Agenda Item No 4
Cabinet
6th March 2024

Title: Treasury Management Strategy 2024/25
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Portfolio Holder: Councillor Jonathan Chilvers
Wards of the District directly affected: All

Approvals required	**Date**	**Name**
Portfolio Holder		Cllr Jonathan Chilvers
Finance	1/2/24	Richard Wilson
Legal Services		N/A
Chief Executive	5/2/24	Chris Elliott
Head of Service(s)	2/2/24	Andrew Rollins
Section 151 Officer	2/2/24	Andrew Rollins
Monitoring Officer	6/2/24	Graham Leach
Leadership Co-ordination Group		
Final decision by this Committee or rec to another Cttee / Council?	No Recommendation to: Council	
Contrary to Policy / Budget framework?	No	
Does this report contain exempt info/Confidential? If so, which paragraph(s)?	No	
Does this report relate to a key decision (referred to in the Cabinet Forward Plan)?	Yes, Forward Plan item 1,429 scheduled for 6 March 2024	
Accessibility Checked?	Yes/No	

Summary

This report details the strategy that the Council will follow in carrying out its treasury management activities in 2024/25

Recommendations

That the Cabinet recommends to Council the approval of:

(1) The Treasury Management Strategy for 2024/25 as outlined in paragraph 1.9 and contained in Appendix B.

(2) The 2024/25 Annual Investment Strategy as outlined in paragraphs 1.10 and contained in Appendix C.

(3) The Minimum Revenue Provision Policy Statement as outlined in paragraph 1.11 and contained in paragraphs 5.1 to 5.5 of Appendix D.

(4) The Prudential and Treasury Indicators as outlined in paragraph 1.18 and contained in Appendix E, including the amount of long-term borrowing required for planned capital expenditure.

1 Reasons for the Recommendations

1.1 The Authority is required to operate a balanced revenue 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 Authority's low risk appetite, providing adequate liquidity initially before considering investment return.

1.2 The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that it 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 risk or cost objectives.

1.3 The contribution the treasury management function makes to the Authority 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.

1.4 The Chartered Institute of Public Finance and Accountancy (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."

1.5 This definition is included within this Council's Treasury Management Policy Statement 2024/25, at Appendix A.

1.6 While 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.

1.7 The Council's treasury management operations are governed by various Treasury Management Practices (TMPs) that the CIPFA Treasury Management Code requires to be produced by the Council and adhered to by those officers engaged in the treasury management function. These TMPs have previously been reported to the Cabinet and are subject to periodic Internal Audit review.

1.8 There were updates made to the TMPs before 1 April 2022, and a major re-write was undertaken to fully incorporate the 2021 CIPFA recommendations.

1.9 Under CIPFA's updated *Treasury Management in Public Services Code of Practice* the Council continues to be required to have an approved annual *Treasury Management Strategy*, under which its treasury management operations can be carried out. The proposed Strategy for 2024/25 is included as Appendix B.

1.10 This Council has regard to the Government's Guidance on Local Government Investments. The guidance states that an *Annual Investment Strategy* must be produced in advance of the year to which it relates and must be approved by the full Council. The Strategy can be amended at any time, and it must be made available to the public. The *Annual Investment Strategy* for 2024/25 is shown as Appendix C.

1.11 The Council must make provision for the repayment of specified outstanding debt and other forms of borrowing such as finance leases. Statutory guidance issued by DLUHC requires that a statement on the Council's *Minimum Revenue Provision (MRP) Policy* should be submitted to full Council for approval before the start of the relevant financial year. This is contained in Appendix D.

1.12 On 30 November 2021 DLUHC issued "*Consultation on changes to the capital framework: Minimum Revenue Provision*", to last for 10 weeks until 8 February 2022. Then on 21 December 2023, the Government launched the final consultation on changes to the MRP regulations and statutory guidance.

1.13 The consultation will close on 16 February 2024, with Link releasing their response to assist clients to respond. All authorities are encouraged to respond.

1.14 The draft legislation in the Consultation says that the changes will take effect from 1 April 2024, impacting on the year 2024/25 and the MRP Policy contained in Appendix D of this report.

1.15 The Government is concerned that all councils comply with the duty to make a prudent minimum revenue provision.

1.16 The latest Consultation acknowledges that councils believe that a prudent MRP policy should enable them to elect to use capital receipts from capital loan repayments to be put aside to repay debt in place of the revenue charge. This had major implications for Warwick District Council, particularly for the housing joint venture, so along with many councils, we responded against the removal of this discretion.

1.17 The recommended MRP Policy at Appendix D would still enable the MRP to exclude such loan repayments, subject to full repayment of the loans. It incorporates several changes recommended by Link (paragraphs 5.4 and 5.5) as part of a report commissioned on the impact of loans to Milverton Homes Limited.

1.18 The Council is required to approve an Annual Treasury Management Strategy, an Annual Investment Strategy, and a Minimum Revenue Provision Policy Statement before each financial year. These strategies and policy for 2024/25 are contained in Appendices B, C and D, respectively. This meeting is on 20 March 2024, ahead of the statutory deadline of 31 March 2024. Therefore recommendations 1 to 3 would ensure compliance with these requirements.

1.19 The Council is also required to publish and monitor Prudential and Treasury Indicators. This is covered by recommendation 4.

1.20 The Prudential Code requires full Council to approve several Prudential and Treasury Indicators, including amounts of borrowing required to support capital expenditure, set out in Appendix E, which must be considered when determining the Council's Treasury Management Strategy, which should assess the risks and rewards of significant investments over the *long-term*, as opposed to the usual three to five years that most local authority financial planning has been conducted over, to ensure the long-term financial sustainability of the authority. (CIPFA has not defined what longer-term means, but it is likely to infer 20-30 years in line with the financing time horizon and the expected life of the assets, while medium-term financial planning, at a higher level of detail, is probably aimed at around a 10-year timeframe and focuses on affordability in particular).

1.21 The *Prudential Code for Capital Finance in Local Authorities* was last revised on 20 December 2021 and introduced new requirements for the way that capital spending plans are considered and approved, in conjunction with the development of an integrated Treasury Management Strategy. It was effective immediately, but councils were permitted to defer reporting until 2023/24. Given the other workstreams the Council was facing, and that this was the advice of the treasury advisers, the Council agreed to defer until the statutory deadline.

1.22 The key points were:

a) An authority must not borrow to invest primarily for financial return,

b) Revised definition of investments,

c) Quarterly monitoring and reporting of Performance Indicators,

d) New performance indicator for net income from commercial and service investments as a percentage of net revenue stream,

e) New performance indicator for the 'liability benchmark[1]',

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[1] a projection of the amount of loan debt outstanding that the Council needs each year into the future to fund its existing debt liabilities, planned prudential borrowing and other cash flows.

f) Capital Finance Requirement includes heritage assets,

g) Annual strategy review of divesting commercial activities,

h) Objectives must include the need for plans and risks to be proportionate,

i) New definitions of prudence,

j) Reference to Environmental Sustainability in the Capital Strategy,

k) Production of an annual Capital Strategy. Link recommends that this should be a separate high-level corporate document.

1.23 Point d) above introduced a new distinction of service investments.

1.24 The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes:

1.24.1 **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.

1.24.2 **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'.

1.24.3 **Commercial return** - Investments held primarily for financial return with no treasury management or direct service provision purpose[2].

1.25 The main requirements of the Prudential Code relating to service and commercial investments are:

1.25.1 The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e., that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services.

1.25.2 An authority must not borrow to invest for the primary purpose of commercial return.

1.25.3 It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.

1.25.4 An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt.

1.25.5 A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream.

[2] CIPFA has defined this as at least 50% of the purpose.

1.25.6 Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

1.26 As previously reported, this Council has no 'Commercial return' investments.

1.27 The recommendations will enable the Council to operate within the known budgetary framework to be set for 2024/25 but if the Prudential Indicators need to be adjusted during the year, a further report will need to be brought to Council for approval.

2 Alternative Options

2.1 This report sets out the capital spending and borrowing requirements for the financial year 2024/25 within the Prudential Indicators (PIs). The Council can increase or decrease these limits, provided that these PIs are within the envelope of what is affordable and prudent, taking account of interest costs and the Minimum Revenue Provision ("depreciation") requirements.

3 Legal Implications

3.1 None directly arising from the Council's Treasury Management activity.

4 Financial

4.1 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 (i.e., Security, Liquidity, Yield = "SLY").

4.2 The second main function of the treasury management service is the funding of the capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially 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.

4.3 The contribution the treasury management function makes to the authority 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 (i.e., the "S" in "SLY" above), as a loss of principal would result in a chargeable loss to the General Fund.

4.4 Treasury Management can have a significant impact on Warwick District Council's budget through its ability to maximise its investment interest income and minimize borrowing interest payable whilst ensuring the security and liquidity of financial resources.

4.5 The 2024/25 budget for investment income is as follows:

Investment Income	23/24 Revised budget £'000	24/25 Original budget £'000	25/26 Original budget £'000
Recurring items:			
External investment income	2,085.3	1,625.7	1,625.7
Deferred capital receipts interest	8.3	8.3	8.3
Long-term debtor loans	3,045.2	2,957.9	2,484.5
add : HRA allocation#	2,218.1	2,754.7	2,754.7
Net interest to General Fund	7,356.9	7,346.6	6,873.2

- a charge to HRA for internal borrowing from the GF rather than the PWLB

4.6 The amount of interest that is to be credited or debited to the Housing Revenue Account as 'HRA allocation#' will vary depending on how the net balances and cashflow of the HRA changes. As the HRA's capital programme has begun to rely on external borrowing in recent financial years, due to interest rates and the Council's overall level of investments (of reserves and balances), this borrowing has been deferred, and the HRA has used 'internal borrowing', for which the interest is paid to the General Fund for that fund's share of the investments foregone.

4.7 Whilst any 'service' (not to be confused with commercial / primarily 'for yield') 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.

5 Corporate Strategy

5.1 The treasury management activity in this report applies to Warwick District Council, in accordance with the statutory framework and local Treasury Management Strategy and Treasury Management Practices.

5.2 The Treasury Management function enables the Council to meet its vision, primarily through having suitably qualified and experienced staff deliver the service in accordance with the Council's Treasury Management Practices and the national framework that local government operates.

5.3 Warwick District Council has adopted a Corporate Strategy which sets three strategic aims for the organisation. Each proposed decision should set out how the report contributes to the delivery of these strategic aims. If it does not contribute to these aims or has a negative effect on them the report should explain why that is the case.

5.4 **Delivering valued, sustainable services** – The Treasury Management function enables Council services to deliver these strategic aims, by minimising borrowing costs and maximising investment returns within the SLY principals outlined in this report.

5.5 **Low cost, low carbon energy across the district** – The Treasury Management function enables Council services to deliver these strategic aims, contributing to obtaining external borrowing for capital expenditure at the optimum time for the Council as a whole, within cash flow requirements.

5.6 **Creating vibrant, safe, and healthy communities of the future** - The Treasury Management function enables Council services to deliver these strategic aims, contributing to obtaining external borrowing for capital expenditure at the optimum time for the Council as a whole, within cash flow requirements.

6 Environmental/Climate Change Implications

6.1 The recommendation to divest from direct ownership of fossil fuels companies or commingled funds that include fossil fuel public equities by no later than 2025, in pursuance of the Council's Climate Emergency Declaration, was realised ahead of target in September 2021.

6.2 The Council updated its Treasury Management Practices in 2023, to incorporate references to Environmental Social and Governance (ESG) criteria, and this will be refined over time as CIPFA provides more guidance and the Council formally defines what ESG means in terms of Treasury Management.

6.3 As a development of future Treasury Management Strategies and Capital Strategies the Council will need to develop an understanding of the ESG 'risks' it is exposed to and evaluate how well it can manage these risks.

6.4 It is not the same as Socially Responsible Investing, (typically negative 'screens' are applied, e.g., no investing in fossil fuels), and equally, it is not the same as Sustainable Investing, (investing in products / companies based on expected sustainable and beneficial societal impact, alongside a financial return).

6.5 The Council would need to consider the risk limiting of potential counterparty options and decreasing diversification of investments.

6.6 The main rating agencies are now claiming that they incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings.

6.7 The Council recognises that Governance is often the greatest risk to treasury investments because poor governance can have a more immediate impact on the financial circumstances of an entity and the potential for a default event that would impact the amount the local authorities receive back from their investments. Those financial institutions that are viewed as having poor or weak corporate governance are generally less well rated in the first instance or have a higher propensity for being subject to negative rating action. So, this element of ESG is of high importance to an investor that is following investment guidance with the Security, Liquidity and Yield (SLY) principle at its core.

6.8 Environmental & Social factors are important, but more for the long-term impact, unless the Council chooses to specifically go down the 'impact' / 'sustainable' type investment route, and currently there are not many options for that in respect of short-term investments that councils can use.

7 Analysis of the effects on Equality

7.1 Not applicable.

8 Data Protection

8.1 Treasury Management activity is compliant with Data Protection Act.

9 Health and Wellbeing

9.1 Not applicable.

10 Risk Assessment

10.1 Investing the Council's funds inevitably creates risk, and the Treasury Management function effectively manages this risk through the application of the SLY principle. Security (S) ranks uppermost, followed by Liquidity (L), and finally Yield (Y). Social impact will be an underlining principle. It is accepted that longer duration investments increase the security risk within the portfolio; however, this is inevitable to achieve the optimal return and still comply with the SLY principle which is a cornerstone of treasury management within local authorities.

10.2 Paragraph 6.7 refers to ESG risks.

10.3 Section 1 of Appendix C (the annual *Treasury Management Investment Strategy*) provides more detail on how the risk is mitigated.

10.4 The Council does not have a specific risk register for Treasury Management, but it does feature within the Finance risk register.

10.5 By engaging with our treasury management consultants, Link Group ('Link'), the Council can minimise the risks to which it is exposed. Link provide regular briefings, alerts, and advice in respect of the Council's portfolio. They also provide training for Members and officers responsible for the Council's treasury management function, to ensure they are informed and competent.

11 Consultation

11.1 Not applicable.

12 Reporting requirements

12.1 Capital Strategy

12.1.1. The CIPFA 2021 Prudential and Treasury Management Codes requires local authorities to prepare a Capital Strategy report, which provides 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.

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

12.1.3. CIPFA produced a document 'Capital strategy guidance 2021 - a whole organisation approach', which would need to be referenced during the production of the next update of the Council's 2019 document.

12.1.4. This capital strategy is reported separately from the Treasury Management Strategy Statement, being a corporate strategy; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under Security, Liquidity and Yield (SLY) principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy shows:

- The corporate governance arrangements for these types of activities.
- Any service objectives relating to the investments.
- The expected income, costs and resulting contribution.
- The debt related to the activity and the associated interest costs.
- The payback period (MRP policy).

- For non-loan type investments, the cost against the current market value.
- The risks associated with each activity.

12.1.5. Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

12.1.6. Non-treasury investments that are for Investment Regeneration purposes would, eventually, be subject to an Investment Regeneration Strategy. Until such a strategy has been produced the Council will evaluate each opportunity on an ad hoc basis.

12.1.7. Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG (DLUHC) Investment Guidance and CIPFA Prudential Code have not been adhered to.

12.1.8. If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy, i.e., through the budget monitoring process and reports to members.

12.1.9. To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report, where appropriate.

12.1.10. The Capital Strategy will be updated during 2024/25, to incorporate the best practice guidance referenced above, and reflect significant new policies and strategies, including the Corporate Strategy 2030, Climate Emergency Declaration, the Asset Management Strategy and the Environmental Social & Governance (ESG) requirements of the revised Prudential Code.

12.2 Treasury Management reporting

12.2.1. 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 (within this report at Appendix E) - 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 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.

12.2.2. The above reports are required to be adequately scrutinised before being recommended to the Council. This role is currently undertaken by the Audit and Standards Committee. The Authority will also carry out quarterly reporting of treasury and prudential indicators as part of the budget monitoring process. These reports are not required to be taken to Council.

12.2.3. It should be noted that the Council did not produce an annual treasury report for 2022/23, primarily due to the impact of the pressures and priority of the external audit of the 2021/22, which for a variety of reasons, including some at a national audit level, has extended far beyond previous deadlines and absorbed all the time of officers involved in the production of this report.

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

Supporting documents:

Appendix A - Treasury Management Policy Statement

Appendix B - Treasury Management Strategy

Appendix C – Annual Investment Strategy

Annex 1 - Types of Investment

Annex 2 - Counterparty Limits

Annex 3 - Approved Countries for Investment

Appendix D – Minimum Revenue Provision Policy

Appendix E – Prudential and Treasury Indicators

Appendix F – Link Economic Background

Appendix G - Interest Rate Forecasts

Appendix A

Treasury Management Policy Statement

Warwick District Council defines its Treasury Management activities as:

1. The management of the local authority’s borrowing, investments, and cash flows, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.
2. This Council regards the successful identification, monitoring, and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
3. This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is, therefore, committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The Treasury investment policy objective for this Council is the prudent investment of its treasury balances. The Council’s Treasury investment priorities are security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and the DLUHC guidance require the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield (the SLY principal).

Treasury Management Strategy for 2024/25

The strategy for 2024/25 covers two main areas:

A. Capital issues

- the capital expenditure plans and the associated prudential indicators – capital expenditure plans form part of the General Fund Budget report, and the prudential and treasury indicators are included in Appendix E.
- the Minimum Revenue Provision (MRP) policy – see Appendix D.
  - On 21 December 2023 the Government (DLUHC) launched the final consultation on changes to MRP regulations and guidance. The consultation was to run until 16 February 2024, with the intention that the regulations and guidance would come into force on 1 April 2024. The Council's MRP policy for 2024/25 in Appendix D has been drafted in accordance with this consultation and there are no further changes expected to be required to the policy for 2024/25 financial year.

B. Treasury management issues

- the current treasury position
- treasury indicators which limit the treasury risk and activities of the Council (Appendix E)
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy (Appendix C)
- creditworthiness policy (Appendix C, section 3), and
- the policy on the 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 Training

1.1 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.

1.2 The Code state that they expect "all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making."

1.3 CIPFA acknowledges that the scale and nature of this will depend on the size and complexity of the organisation's treasury management needs, so that the Council should consider how to assess whether treasury management staff and Council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

1.4 As a minimum, authorities should carry out the following to monitor and review knowledge and skills:

- Record attendance at training, and ensure action is taken where poor attendance is identified.
- Prepare tailored learning plans for treasury management officers and Council members.
- Require treasury management officers and Council members to undertake self-assessment against the required competencies (as set out in the schedule that may be adopted by the organisation).
- Have regular communication with officers and board/council members, encouraging them to highlight training needs on an ongoing basis."

1.5 In further support of the revised training requirements, CIPFA's Better Governance Forum and Treasury Management Network have produced a 'self-assessment by members responsible for the scrutiny of treasury management', which is available from the CIPFA website to download.

1.6 Following the May 2023 Council elections, Link Group (Link) are scheduled to deliver introductory Treasury Management training to Members of the Audit and Standards Committee, other interested Members and senior officers on 28 February 2024. Further training on this topic is likely to be required to some members, as identified by their self-assessment after this training, which would be arranged at the earliest opportunity.

1.7 Officers directly involved in treasury management have received training from the Council's treasury consultants, CIPFA and other providers. This knowledge will be kept up to date by regular attendance at seminars held by our consultants and other sources, such as CIPFA publications and market intelligence.

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

1.9 A formal record of the training received by officers central to the Treasury function will be maintained by the Strategic Finance Manager. Similarly, a formal record of the treasury management / capital finance training received by members will also be maintained by Democratic Services.

2 External service providers

2.1 The Council uses Link Group, Link Treasury Services Limited ('Link') as its external treasury management advisor. A 4-year contract was entered into in January 2023.

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

2.3 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.

2.4 Banking services are provided by HSBC Bank Plc, with the current agreement running until February 2025.

3 Benchmarking

3.1 Link co-ordinates a sub-regional treasury management benchmarking service of which Warwick District Council is an active participant. The Council aims to achieve or exceed the weighted average rate of return of the Link model portfolio, which is published quarterly.

4 Performance

4.1 Performance of the treasury function is reported twice yearly to the Audit and Standards Committee, the performance for the first half of 2023/24 being reported on 9 January 2024.

4.2 The Treasury Management team will seek to achieve a return on its money market investments equivalent to the forward Sterling Overnight Index Average[3] (SONIA) of a similar duration.

4.3 As SONIA is higher than the previous 'LIBID' benchmark, the outperformance of this benchmark is lower than under LIBID.

5 Prospects for interest Rates

5.1 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. Further information is contained in Appendix F and Appendix G, with more details on the economic background and Link's interest rate forecasts. Link provides regular updates to Council officers when these are updated.

5.2 The following table gives Link's central view at 8 January 2024.

5.3 These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps (base points)

Link Group Interest Rate View	08.01.24												
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.80	4.30	3.80	3.30	3.20	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.60	4.10	3.70	3.20	3.20	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

5.4 Link's central forecast for interest rates reflects a view that the MPC would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least the second half of 2024. They do not think that the MPC will increase Bank Rate above 5.25%, but it is possible. Link expect rate cuts to

[3] SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

start when both the CPI inflation and wage/employment data are supportive of such a move, and that there is a likelihood of the overall economy enduring at least a mild recession over the coming months, although most recent GDP releases have surprised with their on-going robustness.

5.5 Timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

5.6 In the upcoming months, Link's forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

5.7 On the positive side, consumers are still anticipated to be sitting on some excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing somewhat better at this stage of the economic cycle than may have been expected. However, as noted previously, most of those excess savings are held by more affluent households whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

5.8 For comparison purposes, the rates assumed when setting the 2023/24 Treasury Management Strategy Statement are repeated below, illustrating the unexpected increases that have impacted on the current Strategy, increasing investment returns but increasing the cost of borrowing. This has widened 'the cost of carrying' new borrowing, leading to retaining 'internal borrowing' for longer than planned.

Link Group Interest Rate View	07.02.23												
	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.25	4.50	4.50	4.25	4.00	3.75	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.30	4.50	4.50	4.30	4.00	3.80	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.40	4.50	4.40	4.20	3.90	3.70	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.50	4.40	4.20	3.80	3.60	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.00	4.00	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.10	3.10	3.10
10 yr PWLB	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.60	4.40	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.40
50 yr PWLB	4.30	4.30	4.20	4.10	3.90	3.80	3.60	3.60	3.40	3.30	3.20	3.20	3.10

5.9 **PWLB rates**

5.10 The short and medium part of the gilt curve has rallied since the start of November 2023 as markets price in a quicker reduction in Bank Rate through 2024 and 2025 than held sway back then. This reflects market confidence in inflation falling back in a similar manner to that already seen in the US and the Euro-zone. At the time of writing there is around a 70 basis points difference between the 5 and 50 year parts of the curve.

5.11 The **overall balance of risks** to economic growth in the UK is even.

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).
- **The Bank of England** has acted too quickly and too far over recent months to raise Bank Rate and causes a deeper and longer UK recession than currently anticipated.
- **Geopolitical risks,** for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

5.13 **Upside risks** to current forecasts for UK gilt yields and PWLB rates include:

- Despite the recent tightening to 5.25%, the **Bank of England allows inflationary pressures to remain elevated** for a long period within the UK economy, which then necessitates Bank Rate staying higher for longer than currently projected.
- The **pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Projected **gilt issuance**, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields compensating.

5.14 **Borrowing advice**: Link's long-term (beyond 10 years) forecast for Bank Rate has increased from 2.75% to 3% and reflects Capital Economics' research that suggests artificial intelligence (AI) and general improvements in productivity will be supportive of a higher neutral interest rate. As all PWLB certainty rates are now above this level, the borrowing strategy will need to be reviewed in that context. Better value can be obtained at the shorter end of the curve and short-dated fixed council to council monies will be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to wait for inflation, and therein gilt yields, to drop back later in 2024.

5.15 Link's target borrowing rates are set two years forward (as they expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below:

PWLB debt	Current borrowing rate as at 08.01.24 p.m.	Target borrowing rate now (end of Q4 2025)	Target borrowing rate previous (end of Q3 2025)
5 years	4.53%	3.70%	3.80%
10 years	4.67%	3.90%	3.80%
25 years	5.19%	4.20%	4.20%
50 years	4.97%	4.00%	4.00%

5.16 As mentioned in paragraph 5.8, while Warwick District Council will not be able to avoid borrowing to finance new capital expenditure 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 as this position will, most likely, incur a revenue cost. Further detail in included in the borrowing strategy in section 7.

5.17 Since November 2020 there has been a prohibition to deny any local authority access to borrowing from the PWLB where it had purchases of ***assets for yield*** in its three-year capital programme.

5.18 From 15 June 2023, the Government introduced the HRA rate which applies an interest rate of the gilt yield plus 40 basis points (0.40%). This rate is solely intended for use in Housing Revenue Accounts and primarily for new housing delivery.

5.19 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 Rate** is gilt plus 40 basis points (G+40bps).

6 Investment rates

6.1 Investment returns are expected to fall from the peak of 2023/24. However, while markets are pricing in further Bank Rate increases, actual economic circumstances may see the MPC adjust for new or changing circumstances.

6.2 Link's suggested budgeted investment earnings rates for investments up to about three months' duration in each financial year are as follows:

Average earnings in each year	Now	Previously
2023/24 (residual)	5.30%	5.30%
2024/25	4.70%	4.70%
2025/26	3.20%	3.00%
2026/27	3.00%	2.80%
2027/28	3.25%	3.05%
Years 6 to 10	3.25%	3.05%
Years 10+	3.25%	3.05%

6.3 As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts, and the Council has used more prudent assumptions, particularly as the levels of investments are being reduced and kept relatively short, pending long-term borrowing. The Council's estimates are included at paragraph 3.14 of Appendix C, the Annual Treasury Management Investment Strategy.

6.4 For its cash flow generated balances, the Authority will seek to utilise its business deposit account, Money Market Funds, and short-dated deposits, in order to benefit from the compounding of interest. The Council's Treasury Management function operates to keep a minimum

6.5 The Council will continue to monitor events and will update its forecasts as and when appropriate, utilising advice from Link and other market commentators.

7 Borrowing Strategy

7.1 The capital expenditure plans set out in Section 4 of Appendix E 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.

7.2 The Council has no short-term borrowing, and residual finance leases having been repaid. An assessment is being made of 'embedded leases' within the Council's contracts as at 31 March 2024 for IFRS 16 reporting purposes.

7.3 The Council's current long-term borrowing portfolio consists of £136.157 million HRA and £68 million General Fund PWLB debt.

7.4 The **HRA loans** were taken out in 2012 to finance the HRA Self Financing settlement, and the interest paid on this debt is entirely borne by the HRA and is provided for as part of the HRA Business Plan. The first of these loans is scheduled to be repaid on 28 March 2053, with the final loan being repaid on 28 March 2062. Any new HRA loans would be 'laddered' to avoid these repayments.

7.5 The current HRA Business Plan from March 2024 includes substantial new PWLB borrowing, with the estimated interest costs based around current rates, which has been factored into this report. This is in addition to the recent borrowing requirement for the HRA, reflected by its Capital Financing Requirement (or CFR, the capital borrowing need) being £185.316 million at 31 March 2023, compared with the £136.157 million externally borrowed, with the difference of £49.159 million being temporary 'internal' borrowing, charged to the HRA by the General Fund.

7.6 Further analysis of this borrowing is included in Appendix E on the Prudential and Treasury Indicators. The new Liability Benchmark for the HRA shows the amount the HRA will soon be borrowing to finance the existing capital programme, peaking at £305.2 million, an increase of £85.5 million over the HRA's CFR in the previous paragraph.

7.7 **General Fund loans**, all from the PWLB, currently total £68 million.

7.8 £12 million was borrowed in September 2019, for repayment at maturity on 28 August 2059, with the interest borne by the General Fund, largely covering unfinanced capital expenditure in 2017/18 and 2018/19 (primarily relating to the Leamington and Warwick Leisure Centres).

7.9 A further £60 million was borrowed by the General Fund in 2021/22 for the Crewe Lane housing joint venture. These £60 million of loans comprise of six smaller amounts, with terms between 1½ and 5½ years, and the PWLB loans and the joint venture loans are coterminous. The first loan repayment of £5m was made by the joint venture to the Council at the end of September 2023, leaving a PWLB balance of £55 million at the start of October.

7.10 A loan of £1 m was taken by the Council (the General Fund) in April 2023 to finance a loan to Milverton Homes Limited, for the initial purchase of homes by the Council's arms-length housing company. Further loans will be required by Milverton Homes to meet its commitments to purchase more new-build homes, subject to financial viability and authorisation by the Council.

7.11 The Council has been maintaining an under-borrowed position, which means that the CFR 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, i.e., borrowing has been deferred. This strategy has been prudent while investment returns remain low relative to borrowing costs, with counterparty risk being an important consideration, i.e., if borrowing is taken when investment levels are above the minimum necessary for liquidity, the new borrowing would result in increased borrowing, involving more counterparties.

7.12 The General Fund's CFR at 31 March 2023 was £107.999 million, and its Net Loans Requirement (NLR) was £29.768 million. The General Fund Liability Benchmark, the NLR, shows that based on the current approved capital programme the debt will increase by £14.859 million to a peak of £44.6 million, due to capital loan (housing joint venture) and MRP repayments.

7.13 The borrowing undertaken for the housing joint venture does not change the under-borrowed position of previous financial years. The position is not sustainable in the longer-term as (a) the Council will eventually need to replenish the cash backing the Reserves and Balances to pay for future developments and maintain liquidity, and (b) the upside risk of PWLB and other borrowing rates because of the risk of further economic shocks make it prudent to consider 'externalising' more of the internal borrowing by taking PWLB loans during 2024/25. This position is actively monitored.

7.14 Additionally, there remain several potentially very large housing-related and other capital schemes that would significantly deplete or extinguish investment balances unless considerable external borrowing in 2024/25 or 2025/26 and beyond is undertaken. Please see Table 4 and Table 5 in Appendix E for details of proposed capital expenditure and financing, including the borrowing requirement. **Approval of these within the borrowing limits does not commit the Council to progressing with these schemes**.

7.15 Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

7.16 If it was forecast that there was a significant risk of:

- a sharp FALL in borrowing rates, then borrowing will be postponed for as long as liquidity makes practical;
- a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from a further global shock, or a sudden increase in inflation risks, then the portfolio position will be re-appraised.

Most likely, limited fixed rate funding will be drawn to maintain liquidity whilst interest rates are higher than they are projected to be in a few years.

7.17 **Approved sources of long and short-term borrowing**

On Balance Sheet	Fixed	Variable
Public Works Loan Board (PWLB)	✓	✓
UK Municipal Bond Agency (UK MBA)	✓	✓
Local authorities	✓	✓
Banks	✓	✓
Pension funds	✓	✓
Insurance companies	✓	✓
UK Infrastructure Bank	✓	✓
Market (long-term)	✓	✓
Market (temporary)	✓	✓
Market (LOBOs)	✓	✓
Stock issues	✓	✓
Local temporary	✓	✓
Local bonds	✓	X
Local authority bills	✓	✓
Overdraft	X	✓
Negotiable bonds	✓	✓
Internal (capital receipts & revenue balances)	✓	✓
Commercial paper	✓	X
Medium term notes	✓	X
Finance leases	✓	✓

7.18 The PWLB Certainty Rate parameters are given in paragraph 5.19, and are usually the most cost-effective option, particularly when costs are factored. However, consideration may still need to be given to sourcing funding from the following sources for the reasons below:

- 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).

7.19 The degree which any of these options could prove cheaper than the PWLB Certainty Rate (the default source of borrowing) may vary, but the Council's advisors will keep the Council informed as to the relative merits of each of these alternative funding sources. Financial institutions and the Municipal Bond Agency (MBA) are likely to have significantly more complex administration and legal arrangements than PWLB loans, even though those arrangements have become more exacting in recent years.

7.20 The Council will use short-term borrowing (up to 365 days), if necessary, to finance temporary cash deficits. However, proactive cash flow management will aim to keep these to a minimum and, wherever possible, the loan would be taken out for periods of less than 7 days to minimise the interest payable. The

Council has not incurred any short-term borrowing (or bank overdrafts) in 2023/24 to date and is not expecting to during 2024/25.

7.21 Any decisions will be reported to the appropriate decision-making body at the next available opportunity.

8 Policy on borrowing in advance of need

8.1 The Council will not borrow more than or in advance of its needs purely 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.

8.2 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.

9 Current treasury position

9.1 The investments at 31 December 2023 are summarised below:

Type of Investment	31 Dec 23 £'000	30 Sep 23 £'000	31 Mar 23 £'000
Money Markets incl. CD's & Bonds	23,021	26,219	29,949
Money Market Funds	3,225	16,848	4,342
Business Reserve Account	2,794	3,399	3,941
Total In House Investments	**29,040**	**46,466**	**38,232**
Corporate Equity Funds (nominal value)	-	-	-
Total Investments	**29,040**	**46,466**	**38,232**

9.2 The corresponding borrowing position is summarised below, showing the split between the HRA and General Fund:

External Borrowing	31 Dec 23 £'000	30 Sep 23 £'000	31 Mar 23 £'000
Public Works Loan Board	204,157	209,157	208,157
Other	-	-	-
Total external borrowing	**204,157**	**209,157**	**208,157**
Split between:			
Housing Revenue Account	136,157	136,157	136,157
General Fund	68,000	73,000	72,000
Total	**204,157**	**209,157**	**208,157**

10 Debt rescheduling

10.1 Rescheduling of current borrowing in the Council’s debt portfolio could be considered while premature redemption rates remain elevated. However, that would rely on there being surplus cash to facilitate any repayment, and that not an option given the running down of investments to avoid new borrowing during higher interest rates.

10.2 The Council’s treasury advisors will continue to monitor the debt portfolio and identify any opportunities for debt restructuring but the options are limited for these reasons.

10.3 If rescheduling was done, it would be reported to the Audit and Standards Committee at the next meeting.

Appendix C

Annual Treasury Management Investment Strategy

1 Investment policy – management of risk

1.1 The Department of Levelling Up, Housing and Communities (DLUHC) – formerly the MHCLG[4]) - and CIPFA[5] have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

1.2 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 2021.

1.3 The Council's investment priorities, using the established 'SLY' principles in decreasing importance, are:

1. **S**ecurity,
2. **L**iquidity and
3. **Y**ield return.

1.4 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 in line with the Council's risk appetite.

1.5 In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider 'laddering' investments for periods up to 12 months with high credit rated financial institutions, while investment rates remain elevated, as well as wider range fund options.

1.6 The above guidance from the DLUHC and CIPFA place a high priority on the management of risk. The Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

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

1.6.2. **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

[4] Ministry of Housing, Communities & Local Government
[5] Chartered Institute of Public Finance & Accountancy

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.

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

1.6.4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use 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 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 more than one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

1.6.5. **Non-specified investments limit**. The Council has determined that it will limit the maximum total exposure to non-specified investments as being 70% of the total investment portfolio.

1.6.6. **Lending limits** (amounts and maturity) for each counterparty will be set through applying the matrix table in Appendix C Annex 2.

1.6.7. **Transaction limits** are not set for each type of investment, being subject to the lending limit.

1.6.8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**. (70% - see paragraph 3.12 below).

1.6.9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (Appendix C Annex 2).

1.6.10. This authority has engaged **external consultants**, (Appendix B section 2), 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.

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

1.6.12. As a result of the change in **accounting standards** for 2023/24 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[6]. This override applied to the Council's previously disposed equity funds and would be a factor in the appropriateness of

[6] 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 commencing from 1 April 2018. DLUHC have confirmed that they will extend the IFRS9 Pooled Investment Fund statutory override to 31 March 2025.

Environmental, Social & Governance (ESG)[7] equity funds, given the uncertainty beyond 2024/25.

1.7 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.

2. Changes in risk management policy from last year

2.1 The above criteria are unchanged from last year.

3. Creditworthiness policy

3.1 The Council makes use of the creditworthiness service provided by the Link Group. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies: Fitch, Moody's, and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- 'watches' and 'outlooks' from credit rating agencies,
- Credit Default Swap (CDS) spreads that may give early warning of changes in credit ratings,
- sovereign ratings to select counterparties from only the most creditworthy countries.

3.2 The Link creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue reliance on any one agency's ratings.

3.3 Typically, the minimum credit ratings criteria the Council use will be a short-term rating (Fitch or equivalents) of F1 and a long-term rating of A. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

3.4 All credit ratings will be monitored weekly and will inform every investment decision. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service:

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of credit ratings the Council will be advised of information in movements in CDS spreads against the iTraxx European Financials benchmark and other market data daily via its *Passport* website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

3.5 Sole reliance will not be placed on the use of this external service. In addition,

[7] ESG – which stands for environmental, social and governance – represents a form of investing that centres around companies that prioritise these three factors. ESG investing can also be known as 'social impact' or 'social responsibility' investing, as it aims to make ethical and impactful investment choices.

the Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

3.6 All investments in property funds, corporate bonds and corporate equity funds will be supported by the advice of Link, the Council's treasury advisors. Where the Council makes Service Investments, these sit outside the service provided by Link and separate risk assessments will be completed (refer to Section 4 below of this report).

3.7 The Council will ensure that it maintains the lists of permitted investments and counterparty limits (Annexes 1 and 2) and will revise and submit the criteria to Council for approval when required. In respect of counterparty limits, the Council's investment balances have increased in recent years mainly due to increasing Housing Revenue Account (HRA) balances that are projected to be utilised in the medium term.

3.8 To provide flexibility and to continue to be able to invest in the highest quality counterparties, long-term credit rating of Fitch or equivalent, it is proposed to keep the counterparty limits for certain institutions as follows:

Institution Type	Limit
A rated private banks	£5m
A+ rated private banks	£7m
AA rated private banks	£8m
Government Debt CNAV MMFs[8]	£10m
LVNAV MMFs[9]	£10m

3.9 The Council has both cash flow derived and core balances available for investment. Investment decisions will be made regarding cash flow requirements, core cash balances and the outlook for short term interest rates.

3.10 The Council will continue to use Money Market Funds (MMFs), call bank accounts and the money markets to invest cash flow driven money until the time when it is required. Core investments may be invested in a combination of ESG corporate equity funds and the financial markets.

3.11 Based on its cash flow forecasts (subject to any 'internal borrowing' pending borrowing for new capital expenditure, including service investment), the Council anticipates that its investments in 2024/25 on average will be in the region of £42m, of which £21m will be 'core' investments i.e. made up of reserves and balances which are not required in the short term.

3.12 The maximum percentage of its investments that the Council will hold in long-term investments (over 365 days) is 70%. It follows therefore that the minimum percentage of its overall investments that the Council will hold in short term investments (365 days or less) is 30%, with the expectation that

[8] Constant Net Asset Value Money Market Funds
[9] Low-Volatility Net Asset Value Money Market Funds

this will be most investments in practice. Having regard to the Council's likely cash flows and levels of funds available for investment the amount available for long-term investment will be a maximum of 70% of the core investment portfolio subject to a total of £30 million at any one time in line with the Prudential Indicator covering this issue. These limits will apply jointly to the in-house team and any fund managers so that the overall ceilings of 70% and £30 million are not breached.

3.13 Based on current investment policies and interest rate projections at budget setting, it is currently estimated that the overall portfolio will achieve a 5.47% return for 2023/24, decreasing to 4.27% for 2024/25, based on expected movements in Base Rate and market forecasts.

4. Investments that are not part of treasury management activity

4.1 Where, in addition to treasury management investment activity, the Council makes service investments in other financial assets and property, and there may be a financial return that is not the primary driver (to avoid the Council being excluded from taking PWLB borrowing), these investments will be proportional to the level of resources available, and the Council will ensure the same robust procedures for the consideration of risk and return are applied to these decisions.

4.2 The Council recognises that investment in other financial assets e.g., loans to third parties and property, may be taken for non-treasury management purposes, requiring careful investment management. Such activity includes loans supporting service outcomes, such as housing provision or economic regeneration.

4.3 The Council's framework to consider such non treasury management investments would be reflected within the *Capital Strategy*, referred to in this report. All such investment proposals will be considered on their own merits and in accordance with the Council's risk appetite and have regard to treasury management principles.

4.4 The Council will ensure the organisation's investments are covered in the capital programme, investment strategy or equivalent, and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

Schedule of specified and non-specified investments

Specified Instruments (365 days or less)

- Deposits with banks and building societies
- Deposits with UK Government, Nationalised Industries, Public Corporations, and UK Local Authorities
- UK Government Gilts
- Debt Management Agency Deposit Facility (DMADF)
- Government Debt Constant Net Asset Value Money Market Funds (AAA rated)
- Low Volatility Net Asset Value Money Market Funds (AAA rated)
- Variable Net Asset Value Money Market Funds (AAA rated)
- Certificates of deposits issued by banks and building societies
- Corporate Bonds issued by private sector financial institutions
- Corporate Bonds issued by financial institutions partly or wholly owned by the UK Government
- Corporate Bonds issued by corporates
- Covered Bonds issued by private sector financial institutions
- Covered Bonds issued by financial institutions partly or wholly owned by the UK Government
- Covered Bonds issued by corporates
- Supranational Bonds issued by Supranational Institutions or Multi-Lateral Development Banks
- Floating Rate Notes issued by private sector financial institutions
- Floating Rate Notes issued by financial institutions partly or wholly owned by the UK Government
- Floating Rate Notes issued by corporates
- Eligible Bank Bills
- Sterling Securities guaranteed by HM Government
- Repos

Non-Specified Investments

- Deposits with unrated building societies
- Deposits with banks and building societies greater than 365 days
- Deposits with UK Local Authorities greater than 365 days
- Certificates of deposits issued by banks and building societies greater than 365 days
- Corporate Bonds issued by private sector financial institutions greater than 365 days
- Corporate Bonds issued by financial institutions partly or wholly owned by the UK Government greater than 365 days
- Corporate Bonds issued by corporates greater than 365 days

- Covered Bonds issued by private sector financial institutions greater than 365 days
- Covered Bonds issued by financial institutions partly or wholly owned by the UK Government greater than 365 days
- Covered Bonds issued by corporates greater than 365 days
- Corporate Bond Funds
- Regulated Property Funds including Real Estate Investment Trusts
- CCLA Property Fund or other similar property fund
- Diversified asset funds (e.g., CCLA DIF)
- UK Government Gilts with over 365 days to maturity
- Supranational Bonds issued by Supranational Institutions or Multi-Lateral Development with over 365 days to maturity
- Corporate Equity Funds (ESG, with no fossil fuel exposure)

Counterparty Limits

Investment / counterparty type:	S/term	L/term	Viability / support	# Sovereign country min. credit rating	Max limit per counterparty	Max. maturity period	Use	Notes ref
Specified instruments: *(repayable within 12 months)*	**(FITCH or equivalent)**							
DMADF	n/a			AA-	£12m	365 days	In house & EFM*	
UK Govt. / local authorities / public corporations / nationalised industries	n/a		High		£10m	365 days	In house & EFM*	11
Bank - part nationalised UK	F1	A		AA-	£9m	365 days	In house & EFM*	1 & 2
Bank - private (includes fixed term deposits, CDs and category 1 FRNs & bonds)	F1	A		AA-	£5m	365 days	In house & EFM*	1 & 2
	F1	A+		AA-	£7m	365 days	In house & EFM*	1 & 2
	F1	AA- & above		AA-	£8m	365 days	In house & EFM*	1 & 2
Other private sector financial institutions (includes category 1 FRNs & bonds)	F1	A		AA-	£4m	365 days	In house & EFM*	1 & 2
	F1	A+		AA-	£6m	365 days	In house & EFM*	1 & 2
	F1	AA- & above		AA-	£7m	365 days	In house & EFM*	1 & 2
Corporates (category 3 FRNs & bonds)	F1	A		AA-	£4m	365 days	In house & EFM*	1 & 2
	F1	A+		AA-	£5m	365 days	In house & EFM*	1 & 2
	F1	AA- & above		AA-	£6m	365 days	In house & EFM*	1 & 2
Bank subsidairies of UK banks	Unrated			Explicit Parent Guarantee	£5m	3 months	In house & EFM*	1 & 3
Money Market Fund (CNAV)	AAAm / Aaa-mf/AAAmmf				£10m	liquid	In house & EFM*	
Money Market Fund (LVNAV)	AAAm / Aaa-mf/AAAmmf				£10m	liquid	In house & EFM*	
Money Market Fund (VNAV)	AAAf S1 / Aaa-bf/ AAA/V1				£6m	liquid	In house & EFM*	4
Building societies - category A	F1	A		AA-	£4m	365 days	In house & EFM*	1a.
Building societies - category B	F1			AA-	£2m	365 days	In house & EFM*	1a.
Corporate bonds - category 2		A			£9m	365 days	In house & EFM*	5
Covered bonds - category 2		A			£9m	365 days	In house & EFM*	12
Bonds - supranational / multi-lateral development banks	AAA / Govt Guarantee				£5m	365 days	In house & EFM*	
Floating Rate Notes (FRN) - category 2		A			£9m	365 days	In house & EFM*	6
Eligible bank bills	n/a			Determined by EFM	£5m	365 days	EFM*	
Sterling securities guaranteed by HM Government	n/a			AA-	9m	not defined	EFM*	

Investment / counterparty type:	S/term	L/term	Viability / support	# Sovereign country min. credit rating	Max limit per counterparty	Max. maturity period	Use	Notes ref
Non-specified instruments:	**(FITCH or equivalent)**							
Building societies - assets > £500m	unrated category C				£1m	3 months	In house	1b & 9
Bank - part nationalised UK > 1 year	F1	A		AA-	£9m	2 years	In house + advice & EFM*	1b, 2, & 10
Bank - private (includes fixed term deposits, CDs and category 1 FRNs & bonds)	F1	A		AA-	£5m	2 years	In house + advice & EFM*	1b, 2, & 10
	F1	A+		AA-	£7m	2 years	In house + advice & EFM*	1b, 2, & 10
	F1	AA- & above		AA-	£8m	2 years	In house + advice & EFM*	1b, 2, & 10
Other private sector financial institutions (includes category 1 FRN's & Bonds)	F1	A		AA-	£4m	2 years	In house + advice & EFM*	1b, 2, & 10
	F1	A+		AA-	£6m	2 years	In house + advice & EFM*	1b, 2, & 10
	F1	AA- & above		AA-	£7m	2 years	In house + advice & EFM*	1b, 2, & 10
Corporates (category 3 FRN'S, Bonds)	F1	A		AA-	£4m	2 years	In house + advice & EFM*	1b, 2, & 10
	F1	A+		AA-	£5m	2 years	In house + advice & EFM*	1b, 2, & 10
	F1	AA- & above		AA-	£6m	2 years	In house + advice & EFM*	1b, 2, & 10
Building societies - > 1 year	F1	A		AA-	£1m	2 years	In house + advice & EFM*	1b & 10
Local authorities > 1 year	n/a		High		£9m	5 years	In house + advice	10
Corporate bonds - category 2 > 1 year		A			£9m	2 years	In house & EFM*	5 & 10
Covered bonds - category 2 > 1 year		A			£9m	2 years	In house & EFM*	10 & 12
Corporate Equity Funds - low risk		N/A		See note 13	£4m	10 years	EFM*	13 & 14
Corporate Equity Funds - medium risk		N/A		See note 13	£2m	10 years	EFM*	13 & 14
Corporate Bond Funds		BBB			£5m	10 years	In house + advice & EFM*	10
Pooled property fund eg: REITS				Authorised FS&MA	£5m	10 years	In house + advice	10
CCLA property funds	n/a			see note 8	£5m	10 years	In house + advice	7 & 10
Day to day balances	n/a				n/a	n/a	In house	8

Notes:	
*	EFM = External Fund Manager
#	Minimum sovereign rating does not apply to UK domiciled counterparties
	All maximum maturity periods include any forward deal period
1.	Includes business call reserve accounts, special tranches & any other form of investment with that institution e.g. certificate of deposits, corporate bonds and repos, except where the repo collateral is more highly credit rated than the counterparty in which case the counterparty limit is increased by £3m with a maximum in repos of £3m
1a.	Includes business call reserve accounts, special tranches & any other form of investment with that institution e.g. certificate of deposits, corporate bonds and repos, except where the repo collateral is more highly credit rated than the counterparty in which case the counterparty limit is increased by £2m with a maximum in repos of £2m
1b.	Includes business call reserve accounts, special tranches & any other form of investment with that institution e.g. certificate of deposits, corporate bonds and repos
2.	Counterparty limit is also the group limit where investments are with different but related institutions
3.	Unrated but with explicit guarantee by parent + parent meets minimum ratings of short-term F1, long-term A. Subject to group limit relating to parent bank e.g. £5m if private of £9m if part or wholly nationalised
4.	Subject to overall group limit of £6m
5.	Corporate bonds must be senior unsecured and above. Category types:
	Category 1: Issued by private sector financial institutions
	Category 2: Issued by financial institutions wholly owned or part owned by the UK Government
	Category 3: Issued by corporates
6.	Floating rate notes - categories as per note 5 above
7.	Security of trustee of fund (LAMIT) controlled by LGA, COSLA who appoint the members and officers of LAMIT
8.	Minimum exposure to credit risk as overnight balances only
9.	Group limit of £8m
10.	£15m overall limit for corporate bond / equity / property funds & £20m limit for all counterparties
11.	UK Government includes gilt edged securities and Treasury bills
12.	Covered bonds category types:
	Category 1: Issued by private sector financial institutions
	Category 2: Issued by financial institutions wholly owned or part owned by the UK Government
	Category 3: Issued by corporates
13.	Risk determined as follows:
	Low - UK equity income funds
	Medium - UK capital growth funds
14.	Maximum investment limit subject to 10% capital growth, i.e. maximum is 110% of original investment

Approved Countries for Investments

This list, as the end of December 2023, is based on those countries which have sovereign ratings of AA- or higher, based on the lowest rating from Fitch, Moodys and S&P, and also have banks operating in sterling markets which have credit ratings of green or above in the Link creditworthiness service.

Based on lowest available rating

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)

AA-

- Belgium
- France
- Qatar
- **U.K.**

Appendix D

Minimum Revenue Provision (MRP) Policy Statement

1 Background

1.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement, 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). The MRP is equivalent to 'depreciation' in other sectors.

1.2 MHCLG (DLUHC) guidance requires 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 Council is recommended to approve the following **MRP Statement**.

1.3 The *Statutory Guidance on Minimum Revenue Provision*[10] offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

2 Four Main Options

2.1 Option 1 – Regulatory Method

This option is the old statutory method of 4% of the CFR and which has to be used in order to calculate MRP on all debt still outstanding at 1 April 2008[11]. It can also be used to calculate MRP on debt incurred under the new system, but which is supported through the annual SCE (Supported Capital Expenditure) allocation from DCLG (now DLUHC).

2.2 Option 2 – Capital Financing Requirement Method

This is a variation of Option 1 and is based on 4% of the CFR with certain changes and is appropriate where the borrowing is not linked to a particular asset.

2.3 Option 3 – Asset Life Method

Under this option, it is intended that MRP should be spread over the useful life of the asset financed by the borrowing or credit arrangement. In future, where borrowing is utilised to finance specific assets it is likely that the period of the loan will match the expected life of the asset and therefore, under this method the annual charge to the Council's accounts is directly related to building up the

[10] Guidance issued by the Secretary of State under section 21(1A) of the *Local Government Act 2003*. Fourth edition applies to periods commencing 1 April 2019.
[11] The Council had no debt at this date

provision required to pay off the loan when it matures which, under Options 1 and 2, is not possible.

There are 2 methods of calculating the annual charge under this option:

a) equal annual instalments or
b) by the annuity method where annual payments gradually increase during the life of the asset.

2.4 Option 4 – Depreciation Method

This is a variation on option 3 using the method of depreciation attached to the asset e.g., straight line where depreciation is charged in equal instalments over the estimated life and the reducing balance method where depreciation is greater in the early years of an assets life and which is most appropriate for short lived assets e.g., vehicles. In this Council's case assets are depreciated using the straight-line method and so option 4 is not materially different from option 3.

3 HRA

3.1 There is no requirement on the HRA to make a MRP but there is a requirement for a charge for depreciation to be made.

3.2 Under the Self Financing regime, the HRA Business Plan has to provide resources for the repayment of the £136.157m borrowed from the PWLB on the 28 March 2012. Repayment of this debt is currently provided for commencing in year 41 (2052/53) and continuing through to year 50 year of the Business Plan.

3.3 The HRA will apply the same principle to new borrowing undertaken for capital investment.

4 MRP Overpayments / Voluntary Revenue Provision (VRP)

4.1 MHCLG (DLUHC) issued revised MRP guidance in 2018 concerning Voluntary Revenue Provision. In future any VRP or overpayment of MRP, which has been disclosed in previous years' MRP statement, can be reclaimed and credited back to the General Fund in certain circumstances. An example would be a loan to a third party where during the duration of the loan MRP or VRP has been made but on full repayment of the loan the principal has been applied to pay down the Capital Financing Requirement. In this instance the VRP is no longer required and can be released back to the General Fund.

4.2 The Council has instances of such loans but has elected to not make MRP or VRP on these as they are of relatively short duration and on repayment the principal repaid will be applied to pay down the Capital Financing Requirement.

5 Warwick District Council Policy

5.1 It is recommended that for any long-term borrowing on the General Fund e.g. leisure centre refurbishments, the following methods of Minimum Revenue Provision be adopted:

- For borrowing specifically linked to a particular asset or capital scheme – Option 3 based on the annuity method.
- For borrowing that cannot be linked to a particular asset or capital scheme – Option 3 based on the annuity method using the weighted average life of assets.

5.2 For any borrowing incurred through finance leases, the annual principal repayments in the lease are regarded as MRP.

5.3 Although not strictly part of MRP requirements, it is also recommended that for internal borrowing (i.e. capital expenditure financed from reserves), where appropriate, Option 3 based on the annuity method be adopted, in most cases, as a means of replenishing those reserves which financed the capital expenditure. In exceptional circumstances another method may be more appropriate.

5.4 For capital loans to third parties (including the Council's subsidiaries and joint ventures) the MRP policy is as follows:

- **For commercial loans** – where loan repayments are received in year then those capital receipts will be used in lieu of MRP and applied to write down the CFR.

In years where no capital receipt is received, or where future capital receipts are anticipated (including maturity loans) then MRP will be provided over a prudent period.

- **For service loans** - where loan repayments are received in year then those capital receipts will be used in lieu of MRP and applied to write down the CFR.

5.5 In years where no capital receipt is received, or where future capital receipts are anticipated (including maturity loans) then MRP will not be provided until the capital receipt is received, at which point the receipt will be applied to write down the CFR. The Authority can however choose to provide MRP if it considers this to be a more prudent approach (e.g. for longer term maturity loans).

- **For commercial & service loans** – where an actual or expected credit loss has been recognised then the MRP amount in the year will be equal to the amount of the credit loss. However, this amount can be reduced by any historic MRP made with respect to that loan.

Appendix E

Prudential and Treasury Indicators

1. Introduction

1.1. The Prudential Capital Finance system came into effect on 1 April 2004, replacing the previous system of approval allocations from central Government, allowing local authorities to decide how much they can prudently afford to borrow *and* pay back from revenue resources.

1.2. CIPFA developed the Prudential Code for Capital Finance in Local Authorities (the 'Prudential Code') to provide a mechanism to enable councils to ensure, that in line with the new freedom given, their capital investment plans are affordable, prudent, and sustainable. This Prudential Code was revised in December 2021, mainly to stop further borrowing for 'commercial' investment, which CIPFA and the Government strongly believe is inappropriate for local government to pursue, given recent high-profile cases.

1.3. It is the Council's responsibility to set its prudential indicators, having regard to its own set of circumstances. The Council must demonstrate that its capital investment proposals are:

- affordable
- prudent and
- sustainable.

1.4. All Indicators must be included in the Council's annual Treasury Strategy and Outturn report. The reporting requirements for 2024/25 will be changing.

1.5. The Prudential and Treasury Indicators are divided into:

a) Prudential:

- Affordability (section 2)
- Prudence (section 3)
- Capital Expenditure (sections 4 - 5)
- External Debt (sections 6 - 7)

b) Treasury:

- Treasury Indicators (section 8).

1.6. This Appendix explains what the Prudential and Treasury Indicators are as well as revising them for the current year, 2023/24, where appropriate and setting them for future years.

2. Affordability - Ratio of financing costs to net revenue stream

2.1. This ratio shows the trend in the cost of capital (borrowing and other long-term obligation costs, net of investment income) against the net revenue stream, i.e., taxation, rents, and non-specific grant income.

2.2. The higher the ratio, the higher the proportion of resources tied up just to service met capital costs, and which represent a potential affordability risk.

2.3. It sets an upper limit on the proportion of the Council's net revenue streams both for General Fund and Housing Revenue Account (HRA) that is committed to servicing debt.

2.4. The table below shows the actual for 2022/23 and the ratios proposed for the General Fund, HRA and Overall, as required by the Prudential Code. These figures exclude unapproved schemes, other than schemes subject to approval at the same Council meeting as this report.

Table 1

Year	General Fund	Housing Revenue Account	Overall
2022/23	-7.8%	41.7%	26.9%
2023/24	-20.00% to 0.00%	40.00% to 50.00%	15.00% to 30.00%
2024/25	-25.00% to 0.00%	40.00% to 50.00%	25.00% to 35.00%
2025/26	-10.00% to 10.00%	40.00% to 55.00%	25.00% to 45.00%
2026/27	-10.00% to 10.00%	44.00% to 60.00%	30.00% to 50.00%

2.5. The ratio for estimates is a range rather than a single figure (except the 2022/23 actual), to allow for both the uncertain amount of borrowing that will take place for developments by the General Fund and HRA (such as the Housing Company and joint venture, which is a General Fund scheme), and the possible movements in long-term interest rates, as a relatively small variation from today's low level in borrowing costs could cause a ratio based on a precise percentage to be breached.

2.6. The significant size of the HRA ratio includes the HRA self-financing debt taken in 2012 and future borrowing included within the HRA Business Plan, including externalising 'internal borrowing' from the General Fund when interest rates improve, or it becomes necessary for the Council's overall cash flow requirements. If income increases at least much as the debt costs the ratio should not increase once the new rental properties are occupied – there will be a short-term cost during any acquisition and construction.

2.7. The General Fund ratio would increase for further borrowing to finance capital expenditure such as Housing Company loan, leisure centres and long-term loans to third parties.

2.8. The ratios will be monitored during the year and, if necessary, remedial action taken – such as Council increasing the limits - to avoid them being breached.

3. Prudence - Gross Debt and the Capital Financing Requirement

3.1 This indicator requires that gross debt, except in the short term, is to be kept below the Capital Financing Requirement (CFR) for the same period. This demonstrates that borrowing has not been taken in advance of need. It is estimated that gross external debt will be significantly lower than the CFR in future years due to internal borrowing.

3.2 Table 2 shows the longer-term projections, compared with total debt and the Authorised Limit and Operational Boundary from sections 6 and 7 respectively:

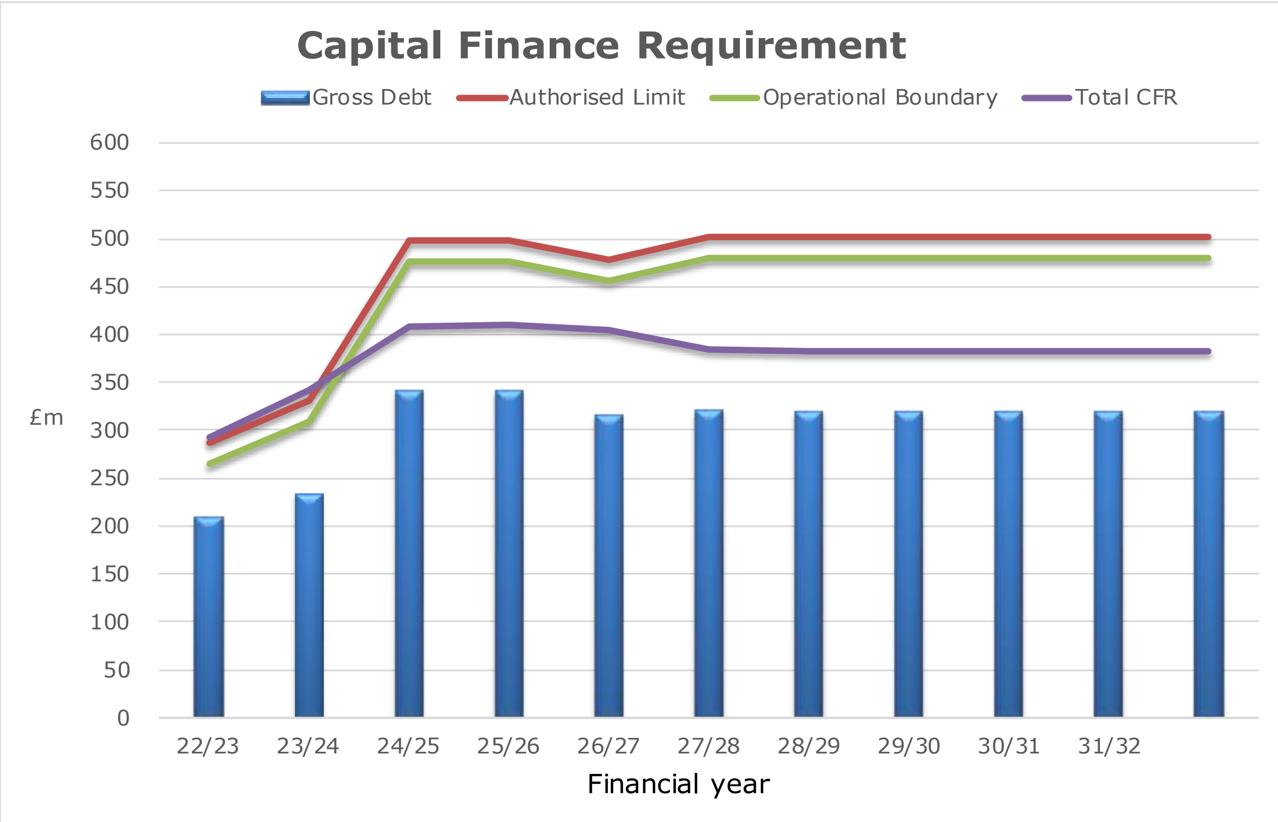
Table 2

Capital Financing Requirement											
£m	**Actual 22/23**	**Est 23/24**	**Est 24/25**	**Est 25/26**	**Est 26/27**	**Est 27/28**	**Est 28/29**	**Est 29/30**	**Est 30/31**	**Est 31/32**	**Est 32/33**
HRA CFR	185.3	223.2	285.3	292.8	300.7	308.7	308.7	308.7	308.7	308.7	308.7
GF CFR	42.3	56.2	66.1	68.9	68.4	52.9	52.9	52.9	52.9	52.9	52.9
Service activity / non-financial investments	65.7	61.9	56.8	48.3	35.2	22.0	20.9	20.9	20.9	20.9	20.9
Total CFR	**293.3**	**341.3**	**408.2**	**410.0**	**404.4**	**383.5**	**382.5**	**382.5**	**382.5**	**382.5**	**382.5**
External borrowing - HRA	136.2	163.2	279.6	292.0	293.9	295.9	295.9	295.9	295.9	295.9	295.9
External borrowing - GF	72.0	69.0	61.5	49.0	21.5	24.0	22.9	22.9	22.9	22.9	22.9
Other long term liabilities	-	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Gross Debt	**208.2**	**233.2**	**342.1**	**342.0**	**316.4**	**320.9**	**319.8**	**319.8**	**319.8**	**319.8**	**319.8**
Internal borrowing - HRA	49.2	60.0	5.7	0.8	6.8	12.8	12.8	12.8	12.8	12.8	12.8
Internal borrowing - GF	36.0	48.1	60.4	67.2	81.2	49.9	49.9	49.9	49.9	49.9	49.9
WDC internal borrowing	**85.2**	**108.1**	**66.1**	**68.0**	**88.0**	**62.7**	**62.7**	**62.7**	**62.7**	**62.7**	**62.7**
Authorised Limit	286.2	331.1	497.4	497.6	478.6	501.3	501.3	501.3	501.3	501.3	501.3
Operational Boundary	264.2	309.1	475.4	475.6	456.6	479.3	479.3	479.3	479.3	479.3	479.3

Internal borrowing in the table reflects the assumption that no new external loans are taken to replace that balance, and *External borrowing* is at an estimated level needed to bring *Internal borrowing* to a level sustained by expected reserves in future years.

3.3 These figures are shown in graphical form, demonstrating that the CFR will be higher than gross debt:

Table 3



3.4 The value of gross debt excludes as yet unapproved borrowing for housing developments (General Fund for Housing Company and Joint Venture; HRA for the Housing Improvement Programme, including new build schemes), and other than HRA schemes being considered in the same Council meeting. Approval of these limits does not commit the Council to the underlying schemes but the borrowing for these does rely on the Council approving the schemes and the limits in *Table 3*.

4. Capital Expenditure

4.1 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.

4.2 The Council is required to publish its estimated capital expenditure for both the General Fund (GF) and Housing Revenue Account (HRA) for a minimum of the next three financial years, as well as the actual for the previous year and latest estimate for the current year.

4.3 By modelling various capital programme scenarios, including new HRA properties and commercial investment opportunities, this indicator provides the data for the ratio of financing costs to net revenue stream indicator.

4.4 Table 4 shows the Council's estimated capital expenditure on the General Fund and HRA for the next four years, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Table 4

Capital expenditure (£'000)	2022/23 Outturn	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
General Fund (non HIP)	28,628	24,468	24,678	2,913	1,365	460
Credit arrangements - finance leases	-	-	-	-	-	-
Housing Investment Programme:						
General Fund (HIP)	-	-	-	-	-	-
HRA	14,015	79,571	79,495	20,407	18,936	18,943
Other:						
'Service investment' activities / non-financial investments*	12,855	996	6,034	7,644	3,106	2,867
Total (A)	**55,498**	**105,035**	**110,206**	**30,963**	**23,407**	**22,270**

* - loans to third parties

4.5 The main item in 'service investment' for 2022/23 is the final £10 million of the £60 million joint venture funding outlined earlier, plus loans for the Sherbourne recycling centre, which is partly owned by Warwick District Council. The additional figures in 2023/24 to 2027/28 include loans to Milverton Homes Limited, with £0.9 million paid in 2023/24, and estimates of £6.0 million in 2024/25, £7.6 m in 2025/26, £3.1 m in 2026/27, and £2.9 m in 2027/28, subject to viability.

5. Capital Financing Requirement

5.1 The Capital Financing Requirement (CFR) is a key measure that shows the underlying need for an authority to borrow for capital purposes, i.e., the difference between the Council's capital expenditure and the revenue or capital resources set aside to finance that spend. 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 Minimum Revenue Provision (MRP) is chargeable on the General Fund underlying borrowing.

5.2 The borrowing may be either external (such as from the PWLB) or internal borrowing (where an authority temporarily utilises cash backing its reserves and balances rather than taking external loans). External borrowing creates a cost to the Council in terms of having to pay interest on and provide for repayment of external loans while internal borrowing creates lost investment interest and an exposure to future interest rate increases when loans must be taken. The CFR provides the starting point for calculating this cost and the results feed into the ratio of financing costs to net revenue stream indicator.

5.3 The CFR does not increase indefinitely, as the 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.

5.4 The CFR includes any other long-term liabilities (e.g., finance leases). Though these liabilities increase the CFR - and therefore, the Council's borrowing requirement - these types of schemes include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these schemes. The Council had no such schemes within the CFR at the end of 2021/22.

5.5 *Table 5* summarises how the capital expenditure plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need (i.e., an increase in the Capital Financing Requirement). Due to the setting aside of the housing joint venture loan repayments – in lieu of MRP charges – the General Fund has a negative borrowing need in 2025/26 to 2027/28, noting that this does not represent monies available to finance capital expenditure a second time.

Table 5

Financing of capital expenditure (£'000)	**2022/23 Outturn**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**
HRA:						
Capital receipts	3,399	1,976	1,624	2,367	500	1,100
Capital grants and contributions	634	13,029	3,160	-	-	-
Reserves	6,554	24,555	9,865	9,397	9,402	9,408
Revenue contributions	-	2,162	2,715	1,135	1,135	478
Total HRA	**10,587**	**41,722**	**17,364**	**12,899**	**11,037**	**10,986**
General Fund:						
Capital receipts	4,463	56	3,360	-	-	-
Loan repayments set aside to repay debt	-	4,442	6,110	12,000	15,000	30,000
Capital grants and contributions	3,344	7,299	11,053	1,600	-	-
Reserves	1,458	2,295	4,050	1,233	1,285	380
Revenue contributions	549	100	80	80	80	80
Total GF	**9,814**	**14,192**	**24,653**	**14,913**	**16,365**	**30,460**
Combined:						
Capital receipts	7,862	2,032	4,984	2,367	500	1,100
Loan repayments set aside to repay debt	-	4,442	6,110	12,000	15,000	30,000
Capital grants and contributions	3,978	20,328	14,213	1,600	-	-
Reserves	8,012	26,850	13,915	10,630	10,687	9,788
Revenue contributions	549	2,262	2,795	1,215	1,215	558
Subtotal (B)	**20,401**	**55,914**	**42,017**	**27,812**	**27,402**	**41,446**
Net borrowing need for the year (A – B)	**35,097**	**49,121**	**68,189**	**3,151**	**-3,995**	**-19,176**
Split between:						
HRA net borrowing need	3,428	37,849	62,131	7,508	7,899	7,957
GF net borrowing need	31,669	11,272	6,058	-4,357	-11,894	-27,133

5.6 The net financing need for service investment activities / non-financial investments included in *Table 5* against expenditure is shown in *Table 6*:

Table 6

'Service investment' activities / non-financial investments (£'000)	**2022/23 Outturn**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**
Capital expenditure	12,855	996	6,034	7,644	3,106	2,867
Financing costs (incl MRP)	358	121	222	254	163	158
Net financing need for the year	**13,213**	**1,117**	**6,255**	**7,897**	**3,269**	**3,025**
Percentage of total net financing need %	37%	2%	9%	243%	n/a	n/a

5.7 These figures are illustrative at this point and are subject to the Council's approval of the underlying capital expenditure.

5.8 The CFR increases where unfinanced capital expenditure takes place and reduces as the Council makes a Minimum Revenue Provision (MRP).

5.9 This Council has four CFRs:

(a) the HRA,

(b) the General Fund, which is further subdivided to show:

(c) service investment activities / non-financial investments (which have, to date, been loans to third parties at commercial rates of interest and, from 2021/22, the housing joint venture), and

(d) combined total for the whole of the Council (the sum of a to c).

5.10 The estimated CFRs at the end of 2023/24 and each of the next four years are based on the Council's latest capital programme and exclude any unapproved service investment / non-financial activities and additional HRA borrowing for schemes that are subject to viability appraisals, and which would be subject to future Council reports and revised Prudential Indicators, where appropriate. The General Fund CFR also includes the impact of the internal borrowing incurred to date, as well as the internal and external borrowing factored into the current 5-year General Fund Capital Programme.

5.11 The Council is asked to approve the CFR projections in *Tables 7* and *8*.

Table 7

Capital Financing Requirement Year	(a) HRA £'000	(b) General Fund £'000	(c) Service investments / non financial investments £'000	(d) Total £'000
2022/23	185,315	42,347	65,651	293,313
2023/24	223,164	51,781	61,871	336,816
2024/25	285,295	55,531	56,776	397,602
2025/26	292,804	46,329	48,282	387,415
2026/27	300,703	30,873	35,247	366,823
2027/28	308,658	-14,676	22,009	315,991

Table 8

£m	**2022/23 Actual**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**
Capital Financing Requirement						
CFR – non housing	42.3	56.2	66.1	68.9	68.4	52.9
CFR – housing	185.3	223.2	285.3	292.8	300.7	308.7
CFR - service and non-financial investment activities	65.7	61.9	56.8	48.3	35.2	22.0
Total CFR	**293.3**	**341.3**	**408.2**	**410.0**	**404.4**	**383.5**
Movement in CFR	108.3	47.9	66.9	1.8	-5.6	-20.8
Service / non-treasury as % of Total CFR	22%	18%	14%	12%	9%	6%

Movement in CFR represented by						
Net financing need for the year ("A-B" above)	35.1	49.1	68.2	3.2	-4.0	-19.2
Less MRP/VRP and other financing movements	73.2	-1.2	-1.3	-1.4	-1.6	-1.6
Movement in CFR	**108.3**	**47.9**	**66.9**	**1.8**	**-5.6**	**-20.8**

5.12 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any 'non-financial activities' (noting that the Council does not enter 'for yield / commercial' activities) in relation to the authority's overall financial position. The capital expenditure figures shown in *Table 4* and the details above demonstrate the scope of this activity (up from 3% in 2020/21 to 22% in 2022/23, and remaining at an estimated 18% in 2023/24 and 14% in 2024/25, mainly due to the housing joint venture) and, by approving these figures, Members consider the scale proportionate to the Authority's remaining activity.

5.13 The opening HRA CFR at 1 April 2023 was £185.315 million, being the HRA self-financing debt settlement of £136.157 million from 2012 plus new borrowing since 2020/21, which is currently 'internal borrowing' (from the General Fund) at the time of writing. At 31 March 2028 the HRA CFR is predicted to have increased to £300.703 million, while the non-housing (General Fund) element would be £52.875 million and the 'non-financial activities' would be £22.009 million, a total General Fund CFR of £74.884 million, the sum of these two amounts.

5.14 Based on the figures in this report, the planned borrowing that would be submitted to the PWLB when applying for the Certainty Rate (a 0.2% reduction) for 2024/25 to 2025/26 would be as shown in Table 9 below.

Table 9

External borrowing (£m)	2022/23 Outturn	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Service spend	28,628	22,884	16,019	2,913	1,365
Housing	24,015	80,467	85,529	28,051	22,042
Regeneration	-	1,584	8,659	-	-
Preventative action	-	-	-	-	-
Treasury Management	2,855	100	-	-	-
Projects for yield	-	-	-	-	-
TOTAL	**55,498**	**105,035**	**110,207**	**30,964**	**23,407**

5.15 The Regeneration schemes in 2023/24 and 2024/25 include the Future High Street project.

6. Liability Benchmark

6.1 A key prudential indicator, first introduced for the 2023/24 Annual Treasury Management Strategy, is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and, as a minimum, the following two financial years. CIPFA strongly recommends that the LB is produced for at least 10 years and should ideally cover the full debt maturity profile of a local authority. This Council follows this latter standard.

6.2 There are four components to the LB:

1. **Existing loan debt outstanding**: the Authority's existing loans that are still outstanding in future years.

2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.

3. **Net loans requirement**: this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.

4. **Liability benchmark (or gross loans requirement)**: this equals net loans requirement plus short-term liquidity allowance.

Chart 1 – Liability Benchmark – whole Council

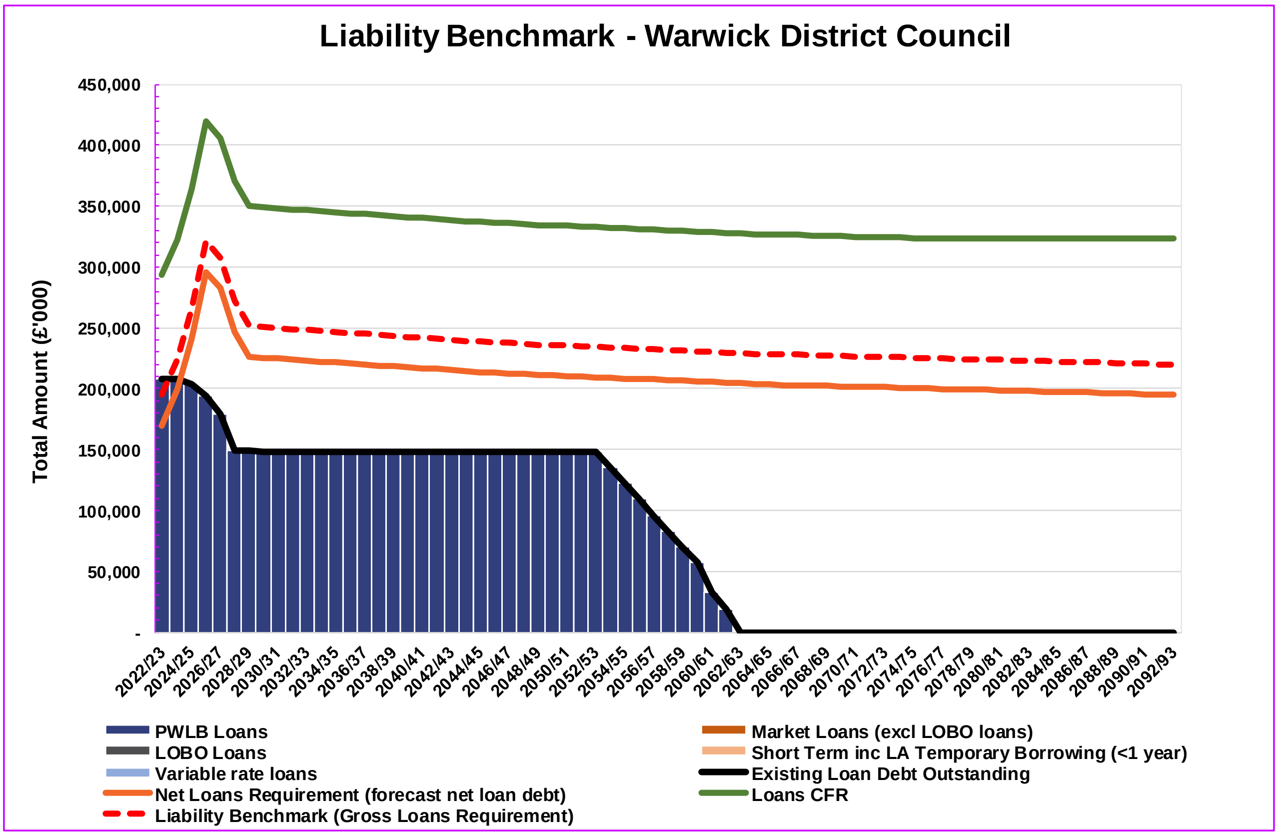


Chart 2 – Liability Benchmark – General Fund

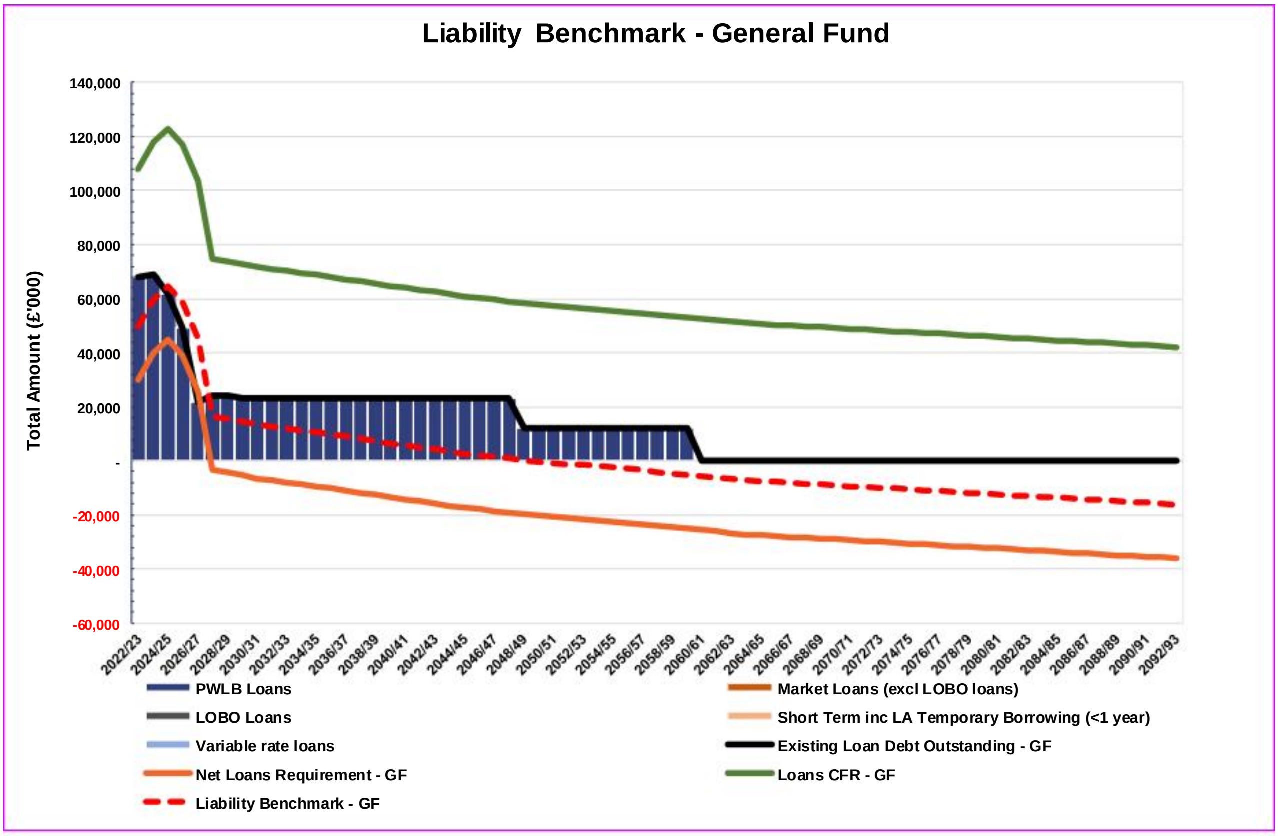
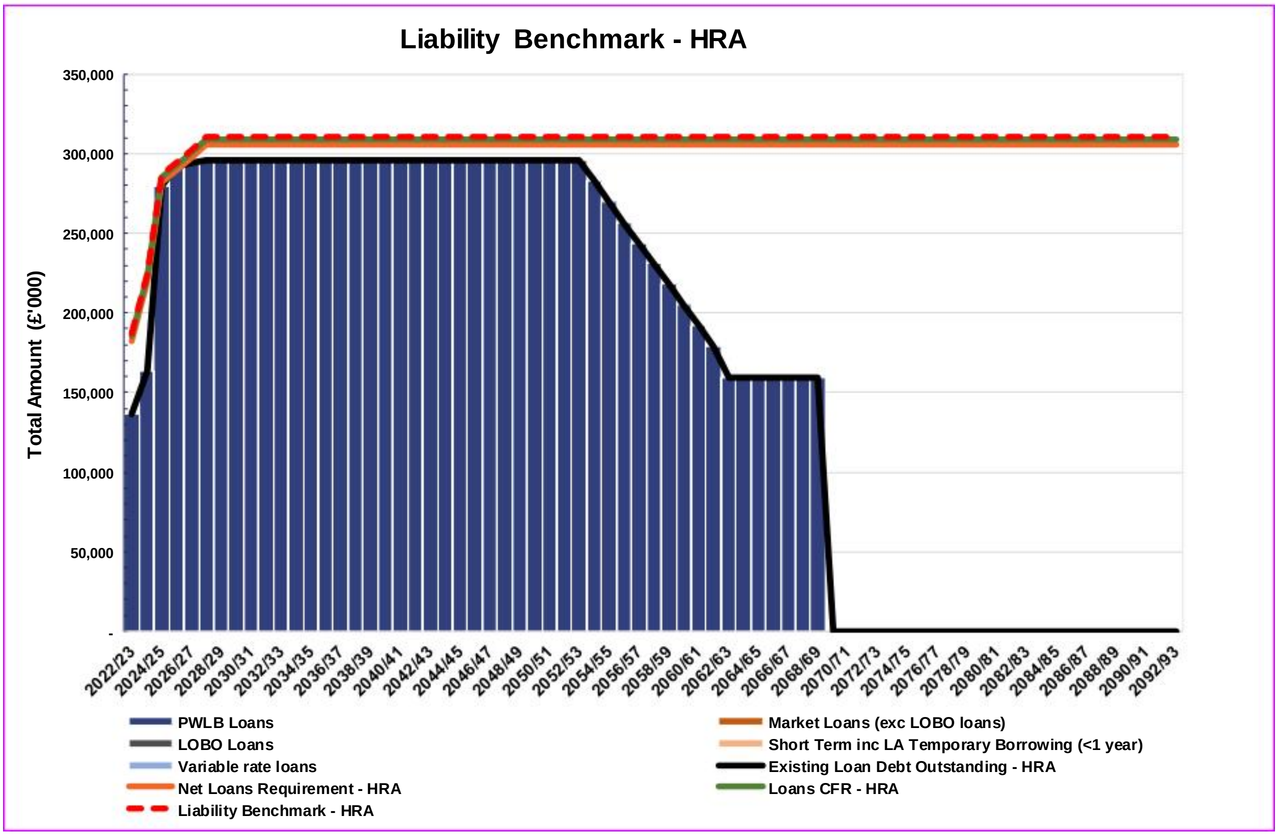


Chart 3 – Liability Benchmark – Housing Revenue Account (HRA)



6.3 CIPFA says, in the 2021 Treasury Management Code, "The liability benchmark should be analysed as part of the annual treasury management strategy, and any substantial mismatches between actual loan debt outstanding and the liability benchmark should be explained".

6.4 The liability benchmark charts above show that actual (PWLB) loans are significantly less than the benchmark, which indicate a future borrowing requirement, the Council having used 'internal borrowing' in recent years, and will need to borrow in future years, especially as investments are eroded by internal borrowing, and the use of reserves and balances, over time. They show that the Council is funding its CFR through a mixture of internal and external borrowing.

6.5 The treasury strategy of the Council will be to replace internal borrowing at the most opportune time, subject to overriding cash flow requirements. The Council is seeking to balance the wish to minimise 'cost of carry' of loans that are surplus to immediate cash requirements with the risk that when it does have to borrow, the costs will be higher than had it borrowed at the time of the capital expenditure being incurred. The Council's treasury advisers will help to determine the optimal balance between these two factors, which can change quickly within an uncertain economic environment.

6.6 The Net Loan Requirement (NLR – a solid orange line in these charts) shows how much the Council currently would need to borrow, based on approved capital budgets and financing. Chart 1 shows that this will peak at £296 million (in 2025/26), decreasing for the General Fund as the loan repayments from the housing joint venture are applied to repay debt. The HRA NLR is currently restricted by the HRA's ability to afford a higher level of debt than this.

6.7 The NLR for the General Fund is a composite of the prudential borrowing to support capital expenditure less the Minimum Revenue Provision and 'capital receipts set aside'. The latter are the repayments of the loans to the housing joint venture, where the Council's MRP policy is to set aside the loan repayments (capital receipts) in lieu of making MRP charges to the General Fund, which would be unaffordable. This results in significantly reduced or negative loans requirements in those financial years.

6.8 Consequently, the NLR for the General Fund, in Chart 2, peaks at £44.6 m, and for the HRA in Chart 3 the peak is currently £305.2 m.

7. External Debt - Authorised Limit

7.1 The Council is required to set - for the forthcoming year and the following two financial years - an Authorised Limit for its total external debt, gross of investments, separately identifying borrowing from 'other long-term liabilities', the latter being credit arrangements, as defined in statute, and which include the principal element of finance leases (or Private Finance Initiative (PFI) if the Council had these contracts).

7.2 The Authorised Limit represents a control on the maximum level of external debt the Council can incur. The Council has no legal power to borrow more than the limits set.

7.3 The recommended Authorised Limit is as shown in *Table 10*:

Table 10

Authorised Limit	2022/23 Outturn £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
Debt including HRA settlement	231,207	226,207	225,588	208,088	175,588	184,970
Other long-term liabilities	-	1,000	1,000	1,000	1,000	1,000
HRA HIP	24,156	62,005	221,636	229,145	237,043	244,999
General Fund HIP	-	-	-	-	-	-
Other General Fund capital programme	30,830	41,029	42,260	44,760	47,260	49,760
Service investment activities / non-financial investments	-	896	6,929	14,573	17,679	20,546
Total Authorised Limit	**286,193**	**331,137**	**497,413**	**497,566**	**478,570**	**501,275**

HIP = Housing Investment Programme

7.4 The Authorised Limit reflects a level of external debt that, although not preferred, could be afforded in the short-term but may not be sustainable in the longer-term. The Indicators for the Operational Boundary and Gross Debt & the CFR will both be set below the Authorised Limit.

7.5 The Authorised Limit takes account of the Housing Improvement Programme (HIP) and the General Fund capital programme. The figures for 'Service investment activities' are for amounts being considered by Council parallel to this report and would need to be excluded if not approved. It excludes additional HRA development and GF investment regeneration that would be expected to generate a net income stream – these are both subject to future Council decisions and could also require the Prudential Indicators to be formally amended.

7.6 It should be noted that the figures for each year are cumulative.

8. External Debt - Operational Boundary

8.1 The Council is, additionally, required to set an Operational Boundary for external debt, which is for three years and gross of investments.

8.2 The Operational Boundary - which is less than the Authorised Limit - is effectively the day-to-day working limit for cash flow purposes, the level that external debt is not ordinarily expected to exceed. This indicator includes anticipated additional borrowing to cater for forecast capital activity.

8.3 An occasional breach of the Operational Boundary is not a cause for concern (provide that the Authorised Limit is not breached) but a sustained breach could indicate that there are problems with the Council's cash flow. Therefore, this indicator is monitored throughout the year and remedial action taken if necessary.

8.4 The recommended Operational Boundaries are as shown in Table 11. It should be noted that the figures for each year are cumulative (for instance, the £6.9m shown in 2024/25 for service investment activities is the cumulative amount potentially reaching £20.5m in 2027/28, subject to feasibility and member approval). They are based on the same assumptions outlined in paragraph 6.5 above.

Table 11

Operational Boundary	2022/23 Outturn £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
Debt including HRA settlement	209,207	204,207	203,588	186,088	153,588	162,970
Other long-term liabilities	-	1,000	1,000	1,000	1,000	1,000
HRA HIP	24,156	62,005	221,636	229,145	237,043	244,999
General Fund HIP	-	-	-	-	-	-
Other General Fund capital programme	30,830	41,029	42,260	44,760	47,260	49,760
Service investment activities / non-financial investments	-	896	6,929	14,573	17,679	20,546
Total Operational Boundary	**264,193**	**309,137**	**475,413**	**475,566**	**456,570**	**479,275**

9. Treasury Indicators

9.1 The following indicators used to be part of the Prudential Code and are part of the Treasury Management Code of Practice.

9.2 Maturity structure of borrowing:

a) Upper and Lower Limits respectively for the Maturity Structure of Fixed Interest Rate Borrowing:

Table 12

Period	Upper	Lower
Under 12 months	20%	0%
12 months & within 24 months	20%	0%
24 months & within 5 years	20%	0%
5 years & within 10 years	20%	0%
10 years & above	100%	0%

b) Upper and Lower Limits respectively for the Maturity Structure of Variable Interest Rate Borrowing:

Table 13

Period	Upper	Lower
Under 12 months	100%	0%
12 months & within 24 months	100%	0%
24 months & within 5 years	100%	0%
5 years & within 10 years	100%	0%

c) Upper limits to fixed interest rate and variable interest rate exposures on borrowing:

Table 14

Year	Upper Limit - Fixed Rate	Upper Limit - Variable Rate
2024/25	100%	30%
2025/26	100%	30%
2026/27	100%	30%

9.3 Upper limit on total principal sums invested for periods longer than a year:

- The total maximum sum that can be invested for more than 365 days is 70% of the core investment portfolio, subject to a maximum of £30 million at any one time.

However, where investments which originally were for periods of more than 365 days currently have 365 days or less to maturity at the 1 April each year they shall be classed from that date as short term i.e., less than 365-day investments and will not count against the 70% or £30 million limit.

Appendix F

Economic Background (at 10 January 2024)

F1. The third quarter of 2023/24 saw:

- A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30 September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
- A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;
- CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
- Core CPI inflation decreasing from April and May's 31-years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;
- The Bank of England holding Bank Rate at 5.25% in November and December;
- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

F2. The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.

F3. However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.

F4. The 0.3% m/m fall in retail sales volumes in October means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.

F5. Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with the Halifax house price index recently pointing to a 1.7% year on year increase whilst Nationwide's December data pointed to a -1.8% year on year decrease. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

F6. Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.

F7. The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

F8. The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.

F9. CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.

F10. The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

F11. Looking ahead, Link's colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why Link think the Bank of England won't feel comfortable cutting interest rates until the second half of 2024.

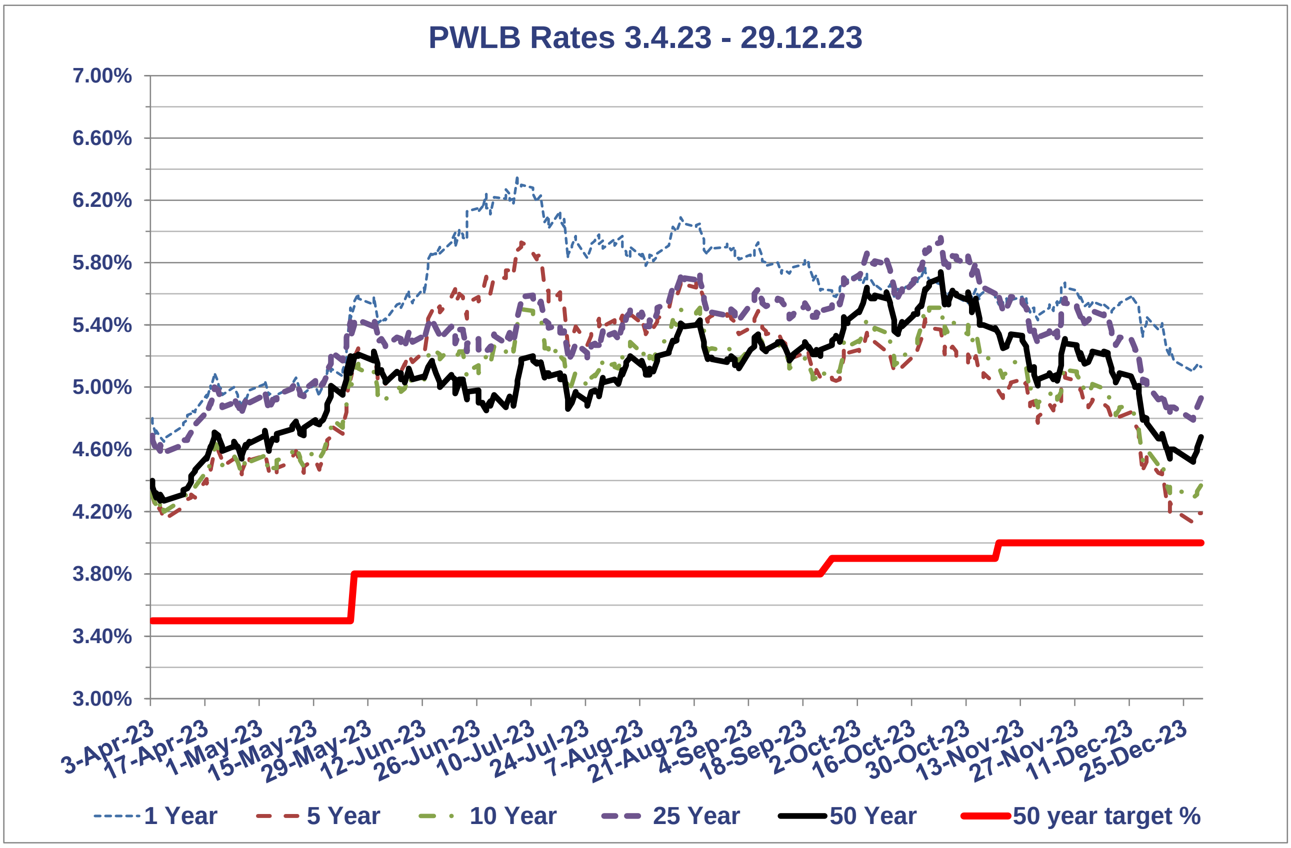
F12. The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% in early January, with further declines likely if the falling inflation story is maintained.

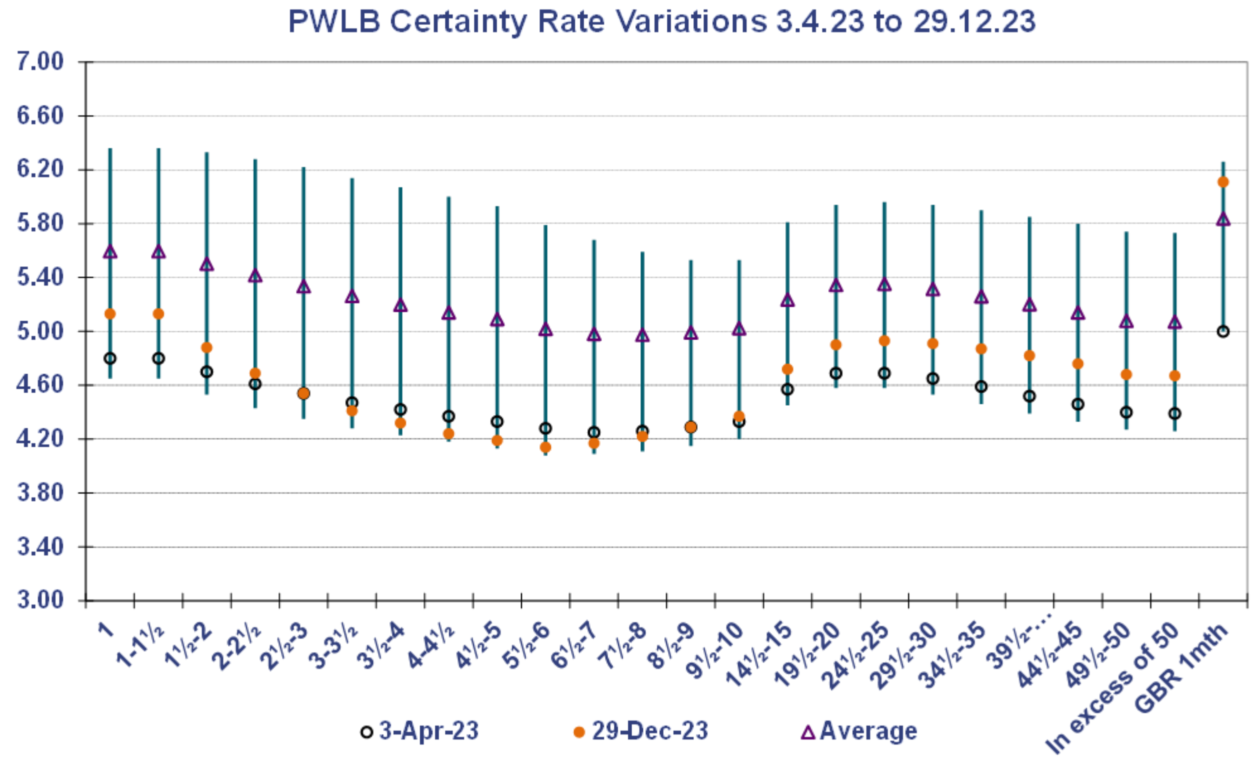
F13. Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.

F14. The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February 2023. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

F15. In the table below, the rise in gilt yields across the curve as a whole in 2023/24, and in PWLB rates, is clear to see.

PWLB RATES - 3 April to 29 December 2023





HIGH/LOW/AVERAGE PWLB RATES FOR 03.04.23 – 29.12.23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.60%	5.09%	5.03%	5.35%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

MPC meetings 2nd November and 14th December 2023

F16. On 2 November, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14 December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.

F17. Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.

F18. In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

Appendix G

INTEREST RATE FORECASTS

G1. The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since November 2012. The lower Housing Revenue Account (HRA) PWLB rate started on 15 June 2023 for those authorities with an HRA (standard rate minus 60 bps).

Link Group Interest Rate View	08.01.24												
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.80	4.30	3.80	3.30	3.20	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.60	4.10	3.70	3.20	3.20	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

G2. LIBOR and LIBID rates ceased at the end of 2021. In a continuation of previous views, money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.

G3. The Link forecast 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.

G4. PWLB forecasts are based on PWLB certainty rates.

Link's latest forecasts at 16 January 2024

Interest Rate Forecasts								
Bank Rate	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link	5.25%	5.25%	4.75%	4.25%	3.75%	3.25%	3.00%	3.00%
Cap Econ	5.25%	5.00%	4.50%	4.00%	3.50%	3.00%	3.00%	3.00%
5Y PWLB RATE								
Link	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.80%	3.70%
Cap Econ	4.50%	4.30%	4.20%	4.00%	3.90%	3.80%	3.80%	3.70%
10Y PWLB RATE								
Link	4.70%	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.90%
Cap Econ	4.50%	4.40%	4.20%	4.10%	4.10%	4.10%	4.10%	4.10%
25Y PWLB RATE								
Link	5.20%	5.10%	4.90%	4.80%	4.60%	4.40%	4.30%	4.20%
Cap Econ	5.10%	4.80%	4.60%	4.30%	4.40%	4.40%	4.50%	4.60%
50Y PWLB RATE								
Link	5.00%	4.90%	4.70%	4.60%	4.40%	4.20%	4.10%	4.00%
Cap Econ	4.70%	4.60%	4.50%	4.30%	4.30%	4.30%	4.40%	4.40%

Bank Rate	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
08.01.24	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00

G5. At its 14 December meeting, the Bank of England's Monetary Policy Committee (MPC) kept rates on hold for the third time in a row, pushing back against the prospect of near-term interest rate cuts. The vote in favour of keeping rates on hold was 6-3.

G6. However, recent softer wage and inflation data (annual CPI is currently 3.9%) mean that markets have moved significantly in the direction of Link's November interest rate forecast, pricing in a first rate cut in Q2 2024, a full quarter earlier than our own forecast which has only undergone a little fine-tuning today. Link now expects Bank Rate to be cut to 4.25% by the end of 2024 (4.5% previously) and 3% by the end of 2025. The low point of the interest rate cycle is also expected to be 3%.

G7. Regarding the Bank of England, it continued to sound hawkish in December. Indeed, the evidence of subsiding price pressures did not dissuade the more hawkish members of the MPC from again voting to raise interest rates by 25 basis points (bps). The MPC maintained its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it reiterated that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time".

G8. At the time of the meeting, the Bank did not appear to have taken any comfort from subsiding price pressures in the US and the Eurozone either, saying that measures of inflation persistence are higher in the UK than in other major advanced economies. And its statement that relative to developments in the US and the Eurozone "measures of wage inflation were considerably higher in the UK and services price inflation had fallen back by less so far". Nonetheless, even if the Bank would prefer to cut interest rates after the Fed and the ECB, Capital Economics' forecast for the CPI measure of inflation to drop below 2% by April, and for core inflation to drop below 2% only three months later, further convinces us that rates will be cut sharply in the second half of 2024 if not before.

G9. Since the December rate decision, the Bank's hawkish bias has also not prevented the markets from forming a view that rates will be falling soon. Accordingly, swap rates and gilt yields have reduced significantly over the past month despite a partial rebound upwards since the turn of the year. This will have the effect of ensuring upcoming mortgage rate resets (c400k per quarter) will be somewhat lower than they were through the second half of 2023. Indeed, it is noteworthy that the Halifax house price index has recently moved into positive territory after registering only a slight fall in house prices from their peak in the summer of 2022.

G10. Looking further afield, Link suspects the wider economy may only endure the lightest of recessions or, possibly, not at all. The Bank's November Quarterly Monetary Policy Report saw it revise down its Q3 and Q4 GDP forecasts for 2023 and its annual forecast for 2024 from 0.4% to 0.0% (2023 stayed at 0.5%). But it could be this outlook underestimates the robustness and resilience of the UK economy, particularly considering upward revisions to GDP stemming from the pandemic years.

G11. As outlined in November, there are, of course, significant risks to their central forecast. First, we are probably still in the early days of the Gaza-Israel conflict, and a meaningful and prolonged shift up in oil prices from $75 per barrel to something closer to $120 would keep inflation higher for longer. Furthermore, the UK domestic labour market is still having to contend with very low unemployment (4.2%) and the total number of job vacancies is only a little below one million. Even if Labour takes over the governmental reins in the next year or so, it is unlikely that a fundamental overhaul of immigration policy, with a view to addressing staff shortages in various sectors of the economy, is going to be a priority, so keeping a lid on wages is going to be a tough challenge even if some of the more recent signs are that wage growth is moderating (still c7% y/y).

G12. Regarding PWLB rates, movement in the short part of the curve has reflected the revised Bank Rate expectations to a large degree, whilst medium to longer-dated

PWLB rates will remain influenced not only by the outlook for inflation, but by the market's appetite for significant gilt issuance. Indeed, although Link has a slightly lower starting point for the envisaged reduction in short and medium dated gilts, they now forecast the 10, 25 and 50 years part of the curve to not fall quite as low as they thought in November.

G13. Furthermore, a General Election is expected in the next year, so Government fiscal policy may potentially loosen at the same time as the Bank's monetary policy is still trying to take momentum out of the economy. That may mean that Bank Rate stays elevated for a little longer than our central forecast.

G14. Of course, what happens outside of the UK remains critical to movement in gilt yields as well. The ECB has made it clear that policy tightening is at, or close to, the terminal rate (currently 4%), whilst the US FOMC has held its Bank Rate equivalent in the range of 5.25% - 5.5%.

G15. From a practical standpoint those clients looking to borrow will, most probably, need to continue to focus on borrowing temporarily from local authorities or with short-dated loans from the PWLB. You will see from our forecast that we still expect both short and longer-term rates to be somewhat lower over the duration of the forecast. Nonetheless, if certainty is paramount within your debt management strategy, we will help you to optimise any longer dated borrowing requirements you may have.

G16. On the flipside, if you are an authority that is fully funded or wishes to reduce its exposure to long-dated debt, the relatively high prevailing yields could provide further scope to repay loans prematurely (both market and PWLB) whilst discount rates are advantageous. Your Client Relationship Manager should be contacted if this is something you wish to look at.

G17. In terms of our forecast, our money market yield 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.

A Summary Overview of the Future Path of Bank Rate

G18. Link's central forecast for interest rates was previously updated on 7 November 2023 (see above) and reflected a view that the MPC would be keen to underpin its anti-inflation credentials by keeping Bank Rate at 5.25% until at least the second half of 2024. They expect rate cuts to start when both the CPI inflation and wage/employment data are unequivocally supportive of such a move, and that there is a strong likelihood of the overall economy enduring tepid growth (at best) or a mild recession (at worst) over the coming months.

G19. Timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

G20. In the upcoming months, their forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

G21. On the positive side, consumers are still anticipated to be sitting on some excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing a little better at this stage of the economic cycle than may have been expected. Nonetheless, with approximately 400,000 households per quarter facing a mortgage interest reset at higher levels than their current rate, the economy will face on-going headwinds from that source, in addition to lower income households having to spend disproportionately on essentials such as food, energy and rent payments.