Report of the Director of Finance & IT to the meeting of the Governance and Audit Committee to be held on 24th March 2022

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Subject:

Treasury Management Strategy 2022-23

Summary statement:

This report shows the Council's 2022-23 Treasury Strategy

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Portfolio:
Corporate

Overview & Scrutiny Area:
Corporate Services

1. INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

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

CIPFA defines treasury management as:

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

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities.

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:

- a high-level long-term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.2.2 Treasury Management reporting

The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
    - the capital plans, (including prudential indicators);
    - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
    - the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
    - an investment strategy, (the parameters on how treasury investments are to be managed).

b. **A mid-year treasury management report –** This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c. **An annual treasury report –** This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.2.3 Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Governance and Audit Committee.

1.3 Treasury Management Strategy for 2022-23

The strategy for 2022-23 covers two main areas:

Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, DLUHC Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training has been undertaken by members on the 25th November 2021 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The Council uses Link Group, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

1.6 Updates to the Prudential and Treasury Management Code

The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services 2017. An updated version of this Code and Prudential Code was published in December 2021. Although the new Codes apply immediately, the Prudential Code states that the changes to reporting requirements that they introduce can be deferred until the 2023-24 financial year. Given the timing of the publication of the updated Codes it has not yet been possible to implement changes to the treasury management prudential indicators, however work will be undertaken with the aim of introducing them during 2022-23.

Members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023-24 Treasury Management Strategy.

2. CAPITAL PRUDENTIAL INDICATORS

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Prudential Indicators currently do not include anything relating to a Council HRA and they will be reviewed again once a decision has been made.

2.1 Capital expenditure and financing

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

Table 1: Capital Plan Expenditure

Capital expenditure	2020-21 Actual £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Total	**64**	**162**	**203**	**242**	**145**	**78**

Table 2 below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Table 2: Capital funding

	2020-21 Actual £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Total Capital Spend	64	162	203	242	145	78
Capital Spend not funded from borrowing	52	81	100	120	72	40
Capital spend funded from borrowing	**12**	**81**	**103**	**122**	**73**	**38**

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities (e.g., PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £155m of such schemes within the CFR.

Table 3: Capital Financing Requirement

	2020-21 Actual £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Capital Financing Requirement	**699**	**755**	**831**	**920**	**956**	**953**
Movement in CFR		**56**	**76**	**89**	**36**	**-3**

Movement in CFR represented by

Net financing need for the year (above)		81	103	122	73	38
Less MRP/VRP and other financing movements		-25	-27	-33	-37	-41
Movement in CFR		**56**	**76**	**89**	**36**	**-3**

2.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

DLUHC regulations have been issued which require the Full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The policy, as approved by Executive 15 February 2022 and Full Council 17 February 2022, is set out in Appendix 2. There are no changes compared to last year, the policy will be reviewed and updated as required once a decision has been taken on the implementation of a Housing Revenue Account.

The main elements of the policy set out in Appendix 2 are set out below:

- Pre 2008 debt, which cannot be distinguished against specific assets, is being repaid over 50 years on an equal instalment basis.

- Some debt taken out between 2008 and 2012 is currently being repaid on an annuity basis. This reflects policy and regulations during this period.

- All other debt is repaid on an equal life basis: as determined by the expected lifespan of each individual asset.

- The policy also provides some discretion to the Section 151 officer in determining debt repayments. However, this is subject to the relevant scheme meeting targets.

3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The overall treasury management portfolio as at 31st March 2021 and as at 31st January 2022 are shown below for both borrowing and investments.

Table 4: Treasury Portfolio

	Actual 31 March 2021 £m	Actual 31 March 2021 %	Current 31 January 2022 £m	Current 31 January 2022 %
Treasury Investments				
Banks	87.5	65.6	134.1	99.1
Building Societies	9.3	7.0	0	0
DMADF (H M Treasury)	36.5	27.4	1.2	0.9
Total Treasury Investments	**133.3**	**100**	**135.3**	**100**
Treasury External Borrowing				
Other	0.4	0.1	0.4	0.1
PWLB	297.8	88.6	292.3	88.5
LOBOs	37.8	11.3	37.8	11.4
Total external borrowing	**336.0**	**100**	**330.5**	**100**
Net Treasury Investments / (borrowing)	**-202.7**		**-195.2**	

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

The Council is forecast to hold around £488 million of external borrowing and other long-term liabilities as at 31 March 2022. This is analysed in Table 5.

Table 5: Borrowing Projection

	2020-21 Actual £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
External Debt						
Debt at 1 April	347.8	336.0	341.0	436.3	536.8	587.0
Expected change in Debt	-11.8	5.0	95.3	100.5	50.2	9.0
Other long-term liabilities (OLTL)	163.0	154.9	147.0	138.5	129.9	121.1
Expected change in OLTL	-8.1	-7.9	-8.5	-8.6	-8.8	-9.9
Actual gross debt at 31 March	**490.9**	**488.0**	**574.8**	**666.7**	**708.1**	**707.2**
The Capital Financing Requirement	698.8	755.0	831.0	920.0	956.0	953.0
Under / (over) borrowing	**207.9**	**267.0**	**256.2**	**253.3**	**247.9**	**245.8**

This table indicates that, based on the capital programme (paragraph 2.2), additional borrowing from PWLB will be required of £95m in 2022-23, £100m in 2023-24 and £50m in 2024-25. The percentage variable debt rate will reduce as interest rates on older debts were higher than current rates.

The relative mix of future internal and external borrowing will be considered in conjunction with advice from the Council's external treasury management advisor, noting that provision has been made in the updated Council budget plan revenue resource assumptions to accommodate a continued future mix of internal and external borrowing.

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2022-23 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Director of Finance & IT reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Salix Finance Limited provides interest free Government funding to the public sector to improve their energy efficiency, reduce carbon emissions and lower energy bills. The Council has taken the opportunity to secure £19.1 million interest free loans to part fund the £45 million approved street lighting replacement scheme in the Council's approved capital plan. To date in 2021-22, the Council has received £1.7m from Salix.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

2. The Council is asked to approve the following authorised limit.

Table 6: Operational Boundary and Authorised Limit

	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m
Operational boundary	850	840	930	960
Authorised limit	852	860	940	970

3.3 Interest Rate Forecast

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 7th February 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.

Table 7: Interest rate Forecast

Link Group Interest Rate View 7.2.22	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month av. earnings	0.80	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month av. earnings	1.00	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month av. earnings	1.40	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40

Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021.

As shown in the forecast table above, the forecast for Bank Rate now includes a further three increases of 0.25% in March, May and November 2022 to end at 1.25%. However, Link Group stress that these forecasts could be subject to risks for the following reasons:

- Mutations of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns. 25% of the population not being vaccinated is also a significant risk to the NHS being overwhelmed and lockdowns being the only remaining option.

- Labour and supply shortages prove more enduring and disruptive and depress economic activity.

- The Monetary Policy Committee acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- The Monetary Policy Committee tightens monetary policy too late to ward off building inflationary pressures.

- The Government acts too quickly to cut expenditure to balance the national budget.

- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- Longer term US treasury yields rise strongly and pull gilt yields up higher than forecast.

- Major stock markets e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.

- Geopolitical risks, for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows, or if there is concerns over inflation an increase in yields.

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. The forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.

3.4 Investment and borrowing rates

Investment returns have started improving in the second half of 21-22 and are expected to improve further during 22-23 as the MPC progressively increases Bank Rate.

Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.

In November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The current margins over gilt yields are as follows: -.

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

Link Group has forecast a long-term (beyond 10 years) Bank Rate of 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing if an authority is seeking to avoid a "cost of carry" but also wishes to mitigate future re-financing risk

While this Council will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances.

3.5 Borrowing strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low.

The Chief Financial Officer has the delegated responsibility to arrange such loans as are legally permitted to meet the Council's borrowing requirement and to arrange terms of all loans to the Council including amounts, periods and rates of interest.

Against this background and the risks within the economic forecast, caution will be adopted with the 2022-23 treasury operations. The Director of Finance & IT will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.

- if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

At the point of acquiring longer term funding consideration will be given to:

- Whether the forecast capital borrowing requirement has reduced or slipped into the following year.
- The forecast changes to levels of reserves/balances, including whether the Council has received funding in advance of spending for capital schemes.

The strategy is to take longer term fixed rate borrowing when opportunities arise in combination with the temporary use of short-term borrowing as required. This strategy is considered prudent as base rate rises are expected to be measured and small during the forecast period (to Q1 2025).

Any decisions will be reported to the appropriate decision-making body at the earliest opportunity.

3.6 Policy on borrowing in advance of need

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

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.7 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of PWLB rates over gilt yields was reduced by 100 bps in November 2020.

3.8 New financial institutions as a source of borrowing and / or types of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency.
- UK Infrastructure Bank.

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

4. ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

The Department of Levelling Up, Housing and Communities (DLUHC and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital and Investment Strategies (separate reports that went to full Council 17th February 2022).

The Council's investment policy has regard to the following: -

- DLUHC's Guidance on Local Government Investments ("the Guidance").
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code").
- CIPFA Treasury Management Guidance Notes 2018.

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

The guidance from the DLUHC and CIPFA places a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration, the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

3. Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This Council has defined the list of types of investment instruments that the treasury management team are authorised to use.
   - Specified investments are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.
   - Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments

which require greater consideration by members and officers before being authorised for use.

5. Non-specified and loan investment limits. The Council has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of £20m.

6. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.

7. Transaction limits are set for each type of investment in 4.2.

8. This Council will set a limit for its investments which are invested for longer than 365 days, (see paragraph 4.4).

9. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 4.3).

10. This Council has engaged external consultants, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Council in the context of the expected level of cash balances and need for liquidity throughout the year.

11. All investments will be denominated in sterling.

12. As a result of the change in accounting standards for 2022-23 under IFRS 9, this Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31st March 2023.

However, this Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

4.2 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Director of Finance & IT will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The criteria for providing a pool of high-quality investment counterparties, (both specified and non-specified investments) are:

Table 8: Investment Counterparties

Institution	Amount	Time limit	To qualify as a "specified investment"	Non-UK Country	Short term Investment rating	Long Term investment rating
Bank /Building Society	£30m	2yrs	Less than 1 year	AA-	Requires if available Fitch F1 S & P A-1 Moody's P-1	Moody's Aa3 or Fitch AA- if not available.
Bank /Building Society	£20m	1yr	Less than 1 year	AA-	Requires if available Fitch F1 S&P A_1 Moody's P_1w	Moody's A1 or Fitch A1 if not available
Bank/Building Society	£7m	100 days	Less than 1 year	AA-	Either F1 or S&P A_1	Either Moody's A1
Nat West Bank	£20m	1yr	Less than 1 year	AA-	Council bank/part Government owned	n/a
Treasury Bill/DMO	No limit	1yr	Less than 1 year		n/a	UK Gov. rating
Money Market Fund	£20m	Instant access	Less than 1 year		n/a	Either Moody's AAA Fitch AAA or S&P AAA
Local Authority	£20m	1yr	Less than 1 year	AA-	n/a	n/a

Use of additional information other than credit ratings - Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, rating Watches/Outlooks) will be applied to compare the relative security of differing investment opportunities.

Creditworthiness - Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

CDS prices - Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

4.3 Other limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

a) **Non-specified treasury management investment limit.** The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being £20m of the total treasury management investment portfolio.

b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of A1 for the UK and AA- for the rest of the world from Fitch or equivalent. The list of countries that qualify using these credit criteria as at the date of this report are shown in Appendix 4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e., rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations.
The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to reach 1.25% in November 2022.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year, are as follows:

Table 9: Investment earnings rates

Average earnings in each year	Now	Previously
2022-23	1.00%	0.50%
2023-24	1.25%	0.75%
2024-25	1.25%	1.00%
2025-26	1.25%	1.25%
Years 6 to 10	1.50%	-
Years 10+	2.00%	2.00%

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

The Council is asked to approve the following treasury indicator and limit:

Table 10: Upper limit for principle sums invested for longer than 365 days

	2022-23 £m	2023-24 £m	2024-25 £m
Principal sums invested for longer than 365 days	£20m	£20m	£20m

4.5 Investment performance / risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of overnight, 7 day, compounded/ SONIA. The investment average return up to the end of January was 0.11% with average investment balance of £176m.

4.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

5. Other considerations

CIPFA published the revised Prudential and Treasury Management codes on 20th December 2021 and has stated that formal adoption is not required until the 2023-24 financial year. This Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports, which are taken to Full Council for approval during the financial year.

Key changes to the codes include the following:

- A requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained.

- Long term treasury investments, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case.

- Clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment. The Council has no plans to invest in commercial activities primarily for revenue yield.

- Address Environmental, Social and Governance (ESG) issues within the Capital Strategy.

- Require implementation of a policy to review commercial property, with a view to divest where appropriate.

- Create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices). These will be prepared and included with the treasury management strategy 2023-24.

- Ensure that any long term treasury investment is supported by a business model.

- A requirement to effectively manage liquidity and longer term cash flow requirements.

- Amendment to TMP1 to address ESG policy within the treasury management risk framework.

- Amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council. These are covered in the Treasury Management Practices that are reviewed every year.

- A new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

In addition, all investments and investment income must be attributed to one of the following three purposes:

- **Treasury management** - Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

- **Service delivery** - Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".

- **Commercial return -** Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not borrow to invest primarily for financial return.

As this Treasury Management Strategy Statement and Annual Investment Strategy deals soley with treasury management investments, the categories of service delivery and commercial investments will be dealt with as part of the Capital Strategy report.

In addition to the revisions to the Treasury Management and Prudential Codes, the DLUHC launched a consultation on changes to the capital framework in November 2021. Implementation of these changes is also set for the 2023-24 financial year

Members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023-24 TMSS report.

6. Financial and Resources Appraisal

6.1 The financial implications are set out in section 1,2,3 and 4 of this report

7. Risk Management and Governance Issues

7.1 The principal risks associated with treasury management are:

Risk: Loss of investments as a result of failure of counterparties.
Mitigation: Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties.

Risk: That the Council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or new borrowing (Liquidity risk).
Mitigation: Ensuring that a minimum proportion of investments are held in short term investments for cash flow purposes.

Risk: Increase in the net financing costs of the Council due to borrowing at high rates of interest.
Mitigation: Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking mostly long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

Risk: Higher interest rates increase borrowing making it more difficult to self-finance capital schemes. Debt servicing becomes less affordable and less sustainable and crowds out revenue spend.
Mitigation: To pause, delay or defer capital schemes. Also review opportunities to borrow in the future at current interest rates.

Risk: Return on non-treasury investments lower than expected.
Mitigation: Review and analysis of risk prior to undertaking non-treasury investments.

Risk: Coronavirus. The level of uncertainty in the future path of economic growth, unemployment, fiscal and monetary policy make it very difficult to accurately assess the impact on investments, capital spend and borrowing for the Council. The scale of impact will depend on the length of any lockdown and the depth of any recessionary impact.
Mitigation: Cash investments will be mainly held short term due to the uncertainties caused by the virus and we will continue to monitoring the situation and report any changes in the next Treasury report.

Risk: The Council's Minimum Revenue Policy charges an insufficient amount to the Revenue Estimates to repay debt.
Mitigation: Align the Minimum Revenue Policy to the service benefit derived from the Council's assets.

Risk: Associated with cash management, legal requirements and fraud.
Mitigation: These risks are managed through:

- Treasury Management Practices covering all aspects of Treasury management procedures including cash flow forecasting, documentation, monitoring, reporting and division of duties.
- All Treasury management procedures and transactions are subject to inspection by internal and external auditors. The council also employs external financial advisors to provide information on market trends, credit rating alerts, lending criteria advice and investment opportunities.

The Council also employs external financial advisors to provide information on market trends, credit rating alerts, lending criteria advice and investment opportunities.

<u>Risk: Anticipated borrowing is lower than expected because the 2022-23 capital programme is underspent. This is explained in more detail below, together with the actions being taken to reduce these risks:</u>
Mitigation: The Council is required to set a balanced budget for its revenue estimates; so in broad terms, income received will match expenditure over the 2022-23 financial year. The 2022-23 revenue estimates cause only temporary cash flow differences, for example when income is received in a different month to when the expenditure is incurred.

However, the 2022-23 capital budget will cause a cash flow shortfall in the long term, which generates a borrowing requirement. While some of the capital budget is funded immediately, mainly with Government grants, other elements are not funded initially, leading to the cash flow deficit that requires borrowing.

Managing borrowing is part of the Treasury Management role. To help in its management, the Treasury Strategy identifies the element within the capital budget that is not funded straightaway, to anticipate the Council's borrowing requirement.

However, when the capital budget is underspent, the Council has a lower borrowing requirement than anticipated. This risk is managed in practice because the Council only borrows when there is an actual cash flow shortage. The uncertainty around spend against the capital budget makes cash flow management more difficult. For example, it is less likely that the Council would take advantage of a short-term fall in interest rates, without more certainty around the timing of any borrowing need. Actions that have taken place to manage the risks relating to this uncertainty in the timing of capital spend are: Councillor and Officer challenge sessions on the capital budget; increased scrutiny of the capital forecasts in the quarterly monitoring, and the collection of additional documentation around the critical paths of individual schemes.

<u>Risk: Geopolitical risk - At present invasion of Ukraine by Russia.</u>

The level of uncertainty in the future effect of the conflict on inflation, economic growth, fiscal and monetary policy make it very difficult to accurately assess the impact on investments, capital spend and borrowing for the Council. The scale of impact will depend on how the conflict develops.

Mitigation: Cash investments will now mainly be held short term due to the uncertainties caused by the conflict and we will continue to monitoring interest rates and the effect on borrowing costs and report any changes in the next Treasury report.

8. Legal Appraisal

8.1 Any relevant legal considerations are set out in the report.

9. Other Implications

9.1 Equality & Diversity – no direct implications
9.2 Sustainability implications – no direct implications
9.3 Green house Gas Emissions Impact – no direct implications
9.4 Community safety implications – no direct implications
9.5 Human Rights Act – no direct implications
9.6 Trade Unions – no direct implications
9.7 Ward Implications – no direct implications
9.8 Implication for Corporate Parenting – no direct implications
9.9 Issues arising from Privacy Impact Assessment– no direct implications

10. Not for publications documents
10.1 None

11. Options
11.1 None

12. Recommendations
12.1 That the report be noted and referred to full Council for adoption.

11. Appendices
Appendix 1 Prudential and Treasury Indicators
Appendix 2 MRP Policy
Appendix 3 Economic Background
Appendix 4 Approved countries for investments
Appendix 5 Treasury management scheme of delegation
Appendix 6 The treasury management role of the section 151 officer

Appendix 1

THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2022-23 – 2025-26

To facilitate the decision making process and support capital investment decisions, the Prudential Code requires the Council to approve and monitor a minimum number of prudential indicators. These indicators are mandatory and cover affordability, prudence, capital expenditure, external debt and treasury management.

The indicators are purely for internal use by the Council and are not intended to be used as comparators between councils. In addition to this in-year indication, the benefit from monitoring arises from following the movement in indicators over time and the year-on-year changes.

Capital expenditure

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital expenditure	2020-21 Actual £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Total	**64**	**162**	**203**	**242**	**145**	**78**

Estimates of Capital Financing Requirement

	2020-21 Actual £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Opening Capital Financing Requirement	**711**	**699**	**755**	**831**	**920**	**956**
Increase in borrowing	12	81	103	122	73	38
Less MRP and other financing movements	-24	-25	-27	-33	-37	-41
Closing Capital Financing Requirement	**699**	**755**	**831**	**920**	**956**	**953**

Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

a. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital, (borrowing and other long-term obligation costs net of investment income), against the net revenue stream.

	2021-22 £m	2022-23 £m	2023-24 £m	2024-25 £m	2025-26 £m
MRP, excluding PFI	20.0	22.8	28.5	32.1	36.1
MRP PFI, finance lease	4.6	4.6	4.6	4.6	4.6
Old West Yorkshire Waste debt	0.2	0.2	0.2	0.2	0.2
Interest on external borrowing	15.9	16.4	17.8	19.3	20.8
Interest on PFI	16.5	15.9	15.3	14.6	14.0
Premium on debt repayment	0.3	0.3	0.3	0.3	0.3
Investment income	-0.3	-0.3	-0.5	-0.5	-0.6
Total Capital Financing Costs	**57.2**	**59.9**	**66.2**	**70.6**	**75.4**
Projected Net Revenue Stream	385.4	391.3	407.2	416.8	425.0
Ratio to Net Revenue Stream	**14.8%**	**15.3%**	**16.3%**	**16.9%**	**17.7%**
Invest to Save element of Total Capital Financing Costs	5.8	6.8	10.3	12.3	15.8
Invest to Save contribution to Ratio to Net Revenue Stream	**1.5%**	**1.7%**	**2.5%**	**2.9%**	**3.7%**

Prudence indicators

- Gross debt and the capital financing requirement

The Prudential Code requires the calculation of the capital financing requirement (CFR). This figure represents the Council's underlying need to borrow for a capital purpose and the change year-on-year will be influenced by the capital expenditure in the year.

In order to ensure that over the medium term gross debt will only be for capital purposes, the Council must ensure that gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. In cases where the CFR is reducing over the period, the Code allows the CFR at its highest point to be used in this calculation.

The Council had no difficulty meeting the previous calculation in 2020-21, nor are any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this budget report and is shown in the table over.

	2020-21 Actual £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
External Debt						
Debt at 1 April	347.8	336.0	341.0	436.3	536.8	587.0
Expected change in Debt	-11.8	5.0	95.3	100.5	50.2	9.0
Other long-term liabilities (OLTL)	163.0	154.9	147.0	138.5	129.9	121.1
Expected change in OLTL	-8.1	-7.9	-8.5	-8.6	-8.8	-9.9
Actual gross debt at 31 March	**490.9**	**488.0**	**574.8**	**666.7**	**708.1**	**707.2**
The Capital Financing Requirement	698.8	755.0	831.0	920.0	956.0	953.0
Under / (over) borrowing	**207.9**	**267.0**	**256.2**	**253.3**	**247.9**	**245.8**

External debt indicators
Operational boundary

	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Total	850	840	930	960	960

Authorised limit

	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Total	852	860	940	970	970

Actual external debt as at 31st March - this will be reported within the outturn report on treasury management.

Maturity structure of borrowing

These gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

Maturity structure of fixed interest rate borrowing 2022-23		
	Lower	**Upper**
Under 12 months	0%	20%
12 months to 2 years	0%	20%
2 years to 5 years	0%	50%
5 years to 10 years	0%	50%
10 years to 20 years	0%	90%
20 years to 30 years	20%	90%
30 years to 40 years	20%	90%
40 years to 50 years	20%	90%

Maturity structure of variable interest rate borrowing 2022-23		
	Lower	**Upper**
Under 12 months	0%	20%
12 months to 2 years	0%	20%
2 years to 5 years	0%	20%
5 years to 10 years	0%	20%
10 years and over	0%	20%

Upper limit for principle sums invested

Total principal sums invested for periods longer than 365 days – if the Council invests or plans to invest for longer than 365 days it must set an upper limit for each financial year for the maturing of such investments.

£m	2021-22 £m	2022-23 £m	2023-24 £m
Principal sums invested for longer than 365 days	£20m	£20m	£20m

Control of interest rate exposure

Please see paragraphs 3.3, 3.4 and 4.4.

Appendix 2

MRP Policy

1.1 The Local Government Act 2003 requires the Council to make a provision for the repayment of borrowing used to finance its capital expenditure, known as the Minimum Revenue Provision (MRP).

1.2 The MRP is the amount of principal capital repayment that is set aside each year in order to repay the Capital Financing Requirement (CFR) based on the requirement of statutory regulation and the Council's own accounting policies.

1.3 The Council is required to state as part of its budget process the policy for determining its MRP. The method for calculating the MRP on each category of debt is outlined below:

a) The policy for charging MRP on historic supported borrowing is on the asset life method calculated on an equal instalment basis over 50 years.

b) Unsupported or prudential borrowing MRP is based on the Asset Life method – that is, the expenditure financed from borrowing is divided by the expected asset life. For schemes funded before 31st March 2012 the MRP is calculated on the annuity basis and for schemes funded after 1st April 2012 the MRP is calculated on an equal instalment basis. This means no change to existing policy.

c) Since 2009-10 the appropriate financing costs for the Council's Building Schools for the Future (BSF) Private Finance Initiative (PFI) schemes have been included in MRP calculations. In 2018-19 the MRP policy for PFI assets was brought into line with the main MRP Policy and the charge of the principal to the revenue account is now over the life of the school building assets.

d) Asset lives are reviewed on an ongoing basis to match the MRP charge to the Revenue Estimates with the service benefit derived from the asset.

e) Where the Council has made property investments [or an invest to save investment] during or after 2018-19, the Section 151 Officer may choose to repay debt over the asset life using the annuity method. This is subject to an in house valuation that the investment property has retained or increased in value. Further it is subject to the condition that the in-year yield is above the average for Treasury Investments and this is expected to continue into the future.

f) Where capital expenditure involves repayable loans or grants to third parties no MRP is required where the loan or grant is repayable. By exception, on the basis of a business case and risk assessment, this approach may be amended at the discretion of the Director of Finance & IT.

1.4 The CFR represents the amount of capital expenditure that has been financed from borrowing, less any amounts that the Council has set aside to repay that debt through the MRP. Borrowing may come from loans taken from the Public Works Loan Board (PWLB) or commercial banks, finance leases (including PFI) or from the use of the Council's own cash balances.

1.5 External debt can be less than the CFR. External debt cannot exceed the CFR (other than for short term cash flow purposes or cash flow management.)

1.6 There is an International Financial Reporting Standards requirement that assets funded from finance leases (including PFI deals) are brought onto the balance sheet. This also includes the liability as well as the asset. Therefore, the term borrowing does not just include loans from the Public Works Loan Board and banks, but also the liability implicit in PFI and other finance leases. IFRS 16 is due to be implemented from the 1 April 2022 and as a result, more of the Council's leases will be treated as finance leases. Therefore, more of the costs of these leases will be included in capital financing costs for the purposes of calculating the Prudential Indicator.

1.7 The CIP will need to be reviewed through the planning cycle to ensure it remains affordable within revenue resources and to take account of the actual implementation of capital schemes.

1.8 Loans to third parties for a capital purpose can be repaid with the repayments providing the following conditions are met: the capital scheme is self-financing; that there is overall confidence that the loan will be repaid; that the third party adheres to the agreed repayment schedule.

Appendix 3 Economic Background (provided by Link Asset Services)

COVID-19 and vaccines

These were the game changer during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, the bursting onto the scene of the Omicron mutation at the end of November, rendered the initial two doses of all vaccines largely ineffective in preventing infection. This dashed such hopes and raised major concerns that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that although this mutation is very fast spreading, it does not cause severe illness in fully vaccinated people. Rather than go for full lockdowns which heavily damage the economy, the government strategy this time focused on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection., It also placed restrictions on large indoor gatherings and hospitality venues over Christmas and into January and requested workers to work from home. This hit sectors like restaurants, travel, tourism and hotels hard which had already been hit hard during 2021.Economic growth will also have been lower due to people being ill and not working, similar to the pingdemic in July. The economy, therefore, faces significant headwinds in early 2022 although some sectors have learned how to cope well with Covid. The big question still remains as to whether any further mutations of this virus could develop which render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- The threat from Omicron was a wild card causing huge national concern at the time of December's MPC meeting; now it is seen as a vanquished foe disappearing in the rear-view mirror.
- The MPC shifted up a gear in February in raising Bank Rate by another 0.25% and narrowly avoiding making it a 0.50% increase by a 5-4 voting margin.
- Our forecast now expects the MPC to deliver another 0.25% increase in March; their position appears to be to go for sharp increases to get the job done and dusted.
- The March increase is likely to be followed by an increase to 1.0% in May and then to 1.25% in November.
- The MPC is currently much more heavily focused on combating inflation than on protecting economic growth.
- However, 54% energy cap cost increases from April, together with 1.25% extra employee national insurance, food inflation around 5% and council tax likely to rise in the region of 5% too - these increases are going to hit lower income families hard despite some limited assistance from the Chancellor to postpone the full impact of rising energy costs.
- Consumers are estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above increases. But most of those holdings are held by more affluent people whereas poorer people already spend nearly all their income before these increases hit and have few financial reserves.
- The increases are already highly disinflationary; inflation will also be on a gradual path down after April so that raises a question as to whether the MPC may shift into protecting economic growth by November, i.e., it is more debatable as to whether they will deliver another increase then.
- The BIG ISSUE – will the current spike in inflation lead to a second-round effect in terms of labour demanding higher wages, (and/or lots of people getting higher wages by changing job)?

- If the labour market remains very tight during 2022, then wage inflation poses a greater threat to overall inflation being higher for longer, and the MPC may then feel it needs to take more action.

PWLB RATES

- The yield curve has flattened out considerably.
- We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate.
- It is difficult to say currently what effect the Bank of England starting to sell gilts will have on gilt yields once Bank Rate rises to 1%: it is likely to act cautiously as it has already started on not refinancing maturing debt. A passive process of not refinancing maturing debt could begin in March when the 4% 2022 gilt matures; the Bank owns £25bn of this issuance. A pure roll-off of the £875bn gilt portfolio by not refinancing bonds as they mature, would see the holdings fall to about £415bn by 2031, which would be about equal to the Bank's pre-pandemic holding. Last August, the Bank said it would not actively sell gilts until the *"Bank Rate had risen to at least 1%"* and, *"depending on economic circumstances at the time."*
- It is possible that Bank Rate will not rise above 1% as the MPC could shift to relying on quantitative tightening (QT) to do the further work of taking steam out of the economy and reducing inflationary pressures.
- Increases in US treasury yields over the next few years could add upside pressure on gilt yields though, more recently, gilts have been much more correlated to movements in bund yields than treasury yields.

MPC MEETING 4TH FEBRUARY 2022

- After the Bank of England became the first major western central bank to put interest rates up in this upswing in December, it has quickly followed up its first 0.15% rise by another 0.25% rise to 0.50%, in the second of what is very likely to be a series of increases during 2022.
- The Monetary Policy Committee voted by a majority of 5-4 to increase Bank Rate by 25bps to 0.5% with the minority preferring to increase Bank Rate by 50bps to 0.75%. The Committee also voted unanimously for the following: -
    - to reduce the £875n stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets.
    - to begin to reduce the £20bn stock of sterling non-financial investment-grade corporate bond purchases by ceasing to reinvest maturing assets and by a programme of corporate bond sales to be completed no earlier than towards the end of 2023.
- The Bank again sharply increased its forecast for inflation – to now reach a peak of 7.25% in April, well above its 2% target.
- The Bank estimated that UK GDP rose by 1.1% in quarter 4 of 2021 but, because of the effect of Omicron, GDP would be flat in quarter 1, but with the economy recovering during February and March. Due to the hit to households' real incomes from higher inflation, it revised down its GDP growth forecast for 2022 from 3.75% to 3.25%.
- The Bank is concerned at how tight the labour market is with vacancies at near record levels and a general shortage of workers - who are in a very favourable position to increase earnings by changing job.
- As in the December 2021 MPC meeting, the MPC was more concerned with combating inflation over the medium term than supporting economic growth in the short term. However, what was notable was the Bank's forecast for inflation: based on the markets' expectations that Bank Rate will rise to 1.50% by mid-2023, it forecast inflation to be only 1.6% in three years' time. In addition, if energy prices beyond the next six months fell as the futures market suggests, the Bank said CPI inflation in three years' time

would be even lower at 1.25%. With calculations of inflation, the key point to keep in mind is that it is the rate of change in prices – not the level – that matters. Accordingly, even if oil and natural gas prices remain flat at their current elevated level, energy's contribution to headline inflation will drop back over the course of this year. That means the current energy contribution to CPI inflation, of 2% to 3%, will gradually fade over the next year.

- So the message to take away from the Bank's forecast is that they do not expect Bank Rate to rise to 1.5% in order to hit their target of CPI inflation of 2%. The immediate issue is with four members having voted for a 0.50% increase in February, it would only take one member more for there to be another 0.25% increase at the March meeting.

- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative tightening) holdings of bonds is as follows: -
    1. Raising Bank Rate as "the active instrument in most circumstances".
    2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
    3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
    4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.

OUR FORECASTS

a. Bank Rate

- Covid remains a major potential downside threat as we are most likely to get further mutations. However, their severity and impact could vary widely, depending on vaccine effectiveness and how broadly it is administered.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

b. PWLB rates and gilt and treasury yields

Gilt yields. Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. Our forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for medium to longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

US treasury yields. During the first part of 2021, US President Biden's, and the Democratic party's, determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. This was in addition to the $900bn support package previously passed in December 2020. Financial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme roll-out had enabled a rapid opening up of the economy during 2021.

2. The economy was growing strongly during the first half of 2021 although it has weakened during the second half.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing substantial stimulus through monthly QE purchases during 2021.

It was not much of a surprise that a combination of these factors would eventually cause an excess of demand in the economy which generated strong inflationary pressures. This has eventually been recognised by the Fed at its recent December meeting with an aggressive response to damp inflation down during 2022 and 2023.

- At its 3rd November Fed meeting, the Fed decided to make a start on tapering its \$120bn per month of QE purchases so that they ended next June. However, at its 15th December meeting it doubled the pace of tapering so that they will end all purchases in February. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that treasury yields will rise over the taper period, all other things being equal.

- It also forecast that it expected there would be three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024. This would take rates back above 2% to a neutral level for monetary policy. It also gave up on calling the sharp rise in inflation as being 'transitory'.

- At its 26th January meeting, the Fed became even more hawkish following inflation rising sharply even further. It indicated that rates would begin to rise very soon, i.e., it implied at its March meeting it would increase rates and start to run down its holdings of QE purchases. It also appears likely that the Fed could take action to force longer term treasury yields up by prioritising selling holdings of its longer bonds as yields at this end have been stubbornly low despite rising inflation risks. The low level of longer dated yields is a particular concern for the Fed because it is a key channel through which tighter monetary policy is meant to transmit to broader financial conditions, particularly in the US where long rates are a key driver of household and corporate borrowing costs.

There are also possible DOWNSIDE RISKS from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to monitor.

Globally, our views are as follows: -

- **EU.** The ECB joined with the Fed by announcing on 16th December that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases during the first half of 2022. The ECB did not change its rate at its 3rd February meeting, but it was clearly shocked by the increase in inflation to 5.1% in January. The President of the ECB, Christine Lagarde, hinted in the press conference after the meeting that the ECB may accelerate monetary tightening before long and she hinted that asset purchases could be reduced more quickly than implied by the previous guidance. She also refused to reaffirm officials' previous assessment that interest rate hikes in 2022 are "very unlikely". It, therefore, now looks likely that all three major western central banks will be raising rates this year in the face of sharp increases in inflation - which is looking increasingly likely to be stubbornly high and for much longer than the previous oft repeated ‘transitory’ descriptions implied.

- **China.** The pace of economic growth has now fallen back after the initial surge of recovery from the pandemic and China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. However, with Omicron having now spread to China, and being much more easily transmissible, lockdown strategies may not prove so successful in future. To boost flagging economic growth, The People’s Bank of China cut its key interest rate in December 2021.

- **Japan.** 2021 was a patchy year in combating Covid. However, recent business surveys indicate that the economy is rebounding rapidly now that the bulk of the population is fully vaccinated, and new virus cases have plunged. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back towards its target of 2% any time soon.

- **World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

- **Supply shortages**. The pandemic and extreme weather events, followed by a major surge in demand after lockdowns ended, have been highly disruptive of extended worldwide supply chains. Major queues of ships unable to unload their goods at ports in New York, California and China built up rapidly during quarters 2 and 3 of 2021 but then halved during quarter 4. Such issues have led to a misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. The latest additional disruption has been a shortage of coal in China leading to power cuts focused primarily on producers (rather than consumers), i.e., this will further aggravate shortages in meeting demand for goods. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods available to purchase.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is now to the downside.

Downside risks to current forecasts for UK gilt yields and PWLB rates include: -

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed or unable to be administered fast enough to stop the NHS being overwhelmed.

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.

- **Bank of England** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **The Government** acts too quickly to increase taxes and/or cut expenditure to balance the national budget.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Geopolitical risks,** for example in Ukraine/Russia, Iran, China, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows. As Russia has invaded Ukraine, this has caused short term volatility in financial markets, and it is difficult to predict how this will impact the gilt market in the future.

Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- Longer term US treasury yields rise strongly and pull gilt yields up higher than forecast.

- Geopolitical risks for example in Ukraine could have the effected of increasing yields due to the concern of higher inflation.

Appendix 4

APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P)

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- France

AA-

- Belgium
- Hong Kong
- Qatar
- **U.K.**

Appendix 5 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Governance and Audit Committee

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Corporate Overview and Scrutiny Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

Appendix 6 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management). These include:

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe.
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money.
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council.
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing.
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the Council to an excessive level of risk compared to its financial resources.
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities.
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees.
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority.
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above.
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following -
    - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
    - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;

- Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;

- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;

- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.