Appendix A

Treasury Management Policy Statement

Warwick District Council defines its Treasury Management activities as:

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

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

Appendix B

Treasury Management Strategy for 2023/24

The strategy for 2023/24 covers two main areas:

A. Capital issues

- the capital expenditure plans and the associated prudential indicators – capital expenditure plans form part of the General Fund Budget report and the prudential and treasury indicators are included in Appendix E.
- the Minimum Revenue Provision (MRP) policy – see Appendix D. 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 2024 and there are no changes required to the policy for 2023/24 financial year.

B. Treasury management issues

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

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

1 Training

1.1 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.

1.2 Following the May 2019 Council elections, Link Group (Link) delivered training to Members of the Audit and Standards Committee and other interested Members in November 2019, with a joint Stratford / Warwick webinar event on 25 January 2022. Further training will be provided to members of the Audit and Standards Committee at the earliest opportunity.

1.3 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, Link Treasury Services Limited ('Link') as its external treasury management advisor. A new 4 year contract was entered into in January 2023.

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

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

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

3 Benchmarking

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

4 Performance

4.1 Performance of the treasury function is reported twice yearly to the Audit and Standards Committee.

4.2 The Treasury Management team will seek to achieve a return on its money market investments equivalent to the forward Sterling Overnight Index Average[1] (SONIA) of a similar duration.

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

5 Prospects for interest Rates

5.1 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Further information is contained in Appendix F and Appendix G.

5.2 The following table gives Link's central view as at 7 February 2023. Their central forecast reflects a view that the MPC will be keen to demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022, but the new Government's policy of emphasising

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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

fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.

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

5.3 Link anticipates that the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures have lessened – but that timing will be one of fine judgement: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged. Their best judgment is that there will be scope for an early Christmas present for households with a December rate cut priced in, ahead of further reductions in 2024 and 2025.

5.4 The CPI measure of inflation peaked close to 11% in Q4 2022 and is currently at 10.5%, and will need to fall considerably and quickly to persuade the MPC that they are not premature in thinking inflation will come back down below 4% by the end of the year. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market (unemployment remains at a near 48 year low 3.7%), and average wage increases are still above 6% year on year, against the backdrop of a significant number of high profile on-going strikes in the public sector (the Bank would broadly want wage increases to be in the range of 3% - 3.5%).

5.5 Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the medium to longer end of the curve in equal measure.

5.6 In the upcoming months, Link forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. And tensions between China / Taiwan / USA also have the potential to have a wider and negative economic impact.

5.7 On the positive side, consumers are still estimated to be sitting on significant excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent or mortgage payments

5.8 For comparison purposes, the rates assumed when setting the 2022/23 Treasury Management Strategy Statement are repeated below, illustrating the unexpected and sysmic increase that have impacted on the current Strategy.

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

5.9 **PWLB rates**

5.10 Yield curve movements have become less volatile under the Sunak / Hunt Government. PWLB 5 to 50 years Certainty Rates have been in the range of 3.75% to 4.75%.

5.11 Link view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

5.12 The **overall balance of risks** to economic growth in the UK is to the downside, with the Bank of England projecting two years of negative growth in their November Quarterly Monetary Policy Report.

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).
- **The Bank of England** acts too quickly, or too far, over the next two years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **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, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- 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 and for a longer period within the UK economy, which then necessitates an even more rapid series of increases in Bank Rate later in the year or 2024.
- The **pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer term **US treasury yields** rise strongly if inflation remains more stubborn than the market currently anticipates, pulling gilt yields up higher as a consequence.

- Projected **gilt issuance**, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields compensating.

5.15 **Borrowing advice**: Link's long-term (beyond 10 years) forecast for Bank Rate is 2.50%. As all PWLB certainty rates are now above this level, the borrowing strategy will need to be reviewed in that context. Better value can be obtained at the shorter end of the curve. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and gilt yields, to drop back later in 2023.

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

PWLB debt	Current borrowing rate as at 07.02.23 p.m.	Target borrowing rate now (end of Q1 2025)
5 years	4.02%	3.30%
10 years	4.19%	3.50%
25 years	4.61%	3.70%
50 years	4.31%	3.40%

5.17 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. Further detail in included in the borrowing strategy in section 7.

5.18 **Borrowing interest rates** fell to historically very low rates because of the COVID crisis and the quantitative easing operations of the Bank of England, but increased rapidly and significantly during 2022/23. 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, although with hindsight the start of 2022 before the invasion of Ukraine would have been an optimum time to have taken some long-term borrowing.

5.19 Since November 2020 there has been a prohibition to deny any local authority access to borrowing from the PWLB where it the 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).

6 Investment rates

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

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

Average earnings in each year	
2022/23 (remainder)	4.30%
2023/24	4.30%
2024/25	3.20%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

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

6.4 For its cash flow generated balances, the Authority will seek to utilise its business deposit account, Money Market Funds and short-dated deposits, in order to benefit from the compounding of interest

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

7 Borrowing Strategy

7.1 The capital expenditure plans set out in Section 4 of Appendix E provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions, and the annual investment strategy.

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

7.3 The Council's current long-term borrowing portfolio consists of £136.157 million HRA and £62 million General Fund PWLB debt.

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

7.5 The current HRA Business Plan from March 2023 includes substantial new PWLB borrowing, with the estimated interest costs based around current rates , which has been factored into this report. This is in addition to the recent borrowing requirement for the HRA, reflected by its Capital Financing Requirement (or CFR, the capital borrowing need) being £181.886 million at 31 March 2022, compared with the £136.157 million externally borrowed, with the difference of £45.729 million being temporary 'internal' borrowing, charged to the HRA by the General Fund.

7.6 Further analysis of this borrowing is included in Appendix E on the Prudential and Treasury Indicators. The new Liability Benchmark for the HRA shows the amount the HRA will soon be borrowing to finance the existing capital programme, peaking at £258 million, an increase of almost £122 million.

7.7 The original **General Fund loan** of £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).

7.8 A further £60 million was borrowed by the General Fund in 2021/22 for the Crewe Lane housing joint venture. These £60 million of loans comprise of six smaller amounts, with terms between 1½ and 5½ years, and the PWLB loans and the joint venture loans are coterminous.

7.9 The Council has been maintaining an under-borrowed position, which means that the CFR has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure, i.e., borrowing has been deferred. This strategy has been prudent while investment returns remain low relative to borrowing costs, with counterparty risk being an important consideration, i.e. if borrowing is taken when investment levels are above the minimum necessary for liquidity, the new borrowing would result in increase borrowing, involving more counterparties.

7.10 The General Fund's CFR at 31 March 2022 was £77.168 million, which excludes the £10 million advance to the joint venture made on 1 April 2022, so is matched to the underlying £62 million of loans, an under-borrowed position of £15.168 million. The General Fund Liability Benchmark shows that based on the current approved capital programme the debt will increase by £31 million to £103 million.

7.11 The borrowing undertaken for the housing joint venture does not change the under-borrowed position of previous financial years. The position is not sustainable in the longer-term as (a) the Council will eventually need to replenish the cash backing the Reserves and Balances to pay for future developments and maintain liquidity, and (b) the upside risk of PWLB and other borrowing rates because of the risk of further economic shocks make it prudent to consider 'externalising' more of the internal borrowing by taking PWLB loans during 2023/24.

7.12 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 2023/24 or 2024/25 and beyond is undertaken. Please see Table 4 and Table 5 in Appendix E for details of proposed capital expenditure and financing, including the borrowing requirement. **Approval of these within the borrowing limits does not commit the Council to progressing with these schemes**.

7.13 Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

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

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

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

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

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

7.16 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).

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

7.18 The Council will use short-term borrowing (up to 365 days), if necessary, to finance temporary cash deficits. However, proactive cash flow management will aim to keep these to a minimum and, wherever possible, the loan would be taken out for periods of less than 7 days to minimise the interest payable. The Council has not incurred any short-term borrowing (or bank overdrafts) in 2022/23 to date and is not expecting to during 2023/24.

7.19 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 2022 are summarised below:

Type of Investment	31 Dec 22 £'000	30 Sep 22 £'000	31 Mar 22 £'000
Money Markets incl. CD's & Bonds	33,735	28,547	32,500
Money Market Funds	24,925	20,551	32,756
Business Reserve Account	5,059	7,359	9,528
Total In House Investments	**63,719**	**56,457**	**74,784**
Corporate Equity Funds (nominal value)	-	-	-
Total Investments	**63,719**	**56,457**	**74,784**

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

External Borrowing	31 Dec 22 £'000	30 Sep 22 £'000	31 Mar 22 £'000
Public Works Loan Board	208,157	208,157	208,157
Other	-	-	-
Total external borrowing	**208,157**	**208,157**	**208,157**
Split between:			
Housing Revenue Account	136,157	136,157	136,157
General Fund	72,000	72,000	72,000
Total	**208,157**	**208,157**	**208,157**

10 Debt rescheduling

10.1 Rescheduling of current borrowing in the Council's debt portfolio portfolio is unlikely to occur as there is still a 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 Audit and Standards Committee at the next meeting.

Appendix C

Annual Treasury Management Investment Strategy

1 Investment policy – management of risk

1.1 The Department of Levelling Up, Housing and Communities (DLUHC) – formerly the MHCLG[2]) - and CIPFA[3] 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.

1.5 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 'laddering' investments for periods up to 12 months with high credit rated financial institutions, while investment rates remain elevated,as well as wider range fund options.

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

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

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

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

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

1.6.4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use under the categories of 'specified' and 'non-specified' investments:

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

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

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

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

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

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

1.6.10. This authority has engaged **external consultants**, (Appendix B section 2), to provide expert advice on how to optimise an appropriate balance of security, liquidity, and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

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

1.6.12. As a result of the change in **accounting standards** for 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[4]. 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, given the uncertainty beyond 2024/25.

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

2. Changes in risk management policy from last year

2.1 The above criteria are unchanged from last year.

3. Creditworthiness policy

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

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

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

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

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

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of credit ratings the Council will be advised of information in movements in CDS spreads against the iTraxx European Financials benchmark and other market data daily via its *Passport* website,

[4] In November 2018, the MHCLG concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1 April 2018. DLUHC have confirmed that they will extend the IFRS9 Pooled Investment Fund statutory override to 31 March 2025.

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

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

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

Institution Type	**Limit**
A rated private banks	£5m
A+ rated private banks	£7m
AA rated private banks	£8m
Government Debt CNAV MMFs[5]	£10m
LVNAV MMFs[6]	£10m

3.9 The Council has both cash flow derived and core balances available for 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 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 2023/24 on average will be in the region of £55m, of which £12m will be 'core' investments i.e. made up of reserves and balances which are not required in the short term.

3.12 The maximum percentage of its investments that the Council will hold in long-

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

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.

3.13 The Bank of England's Monetary Policy Committee made clear at its November 2022 meeting that further rate increases are in the pipeline and markets expect Bank Rate to peak at 4.5%-4.75%. At the time of writing, the MPC had increased the Bank rate by ½% to 4.00% on 2 February 2023. Investing in 2023/24, is therefore likely to be conducted, first, in a rising interest rate environment, but also - potentially - a falling interest rate environment at the back-end of the financial year, depending on how quickly inflation falls back and how growth performs.

3.14 Based on current investment policies and interest rate projections at budget setting, it is currently estimated that the overall portfolio will achieve a 1.85% return for 2022/23, increasing to 2.80% for 2023/24, based on expected movements in Base Rate.

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 C Annex 2

Counterparty Limits

Investment / counterparty type:	# Sovereign country min. credit rating	S/term	L/term	Viability / support	Max limit per counterparty	Max. maturity period	Use	Notes ref
Specified instruments: *(repayable within 12 months)*		**(FITCH or equivalent)**						
DMADF	AA-	n/a			£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	AA-	F1	A		£9m	365 days	In house & EFM*	1 & 2
Bank - private (includes fixed term deposits, CDs and category 1 FRNs & bonds)	AA-	F1	A		£5m	365 days	In house & EFM*	1 & 2
	AA-	F1	A+		£7m	365 days	In house & EFM*	1 & 2
	AA-	F1	AA- & above		£8m	365 days	In house & EFM*	1 & 2
Other private sector financial institutions (includes category 1 FRNs & bonds)	AA-	F1	A		£4m	365 days	In house & EFM*	1 & 2
	AA-	F1	A+		£6m	365 days	In house & EFM*	1 & 2
	AA-	F1	AA- & above		£7m	365 days	In house & EFM*	1 & 2
Corporates (category 3 FRNs & bonds)	AA-	F1	A		£4m	365 days	In house & EFM*	1 & 2
	AA-	F1	A+		£5m	365 days	In house & EFM*	1 & 2
	AA-	F1	AA- & above		£6m	365 days	In house & EFM*	1 & 2
Bank subsidairies of UK banks	Explicit Parent Guarantee	Unrated			£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	AA-	F1	A		£4m	365 days	In house & EFM*	1a.
Building societies - category B	AA-	F1			£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	Determined by EFM	n/a			£5m	365 days	EFM*	
Sterling securities guaranteed by HM Government	AA-	n/a			9m	not defined	EFM*	

Investment / counterparty type:	# Sovereign country min. credit rating	S/term	L/term	Viability / support	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	AA-	F1	A		£9m	2 years	In house + advice & EFM*	1b, 2, & 10
Bank - private (includes fixed term deposits, CDs and category 1 FRNs & bonds)	AA-	F1	A		£5m	2 years	In house + advice & EFM*	1b, 2, & 10
	AA-	F1	A+		£7m	2 years	In house + advice & EFM*	1b, 2, & 10
	AA-	F1	AA- & above		£8m	2 years	In house + advice & EFM*	1b, 2, & 10
Other private sector financial institutions (includes category 1 FRN's & Bonds)	AA-	F1	A		£4m	2 years	In house + advice & EFM*	1b, 2, & 10
	AA-	F1	A+		£6m	2 years	In house + advice & EFM*	1b, 2, & 10
	AA-	F1	AA- & above		£7m	2 years	In house + advice & EFM*	1b, 2, & 10
Corporates (category 3 FRN'S, Bonds)	AA-	F1	A		£4m	2 years	In house + advice & EFM*	1b, 2, & 10
	AA-	F1	A+		£5m	2 years	In house + advice & EFM*	1b, 2, & 10
	AA-	F1	AA- & above		£6m	2 years	In house + advice & EFM*	1b, 2, & 10
Building societies - > 1 year	AA-	F1	A		£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	See note 13		N/A		£4m	10 years	EFM*	13 & 14
Corporate Equity Funds - medium risk	See note 13		N/A		£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	see note 8	n/a			£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

Appendix C Annex 3

Approved Countries for Investments

This list, as at 21 December 2022, is based on those countries which have sovereign ratings of AA- or higher, based on the lowest rating from Fitch, Moodys and S&P.

Significant levels of downgrades to Short and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss / Kwarteng unfunded tax-cuts policy. Although the Sunak / Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. Accordingly, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK.

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.**

Appendix D

Minimum Revenue Provision (MRP) Policy Statement

1 Background

1.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement, CFR) through a revenue charge (the Minimum Revenue Provision, MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP). The MRP is equivalent to 'depreciation' in other sectors.

1.2 MHCLG (DLUHC) guidance requires the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following **MRP Statement**.

1.3 The *Statutory Guidance on Minimum Revenue Provision*[7] 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[8]. 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

[7] 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.
[8] The Council had no debt at this date

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

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

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

2.4 Option 4 – Depreciation Method

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

3 HRA

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

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

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

4 MRP Overpayments / Voluntary Revenue Provision (VRP)

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

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

5 Warwick District Council Policy

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

- For borrowing specifically linked to a particular asset or capital scheme – Option 3 based on the annuity method.

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

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

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

5.4 For short to medium duration capital expenditure loans to third parties no MRP will be charged but instead the capital receipt received through the repayment of the loan will be put aside to repay debt and reduce 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 E

Prudential and Treasury Indicators

1. Introduction

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

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

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

- affordable
- prudent and
- sustainable.

1.4. All Indicators must be included in the Council's annual Treasury Strategy and Outturn report. The reporting requirements for 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, 2022/23, where appropriate and setting them for future years.

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

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

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

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

2.4. The table below shows the actual for 2021/22 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
2021/22	-10.8%	40.8%	25.2%
2022/23	-10.00% to 0.00%	40.00% to 50.00%	20.00% to 30.00%
2023/24	-10.00% to 5.00%	40.00% to 50.00%	25.00% to 35.00%
2024/25	0.00% to 25.00%	40.00% to 55.00%	25.00% to 40.00%
2025/26	0.00% to 20.00%	40.00% to 55.00%	30.00% to 50.00%

2.5. The ratio for estimates is a range rather than a single figure (except the 2021/22 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.

3. Prudence - Gross Debt and the Capital Financing Requirement

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

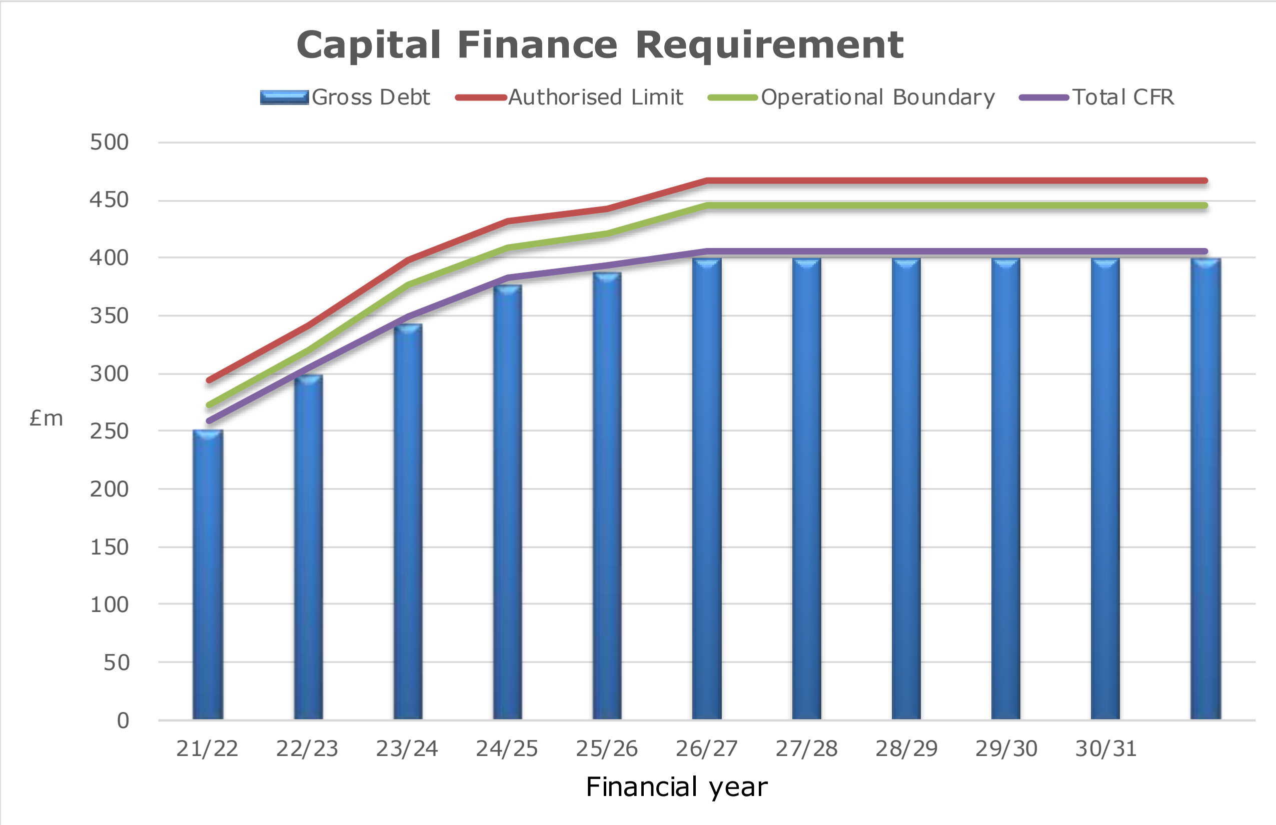
3.2 Table 2 shows the longer-term projections, compared with total debt and the Authorised Limit and Operational Boundary from sections 6 and 7 respectively:

Table 2

Capital Financing Requirement											
£m	**Actual 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**	**Est 31/32**
HRA CFR	181.9	196.3	225.0	254.2	261.7	269.6	269.6	269.6	269.6	269.6	269.6
GF CFR	21.4	46.9	59.5	58.6	62.7	67.2	67.2	67.2	67.2	67.2	67.2
Service activity / non-financial investments	55.7	62.4	65.3	70.1	70.0	69.8	69.7	69.7	69.7	69.7	69.7
Total CFR	**259.1**	**305.6**	**349.8**	**382.9**	**394.4**	**406.6**	**406.5**	**406.5**	**406.5**	**406.5**	**406.5**
External borrowing - HRA	181.9	196.3	225.0	254.2	261.7	269.6	269.6	269.6	269.6	269.6	269.6
External borrowing - GF	68.9	101.0	116.5	120.4	124.4	128.7	128.6	128.6	128.6	128.6	128.6
Other long term liabilities	-	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Gross Debt	**250.8**	**298.3**	**342.5**	**375.6**	**387.1**	**399.3**	**399.2**	**399.2**	**399.2**	**399.2**	**399.2**
Internal borrowing - HRA	-	-	-	-	-	-	-	-	-	-	-
Internal borrowing - GF	8.3	7.3	7.3	7.3	7.3	7.3	7.3	7.3	7.3	7.3	7.3
WDC internal borrowing	**8.3**	**7.3**	**7.3**	**7.3**	**7.3**	**7.3**	**7.3**	**7.3**	**7.3**	**7.3**	**7.3**
Authorised Limit	294.8	342.4	398.4	431.6	443.0	467.2	467.2	467.2	467.2	467.2	467.2
Operational Boundary	272.8	320.4	376.4	409.6	421.0	445.2	445.2	445.2	445.2	445.2	445.2

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

Table 3



3.4 The value of gross debt excludes 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*.

4. Capital Expenditure

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

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

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

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

Table 4

Capital expenditure (£'000)	2021/22 Outturn	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
General Fund (non HIP)	12,985	33,580	33,456	8,099	698	560
Credit arrangements - finance leases	-	-	-	-	-	-
Housing Investment Programme:						
General Fund (HIP)	-	-	-	-	-	-
HRA	36,095	40,301	51,947	44,827	20,257	18,786
Other:						
'Service investment' activities / non-financial investments*	50,100	11,100	3,000	5,000	5,000	4,900
Total (A)	**99,180**	**84,981**	**88,403**	**57,926**	**25,955**	**24,246**

* - loans to third parties

4.5 The main item in 'service investment' for 2021/22 and 2022/23 is the £60 million joint venture funding outlined earlier. The additional figures in 2022/23 to 2024/25 include loans to Milverton Homes, with £1.0 million due to be paid in 2022/23, £3.0 million in 2023/24 and £5.0 m in 2024/25 and 2025/26, subject to viability.

5. Capital Financing Requirement

5.1 The Capital Financing Requirement (CFR) is a key measure that shows the underlying need for an authority to borrow for capital purposes, i.e., the difference between the Council's capital expenditure and the revenue or capital resources set aside to finance that spend. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR. The Minimum Revenue Provision (MRP) is chargeable on the General Fund underlying borrowing.

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

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

5.4 The CFR includes any other long-term liabilities (e.g., finance leases). Though these liabilities increase the CFR - and therefore, the Council's borrowing requirement - these types of 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 no such schemes within the CFR at the end of 2021/22.

5.5 *Table 5* summarises how the capital expenditure plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need (i.e., an increase in the Capital Financing Requirement).

Table 5

Financing of capital expenditure (£'000)	2021/22 Outturn	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
HRA:						
Capital receipts	2,560	5,590	500	500	2,367	500
Capital grants and contributions	3,540	7,449	7,560	3,060	-	-
Reserves	9,178	12,276	13,065	9,965	9,246	9,252
Revenue contributions	90	535	2,162	2,126	1,135	1,135
Total HRA	**15,368**	**25,850**	**23,287**	**15,651**	**12,748**	**10,887**
General Fund:						
Capital receipts	399	4,481	3,416	-	-	-
Capital grants and contributions	6,274	4,618	13,140	6,979	-	-
Reserves	2,010	2,424	3,308	1,041	618	-
Revenue contributions	725	409	80	80	80	80
Total GF	**9,408**	**11,931**	**19,944**	**8,100**	**698**	**80**
Combined:						
Capital receipts	2,959	10,070	3,916	500	2,367	500
Capital grants and contributions	9,814	12,067	20,700	10,039	-	-
Reserves	11,188	14,700	16,373	11,006	9,864	9,252
Revenue contributions	815	945	2,242	2,206	1,215	1,215
Subtotal (B)	**24,776**	**37,781**	**43,231**	**23,751**	**13,446**	**10,967**
Net borrowing need for the year (A – B)	**74,404**	**47,200**	**45,172**	**34,175**	**12,509**	**13,279**
Split between:						
HRA net borrowing need	20,727	14,451	28,660	29,176	7,509	7,899
GF net borrowing need	53,677	32,749	16,512	4,999	5,000	5,380

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

Table 6

'Service investment' activities / non-financial investments (£'000)	2021/22 Outturn	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Capital expenditure	50,100	11,100	3,000	5,000	5,000	4,900
Financing costs (incl MRP)	1,331	551	389	429	429	427
Net financing need for the year	**51,431**	**11,651**	**3,389**	**5,429**	**5,429**	**5,327**
Percentage of total net financing need %	67%	24%	7%	15%	40%	37%

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

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

5.9 This Council has four CFRs:

(a) the HRA

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

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

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

5.10 The estimated CFRs at the end of 2022/23 and each of the next four years are based on the Council's latest capital programme and exclude any unapproved service investment / non-financial activities and additional HRA borrowing for schemes that are subject to viability appraisals, and which would be subject to future Council reports and revised Prudential Indicators, where appropriate. The General Fund CFR also includes the impact of the internal borrowing incurred to date, as well as the internal and external borrowing factored into the current 5-year General Fund Capital Programme.

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

Table 7

Capital Financing Requirement Year	**(a) HRA £'000**	**(b) General Fund £'000**	**(c) Service investments / non financial investments £'000**	**(d) Total £'000**
2021/22	181,887	21,424	55,744	259,055
2022/23	196,337	46,873	62,409	305,619
2023/24	224,998	59,510	65,266	349,774
2024/25	254,174	58,618	70,120	382,912
2025/26	261,683	62,717	69,964	394,364
2026/27	269,581	67,227	69,805	406,613

Table 8

£m	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2025/27 Estimate**
Capital Financing Requirement						
CFR – non housing	21.4	46.9	59.5	58.6	62.7	67.2
CFR – housing	181.9	196.3	225.0	254.2	261.7	269.6
CFR - service and non-financial investment activities	55.7	62.4	65.3	70.1	70.0	69.8
Total CFR	**259.1**	**305.6**	**349.8**	**382.9**	**394.4**	**406.6**
Movement in CFR	74.1	46.6	44.2	33.1	11.5	12.2
Service / non-treasury as % of Total CFR	22%	20%	19%	18%	18%	17%

Movement in CFR represented by						
Net financing need for the year ("A-B" above)	74.4	47.2	45.2	34.2	12.5	13.3
Less MRP/VRP and other financing movements	-0.3	-0.6	-1.0	-1.1	-1.0	-1.1
Movement in CFR	**74.1**	**46.6**	**44.2**	**33.1**	**11.5**	**12.2**

5.12 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any 'non-financial activities' (noting that the Council does not enter 'for yield / commercial' activities) in relation to the authority's overall financial position. The capital expenditure figures shown in *Table 4* and the details above demonstrate the scope of this activity (up from 3% in 2020/21 to 22% in 2021/22, 20% in 2022/23 and 19% in 2023/24, mainly due to the housing joint venture) and, by approving these figures, Members consider the scale proportionate to the Authority's remaining activity.

5.13 The opening HRA CFR at 1 April 2022 was £181.886 million, being the HRA self-financing debt settlement of £136.157 million from 2012 plus new borrowing during 2020/21 and 2021/22, which is currently 'internal borrowing' at the time of writing. At 31 March 2027 the HRA CFR is predicted to have increased to £269.581 million, while the non-housing element would be £67.227 million and the 'non-financial activities' would be £69.805 million, a total General Fund CFR of £137.032 million.

5.14 Based on the figures in this report, the planned borrowing that would be submitted to the PWLB when applying for the Certainty Rate (a 0.2% reduction) for 2023/24 to 2025/25 would be as shown in Table 9 below.

Table 9

External borrowing (£m)	2021/22 Outturn	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Service spend	12,985	31,920	19,337	3,929	698
Housing	86,095	51,301	54,947	49,827	25,257
Regeneration	-	1,660	14,119	4,170	-
Preventative action	-	-	-	-	-
Treasury Management	100	100	-	-	-
Projects for yield	-	-	-	-	-
TOTAL	**99,180**	**84,981**	**88,403**	**57,926**	**25,955**

5.15 The Regeneration schemes in 2023/24 include the Future Hight Street project.

6. Liability Benchmark

6.1 A new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum. CIPFA strongly recommends that the LB is produced for at least 10 years and should ideally cover the full debt maturity profile of a local authority.

6.2 There are four components to the LB:

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

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

3. **Net loans requirement**: this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected

into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.

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

Chart 1 – Liability Benchmark – whole Council

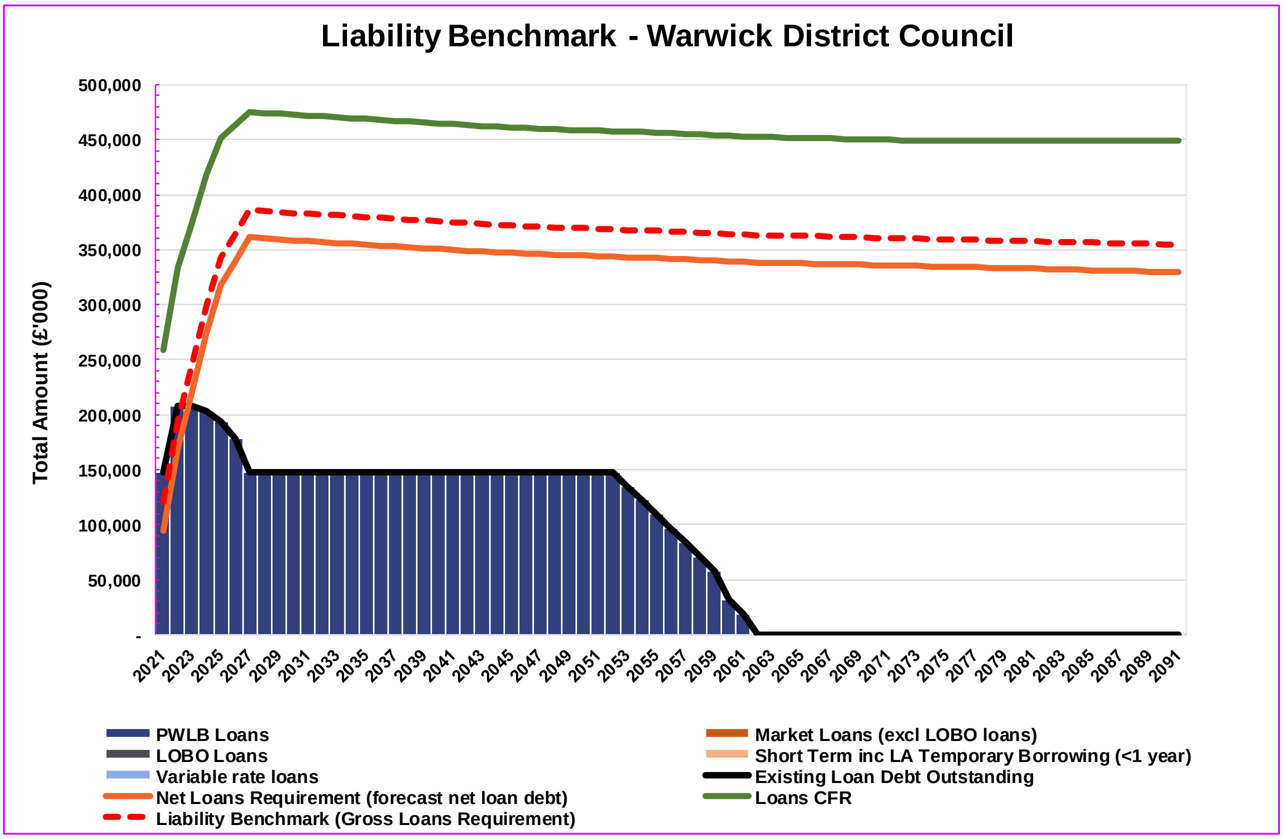


Chart 2 – Liability Benchmark – General Fund

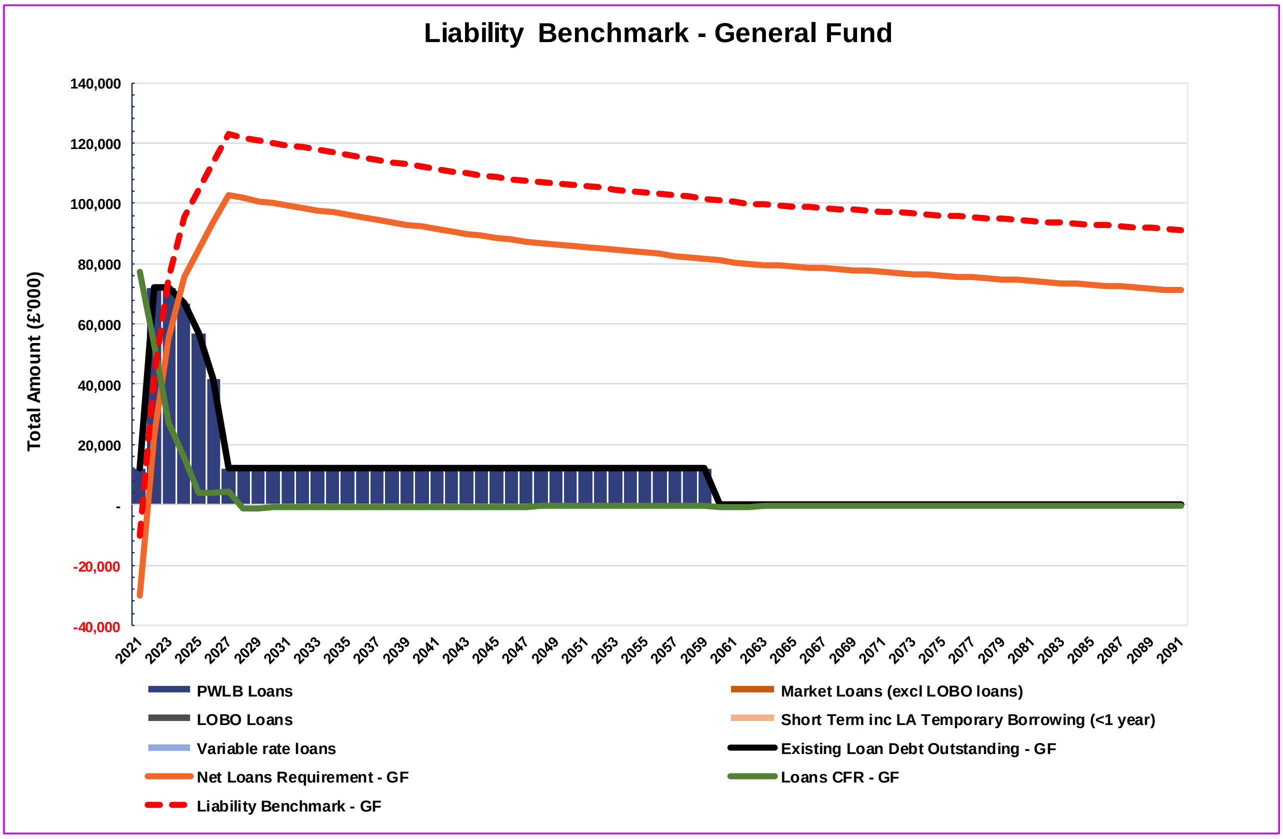
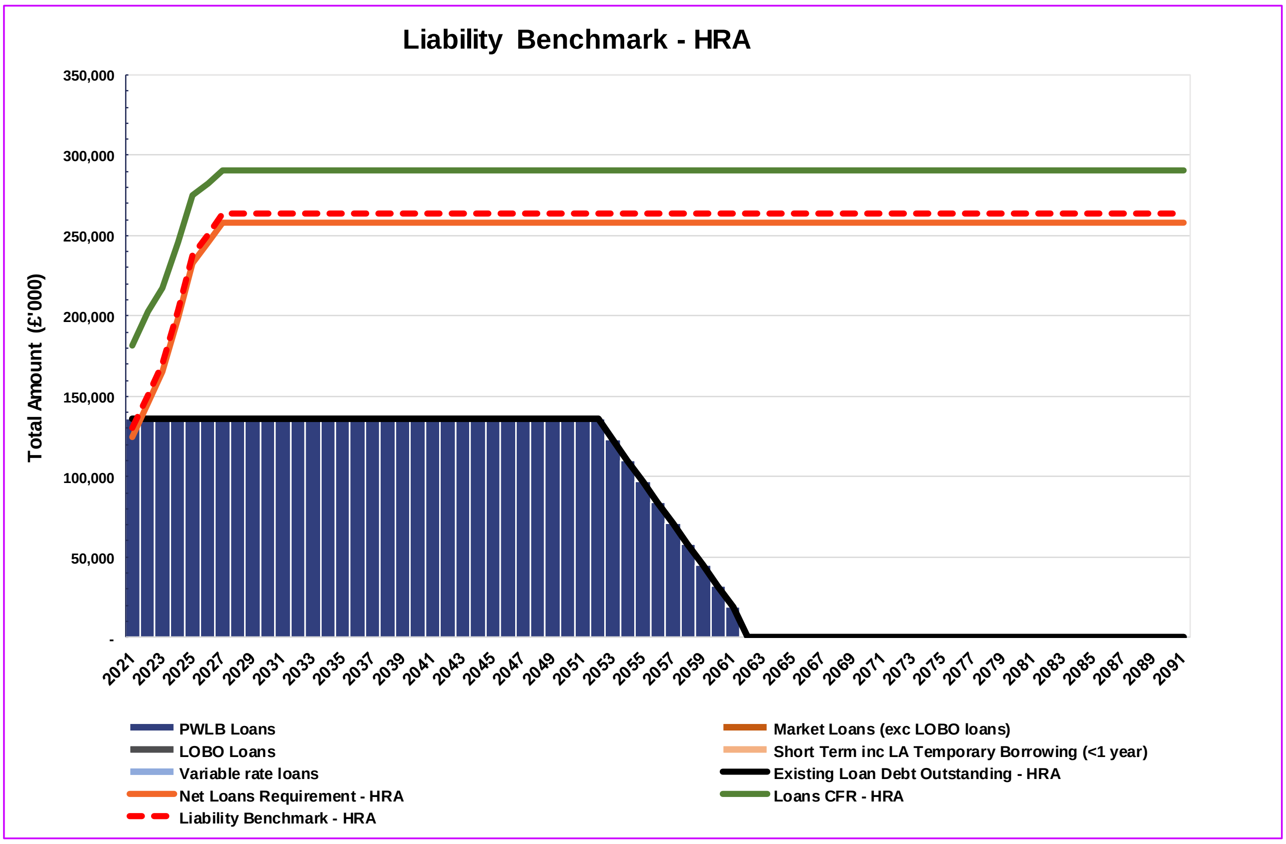


Chart 3 – Liability Benchmark – Housing Revenue Account (HRA)



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

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

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

6.6 The Net Loan Requirement (NLR – a solid orange line in these charts) shows how much the Council currently would need to borrow, based on approved capital budgets and financing. Chart 1 shows that this will peak at £361 million (in 2026/27), but as this is based on a capital programme that only runs to that financial year, it can be expected to increase beyond then.

6.7 The NLR for the General Fund, in Chart 2, peaks at £103 m, and for the HRA in Chart 3 the peak is currently £258 m.

7. External Debt - Authorised Limit

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

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

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

Table 10

Authorised Limit	2021/22 Outturn £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000
Debt including HRA settlement	192,234	192,234	204,115	204,116	204,116	215,997
Other long-term liabilities	-	1,000	1,000	1,000	1,000	1,000
HRA HIP	45,729	60,180	88,841	118,016	125,525	133,424
General Fund HIP	-	-	-	-	-	-
Other General Fund capital programme	56,878	87,992	100,486	99,449	98,392	97,843
Service investment activities / non-financial investments	-	1,000	4,000	9,000	14,000	18,900
Total Authorised Limit	**294,841**	**342,406**	**398,442**	**431,581**	**443,033**	**467,164**

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

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

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

8. External Debt - Operational Boundary

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

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

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

8.4 The recommended Operational Boundaries are as shown in Table 11. It should be noted that the figures for each year are cumulative (for instance, the £4.0m shown in 2023/24 for service investment activities is the cumulative amount from 2021/22). They are based on the same assumptions outlined in paragraph 6.5 above.

Table 11

Operational Boundary	2021/22 Outturn £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000
Debt including HRA settlement	170,234	170,234	182,115	182,116	182,116	193,997
Other long-term liabilities	-	1,000	1,000	1,000	1,000	1,000
HRA HIP	45,729	60,180	88,841	118,016	125,525	133,424
General Fund HIP	-	-	-	-	-	-
Other General Fund capital programme	56,878	87,992	100,486	99,449	98,392	97,843
Service investment activities / non-financial investments	-	1,000	4,000	9,000	14,000	18,900
Total Operational Boundary	**272,841**	**320,406**	**376,442**	**409,581**	**421,033**	**445,164**

9. Treasury Indicators

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

9.2 Maturity structure of borrowing:

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

Table 12

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

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

Table 13

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

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

Table 14

Year	Upper Limit - Fixed Rate	Upper Limit - Variable Rate
2023/24	100%	30%
2024/25	100%	30%
2025/26	100%	30%

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

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

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

Appendix F

Economic Background (at 5 December 2022)

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps since the turn of the year. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	**Eurozone**	**US**
Bank Rate	3.5% (15/12/22)	1.5%	3.75%-4.00%
GDP	-0.2%q/q Q3 (2.4%y/y)	+0.2%q/q Q3 (2.1%y/y)	2.6% Q3 Annualised
Inflation	11.1%y/y (Oct)	10.0%y/y (Nov)	7.7%y/y (Oct)
Unemployment Rate	3.6% (Sep)	6.6% (Sep)	3.7% (Aug)

Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation has picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will spike higher again before dropping back slowly through 2023.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as ong-term sick, the UK labour force actually shrunk by c£500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at 5.5% - 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

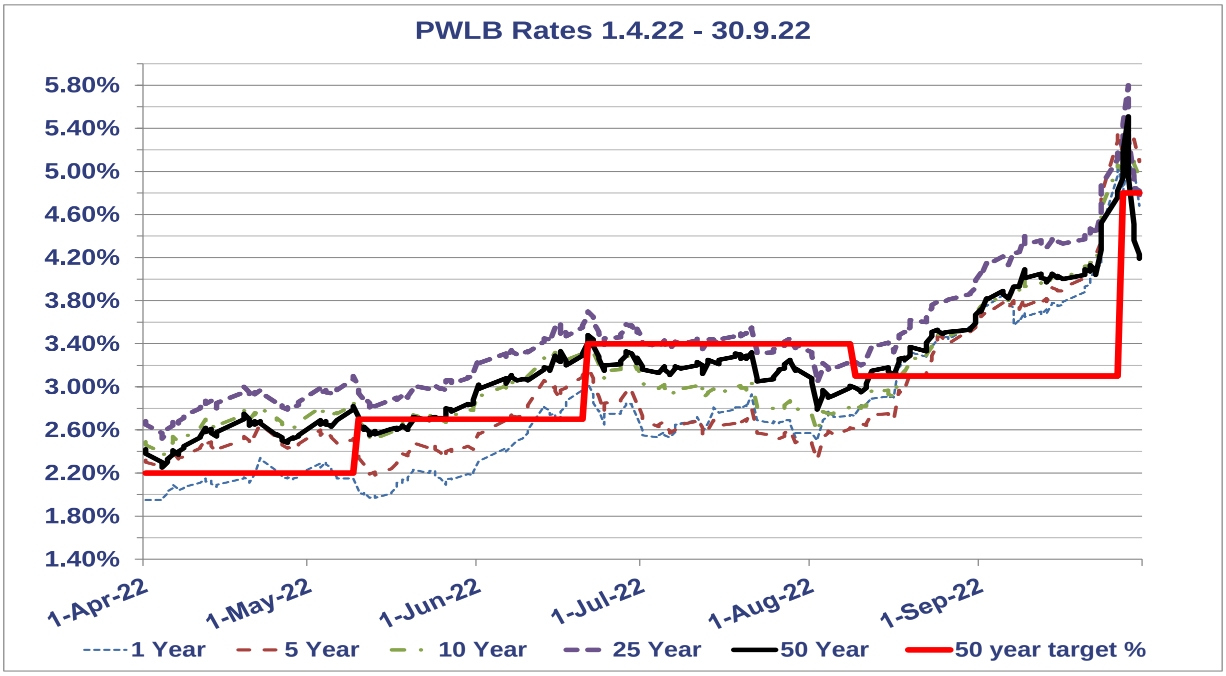
Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3% in November and the market expects Bank Rate to hit 4.5% by May 2023.

Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and December. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17th November gave rise to a net £55bn fiscal tightening, although much of the 'heavy lifting' has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have completely reversed the increases seen under the previous tenants of No 10/11 Downing Street.

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one if not more quarters of GDP contraction. In November, the MPC projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

The £ has strengthened of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.20. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28th September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting ever lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in recent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

CENTRAL BANK CONCERNS – NOVEMBER 2022

At the start of November, the Fed decided to push up US rates by 0.75% to a range of 3.75% - 4%, whilst the MPC followed a day later by raising Bank Rate from 2.25% to 3%, in line with market expectations. EZ rates have also increased to 1.5% with further tightening in the pipeline.

Having said that, the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than markets had expected. Governor Bailey, here in the UK, said the opposite and explained that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.5% - 4.75%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data has proven stronger than expected.

In addition, the Bank's central message that GDP will fall for eight quarters starting with Q3 2022 may prove to be a little pessimistic. Will the £160bn excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

Appendix G

INTEREST RATE FORECASTS

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

PWLB forecasts are based on PWLB certainty rates.

Latest at 14/2/23

Interest Rate Forecasts								
Bank Rate	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Link	4.25%	4.50%	4.50%	4.25%	4.00%	3.75%	3.25%	3.00%
Cap Econ	4.25%	4.50%	4.50%	4.50%	4.25%	4.00%	3.50%	3.00%
5Y PWLB RATE								
Link	4.00%	4.00%	3.90%	3.80%	3.70%	3.60%	3.50%	3.40%
Cap Econ	3.80%	3.70%	3.60%	3.50%	3.50%	3.40%	3.30%	3.30%
10Y PWLB RATE								
Link	4.20%	4.20%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%
Cap Econ	3.80%	3.70%	3.70%	3.60%	3.50%	3.40%	3.40%	3.30%
25Y PWLB RATE								
Link	4.60%	4.60%	4.40%	4.30%	4.20%	4.10%	3.90%	3.80%
Cap Econ	4.20%	4.00%	4.00%	3.80%	3.80%	3.70%	3.60%	3.60%
50Y PWLB RATE								
Link	4.30%	4.30%	4.20%	4.10%	3.90%	3.80%	3.60%	3.60%
Cap Econ	3.80%	3.80%	3.80%	3.80%	3.80%	3.70%	3.60%	3.60%