance arrangements for the Capital Strategy and programme, including the move towards a rolling approach to programme development and management (Section 2)

- The proposed capital programme to 2028/29, its financing, and the revenue implications arising from demands on capital expenditure (Section 3)

- The long-term (10 year) projection for the capital financing costs of the Council and where future demands arise from the various strategic plans across the Council for further capital resources. (Section 4)

- Links between the Capital Strategy and Treasury Management strategy, and treasury decision making. (Section 5)

- The commercial activity of the Council and the strategy going forward. (Section 6)

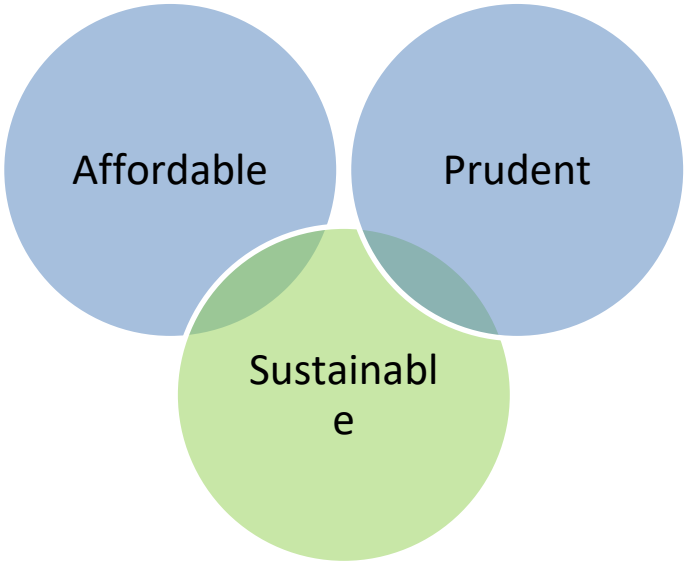
- Overview of other long-term liabilities the Council has, which members need to be aware of when looking at the Capital Strategy. (Section 7)

- Summary of the skills and knowledge the Council holds in order for it to carry out its duties for capital and treasury matters. (Section 8)

2. PRUDENTIAL CODE & GOVERNANCE

2.1. PRUDENTIAL CODE – KEY OBJECTIVES

The objective of the Prudential Code is to ensure, within a clear framework, that the Council's capital expenditure is affordable and prudent. In terms of both affordability and prudence, it is important that sustainability is considered and can be demonstrated;



AFFORDABLE

It is important that the Council's capital investment remains within **sustainable** limits. The Code requires authorities to consider the resources currently available to them and those estimated to be available in the future, together with the totality of the capital plans and income and expenditure forecasts. As well as capital expenditure plans, authorities should consider the cost of past borrowing, ongoing and future maintenance requirements, planned asset disposals and the MRP policy, which all impact upon affordability.

PRUDENT

The Council must ensure that its capital and investment plans are prudent and **sustainable**. As required by the Code, consideration should be given to the arrangements for the repayment of debt and the risk and impact on overall financial **sustainability**. The operational boundary for external debt should align with capital expenditure plans and provide for the most likely, not worse case, scenario. The authorised limit should provide sufficient borrowing headroom to enable day to day cash management. It is important that there is alignment with the treasury management policy statement and practices, and that risk management and analysis is taken into account. Borrowing in advance of need should only be undertaken where appropriate and affordable, and treasury management activities should find a balance between security, liquidity and yield reflecting the Council's risk appetite, but not prioritising yield over security and liquidity.

SUSTAINABLE

As highlighted above, the Council has to ensure sustainability when considering both affordability and prudence. In line with the long-term impact of decisions made in relation to capital investment plans, sustainability is considered over a minimum 10-year period.

In addition, the Council ensures that treasury management decisions are taken in accordance with good professional practice and with the full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation. As part of this, all local authorities are required to have regard to CIPFA's Prudential Code and Treasury Management Code when setting their strategies for the coming financial year.

2.2. GOVERNANCE FOR APPROVAL AND MONITORING OF CAPITAL EXPENDITURE

Member responsibility for strategic finance rests with the Cabinet Member for Economic Growth and Strategic Investment, currently the Leader of the Council. The main governance and approval process for capital expenditure is summarised as follows:

- Council approves the overall revenue and capital budgets following recommendations from the Cabinet. As part of this, Council approves the external borrowing limits, which place a cap on the level of borrowing the Council can undertake during the year. These limits are based around the level of unfunded capital expenditure, including uncommitted expenditure, within the capital programme. The limits will not include expenditure on any schemes where borrowing is required, but which finance themselves through the savings generated. These limits are a key performance indicator for treasury management and ensure that capital expenditure is limited and borrowing remains affordable. Any changes required to the borrowing limits must be approved by full Council.
- Council approves the Treasury Management Strategy, which is intrinsically linked to capital expenditure and the Capital Strategy. Further details of this are provided in section 5.
- The detailed capital programme, contained within the overall budget, is approved by Cabinet following individual project appraisals by officers, which include the views of the Head of Finance and the Capital Assurance Group.
- Items of capital nature are discussed at the Strategic Asset Management Group (SAMG), which is made up of senior officers from all service areas and the Council's property advisors, Newport Norse. Discussions centre on the asset management agenda and asset disposals. Other boards with capital considerations include the Education Service Capital Board.
- The Capital Assurance Group maintains oversight of the overall programme and holds individual services to account for the delivery of their schemes. In addition, the group acts as a gateway for all new capital bids, prior to formal approval being sought from Cabinet.
- Cabinet approves any new capital expenditure to be added to the capital programme, including that funded from external resources, such as specific grants. This will follow an initial review by the Capital Assurance Group of any new bids or requests for capital resources. Cabinet also approves any utilisation of the Council's capital headroom.
- Monitoring of Capital Expenditure is reported to Cabinet, including updates on capital receipts and the impact on the revenue budget of decisions made. Cabinet also approves the transfer of slippage from one financial year to the next.

Affordability and sustainability are key considerations when approving capital expenditure, and therefore the agreed framework detailed in section 3.1 is used. Included within Appendix 2a is the process map used for the approval of capital expenditure.

3. CAPITAL EXPENDITURE AND FINANCING

3.1. CURRENT CAPITAL PROGRAMME

The current capital programme covers the five-year period between 2023/24 and 2027/28. As previously agreed, the Council now has a rolling approach to programme development and, therefore, the new iteration of the programme will cover a new five-year period between 2024/25 and 2028/29. Because of the rolling approach, it means that certain schemes or allocations will be shown as indicative only, until the point at which the full funding is in place for the expenditure planned in that respective year (in the case of debt-funded expenditure, this would require the requisite capital financing budget to be in place).

Given the financial constraints that the Council has faced in recent years, and continues to face, Cabinet and Council established a framework for managing the programme, aimed at maximising capital expenditure but keeping new borrowing at a level that could be afforded within a sustainable revenue budget and, in doing so, not adding unnecessary pressure to the medium-term outlook. This framework is as follows:

a. Funding from sources other than borrowing needs to be maximised; for example, by securing grant funding whenever possible and maximising capital receipts;

b. Any change and efficiency schemes requiring capital expenditure, and generating savings as a consequence, would be funded by offsetting the capital financing costs against the savings achieved;

c. Schemes and projects which generate new sources of income would need to fund any capital expenditure associated with those schemes.

This framework ensures that the programme can be maximised but those schemes which cannot fund any resulting borrowing costs can be afforded and maximised within any capital headroom available. This available headroom is made up of residual borrowing headroom agreed within the previous programme and identified uncommitted capital reserves and capital receipts. The proposed programme indicatively includes new borrowing headroom from 2027/28 onwards, however this will not form part of the headroom until it is possible to formally approve this, once there is greater certainty regarding its affordability.

Because new headroom is not likely to be introduced until nearer the end of the five-year window, the proposed programme, in the first few years at least, will be made up of recurring annual sums, ongoing schemes and those schemes previously approved and funded, but not yet started. Any new schemes required will need to be financed in line with the above framework, or via the capital headroom. The current level of headroom is relatively limited and, as a consequence, it will be necessary to top-up the capital headroom whenever possible, using one-off resources. These one-off resources may include repurposing of existing earmarked reserves, future capital receipts and any underspends against the overall revenue budget.

The proposed new capital programme is summarised in the table below. For 2024/25, the programme contains approved capital schemes of £66.2m, and the overall programme to 2028/29, including uncommitted borrowing, is £125.6m. This total figure includes £1.1m of uncommitted borrowing headroom which is formally part of the capital headroom, (of which only £57,000 is not earmarked for specific schemes), plus £14m of indicative new borrowing headroom from 2027/28.

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

	5-YEAR CAPITAL PROGRAMME					Total programme
	2024/25 Budget £m	2025/26 Indicative £m	2026/27 Indicative £m	2027/28 Indicative £m	2028/29 Indicative £m	£m
Annual Sums	7.4	5.8	5.8	5.8	5.8	**30.5**
Ongoing Schemes	58.7	17.2	2.9	0.0	1.1	**80.0**
Uncommitted borrowing*	0.0	1.1	0.0	7.0	7.0	**15.1**
TOTAL EXPENDITURE	**66.2**	**24.1**	**8.7**	**12.8**	**13.9**	**125.6**

** Uncommitted borrowing headroom to be invested in Council assets or regeneration.*

The proposed capital programme, including previously approved schemes, is large and leads to a sizeable increase in the Capital Financing Requirement (CFR) over the medium term. As a result, there is a consequential increase in capital financing costs. As part of the overall 2021/22 Council budget, a £2.1m investment in the capital financing budget was made in order to provide for the revenue costs arising from the full capital programme. By committing these resources in advance, it means that no additional investment is required over the medium term to meet these costs. In addition, current indications suggest that the capital financing budget over the medium term would be sufficient to enable new borrowing capacity to be introduced towards the end of the five-year window.

As well as providing the necessary coverage for the capital financing costs arising from previously agreed schemes, the forward funding of the capital financing budget has also provided an underspend in recent years. This has been used to offset other service area pressures, but has also contributed to opportunities to bolster the capital headroom. Should there be further slippage over the coming years, it may be possible to add to the headroom further, but this could also present opportunities to accelerate the repayment of historic unfunded capital expenditure, through Voluntary Revenue Provision, which would reduce the ongoing MRP cost by reducing the overall CFR.

In terms of funding, the WG General Fund Capital Grant in 2024/25 has been provisionally set at £4.286m, which is a marginal increase on the figure from 2023/24. This grant is used to fund the Council's annual sums allocations, which covers activities such as asset maintenance and fleet renewal.

The overall programme contains a number of key capital schemes, some of which will continue beyond the forthcoming 2024/25 financial year. These include:

- Sustainable Communities for Learning Band B Programme
- Transporter Bridge renovation
- Cardiff Capital Region City Deal (CCRCD)
- New Leisure & Wellbeing provision

There may be other requirements for capital funding for schemes that are not yet contained within the overall programme. Any new schemes that arise during the year will either need to be funded via specific funding sources (e.g. external grant) or will represent a call upon the residual headroom available. It is important that capital expenditure remains at an affordable level within the framework agreed and, therefore, prioritisation of capital expenditure is essential so that only the most critical schemes are taken forward.

Regular reviews of previously approved schemes, not yet started, will be undertaken to ensure that they remain affordable. This is especially relevant in the climate of recent high construction inflation and where

capital expenditure is to be funded via borrowing, as there is a risk that the existing revenue budget may be insufficient. It will be expected that all necessary steps will be taken to ensure that existing budgets can be kept within, including reducing scope, seeking alternative funding sources and mitigating within a wider programme. As a last resort, consideration as to whether a scheme can still proceed will be required.

3.2. MEDIUM-TERM REVENUE IMPLICATIONS OF CAPITAL (CAPITAL FINANCING)

All capital expenditure must be financed, either from external sources, the Council's own available resources or debt (borrowing, leasing and Private Finance Initiative). All debt has to be repaid and this includes both the actual debt principal plus interest costs. The planned financing of the expenditure shown in Table 1 is as follows:

Table 2: Capital financing in £ millions

	NEW 5-YEAR CAPITAL PROGRAMME					Total new programme
	2024/25 Budget £m	2025/26 Indicative £m	2026/27 Indicative £m	2027/28 Indicative £m	2028/29 Indicative £m	£m
TOTAL EXPENDITURE	**66.2**	**24.1**	**8.7**	**12.8**	**12.8**	**125.6**
Financed by:						
Committed Grants and contributions	40.5	15.5	4.9	4.3	4.3	**69.5**
Committed Reserves, capital receipts, revenue	10.3	1.5	2.8	1.5	1.5	**17.6**
Committed new borrowing	15.3	6.0	1.0	0.0	1.1	**23.5**
TOTAL COMMITTED (Appendix 1)	**66.2**	**23.0**	**8.7**	**5.8**	**6.9**	**110.6**
Uncommitted borrowing	0.0	1.1	0.0	7.0	7.0	**15.1**
TOTAL UNCOMMITTED	**0.0**	**1.1**	**0.0**	**7.0**	**7.0**	**15.1**
TOTAL FINANCING	**66.2**	**24.1**	**8.7**	**12.8**	**13.9**	**125.6**

As outlined previously, when capital expenditure is initially financed by debt/borrowing, the Council is locked into a long-term revenue commitment to finance that expenditure over time. This financing is done via a mechanism known as the Minimum Revenue Provision (MRP). The available budget for MRP payments over the medium term (excluding PFI and leases and including where service areas are making contributions towards the capital financing costs of invest to save schemes) are as follows:

Table 3: Replacement of debt finance (MRP) in £ millions

	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	2028/29 Budget
MRP budget*	10.0	10.8	10.8	10.8	10.8

**It should be noted that the MRP budget has been temporarily used in both 2023/24 and 2024/25 to supplement annual sums allocations, however the budget will be returned to its full value by 2025/26. In addition, there are planned transfers of budget from service area budgets to the MRP budget, in relation to the Council's new Leisure and Wellbeing provision.*

The Council's full MRP Policy is available within the Treasury Management Strategy, which will be approved alongside this Capital Strategy.

Although capital expenditure is not charged directly to the revenue budget, as discussed above, interest payable on loans and MRP (the "financing costs") are charged to revenue. The table below shows the financing costs as a percentage of the Council's net budget, which is one of the required prudential indicators.

Table 4: Prudential Indicator: Proportion of financing costs to net revenue stream

	2024/25 budget	**2025/26 budget**	**2026/27 budget**
Financing costs* (£m)	23.4	24.3	24.5
Proportion of net revenue stream	5.9%	6.0%	6.0%

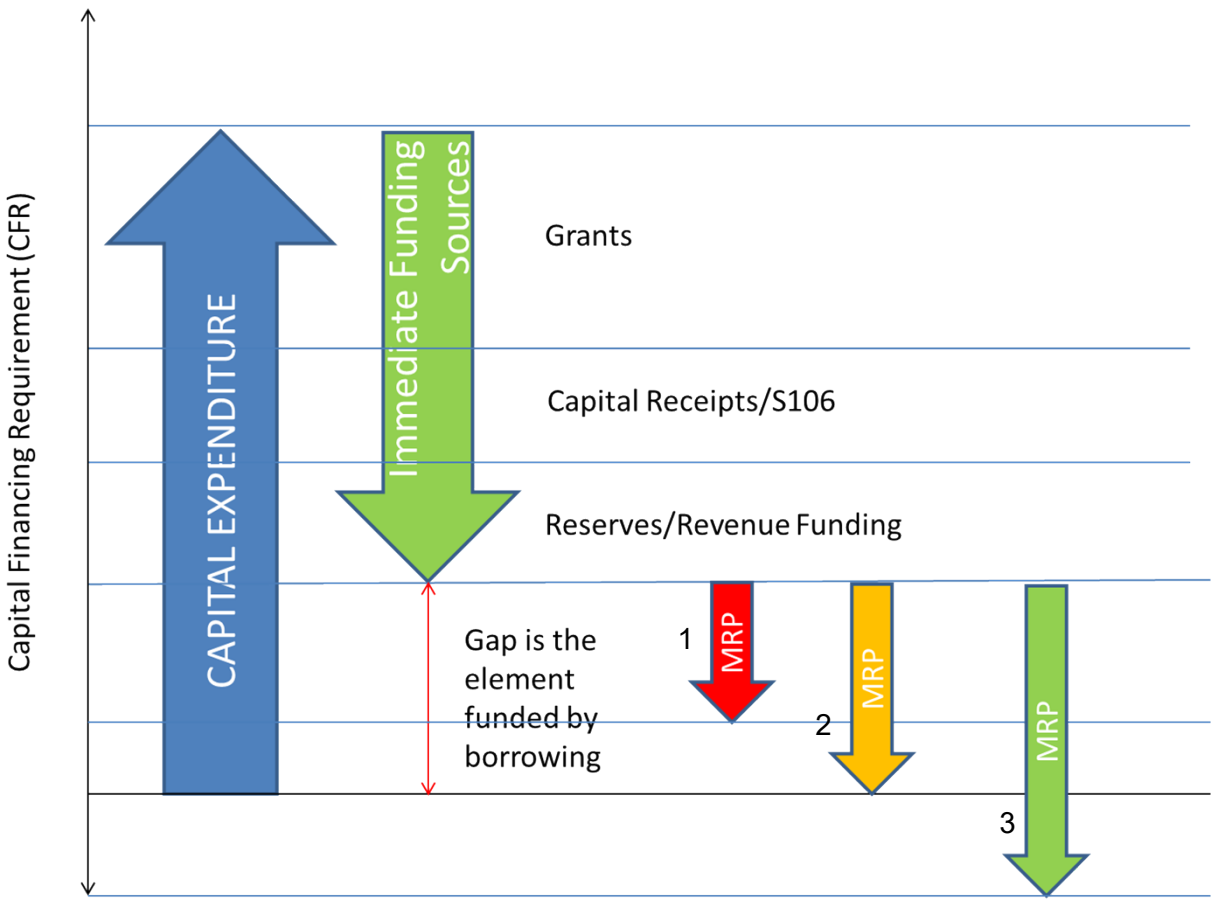
*includes capital financing costs of PFIs and leases

From the table above it is evident that the proportion of the budget set aside to finance capital expenditure is set to stay broadly level over the medium-term. This is largely because the Council's current Medium Term Financial Plan is predicated on an assumption that public sector funding will broadly flatline over the forthcoming years. Any increases in funding, through assumed Council Tax increases predominantly, are anticipated to be matched, or exceeded, by the aforementioned planned increases in the capital financing budget.

- Information on the revenue implications of capital expenditure is also included in the 2024/25 revenue budget report.

Capital Financing Requirement (the underlying need to borrow)

The Council's cumulative outstanding amount of debt finance is measured by CFR. This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The diagram below shows the impact of capital expenditure, financing and MRP on the CFR:



The diagram above shows the following:

- CFR **increases** when capital expenditure is incurred.
- CFR **decreases** when capital expenditure is immediately financed - i.e., through grants, capital receipts, revenue funding, reserves, S106 income.
- If the MRP charge is **less than** the capital expenditure funded by borrowing in any given year (Red [1]) the net CFR increases
- If the MRP charge is **equal to** the capital expenditure funded by borrowing in any given year (Amber [2]) the net CFR stays the same
- If the MRP charge is **more than** the capital expenditure funded by borrowing in any given year (Green [3]) the net CFR decreases

This is an important concept, as it demonstrates how decisions on the level of capital expenditure and MRP budget impact upon the Council's long-term borrowing requirements and consequent capital financing implications. However, it is important to note that the CFR is only an indicator as to the need to undertake borrowing, with the actual need to borrow ultimately being driven by the overall short and long term cashflow requirements of the organisation.

The table below provides the medium-term outlook for the Council's CFR, inclusive of the impact of PFI arrangements. This is based on the proposed programme, including the indicative new borrowing allocations from 2027/28. As can be seen, the CFR is expected to increase by £7.8m by the end of 2023/24 and then a further £18.6m during 2024/25 to £299.7m, before reducing over the remaining years (it should be noted that £15m of this increase is due to technical accounting considerations arising from the adoption of IFRS16 Leases from 1st April 2024). The anticipated position is higher than previous years, where the figure has generally stayed at around £273m, even after ignoring the impact of IFRS16.

This significant increase in capital expenditure, including that funded via other sources, will be a challenge to achieve, evidenced by the significant levels of slippage incurred during the 2021/22 and 2022/23 financial years. Therefore, it is important to recognise the likelihood that the actual CFR may turn out lower by the end of the 2023/24 financial year, in turn reducing the actual need to undertake external borrowing. This is a significant challenge for the Council, as it is important that ambitions for capital expenditure are not unrealistic, as this can result in unnecessarily committing resources towards the capital financing budget, which may result in other budget priorities not being able to be pursued.

Table 5: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31/03/23 Actual	31/03/24 Forecast	31/03/25 Budget	31/03/26 Indicative	31/03/27 Indicative	31/03/28 Indicative	31/03/29 Indicative
TOTAL CFR	**273.3**	**281.1**	**299.7**	**294.4**	**282.8**	**277.3**	**271.9**

With the introduction of the accounting requirements of IFRS 16 Leases, the CFR and debt identified as relating to leases has increased, due to the change in the way that finance leases for lessees are treated. The introduction of this new accounting standard had been deferred by CIPFA/LASAAC for a number of years, however it is now agreed that it will be introduced from 1st April 2024. Work has been undertaken across the Council, including schools, to gather the relevant information and fully understand the impact upon the Council. The figures contained within this strategy document reflect the estimated impact of this accounting regulation change.

Put simply, the greater the CFR, the larger the impact will be on the revenue budget, with that impact being exacerbated by an ongoing reduction in the availability of internal borrowing. Therefore, in the long-term, there will be a need to keep annual capital expenditure funded by borrowing at a level below the annual MRP budget in order to maintain the capital financing revenue budget at a broadly sustainable level.

4. LONG-TERM VIEW OF CAPITAL EXPENDITURE

Expenditure on capital assets/projects are often for assets which have a long-term life i.e. buildings may have an asset life in excess of 40 years. The financing of these assets could also be over a long-term period. Therefore, it is important to take a long-term view of capital expenditure plans and the impact that may have on the affordability and sustainability of capital expenditure. Once a decision has been made to initially fund capital expenditure from borrowing, the Council is locked into the revenue implications arising from that decision (i.e. the annual cost of MRP) for a long-term period.

Due to the financial constraints that the Council continues to face, it is anticipated that revenue to fund capital financing will remain restricted over the long term. The capacity to use internal borrowing is also reducing, which means that the authority will face a challenge in relation to its medium to long term capital aspirations, particularly if there is a need or desire to incur a certain level of capital expenditure funded via borrowing. This comes at a time when the authority is facing challenges in relation to its existing asset base, in terms of maintenance backlogs, as well as demand pressures (e.g. increasing pupil numbers) adding to the need to invest in new and existing assets.

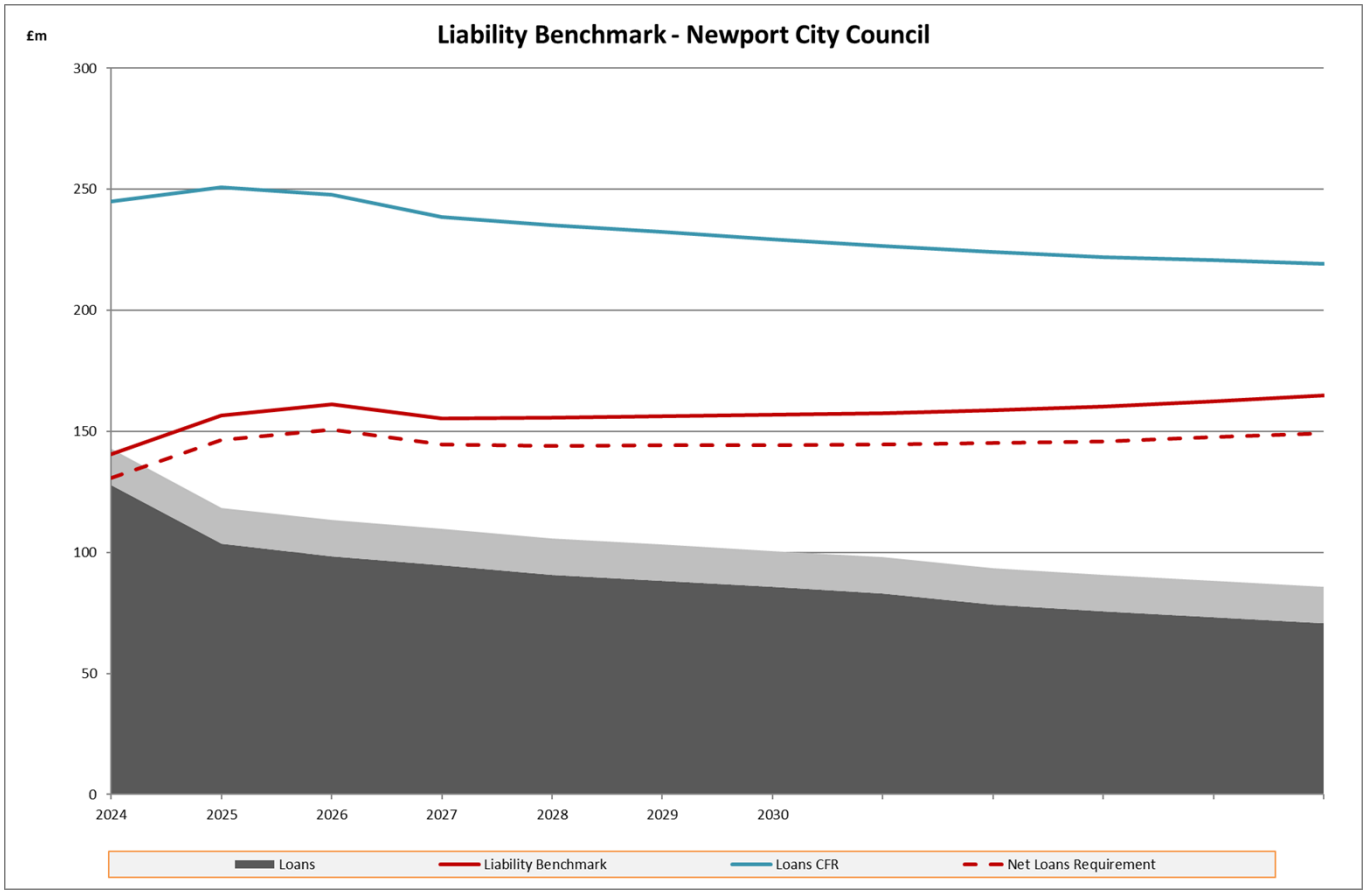
As already outlined, the scope for new borrowing over the medium to long term will be restricted to that that can be afforded from within the existing capital financing budget. The reason for this stance is to ensure that the CFR is stabilised and, ideally, reduced. If this was to be achieved, by ensuring that new capital expenditure funded by borrowing is less than the annual MRP charge, it would minimise the

increase in associated capital financing costs and ensure that they remain affordable and sustainable. This is particularly relevant when considering the position outlined in the Medium Term Financial Plan and the competing financial pressures facing the Council.

The proposed programme includes indicative new borrowing of £7m in both 2027/28 and 2028/29. In addition, to assist with exemplifying the potential impact over the medium to long term, further annual £7m allocations of new borrowing have been modelled beyond 2028/29. It is important to note that the Council will be required to make further CCRCD contributions beyond the current programme. These contributions have been previously agreed and, therefore, represent an unavoidable commitment and the first call upon any new headroom.

The impact of this modelling is outlined in the chart below, in terms of the overall level of the CFR and the actual requirement to undertake external borrowing.

Chart 1 – Liability Benchmark - £7m additional borrowing per year from 2027/28



Charts 1, known as the Liability Benchmark, demonstrates the following, in terms of the impact of the proposed capital programme and the modelled scenario:

- The impact the current capital programme has in terms of the increasing CFR and consequent need for external borrowing, denoted by the steepness of the solid and dashed red lines over the first few years.
- A stabilisation, and then reduction, in the overall level of CFR, as shown by the trajectory of the solid blue line.

- A longer-term stabilisation of the need to undertake actual external borrowing, as shown by the trajectory of the dashed red line.
- The impact of the reducing capacity for internal borrowing, demonstrated by the convergence of the red and blue lines over the course of the 10-year period.
- The fact that a level of existing borrowing is scheduled for repayment (denoted by the shaded grey area) over the medium to long term, although the underlying need to borrow actually grows during that time, meaning that the repaid borrowing will need to be replenished.

The modelled scenario demonstrates that it would be possible to stabilise the CFR and actual need to borrow over the medium to long term, whilst introducing new borrowing capacity at £7m per year from 2027/28. This is critical if the increase in consequent capital financing costs is to be minimised and remain at a level which is prudent, affordable and sustainable over the medium term. However, as the following paragraphs and Chart 2 demonstrate, there are other factors which also impact upon the overall level of capital financing costs incurred.

Chart 2 – Capital Financing Cost Forecast

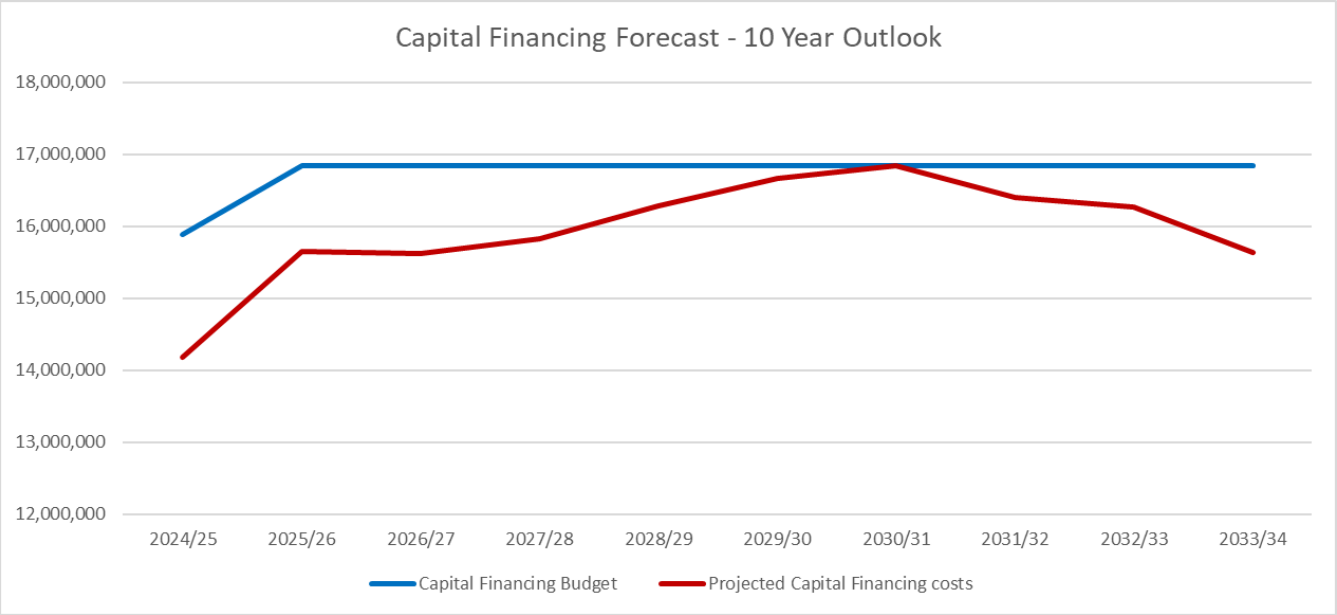


Chart 2 shows the projected capital financing costs over the next 10 years, inclusive of the indicative £7m new borrowing per year from 2027/28. The initial increase is driven by the capital programme that is proposed, resulting in a significant spike in capital financing costs to 2025/26. There is then a more gradual increase in costs, in line with debt-funded capital expenditure in each year being less from 2026/27 onwards. The drop-off in costs from 2030/31 is due to the fallout of MRP charges for historic schemes that will be fully paid off by that point. The budget line included in the graph is based on the existing and planned revenue budget. As can be seen, the peak of the projected costs would consume the full budget, however there could be a period before then whereby there is an underspend, which could be used to supplement the capital headroom or fund VRP, which would reduce the CFR and ongoing MRP charges.

Whilst it is seemingly positive that the existing budget can facilitate new borrowing capacity, it is important to note the risks that the revenue budget could be insufficient, should, for example, interest rates increase or the Council's internal borrowing capacity diminish more quickly than anticipated. What this means, in effect, is that additional external borrowing will need to be undertaken to replace the internal borrowing,

just to maintain the status quo. The impact of this is that additional interest costs will be incurred and these will be borne by the capital financing budget. In the case of MRP, the annuity methodology for unsupported borrowing that the Council has adopted means that MRP charges are lower in earlier years and increase as assets move through their useful life. Therefore, there will be an annual increase in MRP charges, and consequent impact upon the revenue budget, even if no additional unfunded capital expenditure was undertaken.

It should be noted that the scenario above is for modelling purposes only, with assumptions included on the deliverability of the programme. In saying that, it is a good representation of the financial impact on Council finances given the potential levels of capital spend funded from borrowing.

The actual position will of course be impacted by a number of factors that will ultimately determine the level of borrowing and associated capital financing costs. These factors include:

(i) availability of capital grant funding from Welsh Government and other bodies, (i.e. will there be the capacity or need to include those levels of capital expenditure funded by borrowing?)
(ii) the delivery of capital receipts (i.e. as above)
(iii) the utilisation and overall level of earmarked reserves (i.e. as above)
(iv) the general level of slippage within the capital programme (i.e. will the Council spend at the rates modelled)

Sustainability and Ongoing Capital Programme Development

As already outlined, the long-term nature of the impacts arising from short to medium term capital expenditure and financing need to be understood in terms of its prudence, affordability and sustainability. The Head of Finance is satisfied that the current programme meets this key requirement, evidenced by the fact that the revenue implications are already fully funded. However, the key challenge facing the Council, in relation to capital, is the continuing pressure relating to the existing estate, in terms of maintenance backlogs and ensuring no expensive asset failures occur. The current annual sums allocations are not as high as would be ideal, meaning that it can be challenging enough to maintain the status quo in terms of backlogs, before considering reducing them. In addition, there is the potential for demand for new schemes to emerge over the medium term, especially in relation to pupil number increases, for example.

On the basis that the current Medium Term Financial Plan is not balanced, there would appear to be little scope to increase capital resourcing by way of external borrowing in the short term, as the revenue budget would not be able to cater for the increased MRP and interest costs. The MTFP challenge is likely to be especially acute between 2024/25 and 2026/27. Whether or not the challenge will ease beyond those years will largely depend upon the rates of inflation being experienced, the demand for services and the position in relation to core funding via UK and Welsh governments, especially with a general election on the horizon. Therefore, it is a positive position that the Council could potentially be able to commit to new borrowing headroom in future years, without the need to increase the capital financing budget. However, this is reliant upon core assumptions, such as interest rates and the rate of earmarked reserve usage, not adversely changing. It is also inherently dependent upon the Medium Term Financial Plan and whether there is a need to identify savings from all budgets in order to balance the Council's overall budget.

This potential scope for new borrowing will be of great benefit to the Council in that it would assist with addressing a number of likely capital pressures, whether new pressures or increases in existing pressures. However, clear prioritisation of schemes will still be required, in order to ensure that the limited resources available are used for only the most critical issues.

In light of this challenge, it is important that the authority understands the key drivers and risks associated with delivering an annually refreshed capital programme. These drivers are captured through various plans across the authority and are outlined in the diagram that follows. These plans will be subject to ongoing revision and it will be necessary for the authority to develop its understanding of the cost of key priorities arising from each plan, to inform what will potentially be a constrained programme in terms of the overall financial envelope.

There will be a range of priorities originating from these plans, particularly the Corporate Plan. As well as the priorities contained within the Corporate Plan, there is the aforementioned requirement to maintain the current asset base. This is something that has been severely impacted by constrained funding levels in previous years and has resulted in the maintenance backlog developing, which gives rise to the potential for major asset failures to occur where issues have developed over time. There is a particular risk surrounding highways and school buildings, although there are other asset bases that hold maintenance backlogs as well.

Therefore, whilst annual allocations are provided for asset maintenance, they are generally insufficient in value. The challenging revenue budget position does not provide an easy solution in increasing these allocations to a level that would, in the first instance, stop the backlogs from increasing. Because of this, it will be critical that opportunities to augment the annual sums, such as those outlined earlier in the strategy, are taken wherever possible. If it doesn't prove possible to increase the annual sums, they should, as a minimum, ensure the highest priority backlog issues are addressed, first and foremost. However, they would, in most cases, be insufficient to address any asset failures.

In addition to the annual sums, other approaches need to be pursued in order to reduce the maintenance backlog. This would include the ongoing review of the asset base more generally and consideration to rationalising the number of assets, which forms part of the Transformation Plan. Rationalisation through

the review programme could be achieved in a number of ways, such as closure or disposal of assets, asset transfers or schemes to refurbish/redevelop existing assets. Furthermore, it will be necessary to target external grant funding, such as Sustainable Communities for Learning funding, which will enable wholesale upgrade or replacement of existing assets, including those with significant maintenance backlogs.

Therefore, when developing future iterations of the capital programme, it will be necessary for decision-makers to ensure that the ongoing maintenance of existing assets is sufficiently addressed. However, there will be other priorities to be included within the programme at a point in the future, such as the need to address the climate emergency via a pursuit of carbon neutral assets, the next phase of WG's Sustainable Communities for Learning Programme and further regeneration schemes for the city. As already outlined, the pressure to support such initiatives will need to be carefully balanced against other competing priorities for revenue resources.

Although members will ultimately decide upon both the overall size of the new programme, and the schemes contained within it, it will be important that there continues to be appropriate governance surrounding the development of the programme. This will be especially important given the constrained funding outlook and the need to be absolutely clear as to where the highest priorities lie. To achieve this, the newly-constituted Capital Assurance Group will need to act as a gateway and ensure that only those schemes with a clear plan for delivery and where the necessary due diligence has been undertaken are recommended for addition to the programme. The group should also ensure that there is enhanced oversight and management of the programme on an ongoing basis and reduce the likelihood of slippage or grant funding being foregone in future years. As an outcome, a more realistic, deliverable and achievable programme should result.

5. TREASURY MANAGEMENT

The Treasury Management Strategy (detailed in Appendix 3) and Capital Strategy are inextricably linked, with both strategies being considered for approval by Council as part of the same meeting. The figures within the Treasury Management Strategy align with the level of borrowing resulting from this Capital Strategy. The Council will need to approve both the prudential indicators detailed below and the borrowing limits recommended.

5.1. TREASURY MANAGEMENT

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, whilst managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council limits the need to take out actual borrowing by using positive cashflow, largely underpinned by earmarked reserve balances, to fund capital expenditure funded by borrowing, known as internal borrowing.

As a result of decisions taken in the past, the Council as at 31st December 2023, has £140.6m borrowing at a weighted average interest rate of 3.7% and £47m treasury investments at a weighted average rate of 5.16%.

5.2. BORROWING STRATEGY

Whilst the current outlook is for the Council to have significant long-term borrowing requirements, the current strategy is to fund capital expenditure through reducing investments rather than undertaking new borrowing. To clarify, this means deferring new long-term borrowing and funding capital expenditure from day-to-day positive cashflows for as long as possible. By using this strategy, the Council can also minimise cash holding at a time when counterparty risk remains high.

Whilst investment counterparty risk is minimised through this strategy, the risk of interest rate exposure is increased, as the current longer term borrowing rates may rise in the future. However, long-term borrowing interest rates are broadly similar to short-term borrowing interest rates at present. Therefore, should there be a need to undertake borrowing at short notice, the current similarity in interest rates mitigates the risk to some extent and also ensures the Council is no worse off in the short term. The market position is being constantly monitored in order to manage this risk.

The Council's overall main objective when borrowing is to achieve a low but certain cost of finance, whilst retaining flexibility should plans change in the future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between short-term loans (which have traditionally been available at a lower cost) and long-term fixed rate loans where the future cost is known but higher. In the current economic context, short-term borrowing is not much cheaper than long-term borrowing, however this may revert to a more typical scenario in the medium term. The current availability of positive cashflow has meant that the Council has not been required to undertake any significant short-term borrowing recently, although this can change at relatively short notice.

Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities and leases) are shown below, compared with the CFR (which has been detailed in earlier sections). It should be noted that the estimated projected debt is broadly in line with the Operational Boundary, which acts as a borrowing limit for delivering the Capital Programme, as highlighted in the paragraphs that follow.

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2023 Actual	**31.3.2024 Forecast**	**31.3.2025 Budget**	**31.3.2026 Budget**	**31.3.2027 Budget**
Debt (incl. PFI & leases and ST & LT borrowing)	169	177	206	208	199
Capital Financing Requirement	273	281	300	294	283

As outlined earlier, the forthcoming introduction of IFRS 16 Leases has will result in the CFR and debt identified as relating to leases increasing in future years. The estimated impact of this is reflected in the figures contained within this strategy.

Statutory guidance is that debt should remain below the CFR, except in the short-term. As can be seen from Table 6, the Council expects to comply with this in the medium term.

Operational Boundary: The Council is obliged to approve an operational borrowing limit. This boundary has been set in line with the expected borrowing required to finance the current Capital Programme until 2028/29, taking account of likely levels of internal borrowing and the indicative new borrowing previously outlined. If any increase to the operational boundary is required, this will need to be brought to Council for approval.

Authorised Limit: The Council is legally obliged to approve an affordable borrowing limit for external debt each year. This is the absolute limit for external borrowing and is set in line with the CFR. The authorised limit is greater than the Operational Boundary and provides a buffer for managing day to day cash requirements and undertaking borrowing in advance of need, where appropriate and affordable.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2023/24 limit	**2024/25 limit**	**2025/26 limit**	**2026/27 limit**
Authorised limit – borrowing	245	251	248	238
Authorised limit – PFI and leases	39	51	49	47
Authorised limit – total external debt	**284**	**302**	**297**	**285**
Operational boundary – borrowing	141	157	161	155
Operational boundary – PFI and leases	39	51	49	47
Operational boundary – total external debt	**180**	**208**	**210**	**202**

Whilst the above indicators place a theoretical limit upon the level of borrowing that a council can undertake, they do not, for example, make an allowance for any amount of slippage that may be incurred whilst delivering the Capital Programme, which is likely with such a large programme to deliver. Therefore, to ensure that the level of expenditure to be funded via borrowing is controlled, a local indicator exists which restricts any unfunded expenditure being added to the existing Capital Programme over and above the headroom that is already in place. This indicator is in line with Table 1 of this report and limits additional borrowing for new capital expenditure to £1.057m (to potentially be applied to any year within the programme and shown in 2025/26 for exemplification purposes). Should borrowing above this limit be required, it will need to be approved by full Council.

Table 8: Local Prudential Indicator: New capital expenditure to be funded via borrowing (£m)

	2024/25 limit	**2025/26 limit**	**2026/27 limit**
Borrowing headroom	0	1.1	0

5.3. INVESTMENT STRATEGY

Treasury investments arise from receiving, and then holding, cash before there is a need to pay it out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management. The Council's strategies in this area of Treasury Management are (i) to be a short term and relatively low value investor and (ii) investment priorities should follow the priorities of security, liquidity and yield, in that order.

Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Currently, the Council is holding a £10m long-term investment in covered bonds, in order to secure its professional client status as part of the MIFID II directive.

Table 9: Treasury management investments in £millions

	31.3.2024 Forecast	31.3.2025 Budget	31.3.2026 Budget	31.3.2027 Budget	31.3.2028 Budget	31.3.2029 Budget
Near-term investments	0	0	0	0	0	0
Longer-term investments	10	10	10	10	10	10
TOTAL	**10**	**10**	**10**	**10**	**10**	**10**

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and relevant staff, who must act in line with the Treasury Management Strategy approved by Council. Half-year and end of year reports on treasury management activity are presented Council, with an update on compliance with prudential indicators reported quarterly. The Governance & Audit Committee is responsible for scrutinising treasury management decisions.

Loans to other organisations

The Council can and does make investments to assist local public services, including making loans to businesses to promote economic growth. The Council will assess these opportunities and will only plan that such investments at least break even after all costs. Loans to such organisations will be approved following a due diligence process and formal governance arrangements.

The Council will also use other methods of assisting businesses to promote economic regeneration by providing grants or by allowing rent free periods where the Council is the owner of the freehold.

Decisions on service investments are made by the relevant service manager in consultation with the Head of Finance and Monitoring Officer and must meet the criteria and limits laid down in the investment strategy.

6. COMMERCIALISATION

The 2019/20 Capital Strategy contained details of the Council's Commercialisation Strategy, which was agreed by Council during 2019. A feature of this commercial approach was to explore three areas of activity, all aimed at increasing income generation and contributing towards addressing the medium-term budget gap faced by the Council. The three areas of activity were:

1) Current services that could be provided on a more commercial basis - e.g. trade waste
2) New services that could be provided - e.g. energy services
3) Property investment – commercial and residential

As outlined in the 2022/23 strategy, the third element of this approach would entail, in essence, investment primarily for the purpose of yield. This type of activity is now precluded by the Public Works Loans Board no longer lending to local authorities for this purpose and the updated Prudential Code prevented investment funded by borrowing solely for the purpose of yield. Combined with the financial constraints currently being faced, and new borrowing not currently being considered affordable in the short term, this area of the Commercialisation Strategy is no longer being pursued. The first two elements of the strategy are still areas that the Council will consider and potentially pursue, subject to affordability, risk acceptability and the ability to contribute towards the medium-term financial challenges.

7. OTHER LONG-TERM LIABILITIES

In addition to debt of £140.6m outlined above, the Council has a number of other long-term liabilities, which represent potential future calls on Council resources, as follows:

Private Finance Initiative (PFI)

The Council has two PFI arrangements. These are for the provision of the Southern Distributor Road (20 years remaining) and for Glan Usk Primary School (10 years remaining). As at 31st March 2023, the combined value of the liabilities was £38.4m. The Council holds base budget and specific earmarked reserves to cover the future costs of the PFIs.

Pension Liability

The Council is committed to making future payments to cover its pension fund deficit (valued at £96.1m) as at 31st March 2023.

Provisions

The Council has set aside long-term provisions for risks in relation to landfill capping and aftercare, for example.

Contingent Liabilities

The Council also has a number of contingent liabilities, which may or may not ultimately materialise as a call on Council resources. These liabilities are detailed in the annual Statement of Accounts and include potential insurance claims and risks attached to loans extended to external developers. As well as this, the Council has also entered into a number of financial guarantees to act as a guarantor, in particular for the safeguarding of former employee pension rights when their employment is transferred to third party organisations.

8. KNOWLEDGE AND SKILLS

In-house expertise

The overall Capital Programme, Capital Strategy and Treasury Management Strategy are overviewed by the Head of Finance and Assistant Head of Finance, who are both professionally qualified accountants with extensive Local Government finance experience between them. There is a Capital Accounting team consisting of experienced qualified and part-qualified accountants who maintain Continuous Professional Development and attend courses on an ongoing basis to keep abreast of new developments and obtain relevant skills. In addition, there is a Treasury Management team who manage the day-to-day cash-flow activities and banking arrangements of the authority. Members of this team, again, attend the necessary courses and training and have an extensive amount of experience.

External expertise

All of the Council's main capital projects are overseen by project teams comprising the relevant professional disciplines from across the Council. When required, external professional advice is taken, primarily from the Council's property advisors, Newport Norse. The Council also engages with external treasury advisors for advice in relation to treasury management matters.

Members

Training is offered to members to ensure they have up to date skills to make capital and treasury decisions. Training has been provided as recently as December 2023. A register is also kept on member attendance. The Council also involves members at an early stage of a project's life cycle. In addition, the members of the Governance & Audit Committee have received specific treasury management training, delivered by the Council's external treasury advisors.

9. SUMMARY

- Capital expenditure plans for the Council need to be affordable, prudent and sustainable.

- The revenue budget includes the estimated revenue costs for the entire proposed capital programme, which includes a small level of approved headroom, and indicative borrowing headroom, for additional capital projects to be added without impacting further on the MRP budget, as per the agreed framework.

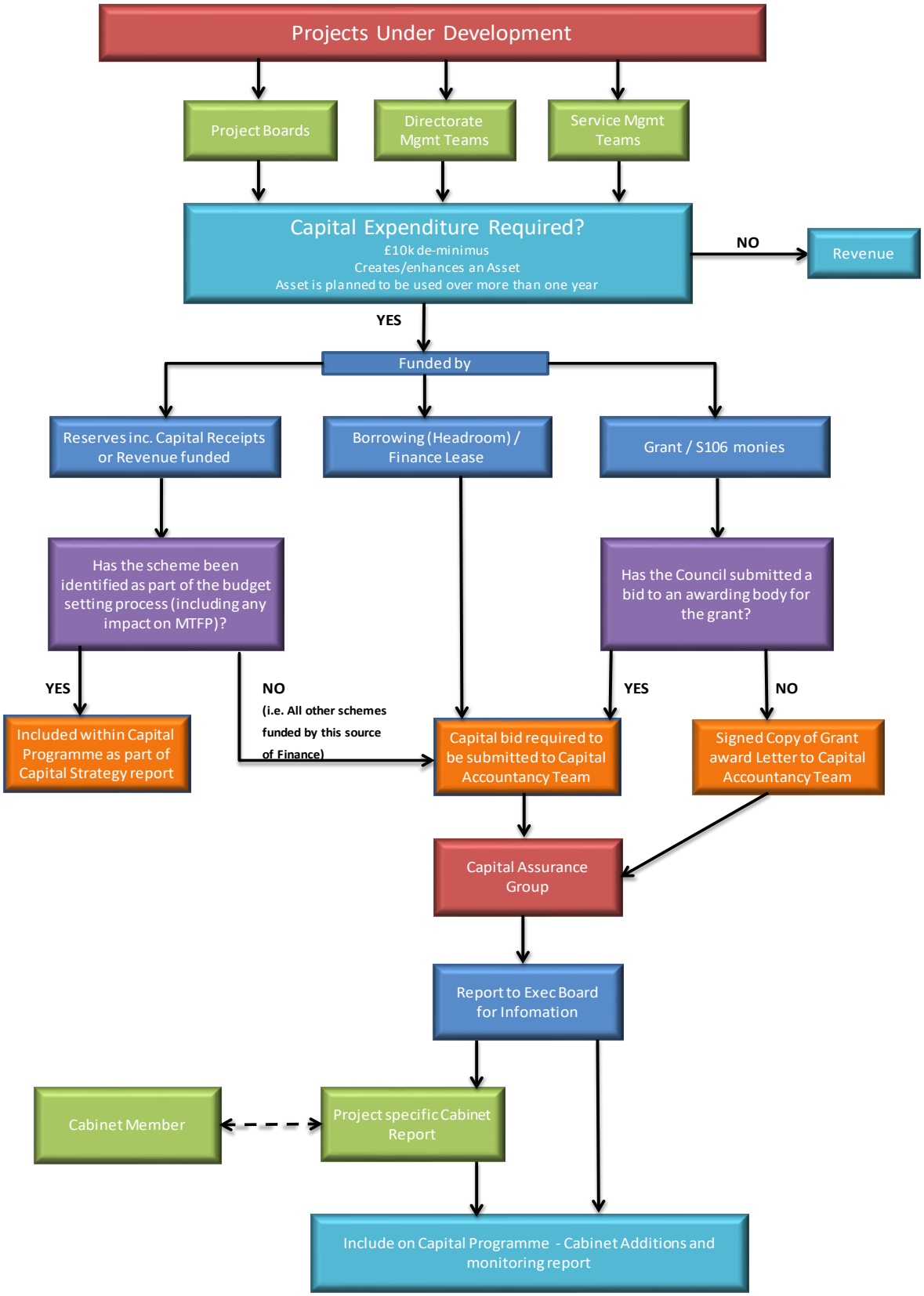
- There are a number of demands on the capital programme and there is the continual need to link the capital strategy with a number of strategic plans across the organisation. This is to ensure that the pressures on the capital programme are known and the risks are assessed and prioritised within an affordable framework. This will include clear visibility and assessment of demand for schools, highways and other operational assets.

- Decisions on funding capital expenditure through borrowing locks the Council into committing revenue funding over a very long period (as long as 40 years +). With the capital financing costs increasing over the long-term, as shown in Chart 2, the Council will need to take careful decisions when developing the Capital Programme, and prioritise accordingly, to ensure the capital plans remain affordable, prudent and sustainable.

- The Treasury Management Strategy, detailed in Appendix 3, highlights the Council's approach to managing its borrowing and investments. The proposed strategy for 2024/25 is in line with previous years and is based upon a low-risk approach to both investments and borrowing. This means that investments held are generally low in value and the approach to borrowing is to look for security of costs, resulting in a generally high proportion of long-term borrowing compared to short term borrowing.

APPENDIX 2a – Capital Additions Process Map

NO CABINET MEMBER/CABINET REPORT SHOULD BE SUBMITTED UNTIL THIS PROCESS IS COMPLETE



Appendix 3

Treasury Management Strategy Statement 2024/25

Introduction

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

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Authority to approve an investment strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

Revised strategy: In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

External Context

Economic background: The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be major influences on the Authority's treasury management strategy for 2024/25.

The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level for the rest of 2023. In December 2023, members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25%. The three dissenters wanted to increase rates by another 0.25%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with upside risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

Office for National Statistics (ONS) figures showed CPI inflation was 3.9% in November 2023, down from a 4.6% rate in the previous month and, in line with the recent trend, lower than expected. The core CPI inflation rate declined to 5.1% from the previous month's 5.7%, again lower than predictions. Looking ahead, using the interest rate path implied by financial markets the BoE expects CPI inflation to continue falling slowly, but taking until early 2025 to reach the 2% target before dropping below target during the second half 2025 and into 2026.

ONS figures showed the UK economy contracted by 0.1% between July and September 2023. The BoE forecasts GDP will likely stagnate through 2024. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.

The labour market appears to be loosening, but only very slowly. The unemployment rate rose slightly to 4.2% between June and August 2023, from 4.0% in the previous 3-month period, but the lack of consistency in the data between the two periods made comparisons difficult. Earnings growth has remained strong, but has showed some signs of easing; regular pay (excluding bonuses) was up 7.3% over the period and total pay (including bonuses) up 7.2%. Adjusted for inflation, regular pay was 1.4% and total pay 1.3%. Looking forward, the MPR showed the unemployment rate is expected to be around 4.25% in the second half of calendar 2023, but then rising steadily over the forecast horizon to around 5% in late 2025/early 2026.

Having increased its key interest rate to a target range of 5.25-5.50% in August 2023, the US Federal Reserve appears now to have concluded the hiking cycle. It is likely this level represents the peak in US rates following a more dovish meeting outcome in December 2023. US GDP grew at an annualised rate of 4.9% between July and September 2023, ahead of expectations for a 4.3% expansion and the 2.1% reading for Q2. But the impact from higher rates has started to feed into economic activity and growth will weaken in 2024. Annual CPI inflation was 3.1% in November.

Eurozone inflation has declined steadily since the start of 2023, falling to an annual rate of 2.4% in November 2023. Economic growth has been weak and GDP contracted by 0.1% in the three months to September 2023. In line with other central banks, the European Central Bank has increased rates, taking its deposit facility, fixed rate tender, and marginal lending rates to 3.75%, 4.25% and 4.50% respectively.

Credit outlook: Credit Default Swap (CDS) prices were volatile during 2023, spiking in March on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in Q2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.

On an annual basis, CDS price volatility has so far been lower in 2023 compared to 2022, but this year has seen more of a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget. Moody's also affirmed the Aa3 rating in recognition of the UK's economic resilience and strong institutional framework.

Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.

There remain competing tensions in the banking sector, on one side from higher interest rates boosting net income and profitability against another of a weakening economic outlook and likely recessions that increase the possibility of a deterioration in the quality of banks' assets.

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.

Interest rate forecast (December 2023): Although UK inflation and wage growth remain elevated, the Authority's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25%. The Bank of England's Monetary Policy Committee will start reducing rates in 2024 to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.

Arlingclose expects long-term gilt yields to be broadly stable at current levels (amid continued volatility), following the decline in yields towards the end of 2023, which reflects the expected lower medium-term path for Bank Rate. Yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix A. For the purpose of setting the budget, it has been assumed that new long-term loans will be borrowed at an average rate of 5%.

Local Context

On 31st December 2023, the Authority held £140.6m of borrowing and £47m of treasury investments. This is set out in further detail at Appendix B. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.23 Actual £m	31.3.24 Estimate £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m
Capital financing requirement	**273.3**	**281.1**	**299.7**	**294.4**	**282.8**
Less: Other debt liabilities *	-38.5	-36.2	-49.0	-46.8	-44.3
Loans CFR	**234.7**	**244.9**	**250.7**	**247.6**	**238.5**
Less: External borrowing **	-130.3	-130.3	-105.2	-99.3	-95.4
Internal (over) borrowing	**104.4**	**114.6**	**145.4**	**148.4**	**143.1**
Less: Balance sheet resources	-130.5	-104.0	-93.8	-86.8	-83.8
Treasury investments (or New borrowing)	**26.1**	**-10.6**	**-51.6**	**-61.6**	**-59.3**

* leases and PFI liabilities that form part of the Authority's total debt
** shows only loans to which the Authority is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £59.3m over the forecast period. This is broken down into £34.9m refinancing of maturing existing borrowing and £24.4m additional net external borrowing.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2024/25.

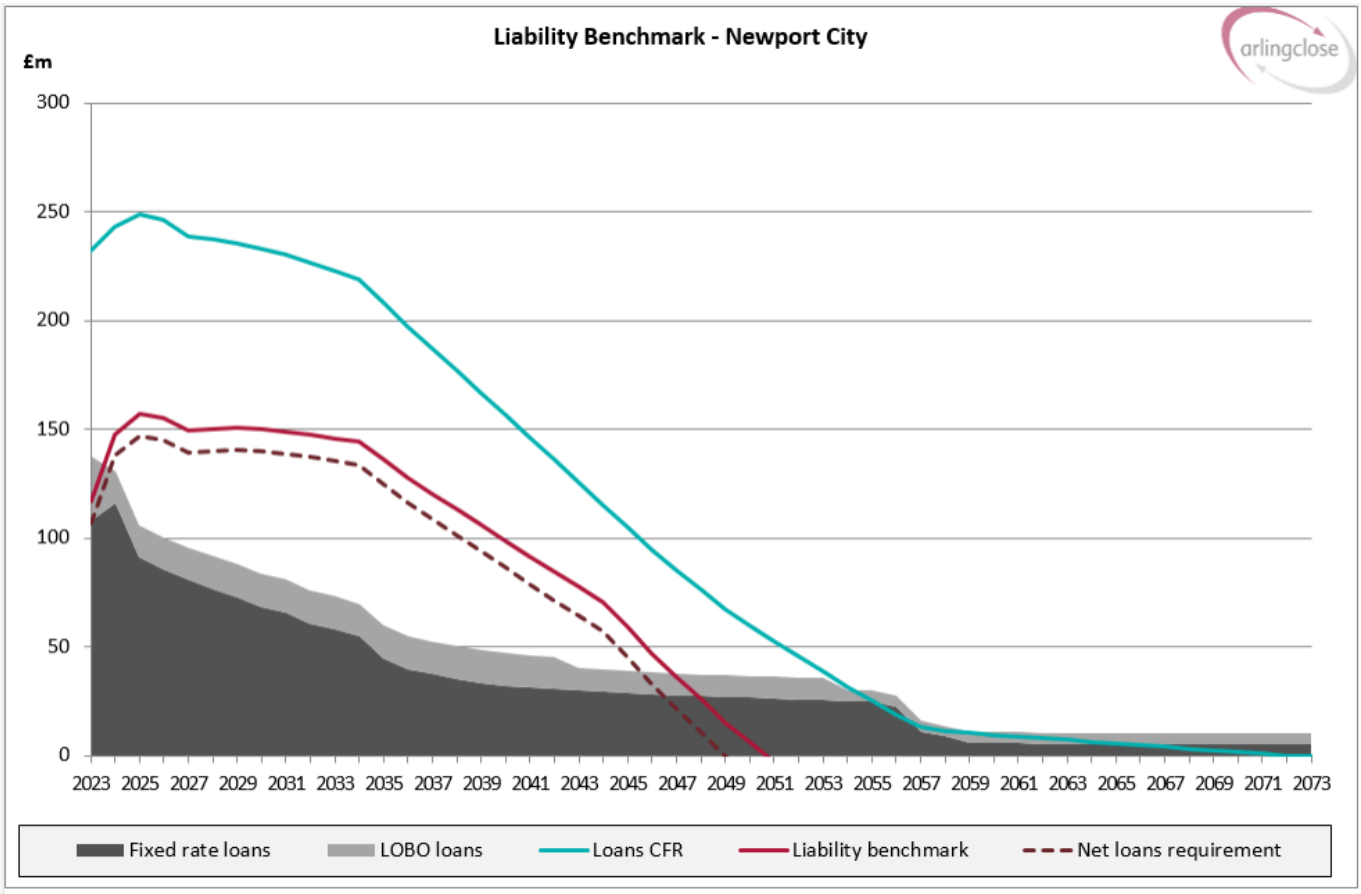
Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark 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 2: Prudential Indicator: Liability benchmark

	31.3.23 Actual £m	31.3.24 Estimate £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m
Loans CFR	234.7	244.9	250.7	247.6	238.5
Less: Balance sheet resources	-140.5	-114.0	-103.8	-96.8	-93.8
Net loans requirement	94.2	130.9	146.8	150.9	144.7
Plus: Liquidity allowance	10	10	10	10	10
Liability benchmark	**104.2**	**140.9**	**156.8**	**160.9**	**154.7**

Following on from the medium-term forecasts in Table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £7m a year from 2027/28 and minimum revenue provision on new capital expenditure based on an average 25 year asset life. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



The chart above shows actual borrowing maturing over time (grey area reducing), however the need to borrow (the blue CFR line) is increasing sharply over the short term due to the proposed capital programme. Over the long-term, to ensure a sustainable position, the CFR needs to stop increasing and ideally come down in order for the liability benchmark to stabilise. This, in turn, reduces the need to borrow and consequent pressure on the capital financing budget. Its important to note that, even with limited planned unfunded capital expenditure beyond the medium term, the liability benchmark doesn't reduce to current levels until circa 2037. Therefore, the chart is demonstrating the following important points/assumptions:

- To be sustainable, the CFR cannot continue increasing at the rate it is currently, and a prudent limit should be placed on the future capital programme to reduce the CFR over the long-term (set out further in the Capital Strategy)
- The ability to use further internal borrowing will diminish, with internal borrowing reducing over time as reserves are utilised.
- As existing borrowing matures (grey area reducing) there will be the need to refinance this debt over the long-term.
- The liability benchmark is increasing significantly in the short term, meaning that the Council will be required to undertake new borrowing over time, although the revenue impact of this is already funded, assuming interest rates don't increase significantly from the current position.
- The only way to reduce this need to borrow is to reduce the level of capital expenditure funded by borrowing.

Borrowing Strategy

The Authority currently holds £140.6 million of loans, an increase of £2.7 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 1 shows that the Authority expects to borrow up to £41.5m in 2024/25. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £251 million.

Objectives: The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are

required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Short-term interest rates are currently at a 15-year high but are expected to fall in the coming years and it is therefore likely to be more cost effective over the medium-term to either use internal resources, or to borrow short-term loans instead.

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

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

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

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

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- UK Infrastructure Bank Ltd
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Greater Gwent Pension Fund)
- Capital market bond investors
- Retail investors via a regulated peer-to-peer platform
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

- leasing
- hire purchase
- Private Finance Initiative
- Sale and leaseback
- Similar asset based finance

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

LOBOs: The Authority holds £15m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £15m of these LOBOs have options during 2024/25, and with interest rates having risen recently, there is now a good chance that lenders will exercise their options. If they do, the Authority will seek to take the option to repay LOBO loans to reduce refinancing risk in later years. Total borrowing via LOBO loans will be limited to the £15m already in existence.

Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

Treasury Investment Strategy

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's treasury investment balance has ranged between £33.6m and £80.7m, although it is expected that investment levels will average little over £10m during the 2024/25, as the Council's internal borrowing capacity is reduced.

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

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

The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Authority may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by adding diversification in the form of a strategic pooled fund portfolio.

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 Authority'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 Authority 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

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

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the limits shown.

Table 3: Treasury investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£10m	Unlimited
Secured investments *	25 years	£10m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£5m	£10m
Registered providers (unsecured) *	5 years	£5m	£25m
Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£10m	£25m
Real estate investment trusts	n/a	£10m	£25m
Other investments *	5 years	£5m	£5m

This table must be read in conjunction with the notes below

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

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £20m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

Government: Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

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

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

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

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

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

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

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

Operational bank accounts: The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

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

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

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

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

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority 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 Authority'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.

Investment limits: The Authority's revenue reserves available to cover investment losses are forecast to be £112.3 million on 31st March 2024 and £102.2 million on 31st March 2025. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation

(other than the UK Government) will be £10 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £1 million in operational bank accounts count against the relevant investment limits.

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

Table 4: Additional investment limits

	Cash limit
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£10m per country

Liquidity management: The Authority 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

The Authority will spread its liquid cash over at least two providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Prudential Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£250,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£150,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.

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

Refinancing rate risk indicator	**Upper limit**	**Lower limit**
Under 12 months	60%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and within 20 years	40%	0%
20 years and within 30 years	30%	0%
30 years and within 40 years	30%	0%

40 years and within 50 years	20%	0%
50 years and above	20%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Long-term treasury management investments: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments will be:

Price risk indicator	2023/24	2024/25	2025/26	No fixed date
Limit on principal invested beyond year end	£10m	£10m	£10m	£10m

Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Related Matters

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

Financial derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in section 24 of the *Local Government and Elections (Wales) Act 2021* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

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

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

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

Markets in Financial Instruments Directive: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Head of Finance believes this to be the most appropriate status.

Government Guidance: Further matters required by the WG Guidance are included in Appendix 3c.

Financial Implications

The budget for investment income in 2024/25 is £0.4 million, based on an average investment portfolio of £10 million at an interest rate of 4%. The budget for debt interest paid in 2024/25 is £6.9 million based on the known annual cost of existing borrowing plus assumed new borrowing at a rate of 5%. If actual levels of investments and

borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

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

Appendix 3a – Arlingclose Economic & Interest Rate Forecast – December 2023

Underlying assumptions:

- UK inflation and wage growth remain elevated but have eased over the past two months fuelling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.
- The MPC's message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.
- Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the more timely PMI figures suggest that the services sector is recovering from a weak Q3. Tighter policy will however bear down on domestic and external activity as interest rates bite.
- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.
- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.
- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant loosening in the future to boost activity.
- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium- term level for Bank Rate.
- There is a heightened risk of fiscal policy and/or geo-political events causing substantial volatility in yields.

Forecast:

- The MPC held Bank Rate at 5.25% in December. We believe this is the peak for Bank Rate.
- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. We see rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.
- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.
- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.40	5.40	5.40	5.30	5.15	4.80	4.30	4.10	3.80	3.50	3.25	3.05	3.05
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.77	3.75	3.75	3.75	3.70	3.60	3.50	3.50	3.40	3.30	3.30	3.30	3.35
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
10yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.72	3.75	3.80	3.80	3.80	3.80	3.80	3.80	3.75	3.65	3.60	3.65	3.70
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
20yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.16	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.25
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
50yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.76	3.80	3.85	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.95	3.95	3.95
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

PWLB Standard Rate = Gilt yield + 1.00%
PWLB Certainty Rate = Gilt yield + 0.80%
PWLB HRA Rate = Gilt yield + 0.40%
UK Infrastructure Bank Rate = Gilt yield + 0.40%

Appendix 3b - Existing Investment & Debt Portfolio Position

	31/12/2023 Actual Portfolio £m	31/12/2023 Average Rate %
External borrowing:		
Public Works Loan Board	105.3	3.8
Local authorities	5.0	5.6
LOBO loans from banks	15.0	4.4
Other loans	15.3	3.8
Total external borrowing	**140.6**	**3.7**
Other long-term liabilities:		
Private Finance Initiative	38.4	
Finance Leases	0.1	
Total other long-term liabilities	**38.5**	
Total gross external debt	**179.1**	**0.0**
Treasury investments:		
Banks (Unsecured)	0.5	5.1
Government	7.5	5.2
Secured Investments	10.0	4.3
Local authorities	29.5	5.4
Total treasury investments	47.0	5.2
Net debt	**132.1**	

Appendix 3c – Additional requirements of Welsh Government Investment Guidance

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities that are not integral to this Authority's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

Contribution: The Authority's investments contribute to its service delivery objectives and/or to promote wellbeing as follows:

- treasury management investments support effective treasury management activities,
- loans to local organisations provide financial support to those organisations to enable them to deliver local public services that would otherwise be provided directly by the Authority, and
- investment property provides a net financial surplus that is reinvested into local public services.

Climate change: The Authority's investment decisions consider long-term climate risks to support a low carbon economy to the extent that the Council has invested in, as part of the overall capital programme, a number of energy efficiency related schemes, including LED projects and Solar PV, as well as ultra-low emission vehicles. In addition, new schools are now being constructed on a net carbon zero basis.

Specified investments: The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Loans: The WG Guidance defines a loan as a written or oral agreement where the authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local authority.

The Council currently has loans totalling £10.3m as at 31st December 2023. These are all developer loans issued to local enterprises and are secured. The current value of loans issued represent approximately 8% of the useable reserve balance held as at 31st March 2023. The authority's aim when issuing loans is to ensure that they do not exceed 15% of total useable reserves as at the end of each financial year and, therefore, the current value of loans is within that self-assessed limit. The authority is also working to the loan limits set out below.

Table C1: Loan limits

Borrower	Cash limit
Local enterprises	£15m
Local charities	£5m
Wholly owned companies	£5m
Joint ventures	£5m
Treasury management investments meeting the definition of a loan	Unlimited

The Authority uses an allowed 'expected credit loss' model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of

its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Authority has appropriate credit control arrangements to recover overdue repayments in place.

Non-specified investments: Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. Limits on non-specified investments are shown in table C2; the Authority confirms that its current non-specified investments remain within these limits.

Table C2: Non-specified investment limits

	Cash limit
Units in pooled funds without credit ratings or rated below A-	£10m
Shares in real estate investment trusts	£10m
Shares in local organisations	£10m
Total non-specified investments	£15m

Non-financial investments: This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset's purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. On an assessment as at 31st March 2023, the Authority's investment property portfolio is anticipated to provide security for capital investment, since its fair value totals £15.812m and is likely to exceed the original purchase price (as in a number of cases, the purchases took place a significant amount of time ago). The authority will undertake further work to confirm, wherever possible, that the necessary security exists.

The Authority consider that the scale of its commercial investments including property are proportionate to the resources of the authority since such investments represent just 11% of its £139m useable reserves.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. However, the Council is not actively pursuing a strategy of acquiring investment properties. Therefore, the current level of investment properties, which represents a relatively low proportion of useable reserves, is not likely to increase in the near future. As a result, it is not anticipated that these investments will need to be liquidated in the medium term.

Because the invested funds, if required, would potentially take time to be liquidated, the authority ensures that it holds adequate available cash balances to be able to, for example, repay capital borrowed. In addition, the authority holds a minimum £10m in investments (to meet Mifid II requirements) which could, if needed, be liquidated at relatively short notice, although this would be avoided if possible to ensure that the professional client status could be retained.

Investment advisers: The Authority has appointed Arlingclose Limited as treasury management advisers and Newport Norse as property investment advisers. The quality of these services is controlled by regular review of the services provided by both advisers and regular strategy meetings with them.

Borrowing in advance of need: Welsh Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority, after having regard to the guidance, will only borrow in advance of need as part of a strategy for reducing risk of future interest rate rises and would not undertake such activity purely in order to profit from an investment.

Capacity and skills: The authority ensures that members and statutory officers involved in investment decisions have the appropriate skills, capacity and information to take informed decisions, assess individual investments in the context of strategic objectives and risk profile, and how the quantum of decisions impact upon the overall risk exposure of the authority. Steps taken include relevant training for elected members and a minimum level of qualification for statutory officers, as well as ensuring continuing professional development, via attendance at relevant training courses. Officers will always take advise from its independent advisers regarding investing and borrowing activity.

Commercial deals: Any commercial deals that the Council would be involved in would involve statutory officers in those discussions and any final decisions. This ensures that the core principles of the prudential framework and the regulatory regime of the local authority is adhered to when making such decisions.

Corporate governance: The Council has a clear corporate governance framework set out within its constitution, scheme of delegations and Annual Governance Statement. This ensures that decisions regarding investment are taken at the appropriate level. For example, the overarching treasury strategy and framework is approved by full Council. Operational decisions, such as day to day cashflow management, including borrowing, are delegated to the Head of Finance.

Appendix 3d – Minimum Revenue Provision Policy

Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Welsh Government's *Guidance on Minimum Revenue Provision* (the WG Guidance) most recently issued in 2018.

The broad aim of the WG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Welsh Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The WG Guidance requires the Authority to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the guidance.

- For supported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments. This is currently deemed to be an average of 40 years.

- For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in on an annuity basis with an annual interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational.

- For capital expenditure loans to third parties that are repaid over a short time period (less than 12 months) or frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement. The only other scenario whereby MRP would not be charged is where there is unencumbered first charge security, held against separate assets, upon which the loan is secured. For all other capital expenditure loans to third parties, MRP will be charged in accordance with the MRP policy for the assets funded by the loan.

- The MRP policy and charges in relation to the Cardiff Capital Region 'City Deal' will reflect those within the Joint Working Agreement.

Capital expenditure incurred during 2024/25 will not be subject to an MRP charge until 2025/26.

Based on the authority's latest estimate of its Capital Financing Requirement as at 31st March 2024, the estimated cost of MRP in 2024/25, including finance leases and PFI, is as follows:

	31.03.2024 Estimated CFR £m	**2024/2025 Estimated MRP £m**
Supported capital expenditure	160	5
Unsupported capital expenditure	82	5
Finance leases* and Private Finance Initiative	51	3
Total General Fund	**294**	**13**