Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2022/23

Including commercial activities / non-treasury investments

INTRODUCTION

Background

1. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet operational expenditure. The function of treasury management is to ensure that the Council's capital programme and corporate investment plans are adequately funded, and the cashflow is adequately planned, with cash being available when it is needed to discharge the Council's legal obligations and deliver Council services. Surplus monies are invested in counterparties or instruments commensurate with the Council's appetite for risk and liquidity requirements, as priorities before considering investment returns.

2. 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."

3. The Council has formally adopted CIPFA's Code of Practice on Treasury Management and follows the key requirements of the Code as set out in Appendix 5.

4. The TMSS covers five main areas summarised below:

Section 1 Capital spending

- Capital strategy
- Commercial activity
- Capital Finance Requirement (CFR)
- Affordability
- Minimum Revenue Provision (MRP) policy statement

Section 2 Borrowing

- Overall borrowing strategy
- Post-PWLB interest rate increase borrowing strategy
- Alternative Borrowing Options
- Limits on external borrowing
- Maturity structure of borrowing
- Policy on borrowing in advance of need
- Debt rescheduling

Section 3 Managing cash balances

- The current cash position and cash flow forecast
- Prospects for investment returns
- Pension pre-funding payment
- Council policy on investing and managing risk
- Balancing short- and long-term investments

Section 4 Summary of Prudential Indicators

Section 5 Legal Implications

5. The Annual Investment Strategy (AIS) at Appendix 2 provides more detail on how the Council's surplus cash investments are to be managed in 2022/23. Approved schedules of specified and non-specified investments will be updated following consideration by Members and finalisation of 2022/23 budget plans.

SECTION 1 - CAPITAL SPENDING

Capital spending plans

6. 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.

7. Table 1 summarises the Council's capital expenditure plans, both in terms of those projects agreed previously, and those forming part of the current budget cycle. The table sets out the Council's current and estimated capital spending and funding.

8. The General Fund capital spend has slipped back by around £10m and HRA capital spend by £20m in 2020/21. The slippage is forecast to be recovered in the 2021/22 revised budget and subsequent years. However there remains a risk of further slippage in future years.

9. The risks are that:

- continued slippage in new starts will push borrowing requirements to later years when interest rates are forecast to be higher than currently.
- slippage in the programme of capital receipts may increase the need to borrow in the short to medium term.

Table 1 Capital spending and funding plans (Prudential Indicator 1)

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s	2026/27 Estimate £000s	Total £000s
	Expenditure							
74,611	General Fund	114,579	98,523	50,164	31,950	1,486	0	296,702
61,075	HRA	64,073	79,755	60,537	49,855	47,722	44,991	346,933
135,686		178,652	178,278	110,701	81,805	49,208	44,991	643,635

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s	2026/27 Estimate £000s	Total £000s
	General Fund							
(23,151)	Government Grant	(20,995)	(20,036)	(20,955)	(10,086)	0	0	(72,072)
(4,160)	Other Contributions	(7,048)	(3,081)	(420)	0	0	0	(10,549)
(1,539)	Revenue Contributions	(7,649)	(400)	0	0	0	0	(8,049)
(4,998)	Capital Receipts	(13,132)	(70)	(60)	(57)	(42)	0	(13,361)
(43,159)	Self-Finance via Future Disposal	(32,998)	(35,957)	(13,632)	(4,920)	(1,444)	0	(88,951)
(18,564)	Prudential Borrowing	(32,757)	(38,979)	(15,097)	(16,887)	0	0	(103,720)
(95,571)	**TOTAL GF FINANCING**	**(114,579)**	**(98,523)**	**(50,164)**	**(31,950)**	**(1,486)**	**0**	**(296,702)**
	HRA							
(2,612)	Government Grant	(1,976)	(12,519)	(7,231)	0	(2,992)	0	(24,718)
(11,367)	Major Repairs Reserve	(21,068)	0	0	0	0	0	(21,068)
(703)	Other Contributions	(813)	0	0	(5,000)	0	0	(5,813)
(11,878)	Revenue Contributions	(2,240)	(30,768)	(35,015)	0	0	0	(68,023)
(13,555)	Capital Receipts	(3,421)	(9,020)	(11,474)	(6,251)	(2,230)	0	(32,396)
0	Self-Finance via Future Disposal	0	0	0	0	0	0	0
0	Prudential Borrowing	(34,555)	(27,448)	(6,817)	(38,604)	(42,500)	(44,991)	(194,915)
(40,115)	**TOTAL HRA FINANCING**	**(64,073)**	**(79,755)**	**(60,537)**	**(49,855)**	**(47,722)**	**(44,991)**	**(346,933)**
(135,686)	**TOTAL FINANCING**	**(178,652)**	**(178,278)**	**(110,701)**	**(81,805)**	**(49,208)**	**(44,991)**	**(643,635)**

Commercial activity

10. As well as investing in assets owned by the Council and used in the delivery of services, the Council can also invest, where appropriate, in:

- infrastructure projects, such as green energy.
- loans to third parties.
- shareholdings, and loans to limited companies and joint ventures.

11. Such investments are treated as capital expenditure for treasury management and prudential borrowing purposes even though they do not create physical assets in the Council's accounts. Appropriate budgets in respect of these activities are agreed as part of the Council's budget setting and ongoing monitoring processes and considered as part of the Annual Investment Strategy.

12. Currently the Council is invested in the following activities which fall within the category of commercial activity under the CIPFA Prudential Code:

- a small commercial investment property portfolio comprising the Tramworks site acquired in October 2017 valued at £8.3m as at 31 March 2021. The Council also has three industrial estates at Lockwood Road, Selborne Walk Acacia and Hainault Road. These are held as operational assets as they were principally acquired for economic regeneration and fall outside the commercial activity category under the Prudential Code. Nonetheless they are managed to achieve a commercial rate of return.
- Investment in a few Council companies summarised in Table 2 below.

Table 2 Investment in Council companies

Company name	Share holding	Nominal value £	Net Worth 31/3/2021 £000s
Subsidiaries			
Waltham Forest Services Ltd	100%	100	44
Waltham Forest Trading Ltd	100%	100	0
Sixty Bricks Ltd	100%	100	(1,733)
Walthamstow Scene Ltd	100%	1	0
Joint Venture			
More Homes Waltham Forest LLP	50%	100	(1,648)
Associate			
NPS (London) Ltd	20%	2	(530)
Investments in PFI companies			
Waltham Forest Local Education Partnership Ltd	10%	5,500	0
BY Education (Waltham Forest) Holdings Ltd	10%	5,000	(356)
Total		**10,903**	**(4,223)**

13. In addition to the investment of £10,903 in the above companies, the Council has provided a loan facility for working capital to Sixty Bricks Ltd of £2m of which £1.733m has been advanced.

14. The Council has Board representation on all companies. The Council's Shareholder Committee represents its interests in its wholly owned companies and other companies, ensuring that they act in the interests of the borough and contribute to the Council's objectives.

15. The Council is not dependent on income generated from the companies, as they are primarily for delivering service policy objectives for the Council. The accumulated losses to date of £4.223m are largely concerned with initial set-up costs and expected to reverse over the next three years as the companies develop further. Equally, the Council's financial accounts review have not highlighted any going concern or value for money issues. It should be noted that progress has been delayed in 2020/21 and 2021/22 by the impact of the Covid-19 pandemic.

Capital Financing Requirement (CFR)

16. The CFR measures the extent to which capital expenditure has not yet been financed 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 which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

17. In addition to traditional capital expenditure on tangible assets, such as buildings, the CFR includes PFI schemes and finance leases. Whilst these increase the CFR, and therefore the Council's borrowing requirement, these contracts include an element of the charge to repay the financing provided by the PFI provider or the lessor. Consequently, the Council is not required to separately borrow for these schemes. At 31 March 2021, £45.1m of the CFR was in respect of PFI schemes and finance leases.

18. 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.

19. Table 3 shows that the CFR will increase over the medium term. Consequently, the capital financing charge to revenue will increase, reflecting the capital spending plans.

Table 3 Capital Financing Requirement forecast (Prudential Indicator 2)

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s	2026/27 Estimate £000s
	CFR as at 31 March						
305,138	General Fund	354,961	350,989	338,833	319,636	299,216	287,222
200,631	HRA	231,765	250,193	245,536	277,889	318,159	363,150
505,768		**586,726**	**601,181**	**584,369**	**597,524**	**617,375**	**650,372**
	Annual change						
57,078	General Fund	49,824	(3,973)	(12,155)	(19,198)	(20,419)	(11,994)
0	HRA	31,134	18,428	(4,657)	32,353	40,270	44,991
57,078		**80,958**	**14,455**	**(16,812)**	**13,155**	**19,851**	**32,997**
	Reason for change						
61,723	Net financing	86,640	21,366	(9,162)	20,583	27,441	40,873
(4,645)	Less MRP	(5,682)	(6,911)	(7,650)	(7,428)	(7,590)	(7,876)
57,078		**80,958**	**14,455**	**(16,812)**	**13,155**	**19,851**	**32,997**

20. Table 4 below confirms that the Council's gross debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current year and the following financial years. This allows some flexibility for limited early borrowing for future years and ensures that borrowing is not undertaken for revenue purposes. The gross debt for 2020-21 is the actual debts plus other long-term liabilities (PFI and finance lease).

Table 4 Borrowing compared to the CFR (Prudential Indicator 3)

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimates £000s	2023/24 Estimates £000s	2024/25 Estimates £000s	2025/26 Estimates £000s	2026/27 Estimates £000s
400,738	Gross Projected Debt	502,889	583,258	562,803	581,529	594,521	614,960
505,768	Capital Financing Requirement	586,726	601,181	584,369	597,524	617,375	650,372
105,030	Under/(Over) borrowing	83,837	17,923	21,566	15,995	22,854	35,412

Affordability

21. The objective of the affordability indicator is to ensure that the level of investment in capital assets proposed remains within sustainable limits and the impact on the Council's "bottom line". The estimates of financing costs include current commitments and the proposals in the Council's budget report. Table 5 below sets out the expected ratio of capital financing costs to income for both General Fund and HRA activities:

Table 5 Ratio of capital financing costs to income (Prudential Indicator 4)

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s	2026/27 Estimate £000s
5.64%	General Fund	5.55%	6.06%	6.53%	6.72%	6.52%	6.49%
32.89%	HRA	29.64%	35.77%	35.97%	35.77%	35.70%	35.78%

22. For the medium-term, gross capital financing charges (loan interest, MRP and finance and PFI payments) for the General Fund capital programme are largely outweighed or balanced by income from investments and the commercial property portfolio.

23. The capital financing charges arising from the HRA capital programme increase in line with the forecast increase income, hence capital charges as a proportion of the HRA net revenue stream remain steady. Table 4 shows a reduction between the outturn for 2020/21 and the forecast for 2021/22. This is because depreciation charges (which fund the Major Repairs Reserve) are expected to rise thereon. This reflects the increase in value of the housing stock anticipated from the completion of the HRA Major Works programme.

Minimum Revenue Provision Policy Statement

24. Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ('the 2003 Regulations') requires local authorities to 'charge to a revenue account a minimum revenue provision (MRP) for that year'. The minimum revenue provision is an annual amount set aside from the General Fund to meet the cost of capital expenditure that has not been financed from available resources, namely: grants, developer contributions (e.g. s.106 and community infrastructure levy) revenue contributions, earmarked reserves or capital receipts.

25. MRP is sometimes referred to as the mechanism for setting aside monies to repay external borrowing. In fact, the requirement for MRP set aside applies even if the capital expenditure is being financed from the Council's own cash resources and no new external borrowing or other credit arrangement has been entered.

26. Regulation 28 of the 2003 Regulations requires full Council to approve a Minimum Revenue Provision (MRP) Statement setting out the policy for making MRP and the amount of MRP to be calculated which the Council considers to be prudent. This statement is designed to meet that requirement.

27. In setting a prudent level of MRP local authorities must “have regard” to guidance issued from time to time by the Secretary of State for Housing, Communities and Local Government. The latest version of this guidance (version four) was issued by Ministry of Housing, Communities and Local Government (MHCLG) in February 2018.

    The Council considers to be prudent, the guidance states that the broad aim is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefit to the Councils.

28. The Department for Levelling Up, Housing and Communities (DLUHC) issued “Consultation on changes to the capital framework: Minimum Revenue Provision” on 30th November 2021. The scope of the consultation includes the statement that local authorities have flexibility in how they calculate MRP, providing it is ‘prudent’. This may lead to additional guidance for 2023/24.

29. The Guidance sets out four “possible” options for calculating MRP, as set out below,

Option	Calculation method	Applies to
1: Regulatory method	Formulae set out in 2003 Regulations (later revoked)	Expenditure incurred before 1 April 2008
2: CFR method	4% of Capital Financing Requirement	Expenditure incurred before 1 April 2008
3: Asset life method	Amortises MRP over the expected life of the asset	Expenditure incurred after 1 April 2008
4: Depreciation method	Charge MRP on the same basis as depreciation	Expenditure incurred after 1 April 2008

30. Two main variants of Option 3 are set out in the Guidance (i) the equal instalment method and (ii) the annuity method. The annuity method weights the MRP charge towards the later part of the asset’s expected useful life and is increasingly becoming the most common MRP option for local authorities.

31. The Guidance also includes specific recommendations for setting MRP in respect of finance lease, investment properties and revenue expenditure which is statutorily defined as capital expenditure under the 2003 Regulations (also referred to as revenue expenditure funded from capital under statute or REFCUS). Examples of REFCUS include capitalised redundancy costs, loans, or grants to third parties for capital purposes, and the purchase of shares in limited companies.

32. Other approaches are not ruled out however they must meet the statutory duty to make prudent MRP provision each financial year.

33. The 2022/23 MRP policy does not propose any changes from the 2021/22 approved policy, which is at Appendix 1.

SECTION 2 - BORROWING

Overall borrowing strategy

34. One of the main functions 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.

35. The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. Given the significant cuts to public expenditure and to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the long-term stability of the debt portfolio.

36. The key factors influencing the 2022/23 strategy are:

- forecast borrowing requirements,
- the current economic and market environment, and
- interest rate forecasts.

37. 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 source of temporary funding. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

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

39. 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. Any such decisions will be reported back to Audit and Governance Committee and full Council at the next available opportunity.

New Borrowing

The council's borrowing strategy will give consideration to the following forms of borrowing to finance capital requirements:

40. Internal borrowing: The need to undertake external borrowing can be reduced by the temporary use of internal balances held for provisions and reserves within the Council's accounts and cashflow movements on a day-to-day basis. The option of postponing borrowing and running down investment balances may provide short term revenue savings and reduce investment risk. The use of internal balances, however, must be monitored to mitigate the risks arising from the need to externally refinance when rates are unfavourable.

- Temporary Borrowing: from the money market or other local authorities.
- Shorter Term Borrowing (1 – 5 years): from non PWLB and other sources.
- Long Term Market Debt: where rates are significantly below those offered by the PWLB for an equivalent maturity period, and to provide diversity within the debt portfolio.
- PWLB: borrowing for periods across all durations where rates offer best value.
- Other borrowing arrangements: such as the use of leasing may be more cost efficient for some types of capital expenditure such as for vehicles and equipment.

41. The council will continue to borrow in respect of the following:

- Maturing debt.
- Approved (prudential) capital expenditure / capital investment.
- To finance short-term cashflow fluctuations.

42. The type, period, rates, and timing of new borrowing will be determined by the Strategic Director of Finance and Governance (Section 151 Officer) under delegated powers, taking into account the following factors:

- Expected movements in interest rates as outlined above.
- Maturity profile of the debt portfolio.
- The impact on the medium-term financial strategy.
- Prudential indicators and limits.

43. The Council's treasury management strategy permits borrowing from various sources, but it has not been previously anticipated that any alternatives to PWLB would need to be utilised, given the current low cost of PWLB funding.

44. The key advantage of PWLB is the speed and ease of transaction processing and the low fee and administration cost associated with the loans. Alternative types of funding could result in lengthy due diligence, consultancy costs, legal advice and fees and will be far more costly administratively.

Other Borrowing Options

45. Other options for funding include:

- **Banks/ Institutional investors**

  Discussions with the Council's treasury consultant (LINK) suggest that the Council could access borrowing from banks providing deferred drawdown.

- **Pension Fund institutional investors**

  Initial indications have suggested that the Council may be able to borrow from institutional investors based on weighted average life of approximately 30 years. Such an arrangement will be subject to extensive negotiations with the lenders, who will need to carry out due diligence on a Council's finances, budgets, and balance sheet.

- **Bond issuance**

  A bond issue would first require the Council to become credit rated by one (or more) of the major ratings agencies: Fitch, S&P or Moody's. This is a complex, lengthy, repetitive, and costly process. The precise rate offered will be market led and dependent on the financial resilience of Council and the market's perception of its creditworthiness.

  Councils with significant reserves and a record of not overspending on budget will be able secure the most advantageous rates. Bond releases typically require a minimum size of at least £200m.

- **The Municipal Bonds Agency**

  This has been in existence since 2013 but has only recently transacted its first bond issuance and local authority borrower.

- **Loans to Third Parties**

The Authority may borrow to make grants or loans to third parties for the purpose of capital expenditure, as allowable under paragraph 25 (1) (b) of the Local Authorities (Capital Financing and Accounting) (England) Regulations 2003 (Statutory Instrument No. 3146). This facility is likely to be used to support local economic regeneration and development activity but not limited to those purposes. The additional capital expenditure may be funded by external borrowing. Loans for working capital or revenue purposes are permitted as long as these are funded from the Council's internal cash balances as external borrowing is not permitted in such circumstances.

- **Pension Fund Cash** - The Local Government Pension Scheme (Management and Investment) Regulations 2016 requires the Council to maintain a separate bank account for the Pension Fund. For the management of Pension Fund cash, there is in place an agreement to pool internally held pension fund balances (working cash and those pending external investment) with the investment balances of the Council. These balances are invested in accordance with the Council's Treasury Management Strategy.

  The Pension Fund receives interest annually on their cash balances at a rate commensurate with that received by the Council. Pension Fund cash balances may be withdrawn anytime. In the event of loss of any investment, this will be borne on a pro rata basis equivalent to the value of each party's contribution to the investment which incurred the loss.

  In view of the limited returns on investments externally, the Council will aim to extend its programme of prepaying pension contributions and it proposes delegated authority be granted to the Strategic Director Finance and Governance.

  This strategy will benefit the Council in that the discount rate earned by paying pension fund contributions in advance at around 6.2% significantly outweighs the returns from direct investment in the money market which is currently generating a return of a little over 1%. In addition, it mitigates counter party risk.

46. Alternative opportunities for the Council may well present themselves, and the borrowing strategy will be designed to allow for this. The 'benchmark' for a borrowing opportunity is regarded at around gilts +0.8%. It is unclear at this stage whether feasible PWLB competition will materialise, and it is likely to take some time to do so. Officers will continue to explore alternatives to the PWLB, working with the Council's treasury advisor, Link. PWLB rates will also be kept under regular monitor and review.

47. Immediate liquidity needs can be satisfied by borrowing from other local authorities in the short term, consistent with the Council's current approved treasury management strategy.

Limits on external borrowing

48. The Prudential Code requires the Council to set two limits on its total external debt, as set out in Table 6 below. The Authorised Limit has been set higher than the CFR and operational limit is set the same as the CFR.

49. The limits are:

- **Authorised Limit for External Debt (Prudential Indicator 5a)** –This is a key prudential indicator and represents a control on the maximum level of borrowing. This limit prescribed by section 3(1) of the Local Government Act 2003 representing the maximum level of borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term.

- **Operational Boundary (Prudential Indicator 5b)** – This is the limit which external debt is not normally expected to exceed. The boundary is set at to equal to the CFR, and the ability to fund under-borrowing by other cash resources.

Table 6 Overall borrowing limits (Prudential Indicators 5a and 5b)

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimates £000s	2023/24 Estimates £000s	2024/25 Estimates £000s	2025/26 Estimates £000s	2026/27 Estimates £000s
	Authorised Limit :						
556,345	Borrowing	645,399	661,299	642,806	657,277	679,112	715,409
	Operational Boundary:						
505,768	Borrowing	586,726	601,181	584,369	597,524	617,375	650,372

50. The Strategic Director Finance and Governance reports that the Council complied with these prudential indicators 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 report.

Maturity structure of borrowing (Prudential Indicator 7)

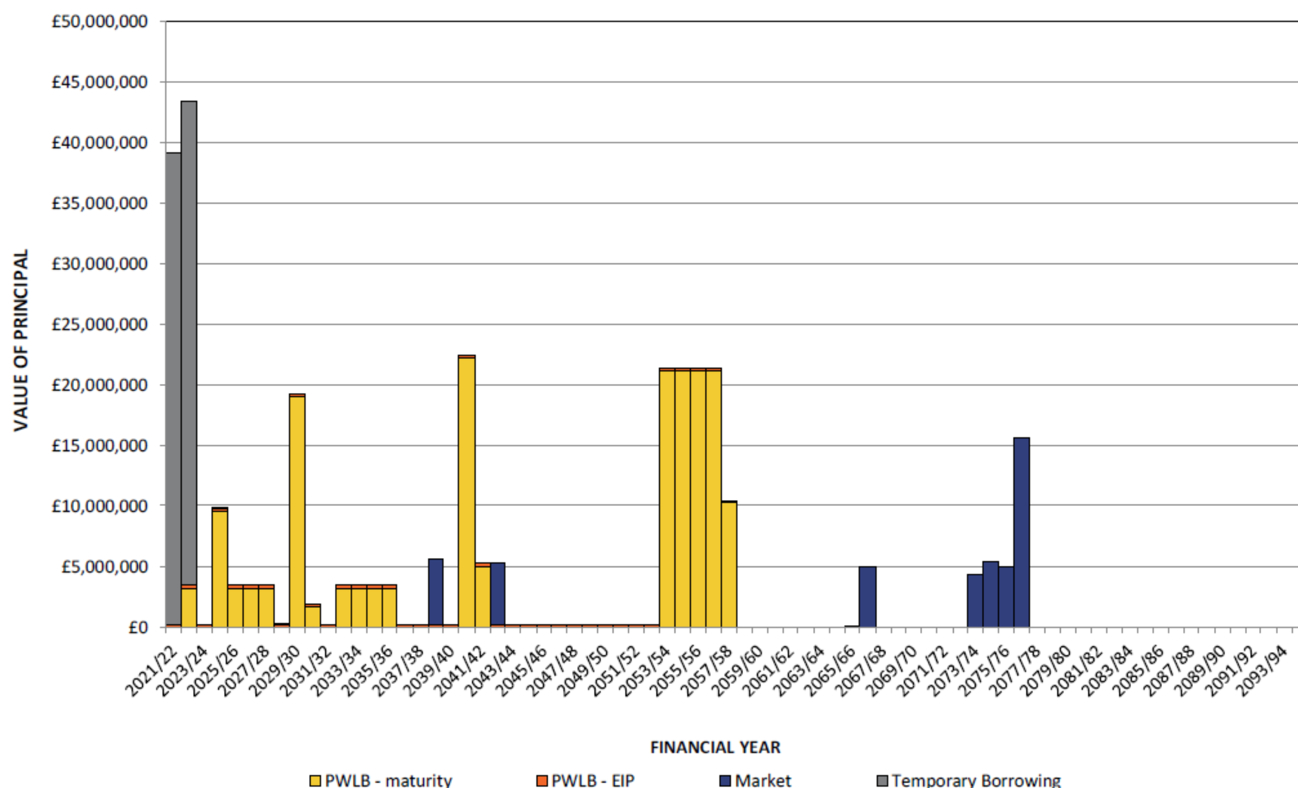
51. Managing the maturity profile of debt is essential for reducing the Council's exposure to large fixed rate sums falling due for refinancing within a short period, and thus potentially exposing the Council to additional cost. Table 7 below sets out current upper and lower limits for debt. The principal repayment profile for current council borrowing remains within these limits.

Table 7 Debt maturity profile limits

31-Dec-21 %	Actual maturity	Upper Limit %	Lower Limit %
18	Under 12 months	50	0
19	1 to 2 years	30	0
6	3 to 5 years	30	0
10	6 to 10 years	30	0
47	more than 10 years	100	0

52. The chart below shows the maturity of loan debt by type of borrowing at 31 December 2021. Currently the borrowing strategy is to continue to use temporary borrowing while rates remain substantially below long-term interest rates.

Chart 1 Loan maturity by type of borrowing



53. Table 8 below sets out the upper limits for interest rate exposures.

Table 8 Interest rate exposures

	2021/22 Upper	2022/23 Upper	2023/24 Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%

54. If there is a much sharper rise in long- and short-term rates than currently forecast, then the balance of the loan portfolio will be revisited with a view to taking on further longer-term fixed rate borrowing in anticipation of future rate rises.

Policy on borrowing in advance of need

55. The Council can borrow in advance of need where the borrowed funds are to support approved function (policies), within the confines of the agreed capital programme. The Council will not borrow more than or in advance of its needs primarily to profit from the investment of the extra sums borrowed i.e. (debt for yield). 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. Therefore, the Council must not borrow to fund primarily yield generating investments.

56. In determining whether borrowing will be undertaken in advance of need the Council will:

- Ensure that the ongoing revenue liabilities created, and the implications for future capital plans and budgets have been considered.
- Evaluate economic and market factors that might influence the manner and timing of the decision to borrow.
- Consider the pros and cons of alternative forms of funding, interest rate structures and repayment profiles.
- Consider the positive and negative impacts of borrowing in advance of need on the Council's cash balances, the increased exposure to credit risk that will arise because of investing this additional cash in advance of need.
- 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.

Debt rescheduling

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

58. The reasons for any rescheduling to take place will include:

- generating cash savings and/or discounted cash flow savings.
- helping to fulfil the treasury strategy; and
- enhancing the balance of the portfolio by amending the maturity profile and/or the balance of volatility.

Consider the positive and negative impacts of borrowing in advance of need on the Council's cash balances, the increased exposure to credit risk that will arise because of investing this additional cash in advance of need.

59. Should an opportunity for debt rescheduling arise, it will be reported to the Audit and Governance Committee and full Council at the earliest meeting following its action.

SECTION 3 – MANAGING CASH BALANCES

The current cash position and cash flow forecast

60. 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).

61. As at 31 December 2021 core cash and short-term investments totalled £60.7m. The medium-term cashflow forecast is that it will remain around this level particularly while the Government provides Covid-19 funding for local businesses through grant supports schemes channelled through local authorities. Treasury officers will work closely with the Corporate Finance team to monitor slippage within the capital programme and income through the Collection Fund, which will impact on cashflow levels.

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). 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.

Prospects for investment rates

62. Investment returns are likely to remain exceptionally low during 2022/23 with little change in the following two years.

The emergence of a new COVID-19 strain throws a spanner in the economic recovery. The Omicron variant has elevated the level of uncertainty about the recovery path from the pandemic.

On the 16th December 2021 the Bank of England unexpectedly raised interest rates for the first time in three years from historic low of 0.10% to 0.25%.

Inflation worries are back at the forefront of economic concerns, as the threat of even higher inflation weighs on the economic outlook. UK inflation accelerated to 4.2% in the 12 months to October, with more increases on the horizon. This is now more than double the Bank of England's target of 2% and marks the fastest pace of consumer price increases for almost a decade.

63. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are set out in Table 9 below (the long-term forecast is for periods over 10 years in the future):

Table 9 Forecast investment returns

Average earning in each year	
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.10%
2025/26	0.25%
Long-term later years	2.00%

Council policy on investing and managing risk

64. The aim is to manage risk and reduce the impact of any adverse movement in interest rates on the one hand but, at the same time, not setting the limits to be so restrictive that they impair opportunities to reduce costs or improve performance.

Balancing short and long-term investments

65. Greater returns are usually obtainable by investing for longer periods. While most cash balances are required 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. During 2020/21, no investments exceeded 364 days. This means the Council remains well within the upper limit for such investments of £70m.

Table 10 Investment limits (Prudential Indicator 6)

	2021/22 Forecast £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s
Upper limit for principal sums invested for more than 365 days	£70m or 50% of the outstanding balances			

SECTION 4 - SUMMARY OF PRUDENTIAL INDICATORS (PIs)

66. The Prudential code 2021 supports local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within a clear reporting framework, that:

- a local authority's capital expenditure plans and investment plans are affordable and proportionate.
- all external borrowing and other long-term liabilities are within prudent and sustainable levels
- the risks associated with investments for commercial purposes are proportionate to their financial capacity, and
- treasury management decisions are taken in accordance with good professional practice.

The prudential indicators are to illustrate the impact of capital programme on treasury management activity.

67. As the Council's S151 officer, the Strategic Director Finance and Governance has a responsibility to ensure that appropriate PIs are set and monitored and that any breaches are reported to Members.

68. The Strategic Director Finance and Governance has confirmed that the PIs set out below are all expected to be complied with in 2021/22 and he does not envisage at this stage that there will be any difficulty in achieving compliance with the suggested indicators for 2022/23.

P1 ref	Par ref	Prudential Indicator	2020/21 Actual £000s	2021/22 Forecast £000s	2022/23 Proposed £000s
1	9	Capital Expenditure	135,686	178,652	178,278
2	19	Capital Financing Requirement	505,768	586,726	601,181
3	20	Gross debt vs CFR - Under/(over) borrowed	105,030	83,837	17,923
4	21	Ratio of Financing cost to revenue stream:			
		General fund	5.64%	5.55%	6.06%
		HRA	32.89%	29.64%	35.77%
5a	49	Authorised limit for external debt	556,345	645,399	661,299
5b	49	Operational debt boundary	505,768	586,726	601,181
6	65	Limit on surplus funds held for more than	£70m or 50% of	£70m or 50% of	£70m or 50% of
		365 days (i.e. non-specified investments)	outstanding bal	outstanding bal	outstanding bal
7	51	Maturity structure of borrowing:			
		Upper limit under 12 months	50%	50%	50%
		Lower limit 10 years and above	0%	0%	0%

SECTION 5 - LEGAL IMPLICATIONS

69. The Local Government Act 2003 provides that a local authority has the power both to borrow and invest money for any purpose relevant to its functions and for the prudent management of its financial affairs. The Act requires the Council to determine and to keep under review how much money it can afford to borrow. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended, provide that, in complying with this duty, the Council must have regard to the Prudential Code for Capital Finance in Local Authorities published by CIPFA. The Council is also required to have regard to the CIPFA Treasury Management Code of Practice.

70. The current CIPFA Treasury Management Code of Practice 2017 and the Secretary of State's Investment Code both require the Section 151 officer (Strategic Director Finance and Governance) to present an Annual Treasury Management Strategy Statement, which includes an Annual Investment Strategy, for the forthcoming year for approval by the Full Council before the beginning of each financial year.

71. The revised CIPFA Prudential Code for Capital Finance in Local Authorities sets out various indicators that are to be used to support capital expenditure plans and treasury management decisions. The prudential and treasury indicators must be set by the Full Council when the budget is set and are monitored during the year. The prudential indicators are included in section 8 of this report.

72. The Council is also required to approve a Treasury Management Policy Statement setting out the overarching framework for treasury management services within the Council. This statement is set out in sections 5-7 of this report.

APPENDICES

1 Minimum Revenue Provision (MRP) Policy

2 Annual Investment Strategy

3 Approved Counterparty List

4 Approved Countries for Investments

5 CIPFA Treasury Management Code requirements including:

   a. Treasury Management Scheme of Delegation

   b. Treasury Management role of s.151 officer

6 Prospect for Interest Rates/ Economic Update

BACKGROUND PAPERS

1. Treasury Management Strategy Statement 2021/22 (Approved by Council March 2021)
2. Section 3 Local Government Act 2003
3. Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended
4. MHCLG Guidance on Minimum Revenue Provision (fourth edition) February 2018
5. MHCLG Capital Finance Guidance on Local Government Investments February 2018
6. CIPFA Prudential Code for Capital Finance in Local Authorities, 2017
7. CIPFA Treasury Management Code of Practice, 2017
8. CIPFA Treasury Management Guidance Notes 2018

APPENDIX 1

Minimum Revenue Provision (MRP) policy statement

1. Having regard to current Guidance on MRP issued by MHCLG and the "options" outlined in that Guidance, the Council is recommended to approve the following MRP Statement to take effect from 1 April 2021:

    - For all pre-2007/08 capital expenditure, MRP will be calculated on a straight-line to repay this element over 50 years.
    - except for invest-to-save schemes, all capital expenditure incurred since 2007/08, MRP will be based on expected useful asset lives (Option 3 – asset life), calculated using the annuity method.
    - for invest-to-save schemes MRP will be profiled to mirror the income generated from the scheme.
    - asset lives will be arrived at after discussion with valuers, but on a basis consistent with depreciation policies set out in the Council's annual Statement of Accounts and will be kept under regular review.
    - MRP for finance leases and service concession contracts shall be charged over the primary period of the lease, in line with the Guidance,
    - for expenditure capitalised by virtue of a capitalisation direction under section 16(2)(b) of the Local Government Act 2003 or Regulation 25(1) of the 2003 regulations, the 'asset' life should equate to the value specified in the statutory Guidance.

2. In applying 'Option 3':

    - MRP should normally begin in the financial year following the one in which the expenditure was incurred. However, in accordance with the statutory Guidance, commencement of MRP may be deferred until the financial year following the one in which the asset becomes operational.
    - the estimated useful lives of assets used to calculate MRP should not exceed a maximum of 50 years except as otherwise permitted by the Guidance (and supported by valuer's advice);
    - if no life can reasonably be attributed to an asset, such as freehold land, the estimated useful life should be taken to be a maximum of 50 years.

APPENDIX 2

ANNUAL INVESTMENT STRATEGY

Investment policy

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

   - MHCLG' 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

2. The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The above guidance from MHCLG and CIPFA places a high priority on the management of risk. This Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

   i. Minimum acceptable **credit criteria** are applied 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.

   ii. **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 where applicable.

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

   iv. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 5.4 under the categories of 'specified' and 'non-specified' investments.

      - **Specified investments** are those with a high level of credit quality and subject to a maturity limit at the start of the investment of up to one year.

      - **Non-specified investments** are any financial investments that are not loans and do not meet the criteria to be treated as specified investments. These are long-term investment so may not just be lower credit quality than specified investments and carry a higher degree of credit risk.

   v. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating.**

   vi. This authority has engaged **external consultants**, to provide expert advice on how to optimise an appropriate balance of security, liquidity, and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

   vii. All investments will be denominated in **sterling**.

   viii. As a result of the change in accounting standards for 2020/21 under IFRS 9, this authority 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.

3. However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Creditworthiness Policy

4. 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.

5. 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.

6. The Strategic Director Finance and Governance 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 those which determine which types of investment instrument are either specified or non-specified as they provide 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.

7. Credit rating information is supplied by the Council's treasury advisors, Link Group, any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur, and this information is considered before dealing.

8. The Council takes into account the following relevant matters when proposing counterparties:

- the financial position and jurisdiction of the institution.
- the market pricing of credit default swaps for the institution.
- any implicit or explicit Government support for the institution.
- Standard & Poor's, Moody's and Fitch's short- and long-term credit ratings.
- sovereign ratings to select counterparties from only the most creditworthy countries; and
- core Tier 1 capital ratios.

9. Changes to the credit rating will be monitored and, in the event, that a counterparty is downgraded and does not meet the minimum criteria specified in Appendix 1, which is MRP policy the following action will be taken immediately:

- no new investments will be made.
- existing investments will be recalled if there are no penalties; and
- full consideration will be given to recall or sale of existing investments which would be liable to penalty clause.

Specified and Non-specified investments

10. The MHCLG Guidance on Local Government Investments made under section 15(1) of the Local Government Act 2003, places restrictions on local authorities around the use of specified and non-specified investments.

11. A **specified investment** is defined as an investment which satisfies all the conditions below:

- the investment and any associated cash flows are denominated in sterling.
- the investment has a maximum maturity of one year.
- the investment is not defined as capital expenditure; and
- the investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

12. **Non-specified investments**

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. In addition to the long-term investments listed in the table at the end of Appendix 1, the following non-specified investments that the Council may make include:

- **Green Energy Bonds** - Investments in solar farms are a form of Green Energy Bonds that provide a secure enhanced yield. The investments are structured as unrated bonds and secured on the assets and contracts of solar and wind farms. Before proceeding with any such investment, internal and external due diligence will be undertaken in advance of investments covering the financial, planning, and legal aspects.

- **Social Housing Bonds** – Various fund managers facilitate the raising of financing housing associations via bond issues. The investment is therefore asset backed and provides enhanced returns. Officers will need to undertake due diligence on each potential investment to understand the risks and likelihood of default. This is a type of vehicle a few local authorities are involved which not only helps to meet a local authority's statutory duty to house the homeless, but also provides a return more than short-term investment rates.

- **Loans** - The Council will allow loans (as a form of investment) to be made to organisations delivering services for the Council where this will lead to the enhancement of services to the Council's Stakeholders. The Council will undertake due diligence checks to confirm the borrower's creditworthiness before any sums are advanced and will obtain appropriate levels of security or third party guarantees for loans advanced. The Council would expect a return commensurate with the type, risk, and duration of the loan. A limit of £70 million for this type of investment is proposed with a duration commensurate with the life of the asset and Council's cash flow requirements. All loans will need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels.

- **Shareholdings in limited companies and joint ventures** – The Council invests in two forms of company:

    i. Trading vehicles which the Council has set up to undertake functions. These are not held primarily as investments but to fulfil Council service objectives. Examples include Sixty Bricks Ltd and the More Homes joint venture. Any new proposals will be subject to due diligence as part of the initial business case. As these are not to be held primarily as investment vehicles, then there is an expectation that they will break even.

    ii. Trading vehicles held for a commercial purpose where the Council is obliged to undertake transactions via a company vehicle. Examples include the companies set up

under the former Building Schools for the Future programme which operate the schools PFI contracts.

13. For any such investments, specific proposals will be considered by the Strategic Director Finance and Governance after taking into account of the following:

- cash flow requirements
- investment period
- expected return
- the general outlook for short to medium term interest rates
- creditworthiness of the proposed investment counterparty
- other investment risks.

14. The nominal value of non-specified investments will be capped at £70m.

Country of Domicile

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

16. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- or equivalent except in the UK. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 4. This list will be kept under review and any proposed changes to the policy reported to the next meeting.

Schedule of investments

17. The criteria for providing a pool of high quality short, medium, and long-term, cash-based investment counterparties along with the time and monetary limits for institutions on the Council's counterparty list are set out in Appendix 3.

18. Officers will monitor the impact of the UK's exit from the European Union on the names within the Council's counterparty list.

APPENDIX 3
Approved counterparty list

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
Specified Investments			
DMADF – UK Government	N/A	**100%**	6 months*
Money market funds: CNAV and VNVAV	AAA	100%	Daily Liquidity
Local authorities	N/A	100%	3 years
Barclays Bank plc (the Council's bankers)		£20m £5m	Overnight deposits ** Up to 12 months
Term deposits with banks and rated building societies	Yellow Purple Blue Orange Red Green		Up to 3 years Up to 3 years Up to 3 years Up to I year Up to 6 Months Up to 3 months
Current and Ex - Government Supported banks	Green	50%	Up to 1 year

* DMO – is the maximum period offered by the Debt Management Office of H.M Treasury

** Over £20 million with the explicit agreement of the Strategic Director of Finance and Governance (Section 151 Officer).

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
Non-specified investments			
Term deposits with unrated Building Societies	Assets over £1.0bn	25%	12mths
UK Government supported banks and Ex- Government supported banks	n/a	£70m or 50% of total investments	3 yrs.
Pooled Vehicles: Enhanced Money Market Funds: UK Government and Government Guaranteed securities Pooled Property Funds Short – Term Investment – grade sterling denominated instruments	N/A	£10m	4yrs
UK Treasury Bills, Certificate of Deposits and T-bills	Yellow Purple Blue Orange Red Green No Colour		Up to 3 years Up to 2 years Up to I year Up to 6 Months Up to 6 Months Up to 3 months Not for use
Corporate Bonds including Floating Rate Notes (FRNs)	Minimum Credit Rating: BBB		3yrs

APPENDIX 4

APPROVED COUNTRIES FOR INVESTMENTS

1. 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) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

Lowest available rating	Approved Country
AAA	Australia Denmark Germany Luxembourg Netherlands Norway Singapore Sweden Switzerland
AA+	Canada Finland U.S.A.
AA	Abu Dhabi (UAE) France
AA-	Belgium Hong Kong Qatar United Kingdom

APPENDIX 5
CIPFA TREASURY MANAGEMENT CODE

The Council has formally adopted CIPFA's Code of Practice on Treasury Management (updated 2017) and complies with the requirements of the Code. CIPFA has published the revised codes on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. This Council must have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and related reports during the financial year, which are taken to Full Council for approval.

The revised codes will have the following implications:

- 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.
- 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.
- address 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 (like the current Treasury Management Practices).
- 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.
- a new requirement to clarify reporting requirements for service and commercial investment, (especially were 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.

Training

1. 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 will be arranged as required.

2. The training needs of treasury management officers are periodically reviewed.

Treasury management consultants

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

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

5. It also recognises that there is value in employing external providers of treasury management services 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.

6. The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties. The commercial type investments require specialist advisers, and the Council uses Link Group in relation to this activity.

Treasury Management Delegations and Responsibilities

7. The respective roles of the Council, Audit and Governance Committee and Strategic Director of Finance and Governance (Section 151 officer) are summarised below. Further details are set out in the Treasury Management Practices.

(i) Full Council

- Approval of annual strategy, mid-year review and Annual Report

(ii) Treasury Strategy Group/Strategic Director Finance and Governance

- 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) Audit and Governance Committee with responsibility for scrutiny

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

THE TREASURY MANAGEMENT ROLE OF STRATEGIC DIRECTOR OF FINANCE AND GOVERNANCE (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.

APPENDIX 6
Prospects for interest rates

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 20th December 2021. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View 20.12.21	Dec-21	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	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

Additional notes by Link on this forecast table: -

- *LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.*
- *Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.*

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 four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

Significant risks to the forecasts

- **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.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is now to the downside, including risks from Covid and its variants - both domestically and their potential effects worldwide.

Forecasts for Bank Rate

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.

- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a

dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.

- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?

- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.

- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?

- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.

- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.

- 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.

It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though 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 our 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 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. However, this was in addition to the $900bn support package already passed in December 2020. This was then followed by additional Democratic ambition to spend $1trn on infrastructure, (which was eventually passed by both houses later in 2021), and an even larger sum on an American families plan over the next decade; this is still caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme 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 overall 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 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 and after the taper ends, all other things being equal. The Fed 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, taking rates back above 2% to a neutral level for monetary policy.

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.

There is likely to be **exceptional volatility and unpredictability in respect of gilt yields and PWLB rates** due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields (see below). Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to

cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.

- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures actually turn out to be in both the US and the UK and so put upward pressure on treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases eventually needed to suppress inflation, are likely to be faster and stronger than Bank Rate increases in the UK. This is likely to put upward pressure on treasury yields which could then spill over into putting upward pressure on UK gilt yields.

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and Russia, China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

The balance of risks to medium to long term PWLB rates: -

- There is a balance of upside risks to forecasts for medium to long term PWLB rates.

10.1.22 UPDATE TO FORECASTS

The Fed minutes for their December 14-15 meeting were released last week. These showed there is a very likely going to be an acceleration in the pace of monetary tightening policies including a faster rate of increase in the Fed rate and running down the stock of QE purchases. This has led to a sharp jump up in treasury yields, and also in gilt yields in this country.

It is also now clearer that there could be a 50% increase in the price cap on fuel prices from 1st April 2022 in this country: this could boost inflation significantly and would then put added pressure on the Bank of England to raise Bank Rate faster as inflation would be unlikely to come down as fast as previously expected. What is still an unknown is whether the Government will damp down the calculation of inflation figures by providing some kind of subsidy for gas and electricity costs e.g., it could make loans to energy companies by spreading increased costs incurred this year over several future years as those loans are gradually repaid.

There has therefore been a sharp increase in the balance of upside risks to the forecasts for gilt yields, PWLB rates and Bank Rate. *(Link Group will be reviewing its forecasts after the MPC quarterly meeting of 3rd February)*

A new era for local authority investing
– a fundamental shift in central bank monetary policy
One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US, before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.
- ***For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.***
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

Investment and borrowing rates

- **Investment returns** are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.

- **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.

- On 25.11.20, 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)

- **Borrowing for capital expenditure.** Our long-term (beyond 10 years), forecast for Bank Rate is 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 authority 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.