Cabinet

Excerpt of the minutes of the meeting held on Thursday 10 March 2022 in the Town Hall, Royal Leamington Spa at 6.00 pm.

Present: Councillors Day (Leader), Bartlett, Cooke, Falp, Grainger, Hales, and Matecki.

Also Present: Councillors: Boad (Liberal Democrat Group Observer), Davison, (Green Group Observer), Mangat (Labour Group Observer), Milton (Chair of Overview & Scrutiny Committee) and Nicholls (Chair of Finance & Audit Scrutiny Committee and Labour Group Observer)

107. **Apologies for Absence**

Apologies for absence were received from Councillor Rhead.

108. **Declarations of Interest**

There were no declarations of interest.

109. **Minutes**

The minutes of the meeting held on 10 February 2022 were taken as read and signed by the Chairman as a correct record.

Part 1
(Items upon which a decision by the Council was required)

110. **Length of Council, Cabinet & Committee meeting**

The Cabinet considered a report from Democratic Services which brought forward proposals for length of meetings of the Council/Cabinet and Committees.

The proposals were brought forward following discussion with Group Leaders.

An investigation into a complaint, about the handling and determination of a planning application, highlighted the potential risks and impact of taking decisions late into the evening, especially on more technical matters. Informally, officers and Councillors raised concerns about length of Council/Cabinet and Committee meetings after working during the day. Lengthy and/or late finishing meetings could also pose a wider risk to health, safety and well-being of those participating and the report sought to provide some assurance and mitigations against long meetings.
In essence, the proposal formalised the understanding currently in place with Chairmen on a break after two hours and to minimise meetings going on significantly past 10.00pm. The recommendations provided a framework to support those decisions, so they were clear and transparent for all parties.

The report proposals were considered a reasonable approach to provide clarification on current informal practices.

In terms of alternative options, the Cabinet could decide not to progress with the proposals and/ or amend the proposed times, however, the proposal provided a structured approach which allowed for variation at individual meetings.

The Group Observers expressed support for the recommendations in the report, stating that decisions could not be made effectively past a certain time.

Councillor Day then proposed the report as laid out.

Recommended to Council that

(1) a formal break in the meeting of no less than 10 minutes be taken, after no later than two and a half hours into a meeting, at the conclusion of an item, unless at least half of those present agree to continue;

(2) no item of business will be started after 9.30pm unless at least half of those present agree to proceed. The proposal must be moved by the Chairman of the meeting, duly seconded and voted upon; and

(3) if the motion in recommendation (2) above is lost, any remaining business will either be adjourned/deferred to a time and date fixed by the Chairman, which is to be no earlier than 6.00pm the next working day; but if no date is fixed, any item not considered will stand deferred to the next scheduled meeting of the Council/ Cabinet/ Committee.

(The Portfolio Holder for this item was Councillor Day)

111. **Treasury Management Strategy 2022/23**

The Cabinet considered a report from Finance which detailed the strategy that the Council would follow in carrying out its treasury management activities in 2022/23.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defined 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."*

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

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

There would be updates made to the TMPs before 1 April 2022 for the recent changes required below.

Under CIPFA’s updated *Treasury Management in Public Services Code of Practice*, the Council continued to be required to have an approved annual Treasury Management Strategy, under which its treasury management operations could be carried out. The proposed Strategy for 2022/23 was included as Appendix A to the report.

This Council had regard to the Government’s Guidance on Local Government Investments. The guidance stated that an Annual Investment Strategy had to be produced in advance of the year to which it related and had to be approved by the Council. The Strategy could be amended at any time, and it had to be made available to the public. The Annual Investment Strategy for 2022/23 was shown as Appendix B to the report.

The Council had to make provision for the repayment of its outstanding long-term debt and other forms of long-term borrowing such as finance leases. Statutory guidance issued by MHCLG / DLUHC required that a statement on the Council’s Minimum Revenue Provision (MRP) Policy be submitted to Council for approval before the start of the relevant financial year. This was contained in Appendix C to the report.

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.

The paper primarily covered the concerns that the Government had in respect of compliance with the duty to make a prudent revenue provision, which in their view, resulted in an underpayment of MRP. The consultation document stated that the DLUHC were not intending to change the statutory MRP guidance, but to clearly set out in legislation the practices that authorities should already be following.

However, the proposals would result in a removal of the discretion of councils to interpret their measure of a prudent MRP policy, and, in particular, to elect to use capital receipts from capital loan repayments in place of the revenue charge (a MRP ‘holiday’). This would have major implications for councils such as Warwick District Council.

The changes would take effect from 1 April 2023 and the Government said that they would be “prospective”, meaning that although they would not apply to previous financial years, they would apply to existing loans repayable after that date. This would, contrary to the accountancy and legal advice obtained at the time, apply to the housing joint venture loans, which would require MRP being charged, which would run into many millions of pounds each year. The Council responded to the Government’s consultation, pointing out the severe impact and uncertainty such changes would make.

If the changes, as originally proposed, did come in from April 2023, many local authorities, along with Warwick District Council, were likely to incur substantial additional revenue costs. While the Government's original intention was to limit MRP 'holidays' on borrowing for investment purposes, the proposals would also restrict invest for housing and regeneration purposes. Consequently, it was hoped that the new Regulations would recognise this, so as to allow such investment and not inflict significant additional revenue costs on such local authorities.

The recommended MRP Policy at Appendix C to the report would still enable the MRP to exclude such loan repayments, while the consultation was underway, but a full risk assessment based on the latest information and recommendations from Link etc. would be undertaken before any capital investment for which the MRP 'holiday' might be deemed to apply was committed.

The Prudential Code required full Council to approve several Prudential Indicators, including amounts of borrowing required to support capital expenditure, set out in Appendix D to the report, which had to be considered when determining the Council's Treasury Management Strategy for a minimum of the next three financial years.

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 were considered and approved, in conjunction with the development of an integrated Treasury Management Strategy. It was effective immediately, but councils might 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 was recommended to defer until the statutory deadline.

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';
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; and
j) reference to Environmental Sustainability in the Capital Strategy.

Point d) above introduced a new distinction of service investments, for investments that were neither treasury investments as defined in paragraph 1.1 in the report and were not unpermitted 'commercial' investments primarily for yield. Examples of service investments would be the Council's housing joint venture to enable the greater provision of housing in the district, or third-party loans to facilitate economic regeneration.

The Cabinet previously requested that the 2020/21 Treasury Management Strategy Statement considered the policy of investing in fossil fuels. The

Council had some exposure to fossil fuel extraction companies in two corporate equity funds, operational since 2017/18. The Council divested from these funds during 2021/22 and now did not have any directly measurable investment exposure to fossil fuel extraction.

The Council was required to operate a balanced budget, which broadly meant that cash raised during the year would meet cash expenditure. Part of the treasury management operation was to ensure that this cash flow was adequately planned, with cash being available when it was needed. Surplus monies were 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").

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

The contribution the treasury management function made to the authority was critical, as the balance of debt and investment operations ensured liquidity or the ability to meet spending commitments as they fell due, either on day-to-day revenue or for larger capital projects. The treasury operations would 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 resulted from reserves and balances, it was 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.

Treasury Management could 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.

The 2022/23 budget for investment income, after inclusion of growth items, was as follows:

Investment Income	21/22 Revised budget £'000	22/23 Original budget £'000
One-off item:		
Capital gains on divestment of corporate equity funds	405.6	-
Recurring items:		
External investment income	296.4	242.6
Deferred capital receipts interest	13.7	10.6
Long-term debtor loans	234.1	201.8
less : HRA allocation	-114.5	-106.5
Net interest to General Fund	429.7	348.5

The divestment from the Council's two corporate equity funds, as part of its Climate Change Emergency targets, during September 2021 realised actual capital gains of £405,593, taking the opportunity when it was believed that equities were near an optimum 'high' to sell at a favourable time. This could be compared with the position on 31 March 2021 when there would have been a loss of £94,585 and on 31 March 2020 when the loss would have been over £1.4m.

The amount of interest that was to be credited to the Housing Revenue Account as 'HRA allocation' would vary depending on how the net balances and cashflow of the HRA changes.

Whilst any 'service' (not primarily 'for yield') initiatives or loans to third parties would impact on the treasury function, these activities were generally classed as non-treasury activities, (arising usually from capital expenditure), and were separate from the day-to-day treasury management activities.

The treasury management activity in the report applied to Warwick District Council, in accordance with the statutory framework and local Treasury Management Strategy and Treasury Management Practices.
The Treasury Management function enabled 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 operated.

The Council was also required to approve a Minimum Revenue Provision Policy Statement before each financial year.

These recommendations would enable the Council to operate within the known budgetary framework to be set for 2022/23 but if the Prudential Indicators needed to be adjusted during the year, a further report would need to be brought to Council for approval.

In terms of alternative options, the report set out the capital spending and borrowing requirements for the financial year 2022/23 within the Prudential Indicators (PIs). The Council could increase or decrease these limits, provided that these PIs were within the envelope of what was affordable and prudent, taking account of interest costs and the Minimum Revenue Provision ("depreciation") requirements.

The Finance & Audit Scrutiny Committee supported the recommendations in the report and thanked officers for all their hard work, especially that the work was carried out so quickly and timely for the disinvestment from the two equity funds. Members noted that the timing of disposals had saved taxpayers money, alongside meeting the Council's objectives of not investing in fossil fuel.

Councillor Hales also thanked the Finance officers and then proposed the report as laid out.

Recommended to Council that

(1) the Treasury Management Strategy for 2022/23 contained in Appendix A to the minutes, be approved;

(2) the deferral of the new reporting requirements of the updated Prudential Code for Capital Finance in Local Authorities until the statutory deadline of 2023/24, be approved;

(3) the 2022/23 Annual Investment Strategy as contained in Appendix B to the minutes, be approved;

(4) the Minimum Revenue Provision Policy Statement as contained in Appendix C to the minutes, be approved; and

(5) the Prudential Indicators as outlined in Appendix D to the report, including the amount of long-term borrowing required for planned capital expenditure, be approved.

(The Portfolio Holder for this item was Councillor Hales)
Forward Plan Reference 1,266

(The meeting ended at 6.45pm)

CHAIRMAN

20 April 2022

Treasury Management Strategy for 2022/23

The strategy for 2022/23 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 indicators are included in Appendix D.
- the minimum revenue provision (MRP) policy – see Appendix C. The DLUHC have recently released consultation covering proposed changes to Regulation 28, which could impact the current MRP policy. Please note that this will not be in force until 1 April 2023 and there are no changes required to the policy for 2022/23 financial year.

B. Treasury management issues

- the current treasury position
- treasury indicators which limit the treasury risk and activities of the Council (Appendix D)
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy (Appendix B)
- creditworthiness policy (Appendix B, section 3)
- training
- benchmarking
- performance and
- the policy on the use of external service providers.

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

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. Following the May 2019 Council elections, Link Group (Link) delivered training to Members of the Finance and Audit Scrutiny Committee and other interested Members in November 2019, with a joint Stratford / Warwick webinar event on 25 January 2022. Further training will be provided as and when required.

1.2 Officers involved in treasury management have received training from the Council's treasury consultants, CIPFA and other providers, as well as from a previous post holder. 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.

2 External service providers

2.1 The Council uses Link Group, Treasury Solutions ('Link') as its external treasury management advisor. The option to extend the contract with Link by one year was recently exercised, taking the current agreement to January 2023, bringing the contract to the closest date to Stratford District Council's arrangement with Link.

2.2 The Council recognises that responsibility for treasury management decisions always remains with the organisation 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 our 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 Finance and Audit Scrutiny Committee.

4.2 The Treasury Management Team will seek to achieve a return on its money market investments of 0.0625% over the Sterling Overnight Index Average[1] (SONIA) - previously the London Interbank Bid Rate (LIBID) - of a similar duration. As SONIA is higher than LIBID, the expected outperformance of this benchmark will be lower than previously.

5 Prospects for interest Rates

5.1 Link assists the Council to formulate a view on interest rates. Further information is contained in Appendix F.

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[1] 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

5.2 The following table gives Link's central view as at 7 February 2022.

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

5.3 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to first 0.25%, and then to 0.10%, it raised Bank Rate back to 0.25% at its meeting on 16 December 2021, surprising markets who expected no changes due to the threat of Omicron. The Rate increased to 0.5% on 3 February 2022.

5.4 Link now expects the MPC to deliver another 0.25% increase in March; their position appears to be to go for sharp increases to get the job done and dusted.

5.5 The March increase is likely to be followed by an increase to 1.0% in May and then to 1.25% in November. The MPC is currently much more heavily focused on combating inflation than on protecting economic growth.

5.6 However, 54% energy cap cost increases from April, together with 1.25% extra employee national insurance, food inflation around 5% and council tax likely to rise in the region of 5% too – these increases are going to hit lower income families hard despite some limited assistance from the Chancellor to postpone the full impact of rising energy costs.

5.7 Consumers are estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above increases. But most of those holdings are held by more affluent people whereas poorer people already spend nearly all their income before these increases hit and have few financial reserves.

5.8 The increases are already highly disinflationary; inflation will also be on a gradual path down after April so that raises a question as to whether the MPC may shift into protecting economic growth by November, i.e., it is more debatable as to whether they will deliver another increase then.

5.9 The big issue is will the current spike in inflation lead to a second-round effect in terms of labour demanding higher wages, (and/or lots of people getting higher wages by changing job)?

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

5.11 **Bond yields / PWLB rates**. The yield curve has flattened out considerably.

5.12 Link view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate.

5.13 It is difficult to say currently what effect the Bank of England starting to sell gilts will have on gilt yields once Bank Rate rises to 1%: it is likely to act cautiously as it has already started on not refinancing maturing debt. A passive process of not refinancing maturing debt could begin in March when the 4% 2022 gilt matures; the Bank owns £25bn of this issuance. A pure roll-off of the £875bn gilt portfolio by not refinancing bonds as they mature, would see the holdings fall to about £415bn by 2031, which would be about equal to the Bank's pre-pandemic holding. Last August, the Bank said it would not actively sell gilts until the "Bank Rate had risen to at least 1%" and, "depending on economic circumstances at the time."

5.14 It is possible that Bank Rate will not rise above 1% as the MPC could shift to relying on quantitative tightening (QT) to do the further work of taking steam out of the economy and reducing inflationary pressures.

5.15 Increases in US treasury yields over the next few years could add upside pressure on gilt yields though, more recently, gilts have been much more correlated to movements in bund yields than treasury yields.

5.16 The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more 'risky' assets i.e., equities, or the safe haven of government bonds. The overall longer-run trend is for gilt yields and PWLB rates to rise moderately.

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

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong and enduring will inflationary pressures turn out to be in both the US and the UK, and so impact treasury and gilt yields?
- Will the major western central banks implement their previously stated new average or sustainable level inflation monetary policies when inflation has now burst through all previous forecasts and far exceeded their target levels? Or are they going to effectively revert to their previous approach of prioritising focusing on pushing inflation back down and accepting that economic growth will be very much a secondary priority - until inflation is back down to target levels or below?

- How well will central banks manage the running down of their stock of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the 'taper tantrums' in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

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

5.19 Their target borrowing rates and the current PWLB (certainty) borrowing rates are set out below:

PWLB debt	Current borrowing rate as at 7.2.22 p.m.	Target borrowing rate now (end of Q1 2022)	Target borrowing rate previous (end of Q1 2022)
5 year	2.12%	2.20%	1.50%
10 year	2.24%	2.30%	1.70%
25 year	2.38%	2.40%	1.90%
50 year	2.06%	2.20%	1.70%

5.20 **Borrowing advice**: Link's long-term (beyond 10 years) forecast for Bank Rate is 2.00%. As nearly all PWLB certainty rates are now above this level, the borrowing strategy will need to be kept under review, especially as the maturity curve has flattened out considerably. Better value can be obtained at the very short and at the longer end of the curve and longer-term rates are still at historically low levels. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio.

5.21 The suggested budgeted investment earnings rates for investments up to about three months' duration in each financial year for the next six years are as follows:

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

5.22 The long-term later years forecast in the table above is an indicator for 10 years.

5.23 As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts. The general expectation for a trend of gently rising gilt yields is unchanged. Negative, (or positive) developments could significantly impact safe haven flows of investor money into UK, US and German bonds and produce shorter-term movements away from these central forecasts.

5.24 Link's interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of plus or minus 25 bps.

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

6 Investment and borrowing rates

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

6.2 **Borrowing interest rates** fell to historically very low rates because of the COVID crisis and the quantitative easing operations of the Bank of England and remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities, including Warwick, well over the last few years, saving on borrowing costs.

6.3 On 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had **purchase of assets for yield** in its three-year capital programme. The current margins over gilt yields are as follows:

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)[2]

6.4 **Borrowing for capital expenditure**. As outlined in paragraph 5.20, Link's long-term (beyond 10 years) forecast for Bank Rate is 2.00%. As most PWLB certainty rates are above this level, better value can be obtained at the very short and at the longer end of the curve, and longer-term rates are still at historically low levels. Temporary borrowing rates are likely, however, to

[2] 3rd Round ran from 11th April to 11th July 2020 so closed until HM Treasury announces a 4th Round

remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio.

6.5 While this authority 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.

7 Borrowing Strategy

7.1 The capital expenditure plans set out in Section 4 of Appendix D 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's current long-term borrowing portfolio consists of £136.157 million HRA and £62 million General Fund PWLB debt.

7.3 The original General Fund £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).

7.4 A further £50 million was borrowed by the General Fund in August 2021 for a housing joint venture, with a further £10 million payable under this agreement in April 2022. These £60 million of loans will be made up of six smaller amounts, with terms between 1½ and 5½ years, and the PWLB loans and the joint venture loans are coterminous.

7.5 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. As part of reviewing the HRA Business Plan in December 2020, the Cabinet agreed that the Business Plan should allow for this debt to be replaced, so maintaining the overall level of debt and so give additional funds to invest in the housing stock. The current HRA Business Plan from December 2021 includes new PWLB borrowing, which has been factored into this report. and the Capital Financing Requirement (or CFR, the capital borrowing need) and other Performance Indicators.

7.6 The Council has no short-term borrowing other than residual finance leases. An assessment will be made of 'embedded leases' within the Council's contracts as at 31 March 2022 for IFRS 16 reporting purposes.

7.7 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 and counterparty risk is still an issue that needs to be considered.

7.8 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 (b) the upside risk of PWLB and other borrowing rates because of economic factors make it prudent to consider 'externalising' more of the internal borrowing by taking PWLB loans during 2022/23.

7.9 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 2022/23 or 2023/24 and beyond is undertaken. Please see Appendix D, Tables 4 and 5, 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**.

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

7.11 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 practical;
- a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised.

Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

On Balance Sheet	Fixed	Variable
Public Works Loan Board (PWLB)	✓	✓
Municipal Bond Agency (MBA)	✓	✓
Local authorities	✓	✓
Banks	✓	✓
Pension funds	✓	✓
Insurance companies	✓	✓
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	✓	✓

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

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

7.14 The degree which any of these options proves cheaper than PWLB Certainty Rate 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 demanding in the last year or two.

7.15 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 (other than minimal bank overdrafts) in 2021/22 to date and is not expecting to during 2022/23.

7.16 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 2021 are summarised below:

Type of Investment	31 Dec 21 £'000	30 Sep 21 £'000	31 Mar 21 £'000
Money Markets incl. CD's & Bonds	39,921	31,592	33,000
Money Market Funds	42,305	34,195	12,334
Business Reserve Account	6,075	5,000	2,003
Total In House Investments	**88,301**	**70,787**	**47,337**
Corporate Equity Funds (nominal value)	-	-	6,000
Total Investments	**88,301**	**70,787**	**53,337**

9.2 The corresponding borrowing position is summarised below:

External Borowing	31 Dec 21 £'000	30 Sep 21 £'000	31 Mar 21 £'000
Public Works Loan Board	198,157	198,157	148,157
Total	**198,157**	**198,157**	**148,157**

10 Debt rescheduling

10.1 Rescheduling of borrowing in the Council’s debt portfolio will remain uneconomic within current interest rates, given the high premia the PWLB would charge, reflecting the very large difference between premature redemption rates and new borrowing rates.

10.2 The Council’s treasury advisors will continue to monitor the debt portfolio and identify any opportunities for debt restructuring but there would need to be a significant increase in interest rates for this occur.

10.3 If rescheduling was done, it would be reported to the Finance and Audit Scrutiny Committee at the earliest meeting following its action.

Appendix B to Minute 111

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[3]) - and CIPFA[4] 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 2018,
- Any revised reporting requirements included in the revised editions of Treasury Management Code and Prudential Code (Dec 2021) will be incorporated into the 2023/24 reports approved by Full Council
- The Council will have regard to the revised Treasury Management Code and Prudential Code (December 2021) and comply with new framework requirements ahead of formal adoption of reporting requirements from 1 April 2023.

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

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

1.5.1. Minimum acceptable **credit criteria** are applied to generate a list of

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

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.

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

1.5.3. **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.

1.5.4. 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.
- **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. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e., an 18-month deposit would still be non-specified even if it has only 11 months left until maturity.

1.5.5. **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.

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

1.5.7. **Transaction limits** are not set for each type of investment, being subject to the overall lending limit in 1.4.7 above.

1.5.8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**. (70% - see paragraph 3.11 below).

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

1.5.10. This authority has engaged **external consultants**, (Appendix A 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.

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

1.5.12. As a result of the change in **accounting standards** for 2022/23 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[5]. This override applied to the Council's recently disposed equity funds and will be a factor in the appropriateness of Environmental Social & Governance (ESG) equity funds after 2022/23.

1.6 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, save for any reference to commercial investments, which are no longer permitted, and have been removed. 'Service investments' are a new nomenclature introduced for non-treasury investments where the primary objective is service delivery, such as for the provision of housing or economic development.

3. Creditworthiness policy

3.1 The Council applies 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, Moodys, 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

[5] 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

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, 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, corporate bond 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 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[6]	£10m
LVNAV MMFs[7]	£10m

3.9 The Council has both cash flow derived and core balances available for

[6] Constant Net Asset Value Money Market Funds
[7] Low-Volatility Net Asset Value Money Market Funds

investment. Investment decisions will be made with regard to 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 The Council had two corporate equity fund managers until September 2021. These specific equity funds had around 5% exposure to investing in companies extracting fossil fuels[8] and the recommendation is to divest from these funds by the end of 2025 as part of the Council's Climate Emergency Declaration. One option would be to re-invest the £6 million in ESG equity funds. Any new fund manager appointments would be made in conjunction with the treasury advisers and in adherence with the Council's procurement rules. Re-procuring to invest these funds would incur an additional cost, as well as taking officer and member time, and it should be noted that the regulatory framework for evaluating ESG investments for risk has yet to be agreed, so it is recommended that any decision on this is deferred until the market is 'more mature' and the national risk reporting framework has been agreed.

3.12 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 2022/23 on average will be in the region of £66m, of which £28m will be "core" investments i.e. made up of reserves and balances which are not required in the short term.

3.13 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 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.

3.14 After the Bank of England's December 2021 decision to raise the Base Rate by 0.15% to 0.25%, and by a further 0.25% to 0.50% in February 2022, the 2022/23 interest rate outlook is for Base Rate to increase again and start the year at 0.75%. Link expect it to increase by June 2022 to 1.00% and increase again by March 2023 to 1.25%, remaining at that rate until March 2025. Based on current investment policies and interest rate projections at budget setting, it is currently estimated that the overall portfolio will achieve a 0.32% return for 2021/22, augmented by the dividends from the equity funds, increasing to 0.39% for 2022/23 before the more recent movements in Base Rate.

[8] Oil and gas

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)

Appendix B Annex 2

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 at 21 December 2021, is based on those countries which have sovereign ratings of AA- or higher, based on the lowest rating from Fitch, Moodys and S&P.

Based on lowest available rating

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

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

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*[9] 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[10]. 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

[9] 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.
[10] 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 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. 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 short to medium duration loans to third parties the Council will not make either MRP or VRP but instead apply the capital receipt received through the repayment of the loan to pay down the Capital Financing Requirement.

5.5 The Council may on occasion enter into agreement to undertake a scheme / capital payment whereby monies and resources (grants, capital receipts, S106 receipts, etc.) will be received some time after the scheme / capital payment has been completed. On such occasions whereby the capital expenditure is expected to be fully reimbursed by future capital or revenue income, no MRP will be provided. This position will be kept under review and should the likelihood of receipt of the income change, then MRP may be initiated. Such an example would be the granting of monies to an external organisation and S106 receipts are expected to pay for the capital liability.

Note: The use of paragraphs 5.4 and 5.5 will be subject to the outcome of Government consultation on MRP Regulation 28 and a full risk assessment would be undertaken, considering the latest information, before any capital investment is undertaken to which this MRP policy may apply, as discussed in the covering report.

Appendix D to Minute 111

Prudential and Treasury Indicators

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 believe is inappropriate for local government to pursue, given some 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 2023/24 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, 2021/22, where appropriate and setting them for future years.

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 2020/21 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
2020/21	-0.6%	40.3%	24.6%
2021/22	-2.00% to 5.00%	38.00% to 50.00%	23.00% to 33.00%
2022/23	0.00% to 20.00%	38.00% to 50.00%	24.00% to 37.50%
2023/24	0.00% to 30.00%	38.00% to 50.00%	24.00% to 40.00%
2024/25	0.00% to 26.00%	38.00% to 50.00%	24.00% to 40.00%

2.5. The ratio for estimates is a range rather than a single figure (except the 2020/21 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. 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.

Prudence - Gross Debt and the Capital Financing Requirement

1.1 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 lower than the CFR in future years.

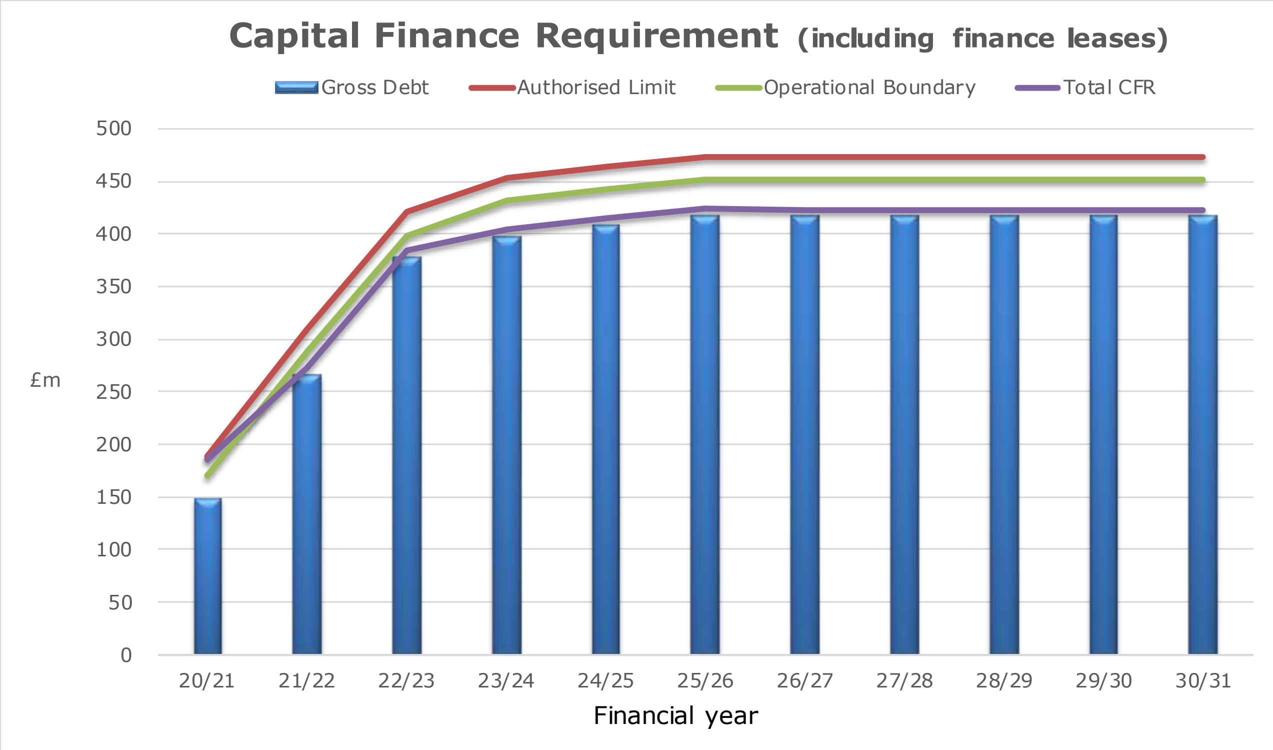
1.2 Table 2 shows the longer-term projections, compared with total debt and the Authorised Limit and Operational Boundary from sections 6 and 7 respectively:

Table 2

Capital Financing Requirement (including finance leases)											
£m	**Actual 20/21**	**Est 21/22**	**Est 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**
HRA CFR	161.2	194.5	203.6	212.6	221.6	230.7	230.7	230.7	230.7	230.7	230.7
GF CFR	18.3	22.5	56.5	69.7	69.0	68.3	68.3	68.3	68.3	68.3	68.3
Service activity / non-financial investments	5.6	55.6	124.3	122.7	124.9	124.8	124.6	124.5	124.5	124.5	124.5
Total CFR	**185.0**	**272.7**	**384.3**	**405.0**	**415.6**	**423.8**	**423.6**	**423.5**	**423.5**	**423.5**	**423.5**
External borrowing - HRA	136.2	194.5	203.6	212.6	221.6	230.7	230.7	230.7	230.7	230.7	230.7
External borrowing - GF	12.0	69.9	172.5	184.1	185.7	185.7	185.5	185.4	185.4	185.4	185.4
Other long term liabilities	0.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Gross Debt	**148.2**	**265.4**	**377.0**	**397.7**	**408.3**	**417.3**	**417.2**	**417.1**	**417.1**	**417.1**	**417.1**
Internal borrowing - HRA	25.0	-	-	-	-	-	-	-	-	-	-
Internal borrowing - GF	11.8	7.3	7.3	7.3	7.3	6.4	6.4	6.4	6.4	6.4	6.4
WDC internal borrowing	**36.8**	**7.3**	**7.3**	**7.3**	**7.3**	**6.4**	**6.4**	**6.4**	**6.4**	**6.4**	**6.4**
Authorised Limit	189.3	309.5	421.1	453.7	464.3	473.3	473.3	473.3	473.3	473.3	473.3
Operational Boundary	170.3	287.5	399.1	431.7	442.3	451.3	451.3	451.3	451.3	451.3	451.3

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

Table 3



1.4 The value of gross debt excludes unapproved borrowing for housing developments (General Fund for Housing Company and Joint Venture; HRA for the Housing Improvement Programme, including new build schemes), 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*.

Capital Expenditure

1.5 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.

1.6 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.

1.7 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.

1.8 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	2020/21 Outturn £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
General Fund (non HIP)	11,275	17,515	55,905	14,760	374
Credit arrangements - finance leases	12	-	-	-	-
Housing Investment Programme:					
General Fund (HIP)	-	-	-	-	-
HRA	33,135	59,533	24,489	18,493	18,499
'Service investment' activities / non-financial investments*	350	50,100	68,725	3,000	2,375
Total (A)	**44,772**	**127,148**	**149,119**	**36,253**	**21,248**

* - loans to third parties

1.9 The main item in 'service investment' for 2021/22 is the £50 million joint venture funding outlined earlier. The equivalent figure for 2022/23 includes the final £10 million commitment for this joint venture, plus a speculative additional £50 million of a further joint venture and £8.625 million to finance Milverton Homes, with a further £3 million of this in 2023/24.

Capital Financing Requirement

1.10 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.

1.11 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.

1.12 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.

1.13 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 scheme include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these schemes. The Council had £12,100 of such schemes within the CFR at the end of 2020/21.

1.14 *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).

Table 5

Financing of capital expenditure	**2020/21 Outturn £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**
HRA:					
Capital receipts	420	6,270	1,288	500	500
Capital grants and contributions	-	6,397	2,909	-	-
Reserves	7,713	13,365	9,728	8,359	8,364
Revenue contributions	-	123	1,533	600	600
Total HRA	**8,133**	**26,155**	**15,458**	**9,459**	**9,464**
General Fund:					
Capital receipts	395	1,261	6,835	160	-
Capital grants and contributions	5,215	8,796	11,008	3,582	-
Reserves	1,815	2,200	3,434	1,427	294
Revenue contributions	422	659	155	80	80
Total GF	**7,847**	**12,916**	**21,432**	**5,249**	**374**
Combined:					
Capital receipts	815	7,531	8,123	660	500
Capital grants and contributions	5,215	15,193	13,917	3,582	-
Reserves	9,528	15,565	13,162	9,786	8,658
Revenue contributions	422	782	1,688	680	680
Subtotal (B)	**15,980**	**39,071**	**36,890**	**14,708**	**9,838**
Net borrowing need for the year (A – B)	**28,792**	**88,077**	**112,229**	**21,545**	**11,410**

1.15 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	**2020/21 Outturn**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Capital expenditure	350	50,100	68,725	3,000	2,375
Financing costs (incl MRP)	10	1,752	2,404	120	96
Net financing need for the year	**360**	**51,852**	**71,129**	**3,120**	**2,471**
Percentage of total net financing need %	1%	57%	61%	14%	21%

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

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

1.18 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).

1.19 The estimated CFRs at the end of 2021/22 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.

1.20 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**
2020/21	161,160	18,271	5,564	184,995
2021/22	194,539	22,546	55,644	272,729
2022/23	203,572	56,478	124,276	384,326
2023/24	212,606	69,739	122,691	405,036
2024/25	221,639	69,033	124,920	415,592
2025/26	230,672	68,321	124,764	423,757

Table 8

£m	2020/21 Outturn	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Capital Financing Requirement						
CFR – non housing	18.3	22.5	56.5	69.7	69.0	68.3
CFR – housing	161.2	194.5	203.6	212.6	221.6	230.7
CFR - service and non-financial investment activities	5.6	55.6	124.3	122.7	124.9	124.8
Total CFR	**185.0**	**272.7**	**384.3**	**405.0**	**415.6**	**423.8**
Movement in CFR	-27.2	87.7	111.6	20.7	10.6	8.2
Service / non-treasury as % of Total CFR	3%	20%	32%	30%	30%	29%

Movement in CFR represented by						
Net financing need for the year ("A-B" above)	28.8	88.1	112.2	21.5	11.4	9.0
Less MRP/VRP and other financing movements	-56.0	-0.4	-0.6	-0.8	-0.8	-0.8
Movement in CFR	**-27.2**	**87.7**	**111.6**	**20.7**	**10.6**	**8.2**

1.21 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 20% in 2021/22 and 32% in 2022/23, mainly due to the housing joint venture) and, by approving these figures, Members consider the scale proportionate to the Authority's remaining activity.

1.22 The opening HRA CFR at 1 April 2021 was £161.159 million, being the HRA self-financing debt settlement of £136.157 million from 2012 plus new borrowing during 2020/21. At 31 March 2026 the HRA CFR is predicted to have increased to £230.672 million, while the non-housing element would be £68.321 million and the 'non-financial activities' would be £124.764 million, a total General Fund CFR of £193.085 million.

External Debt - Authorised Limit

1.23 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).

1.24 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.

1.25 The recommended Authorised Limit is as shown in *Table 9*:

Table 9

Authorised Limit	2020/21 Outturn £'000	2021/22 Latest £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Debt including HRA settlement	189,279	192,234	192,234	204,116	204,116	204,115
Other long-term liabilities	12	1,000	1,000	1,000	1,000	1,000
HRA HIP	-	58,382	67,415	76,448	85,481	94,515
General Fund HIP	-	-	-	-	-	-
Other General Fund capital programme	-	7,899	41,838	50,514	49,663	49,663
Service investment activities / non-financial investments	-	50,000	118,625	121,625	124,000	124,000
Total Authorised Limit	**189,291**	**309,515**	**421,112**	**453,703**	**464,260**	**473,293**

1.26 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.

1.27 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.

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

External Debt - Operational Boundary

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

1.30 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.

1.31 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.

1.32 The recommended Operational Boundaries are as shown in Table 10. It should be noted that the figures for each year are cumulative (for instance, the £118.6m shown in 2022/23 for service investment activities is the brought forward amount from 2021/22). They are based on the same assumptions outlined in paragraph 6.5 above.

Table 10

Operational Boundary	2020/21 Outturn £'000	2021/22 Latest £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'001	2025/26 Estimate £'002
Debt including HRA settlement	170,279	170,234	170,234	182,116	182,116	182,115
Other long-term liabilities	12	1,000	1,000	1,000	1,000	1,000
HRA HIP	-	58,382	67,415	76,448	85,481	94,515
General Fund HIP	-	-	-	-	-	-
Other General Fund capital programme	-	7,899	41,838	50,514	49,663	49,663
Service investment activities / non-financial investments	-	50,000	118,625	121,625	124,000	124,000
Total Operational Boundary	**170,291**	**287,515**	**399,112**	**431,703**	**442,260**	**451,293**

Treasury Indicators

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

1.34 Maturity structure of borrowing:

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

Table 11

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 12

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 13

Year	Upper Limit - Fixed Rate	Upper Limit - Variable Rate
2022/23	100%	30%
2023/24	100%	30%
2024/25	100%	30%

1.35 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.

Economic Background

UK

COVID-19 vaccines

These were the game changer during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year.

However, the bursting onto the scene of the Omicron mutation at the end of November, rendered the initial two doses of all vaccines largely ineffective in preventing infection. This has dashed such hopes and raises the spectre again that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that this mutation is very fast spreading with the potential for total case numbers to double every two to three days, although it possibly may not cause so much severe illness as previous mutations.

Rather than go for full lockdowns which heavily damage the economy, the Government strategy this time is focusing on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection, as a booster has been shown to restore a high percentage of immunity to Omicron to those who have had two vaccinations. There is now a race on between how quickly boosters can be given to limit the spread of Omicron, and how quickly will hospitals fill up and potentially be unable to cope. In the meantime, workers have been requested to work from home and restrictions have been placed on large indoor gatherings and hospitality venues.

With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in sectors like restaurants, travel, tourism, and hotels which had been hit hard during 2021, but could now be hit hard again by either, or both, of Government restrictions and/or consumer reluctance to leave home. Growth will also be lower due to people being ill and not working, similar to the pingdemic in July. The economy, therefore, faces significant headwinds although some sectors have learned how to cope well with Covid.

However, the biggest impact on growth would come from another lockdown if that happened. The big question remains as to whether any further mutations of this virus could develop which render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

Covid remains a major potential downside threat as we are most likely to get further mutations. However, their severity and impact could vary widely, depending on vaccine effectiveness and how broadly it is administered.

A summary overview of the future path of Bank Rate

- After the Bank of England became the first major western central bank to put interest rates up in this upswing in December, it has quickly followed up its first 0.15% rise by another 0.25% rise to 0.50%, in the second of what is very likely to be a series of increases during 2022.

- The Monetary Policy Committee voted by a majority of 5-4 to increase Bank Rate by 25bps to 0.5% with the minority preferring to increase Bank Rate by 50bps to 0.75%. The Committee also voted unanimously for the following:
    - to reduce the £875n stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets.
    - to begin to reduce the £20bn stock of sterling non-financial investment-grade corporate bond
    - purchases by ceasing to reinvest maturing assets and by a programme of corporate bond sales to be completed no earlier than towards the end of 2023.
- The Bank again sharply increased its forecast for inflation – to now reach a peak of 7.25% in April, well above its 2% target.
- The Bank estimated that UK GDP rose by 1.1% in quarter 4 of 2021 but, because of the effect of Omicron, GDP would be flat in quarter 1, but with the economy recovering during February and March. Due to the hit to households' real incomes from higher inflation, it revised down its GDP growth forecast for 2022 from 3.75% to 3.25%.
- The Bank is concerned at how tight the labour market is with vacancies at near record levels and a general shortage of workers - who are in a very favourable position to increase earnings by changing job.
- As in the December 2021 MPC meeting, the MPC was more concerned with combating inflation over the medium term than supporting economic growth in the short term. However, what was notable was the Bank's forecast for inflation: based on the markets' expectations that Bank Rate will rise to 1.50% by mid-2023, it forecast inflation to be only 1.6% in three years' time. In addition, if energy prices beyond the next six months fell as the futures market suggests, the Bank said CPI inflation in three years' time would be even lower at 1.25%. With calculations of inflation, the key point to keep in mind is that it is the rate of change in prices – not the level – that matters. Accordingly, even if oil and natural gas prices remain flat at their current elevated level, energy's contribution to headline inflation will drop back over the course of this year. That means the current energy contribution to CPI inflation, of 2% to 3%, will gradually fade over the next year.
- So the message to take away from the Bank's forecast is that they do not expect Bank Rate to rise to 1.5% in order to hit their target of CPI inflation of 2%. The immediate issue is with four members having voted for a 0.50% increase in February, it would only take one member more for there to be another 0.25% increase at the March meeting.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

- In summary, with the high level of uncertainty prevailing on several different fronts, Link expect to have to revise their forecasts again - in line with whatever the new news is.
- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows:
    - Raising Bank Rate as "the active instrument in most circumstances".
    - Raising Bank Rate to 0.50% before starting on reducing its holdings.
    - Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
    - Once Bank Rate had risen to at least 1%, it would start selling its holdings.

USA

- Shortages of goods and intermediate goods like semi-conductors, have been fuelling increases in prices and reducing economic growth potential. In November, **CPI inflation hit a near 40-year record level of 6.8%** but with energy prices then falling sharply, this is probably the peak. The biggest problem for the Fed is the mounting evidence of a strong pick-up in cyclical price pressures e.g., in rent which has hit a decade high.
- **Shortages of labour** have also been driving up wage rates sharply; this also poses a considerable threat to feeding back into producer prices and then into consumer prices inflation. It now also appears that there has been a sustained drop in the labour force which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023 while core inflation is likely to remain elevated at around 3% in both years instead of declining back to the Fed's 2% central target.
- Inflation hitting 6.8% and the feed through into second round effects, meant that it was near certain that the **Fed's meeting of 15 December** would take aggressive action against inflation. Accordingly, the rate of tapering of monthly $120bn QE purchases announced at its November 3 meeting. was doubled so that all purchases would now finish in February 2022. In addition, Fed officials had started discussions on running down the stock of QE held by the Fed. Fed officials also expected three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy. The first increase could come as soon as March 2022 as the chairman of the Fed stated his view that the economy had made rapid progress to achieving the other goal of the Fed – "maximum employment". The Fed forecast that inflation would fall from an average of 5.3% in 2021 to 2.6% in 2023, still above its target of 2% and both figures significantly up from previous forecasts. What was also significant was that this month the Fed dropped its description of the current level of inflation as being "transitory" and instead referred to "elevated levels" of inflation: the statement also dropped most of the language around the flexible average inflation target, with inflation now described as having exceeded 2 percent "for some time". It did not see Omicron as being a major impediment to the need to take action now to curtail the level of inflationary pressures that have built up, although

Fed officials did note that it has the potential to exacerbate supply chain problems and add to price pressures.

EUROZONE

- The slow role out of vaccines initially delayed **economic recovery** in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery was then within 0.5% of its pre Covid size. However, the arrival of Omicron is now a major headwind to growth in quarter 4 and the expected downturn into weak growth could well turn negative, with the outlook for the first two months of 2022 expected to continue to be very weak.
- **November's inflation figures** breakdown shows that the increase in price pressures is not just due to high energy costs and global demand-supply imbalances for durable goods as services inflation also rose. Headline inflation reached 4.9% in November, with over half of that due to energy. However, oil and gas prices are expected to fall after the winter and so energy inflation is expected to plummet in 2022. Core goods inflation rose to 2.4% in November, its second highest ever level, and is likely to remain high for some time as it will take a long time for the inflationary impact of global imbalances in the demand and supply of durable goods to disappear. Price pressures also increased in the services sector, but wage growth remains subdued and there are no signs of a trend of faster wage growth which might lead to *persistently* higher services inflation - which would get the ECB concerned. The upshot is that the euro-zone is set for a prolonged period of inflation being above the ECB's target of 2% and it is likely to average 3% in 2022, in line with the ECB's latest projection.
- **ECB tapering.** The ECB has joined with the Fed by also announcing at its meeting on 16 December that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases for over half of next year. However, as inflation will fall back sharply during 2022, it is likely that it will leave its central rate below zero, (currently -0.50%), over the next two years. The main struggle that the ECB has had in recent years is that inflation has been doggedly anaemic in sticking below the ECB's target rate despite all its major programmes of monetary easing by cutting rates into negative territory and providing QE support.
- The ECB will now also need to consider the impact of **Omicron** on the economy, and it stated at its December meeting that it is prepared to provide further QE support if the pandemic causes bond yield spreads of peripheral countries, (compared to the yields of northern EU countries), to rise. However, that is the only reason it will support peripheral yields, so this support is limited in its scope.
- The EU has entered a **period of political uncertainty** where a new German Government formed of a coalition of three parties with Olaf Scholz replacing Angela Merkel as Chancellor in December 2021, will need to find its feet both within the EU and in the three parties successfully working together. In France there is a presidential election coming up in April 2022 followed by the legislative election in June. In addition, Italy needs to elect a new president in January with Prime Minister Draghi being a favourite due to having suitable

gravitas for this post. However, if he switched office, there is a significant risk that the current government coalition could collapse. That could then cause differentials between Italian and German bonds to widen when 2022 will also see a gradual running down of ECB support for the bonds of weaker countries within the EU. These political uncertainties could have repercussions on economies and on Brexit issues.

CHINA

- After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of **2020**; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021.
- However, the pace of economic growth has now fallen back in **2021** after this initial surge of recovery from the pandemic and looks likely to be particularly weak in 2022. China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. Chinese consumers are also being very wary about leaving home and so spending money on services. However, with Omicron having now spread to China, and being much more easily transmissible, this strategy of sharp local lockdowns to stop the virus may not prove so successful in future. In addition, the current pace of providing boosters at 100 billion per month will leave much of the 1.4 billion population exposed to Omicron, and any further mutations, for a considerable time. The **People's Bank of China** made a start in December 2021 on cutting its key interest rate marginally to stimulate economic growth. However, after credit has already expanded by around 25% in just the last two years, it will probably leave the heavy lifting in supporting growth to fiscal stimulus by central and local government.
- Supply shortages, especially of coal for power generation, were causing widespread power cuts to industry during the second half of 2021 and so a sharp disruptive impact on some sectors of the economy. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

JAPAN

- 2021 has been a patchy year in combating Covid. However, recent business surveys indicate that the economy has been rebounding rapidly in 2021 once the bulk of the population had been double vaccinated and new virus cases had plunged. However, Omicron could reverse this initial success in combating Covid.
- The Bank of Japan is continuing its **very loose monetary policy** but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida, having

won the November general election, brought in a supplementary budget to boost growth, but it is unlikely to have a major effect.

WORLD GROWTH

- World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum in the second half of the year, though overall growth for the year is expected to be about 6% and to be around 4-5% in 2022. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. While headline inflation will fall sharply, core inflation will probably not fall as quickly as central bankers would hope. It is likely that we are heading into a period where there will be a **reversal of world globalisation** and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

SUPPLY SHORTAGES

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

INTEREST RATE FORECASTS

The balance of risks to the UK

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

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

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed or unable to be administered fast enough to stop the NHS being overwhelmed.
- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.
- **Bank of England** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- The **Government** acts too quickly to cut expenditure to balance the national budget.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Geopolitical risks**, for example in Ukraine / Russia, Iran, China, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- Longer term US treasury yields rise strongly and pull gilt yields up higher than forecast.

Link Group forecast

- Link now expect the MPC to sharply increase Bank Rate during 2022 to combat the sharp increase in inflationary pressures. They do not think that the MPC will embark on a series of increases in Bank Rate of more than 1.00% during the current and next three financial years as they do not expect inflation to return to being sustainably above 2% during this forecast period.
- **With unpredictable virus factors now being part of the forecasting environment, there is a risk that forecasts could be subject to significant revision during the next three years.**