



**Governance and Audit  
Committee**

**Tuesday 11 January 2022**

**Subject: Draft Treasury Management Strategy 2022/23**

Report by:	Assistant Director of Finance and Property Services and Section 151 Officer
Contact Officer:	Paul Loveday Corporate Finance Manager  paul.loveday@west-lindsey.gov.uk
Purpose / Summary:	To seek approval for the Treasury Management Strategy, Prudential Indicators, Minimum Revenue Provision Policy and Capital Investment Strategy to facilitate effective financial management and planning

**RECOMMENDATION(S):**

- 1. That the Committee review, comment on and scrutinise the Treasury Management Strategy, Prudential Indicators and Minimum Revenue Provision (MRP) Policy 2022/23 and recommend to the Council for approval.**
- 2. To review, comment on and scrutinise the Capital Investment Strategy in conjunction with the Treasury Management Strategy.**
- 3. Approval of any changes to the Capital Strategy and Minimum Revenue Provision (MRP) Policy and Prudential Indicators be delegated to the Chief Finance Officer in consultation with the Chair of the Governance and Audit Committee, prior to the final strategy being presented to Council in March.**

## IMPLICATIONS

### **Legal:**

The Local Government and Finance Act 2003, the Prudential Code and the Treasury Management Code of Practice and Sectorial Guidance include a key principal that an organisations appetite for risk is included in their annual Treasury Management Strategy and this should include any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing.

### **Financial : FIN/151/22/PL**

There are no direct financial implications arising from this report.

### **Staffing :**

None from this report.

### **Equality and Diversity including Human Rights :**

None from this report.

### **Data Protection Implications :**

None from this report.

### **Climate Related Risks and Opportunities:**

The strategy includes for investment in Environmental, Social and Governance (ESG) financial instruments where such factors are taken into account when choosing investment products.

### **Section 17 Crime and Disorder Considerations:**

None from this report.

### **Health Implications:**

None from this report.

**Title and Location of any Background Papers used in the preparation of this report :**

Prudential Code for Capital Finance in Local Authorities 2021

Treasury Management Code of Practice and Cross-Sectorial Guidance Notes 2021

Treasury Management in Public Services: Guidance Notes 2021

All papers are located in the Financial Services section, Guildhall

**Risk Assessment :**

Interest Rate Risk: A rise in interest rates may lead to capital investment loss due to the inverse price and yield relationship and vice versa.

Inflation Risk: Real returns can be eroded if inflation is expected to or rises during the term of the investment, therefore capital value may be reduced

Re-Investment Risk: the effect of changing interest rates on re-investment before maturity.

Credit Risk: The value of an investment can be affected by the credit quality/rating of the issuer.

Default Risk: Possibility that total principal may not be returned before maturity, or partially returned.

Net Cost of Services Risk: Under the IFRS9 amendments in 2018/19 there is a risk that adverse fair value valuations for some investments (such as the Property Fund) would have a direct negative impact on the Comprehensive Income and Expenditure Statement for Net Cost of Services.

This risk will be mitigated for 5 years by a statutory over-ride approved by Government.

Risks associated with investing for longer periods, and in instruments/assets where the values can go down as well as up, will require mitigation as there will be increased risk to the security and liquidity of investments.

Mitigation of these risks will be undertaken by defining the restrictions of time and maximum value of investment made and with appropriate financial appraisals being undertaken for each investment. Close monitoring of the investment performance will also be undertaken. Risk to the Net cost of services due to IFRS9 will be mitigated through the maintenance of a reserve for Investments Volatility Reserve, this will prevent any adverse change in valuation have a direct impact on the Comprehensive Income and Expenditure Statement. Ongoing review and maintenance of this reserve will be required each year.

**Call in and Urgency:**

**Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?**

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)

Yes

No

**Key Decision:**

A matter which affects two or more wards, or has significant financial implications

Yes

No

## 1. Executive Summary

1.1 The Council is required to approve a Treasury Management Strategy Statement for 2022/23 before 1 April 2022. In accordance with the constitution the Governance and Audit Committee are responsible for the scrutiny of the Council's Treasury Management Strategy and Policies. The Treasury Management Strategy is therefore attached for this purpose. In addition the Capital Investment Strategy, which has direct links to the Treasury Management Strategy is also provided for your scrutiny.

1.2 The Council is required to by statutory provision and regulation to 'have regard to' the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003

An updated Prudential Code has been published in December 2021 and applies with immediate effect, except that authorities may defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. The revised reporting requirements include changes to the capital strategy, prudential indicators and investment reporting. The general ongoing principles of the revised Prudential Code, including the requirement in paragraph 51 that an authority must not borrow to invest primarily for financial return, apply with immediate effect.

1.3 By using the Prudential Code Framework the Council ensures that the following objectives are met;

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

### The Borrowing Strategy (para 3.5)

HM Treasury announced reforms on Public Works Loan Board (PWLB) borrowing in November 2020, in that it would no longer support borrowing for the acquisitions of new investment assets purchased primarily for yield (Non Treasury Activity i.e. Commercial property investment). In addition the Prudential Code 2021 now precludes the use of any type of borrowing for primarily for a financial return (including

internal borrowing) for this purpose. The Borrowing Strategy therefore no longer includes borrowing for this purpose.

However, borrowing is allowable to enable the effective management of the Property Portfolio.

The key objectives of the Council's Borrowing Strategy are;

- To ensure that future external debt is affordable and sustainable within the long term within the revenue budget constraints.
- To support schemes with a socio-economic value i.e. for the regeneration and growth of the District.
- To support significant service investment where the cost of borrowing will be offset by efficiencies and/or cost savings and/or income.
- All external debt undertaken will be repaid at loan maturity

#### 1.4 The Investment Strategy (para 4.4)

The main objective of the strategy is the security, liquidity and finally yield of the investment, in the context of the Councils risk appetite and through the mitigation of risks.

The Council has now developed its strategy in relation to Sustainability, Climate Change and Environment. As the Council will be interested in undertaking actions to reduce climate change, the Council as an ethical investor will consider the environmental, social and governance issues (ESG) when making treasury investment decisions.

However, the Treasury function is controlled by statute and professional guidance and its main priorities must remain as security, liquidity and yield.

Consideration of ESG will be undertaken when considering new investment opportunities and will be in accordance with our counterparty limits and rating criteria.

#### 1.5 The Minimum Revenue Provision Policy (MRP) (Appendix A)

The Council will repay an element of prudential borrowing annually. This policy has been revised in relation to where borrowing has previously been undertaken for Non Treasury Activity.

The MRP Policy will be as detailed below;

- Asset Life Method – debt repaid over the life of the asset
- Asset Life – Annuity Method – for regeneration schemes or admin projects where revenue benefits are only realised in future years or increase in future years, and will be based on an appropriate rate comparable with PWLB Rates
- Loan Principal repayment will be proxy for MRP for loans funded from borrowing

- Where the Council has previously borrowed for the acquisition of Investment Properties the Asset Life Method will now be used to calculate the MRP charge applicable on an annual basis.

## 1.6 Commercial Investments (Property Portfolio)

Whilst it is appreciated that these properties will be subject to wear and tear, all leases are fully insuring and repairing leases, with the liability for maintaining the asset at its current state being the responsibility of the Lessee.

The transactional costs of acquisition of these properties has been capitalised. However, all leases include contractual rental increases which are likely to result in an increased market value (all things being equal). Investment Properties will be revalued annually as at the Balance Sheet date.

The intention to hold these assets for between 5-10 years at which point the capital receipt will repay borrowing. However, valuations of these properties can go up as well as down. Our previous approach was that, on an annual basis, a Voluntary Minimum Revenue Provision (VMRP) would be considered, this enables any overpayment to be recovered. However, guidance and good practice no longer allow this so, as already stated, there will now be an annual MRP charge provided.

MRP Overpayments – The current DLUHC MRP Guidance allows that any charges made over the statutory minimum revenue provision (MRP) i.e. voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year.

Up until the 31 March 2021 the total Voluntary MRP (VMRP) overpayments have been £707k however this relates to payments to reduce prudential borrowing against the Commercial Investments Property Portfolio and is therefore not deemed an overpayment.

To mitigate the risk of loss of the capital receipt not meeting outstanding debt, a Valuation Volatility Reserve had been created and a minimum balance of 5% of acquisition price set. It is intended that this reserve will be reduced to 3% over the medium term to reflect the implementation of an annual MRP.

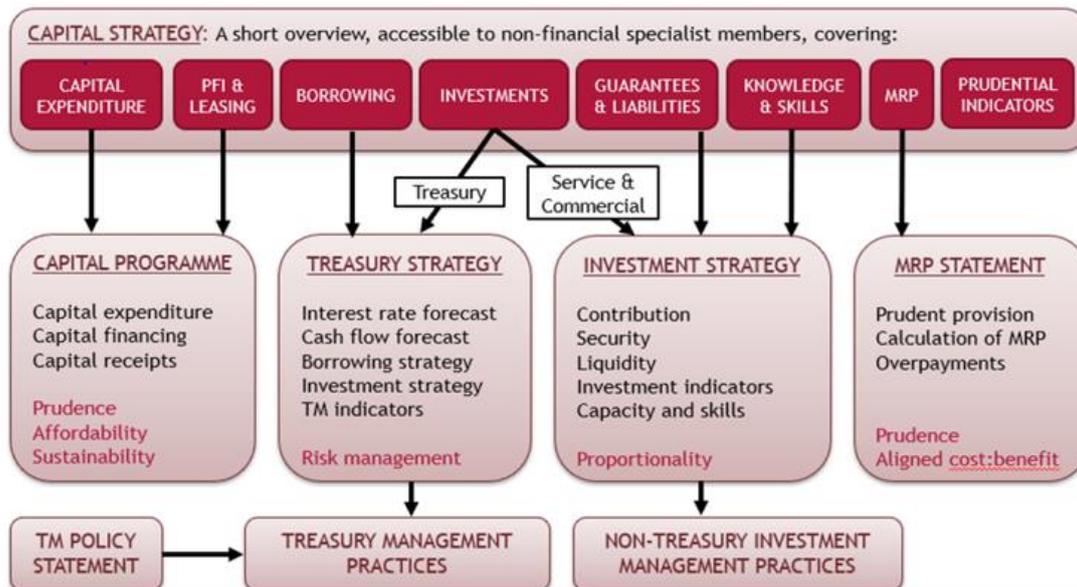
- 1.7 To provide transparency the Treasury Management Strategy includes at 4.7 the (Non-Treasury) Investment Strategy in the context of the investing in commercial activity to ensure services can be maintained as government funding reduces and as previously approved by Corporate Policy and Resources Committee. Expert and legal advice will always be sought to ensure that any additional purchases, or replacement purchases are within our powers.

- 1.8 The Treasury Management Strategy including the Borrowing Strategy, Investment Strategy and Minimum Revenue Provision Policy are detailed below.
- 1.9 The Capital Investment Strategy is attached at Appendix 1 for consideration. The Capital Investment Strategy forms a key part of the Council's overall Corporate Planning Framework. It provides a mechanism by which the Council's capital investment and financing decisions can be aligned with the Council's over-arching corporate priorities and objectives over a medium term (five year) planning horizon.

The Capital Investment Strategy provides a framework to enable both revenue and capital investment decisions which contribute to the achievement of the Council's priorities and objectives as set out in the Corporate Plan.

The strategy defines how the capital programme is to be formulated, and it identifies issues and options that influence revenue and capital spending, and sets out how the resources will be managed.

The framework below illustrates the Prudential Framework.



1.10 Prudential indicators are designed to provide support and record local decision making and not as comparative performance indicators. These are contained within the Treasury Management Strategy. As we await the final finance settlement, indicators will be finalised prior to submission to Council for approval.

## APPENDIX 1

# TREASURY MANAGEMENT STRATEGY

## Minimum Revenue Provision Policy and Annual Investment Strategy

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# 1. INTRODUCTION

## 1.1 Background

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

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

The Councils Corporate Plan identifies the Corporate Objectives of the Council and which then informs capital investment requirements. The 2022/23 to 2026/27 Capital Programme therefore includes significant capital investment which will require resourcing, from revenue, earmarked reserves, capital receipts, grant income, and borrowing.

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

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

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as;

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

The treasury management activity involves substantial sums of money, which it borrows and invests. This exposes the Council to potential large financial risk, which can include the loss of invested funds, or the revenue consequence

of changes in interest rates. Therefore the successful identification, control and monitoring of risk are integral to this function and include credit and counterparty risk, liquidity risk, market or interest rate risk, refinancing risk and legal and regulatory risk.

## **1.2 Reporting Requirements**

### **1.2.1 Capital Investment Strategy**

The CIPFA 2021 Prudential and Treasury Management Codes require all Local Authorities to prepare a capital investment strategy report, which will provide the following:

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

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

This capital investment strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital investment strategy shows:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

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

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

If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital investment strategy.

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

### **1.2.2 Treasury Management Reporting**

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

**a) Prudential and treasury indicators and treasury strategy (this report)**

The first and most important report is forward looking and covers:

- The capital plans (including prudential indicators);
- A Minimum Revenue Provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- The Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- An Investment Strategy (the parameters on how investments are to be managed).

**b) A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, the Corporate Policy and Resources Committee will receive quarterly update reports.

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

### **Scrutiny**

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

### **1.3 Treasury Management Strategy for 2022/23**

The strategy for 2022/23 covers two main areas:

#### **Capital issues**

- The capital expenditure plans and the associated prudential indicators;
- The Asset Management Plan
- The Minimum Revenue Provision (MRP) policy.

#### **Treasury management issues**

- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the Council;

- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- Creditworthiness policy; and
- The policy on use of external service providers.

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

#### **1.4 Training**

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. This is mandatory training for the Governance and Audit Committee and is delivered annually. This training was undertaken on 5 January 2022. Further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

#### **1.5 Treasury Management Consultants**

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

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

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

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

## **2. THE CAPITAL PRUDENTIAL INDICATORS 2022/23 – 2024/25**

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.

## 2.1 Capital Expenditure and Financing

This prudential indicator is a summary of the Council's capital expenditure plans which are included in the approved Capital Programme and which are the key drivers to treasury management activity. The output of the programme is reflected in the Council's prudential indicators, which are designed to provide Members with an overview and Members are asked to approve the capital expenditure forecasts:

Capital Expenditure By Cluster £m	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
<b>Our People</b>	2.844	1.677	1.731	0.675	1.425
<b>Our Place</b>	5.909	7.452	10.384	11.763	0.718
<b>Our Council</b>	0.281	0.868	0.787	0.420	0.115
<b>Investment*</b>	0	0	0	3.000	0
<b>Total</b>	<b>9.034</b>	<b>9.997</b>	<b>12.902</b>	<b>15.858</b>	<b>2.258</b>

\*Investment relates to areas such as capital expenditure on investment properties, loans to third parties etc.

Capital expenditure can be financed from a range of external and internal sources. External sources include private sector contributions i.e. S106 developer agreements, as well as government grants. Internal sources include capital receipts, earmarked reserves, and revenue contributions.

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

Financing of capital expenditure £m	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Capital receipts	2.519	0.166	0.527	0.186	0
External Grants	3.314	5.120	7.790	9.498	1.018
S106	0.017	0.477	1.056	0.140	0.750
Earmarked Reserves	0	1.759	3.386	1.450	0.490
Revenue Resources	1.576	0.061	0	0	0
<b>Net borrowing need for the year</b>	<b>1.608</b>	<b>2.414</b>	<b>0.143</b>	<b>4.584</b>	<b>0</b>
<b>Total Financing</b>	<b>9.034</b>	<b>9.997</b>	<b>12.902</b>	<b>15.858</b>	<b>2.258</b>

The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown below

<b>Commercial activities / non-financial investments £m</b>	<b>2020/21 Actual</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>
Capital Expenditure	0	0	0	3.000	0
Financing costs	0	0	0	3.000	0
<b>Net borrowing need for the year</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>100</b>	<b>0</b>
Percentage of total net financing need %	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

The Council, will need to manage their Commercial Property Portfolio effectively and as such a £3m Capital Budget is proposed, to support the replacement of one of the properties (should it be sold) subject to the annual review of the portfolio.

Other long-term liabilities - The above financing need excludes other long term liabilities, such as leasing arrangements which already include borrowing instruments.

The forecast of Revenue and Capital Reserves after taking into account contributions to and from these reserves for both capital and revenue purposes are detailed in the table below;

<b>Year End Resources £m</b>	<b>2020/21 Actual</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>
General Fund Balance	7.338	4.007	3.735	3.686	3.645
Earmarked Reserves	18.217	17.494	15.037	13.585	13.496
<b>Total Revenue Reserves</b>	<b>26.585</b>	<b>21.501</b>	<b>18.772</b>	<b>17.271</b>	<b>17.141</b>
Capital receipts	1.168	1.246	0.955	0.844	0.910
Capital Grants Unapplied	2.366	0	0	0	0
<b>Total Capital Reserves</b>	<b>3.534</b>	<b>1.246</b>	<b>0.955</b>	<b>0.844</b>	<b>0.910</b>
<b>Total Useable Reserves</b>	<b>29.089</b>	<b>22.747</b>	<b>19.727</b>	<b>18.115</b>	<b>18.051</b>

## **2.2 The Council's Borrowing Need (The Capital Financing Requirement)**

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure

which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so it's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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

The CFR includes any other long-term liabilities (e.g. finance leases). Whilst these 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 is asked to approve the CFR projections below:

£m	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
<b>Capital Financing Requirement</b>					
<b>Accounting Adj</b>	1.065	1.065	1.065	1.065	1.065
<b>Finance Leases</b>	0	0	0	0	0
<b>Prudential Borrowing</b>	37.460	38.360	37.176	37.787	36.813
<b>Total CFR</b>	<b>38.525</b>	<b>39.425</b>	<b>38.241</b>	<b>38.852</b>	<b>37.878</b>
Of which: Commercial Investment Property	20.959	20.585	20.211	19.837	19.463
<b>Movement in CFR</b>	<b>0.620</b>	<b>0.890</b>	<b>-1.184</b>	<b>0.611</b>	<b>-0.974</b>

<b>Movement in CFR represented by</b>					
Net borrowing need for the year (above)	1.608	1.743	0.143	4.585	0
Less MRP and other financing movements	-0.958	-0.824	-0.898	-3.945	-0.945
Loan Principal repaid	-0.030	-0.029	-0.429	-0.029	-0.029
<b>Movement in CFR</b>	<b>0.620</b>	<b>0.890</b>	<b>-1.184</b>	<b>0.611</b>	<b>-0.974</b>

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 2.1 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

### 3. BORROWING

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

#### 3.1 Core Funds and Expected Investment Balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources £m	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
CFR	38.535	39.425	38.241	38.852	37.878
Less Leases	0	0	0	0	0
<b>Borrowing CFR</b>	<b>38.535</b>	<b>39.425</b>	<b>38.241</b>	<b>38.852</b>	<b>37.878</b>
Less Borrowing	20.000	21.500	26.500	33.500	31.500
<b>Over(-)/Under Borrowing</b>	<b>18.535</b>	<b>17.925</b>	<b>11.741</b>	<b>5.352</b>	<b>6.378</b>
General Fund Balance	-7.338	-4.007	-3.735	-3.686	-3.645
Earmarked Reserves	-19.209	-17.494	-15.037	-13.585	-13.496
Capital receipts	-1.168	-1.246	-0.955	-0.844	-0.910
Capital Grants Unapplied	-2.366	0	0	0	0
Provisions	-1.045	-1.400	-1.500	-1.600	-1.800
Working capital*	-7.362	-1.018	-1.580	-0.288	-0.288
<b>TOTAL FUND</b>	<b>-38.488</b>	<b>-25.165</b>	<b>-22.807</b>	<b>-20.003</b>	<b>-20.139</b>
<b>Expected investments (-) /Borrowing</b>	<b>-19.953</b>	<b>-7.240</b>	<b>-11.066</b>	<b>-14.651</b>	<b>-13.761</b>

\*Working capital balances shown are estimated year-end; these may be higher mid-year

### 3.2 Current Portfolio Position

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), and internal borrowing as a percentage of the CFR.

£m	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
<b>External Debt</b>					
Debt at 1 April	20.000	20.000	21.500	26.500	33.500
Expected change in Debt	0	1.500	5.000	7.000	-2.000
<b>Gross external debt at 31 March</b>	<b>20.000</b>	<b>21.500</b>	<b>26.500</b>	<b>33.500</b>	<b>31.500</b>
Internal Borrowing (at 31 March)	18.535	17.925	11.741	5.352	6.378
<b>The Capital Financing Requirement</b>	<b>38.535</b>	<b>39.425</b>	<b>38.241</b>	<b>38.852</b>	<b>37.878</b>
<b>Internal Borrowing %</b>	<b>48.09</b>	<b>45.47</b>	<b>30.70</b>	<b>13.78</b>	<b>16.84</b>

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

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

### 3.3 Treasury Indicators: Limits to Borrowing Activity

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

Operational boundary £m	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
External Debt	21.500	26.500	33.500	31.500
<b>Operational Boundary</b>	<b>39.425</b>	<b>38.241</b>	<b>38.852</b>	<b>37.878</b>

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

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

Authorised £m	limit	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Gross Debt*		21.500	26.500	33.500	31.500
<b>Authorised Limit</b>		<b>45.000</b>	<b>43.000</b>	<b>44.000</b>	<b>43.000</b>

\*The Authorised limit allows for external borrowing in advance of need for up to a maximum of two years and includes additional headroom of £5m for unexpected cashflow movements.

### 3.4 Prospects for Interest Rates

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 8<sup>th</sup> November 2021. These are forecasts for certainty rates (gilt yields plus 80 bps).

Link Group Interest Rate View 8.11.21														
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.10	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.50	0.60	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	1.80	1.90	1.90	2.00	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.40
25 yr PWLB	2.10	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70
50 yr PWLB	1.90	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50

(A more detailed interest rate forecast and economic commentary are set out in appendices B and C)

The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

The Bank Rate was increased to 0.25% on 16 December 2021. The forecast now includes a further 4 increases, quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

#### **Significant risks to the forecasts:-**

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.
- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, resulting in further national lockdowns or severe regional restrictions.
- **The Monetary Policy Committee** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **The Monetary Policy Committee** tightens monetary policy too late to ward off building inflationary pressures.
- **The Government** acts too quickly to cut expenditure to balance the national budget.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **German general election** in September 2021. Germany faces months of uncertainty while a new coalition government is cobbled together after the indecisive result of the election. Once that coalition is formed, Angela Merkel's tenure as Chancellor will end and will leave a hole in overall EU leadership.
- **Longer term US treasury yields** rise strongly and pull gilt yields up higher than forecast.
- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- **Geopolitical risks**, for example in Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

## **The balance of risks to the UK economy: -**

- The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from COVID-19 and its variants - both domestically and their potential effects worldwide.

## **Forecasts for Bank Rate**

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

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- It is estimated that there were around 1 million people who came off furlough at the end of September; how many of those would not have had jobs on 1<sup>st</sup> October and would therefore be available to fill labour shortages which are creating a major headache in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate one of the MPC's key current concerns.
- We also recognise there could be further nasty surprises on the COVID-19 front, on top of the flu season this winter, and even the possibility of another lockdown, which could all depress economic activity.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will be revised again over the next few months - in line with what the new news is.

## Forecasts for PWLB Rates, Gilt and Treasury Yields

As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

Further information is included at Appendix C.

## Investment and Borrowing Rates

- **Investment returns** are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.
- **Borrowing interest rates** fell to historically very low rates as a result of the COVID-19 crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The current margins over gilt yields are as follows: -
  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- **Borrowing for capital expenditure.** Link's long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio.
- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances.

### **3.5 Borrowing Strategy**

The Borrowing Strategy covers the relevant prudential and treasury indicators, and the current and projected debt positions as detailed above.

The key objectives of the Council's Borrowing Strategy are;

- To ensure that future external debt is affordable and sustainable within the long term within the revenue budget constraints.
- To support schemes with a socio-economic value i.e. for the regeneration and growth of the District.
- To support significant service investment where the cost of borrowing will be offset by efficiencies and/or cost savings
- All external debt undertaken will be repaid on loan maturities

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

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

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

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

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

### **3.6 Policy on Borrowing in Advance of Need**

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

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

### **3.7 Debt Rescheduling**

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as upfront redemption costs would be significant based on the maturity profiles we currently have.

However, if rescheduling was done, it will be reported to the Council, at the earliest meeting following its action.

### **3.8 New Financial Institutions as a Source of Borrowing**

In addition to borrowing from the PWLB, consideration will be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years)
- Municipal Bonds Agency

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

### **3.9 Approved sources of Long and Short Term Borrowing**

<b>On Balance Sheet</b>	<b>Fixed</b>	<b>Variable</b>
PWLB	Unlimited	25%
Municipal bond agency	Unlimited	0
Local authorities	Unlimited	0
Banks	25%	10%
Market (long-term)	25%	10%
Market (temporary)	25%	10%
Local authorities temporary	25%	N/A
Local / Community Bonds	25%	10%
Overdraft (notified in advance)		£1m
Internal (capital receipts & revenue balances)	50%	N/A
Finance leases	Unlimited	N/A

## **4.0 ANNUAL INVESTMENT STRATEGY**

### **4.1 Investment Policy – Management of Risk**

The Department of Levelling Up, Housing and Communities (DLUHC – formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA 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.

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 ("the CIPFA TM Code") 2017.
- CIPFA Treasury Management Guidance Notes 2018

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

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

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.
3. **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Appendix D under the categories of 'specified' and 'non-specified' investments.
  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were originally classified as

being non-specified investments solely due to the maturity period exceeding one year.

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.
5. **Non-specified and loan investment limits.** The Council has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of 40%.
  6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
  7. **Transaction limits** are set for each type of investment in 4.2.
  8. This authority will set a limit for its investments which are invested for **longer than 365 days**, (see paragraph 4.4).
  9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).
  10. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
  11. All investments will be denominated in **sterling**.
  12. As a result of the change in accounting standards for 2022/23 under IFRS 9, this 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. In November 2018, MHCLG (now DLUHC), concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.

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, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

## 4.2 Creditworthiness Policy

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

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

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

Credit rating information is supplied by the Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

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

- Banks 1 - good credit quality – the Council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA
 and have, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where rated):
  - i. Short Term – F1
  - ii. Long Term – A
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland ring-fenced operations. This bank can be included provided they continue to be part nationalised or meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.

- Bank subsidiary and treasury operation -. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies - The Council will use all societies which meet the ratings for banks outlined above;
- Money Market Funds (MMFs) CNAV – AAA
- Money Market Funds (MMFs standard) LNAV – AAA
- Money Market Funds (MMFs enhanced) VNAV – AAA
- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, parish councils etc.
- Housing associations
- Supranational institutions
- Local Authority Property Asset Fund (CCLA)
- Local/Community Bonds
- Corporate Bond Funds
- Covered Bonds

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

**Time and monetary limits applying to investments.** The time and monetary limits for institutions on the Council’s counterparty list are as follows (these will cover both specified and non-specified investments). It should be noted that in the case of Lloyds Bank, our current bankers, that as well as allowing £7.5m fixed term investment in that one institution that there is flexibility to hold, in current account balances at Lloyds Bank, up to £2m ‘cash’ on any one day:

	Fitch	Moody’s	Standard & Poors	Money Limit	Time Limit
Banks 1 – up to 1 year	F1	P1	A1	£7.5m per counterparty at Group level	1 year
Banks 1 – over 1 year	AA	Aa2	AA	£2m maximum exposure	1 year to 5 years

<b>Banks 2 – UK part nationalised</b>				<b>£5m per counterparty at Group Level</b>	<b>1 year</b>
<b>Banks 3 – Council’s own bank if not covered by 1 or 2</b>				<b>£1m</b>	<b>1 Day</b>
<b>Other Local Authorities</b>				<b>£5m per counterparty</b>	<b>5 years</b>
<b>Housing Associations</b>				<b>£1m maximum exposure</b>	<b>6 mths</b>
<b>Bank of England DMADF</b>				<b>No limit</b>	<b>6 mths</b>
<b>Gilts/Treasury Bills – where no loss of principal if held to maturity</b>				<b>£5m maximum exposure</b>	<b>5 years</b>
<b>Supranational</b>				<b>£5m per counterparty</b>	<b>1 year</b>
<b>Quality Corporate Bonds Funds</b>				<b>£2m</b>	<b>5 years</b>
<b>Local Authority Property Asset Funds</b>				<b>£4m</b>	<b>5 years</b>
<b>Certificates of Deposit</b>				<b>£2m</b>	<b>5 years</b>
<b>Covered Bonds</b>				<b>£1m</b>	<b>5 years</b>
	<b>Fund rating</b>			<b>Money and/or % Limit</b>	<b>Time Limit</b>
<b>Money market funds CNAV</b>	<b>AAA</b>			<b>£7.5m per counterparty</b>	<b>Overnight</b>
<b>Money market funds LVNAV (standard)</b>	<b>AAA</b>			<b>£7.5m per counterparty</b>	<b>Overnight</b>
<b>Money market funds VNAV (Enhanced)</b>	<b>AAA</b>			<b>£5m</b>	<b>5 years</b>

### 4.3 Other Limits

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

- a) **Non-specified treasury management investment limit.** The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being 40% of the total treasury management investment portfolio.
- b) **Country limit.** The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix E. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
- c) Other limits. In addition:
  - No more than £2m will be placed with any non-UK country at any time;
  - Limits in place above will apply to a group of companies;
  - Sector limits will be monitored regularly for appropriateness

### 4.4 Investment Strategy

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

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

#### **Investment Returns Expectations.**

The current forecast shown in paragraph 3.4, includes the increase in Bank Rate in December 2021.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):

Average earnings in each year	
2021/22	0.10%
2022/23	0.50%
2023/24	0.75%
2024/25	1.00%
2025/26	1.25%
Long term later years	2.00%

- The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from COVID-19 and its variants - both domestically and their potential effects worldwide.
- It is not expected that the Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%.
- PWLB certainty rates are likely to show a steady rise over the forecast period, with some degree of the uplift due to rising treasury yields in the United States. There is also likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to a number of economic factors. The balance of upside risks are for medium to long term PWLB rates.

Money market funds (MMFs), yields have remained low with a number of market operators offering nil rates. Continuing investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money at the very short end of the market

Inter-local authority lending and borrowing rates have also remained low due to the surge in the levels of cash seeking a short-term home resulting from the tail end effect of large receipts received from the Government in support to combat the COVID-19 epidemic.

### **CCLA Property Fund Issues**

The Property Fund continues to have a 90 day notice period for redemptions which will have to be taken into account when assessing the Council's cashflow forecasting.

The income from the fund stills remains attractive in this period of ultra-low interest rates.

## Ethical Investing

The Council continues to develop its strategy in relation to Sustainability, Climate Change and Environment. As the Council will be interested in undertaking actions to reduce climate change, the Council as an ethical investor will consider the environmental, social and governance issues (ESG) when making treasury investment decisions.

Investments will be in accordance with counterparty and creditworthiness (as detailed at 4.2

## Treasury Investment Portfolio

The Council is expecting to have an average investment portfolio of £13m throughout 2022/23 and expects to receive investment income totalling £0.105m as shown below:

Treasury Investment Portfolio	Average Portfolio £m	Interest Rate %	Interest £m
Liquidity Investments	10.0	0.15	0.015
Long Term Investments	3.00	3.00	0.090
<b>Total Investment Income (2022/2023)</b>	<b>13.00</b>	<b>0.08</b>	<b>0.105</b>

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

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

<b>Maximum principal sums invested &gt; 364 &amp; 365 days</b>			
£m	2022/23	2023/24	2024/25
Principal sums invested > 365 days	£5m	£5m	£5m

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

## 4.5 Investment Risk Benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage

risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.06% historic risk of default when compared to the whole portfolio.

Liquidity – in respect of this area the Council seeks to maintain:

- Liquid short term deposits of at least £4m available with a week's notice.
- Weighted average life benchmark is expected to be 0.25 years, with a maximum of 1 years.

Yield - local measures of yield benchmarks are;

- Investments – internal returns above the 7 day Sterling Overnight Index Average (SONIA) compounded rate

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
<b>Maximum</b>	<b>0.07%</b>	<b>0.19%</b>	<b>0.36%</b>	<b>0.55%</b>	<b>0.77%</b>

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

#### **4.6 End of Year Investment Report**

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

#### **4.7 Non-Treasury Investments (Commercial Property)**

The Council has invested £21.666m (£30m budget approved) in creating a Commercial Property Portfolio, to generate a revenue return to support the future sustainability of the Council and therefore protecting the services as government funding was reduced. The net return was estimated to be £600k p.a. based on the approved £20m investment limit. The first acquisition was made in October 2017. The Council's portfolio currently consists of 6 properties, with £20.500m having been spent on these acquisitions (excludes costs) to date and the gross return for 2022/23 is estimated to be 7.73%. After taking account of management and financing costs (including MRP) a return of 3.00% is being achieved.

It is no longer anticipated that additional assets will be acquired. However, the portfolio will be managed within the current values and replacement properties acquired if existing properties are sold ensuring income levels are maintained.

The Council has a Commercial Contingency Budget of £0.2m to mitigate the risk of rental losses, and a Valuation Volatility Reserve to mitigate the risk of capital loss on disposal.

In addition the Council has set aside £1.084m as a Valuation Volatility Reserve, this reflects 5% of the purchase price. However, now that MRP will be charged annually, thus reducing outstanding borrowing, the Reserve will be reduced to 3% over the Medium Term Financial Plan.

## **Strategy**

Working with the commercial property consultant, Cushman & Wakefield, officers have developed an investment strategy for the Council that aims to balance risk across the portfolio whilst achieving the target returns required.

However, any future additional property investments can no longer be funded from borrowing, and our own resources must be utilised to fund any acquisitions. Currently there is no expectation that any additional properties will be acquired.

The strategy included;

1. To acquire an investment portfolio of commercial property assets in lot sizes of £1.0m to £10.0m, targeting an average lot size of circa £3.5m to £4m across the portfolio and total investment of £30.0m.
2. Authority to complete on acquisitions should be delegated to the Chief Executive in consultation with the Chief Finance Officer and Leader of the Council, provided that the purchase is within agreed criteria. All assets will be assessed against these criteria and the Chief Executive will have delegated Authority to complete on the acquisition of assets which score 50 or more out of 70. Any asset which falls below this threshold or registers a zero against any criteria may still be considered but specific justification will need to be provided and the decision to proceed taken to the Corporate Policy and Resources Committee for approval.
3. Reserves will be utilised to fund any further acquisitions. Business case modelling will be developed using an opportunity cost of capital based on debt funded through Prudential Borrowing. The business case will be made on the basis of borrowing the full amount each time to ensure that resources are able to be recycled.
4. All assets will be acquired against a target hold period of 5 to 10 years with consideration given to asset management to enhance/protect value over the period of ownership (and any additional resource required/expected in this respect) and risks relating to disposal after the proposed hold period. A proportion of the income will be allocated for risk provision. Further returns would depend on investment performance relative to target and might be achieved through release of the risk provision and/or capital returns.
5. The financial position will be thoroughly monitored throughout the hold period and adequate response made to any change in market conditions and portfolio performance. Decisions regarding the funding of acquisitions will be made by the Assistant Director, Finance, Business

Support and Property Services (Section 151 Officer) and will be based on:

- An analysis of disposal value risk after an assumed hold period
  - The expectation that the asset will generate a capital return that tracks inflation or better with a provision for risk should this not be achieved
6. Access to suitably qualified/experienced resource is essential for successful delivery and management of the risks involved. Resources should be identified and ring-fenced to the activity. The property and asset team has been restructured to ensure that sufficient resources available to manage the existing assets and the new additions that would be acquired in line with this strategy.

#### **4.8 Capital Investment Strategy**

The Capital Investment Strategy forms a key part of the Council's overall Corporate Planning Framework. It provides a mechanism by which the Council's capital investment and financing decisions can be aligned with the Council's over-arching corporate priorities and objectives over a medium term (five year) planning horizon. The Strategy has direct links to the Treasury Management Strategy and it is therefore appropriate that the Governance and Audit Committee scrutinise and provide assurance to Council on both policies. The Capital Investment Strategy is attached at Appendix H.

### **5 APPENDICES to the Treasury Management Strategy**

- A Prudential and Treasury Indicators and MRP statement
- B Interest rate forecasts
- C Economic background
- D Treasury management practice 1 – credit and counterparty risk management
- E Approved countries for investments
- F Treasury management scheme of delegation
- G The treasury management role of the section 151 officer
- H The Capital Investment Strategy

## APPENDIX A

### THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2022/23 – 2024/25 AND MRP STATEMENT

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

#### Capital Expenditure

Capital Expenditure By Cluster £m	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
<b>Our People</b>	2.844	1.677	1.731	0.675	1.425
<b>Our Place</b>	5.909	7.452	10.384	11.763	0.718
<b>Our Council</b>	0.281	0.868	0.787	0.420	0.115
<b>Investment*</b>	0	0	0	3.000	0
<b>Total</b>	<b>9.034</b>	<b>9.997</b>	<b>12.902</b>	<b>15.858</b>	<b>2.258</b>

#### Minimum Revenue Provision (MRP) Policy Statement

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

DLUHC regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement;

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** - MRP will be charged, and therefore debt repaid over the expected useful life of the asset financed from borrowing based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

In applying the Asset Life Method MRP should normally follow the year after the expenditure has been incurred. However, in accordance with Statutory Guidance commencement of MRP may be deferred until the asset becomes operational.

The estimated useful life of assets will not exceed 50 years except as otherwise permitted by the guidance (and supported by valuer's advice). If no useful life can be attributed to the asset, i.e. land, then the estimated useful life will be taken as 50 years

- **Asset life method – Annuity Method**  
Under this approach the debt is repaid over the expected useful life of the asset financed from borrowing. For, regeneration schemes or administrative projects, where revenue benefits are only realised in future years or increase in future years, and will be based on an appropriate rate.
- **Loan Principal Repayment as Proxy for MRP**  
The council considers that where borrowing has funded capital loan advances, the loan principal repaid (or in the event of default the realisation of security) as a capital receipt will be utilised to repay the borrowing and therefore negates the requirement to set aside an annual MRP charge.
- **Borrowing for Non-Treasury Investments**  
Where the Council has previously borrowed for the acquisition of Commercial Investment Properties the Asset Life Method will be used to calculate the MRP charge applicable on an annual basis.
- **Finance Leases**  
MRP for finance leases and service concessions will be charged over the primary period of the lease, in line with the guidance.
- **Voluntary MRP Overpayments** – The Council has the ability to repay additional amounts for MRP as voluntary contributions as it considers appropriate. A change introduced by the revised DLUHC MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until 31 March 2021 the total VRP overpayments were £707k however, as there has been a change in our Policy to charge MRP on Commercial Investment assets, then this VRP will not be deemed an overpayment.

These options provide for a reduction in the borrowing need over approximately the asset's life.

### **Affordability Prudential Indicators**

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

**a. Ratio of Financing Costs to Net Revenue Stream**

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

%	2022/23	2023/24	2024/25	2025/26	2026/27
	Estimate	Estimate	Estimate	Estimate	Estimate
<b>Net Revenue Expenditure £m</b>	<b>15.203</b>	<b>14.728</b>	<b>15.258</b>	<b>15.757</b>	<b>16.613</b>
Interest Payable £m	0.452	0.955	0.978	1.002	1.002
Interest Receivable (-) £m	0.149	0.151	0.160	0.163	0.161
MRP £m	0.898	0.945	0.945	0.945	0.945
<b>Capital Financing Charges</b>	<b>1.499</b>	<b>1.951</b>	<b>2.083</b>	<b>2.110</b>	<b>2.108</b>
<b>Ratio</b>	<b>9.86%</b>	<b>13.25%</b>	<b>13.65%</b>	<b>13.39%</b>	<b>12.69%</b>

The estimates of financing costs include current commitments and the proposals in this budget report.

Interest receivable excludes interest from loans.

**b. Incremental Impact of Capital Investment Decisions on Council Tax**

This indicator identifies the revenue costs associated with proposed changes to the five year capital programme recommended in this budget report compared to the Council’s existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

New schemes funded from borrowing are expected to generate income/efficiencies to support the cost of borrowing therefore £0 impact on the Tax Payer.

Incremental impact of capital investment decisions on the band D council tax:

£	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
<b>Council tax - band D</b>	0	0	0	0	0

**Treasury Indicators for Debt**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby

managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. The Council is asked to approve the following treasury indicators and limits:

£m	2022/23	2023/24	2024/25
<b>Interest rate exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates:</b>			
• Debt only	100%	100%	100%
• Investments only	75%	75%	75%
<b>Limits on variable interest rates</b>			
• Debt only	25%	25%	20%
• Investments only	100%	100%	100%
<b>Maturity structure of fixed interest rate borrowing 2022/23</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years to 20 years	0%	100%	
20 years to 30 years	0%	100%	
30 years to 40 years	0%	100%	
40 years to 50 years	0%	50%	
<b>Maturity structure of variable interest rate borrowing 2022/23</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	0%	
5 years to 10 years	0%	0%	
10 years to 20 years	0%	0%	
20 years to 30 years	0%	0%	
30 years to 40 years	0%	0%	
40 years to 50 years	0%	0%	

## APPENDIX B

PWLB forecasts shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Group Interest Rate View 8.11.21														
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
<b>BANK RATE</b>	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.10	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.50	0.60	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	1.80	1.90	1.90	2.00	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.40
25 yr PWLB	2.10	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70
50 yr PWLB	1.90	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50

## APPENDIX C

### ECONOMIC BACKGROUND (as at November 2021)

#### MPC meeting 4<sup>th</sup> November 2021

- The Monetary Policy Committee (MPC) voted 7-2 to leave Bank Rate unchanged at 0.10% with two members voting for an increase to 0.25% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn by a vote of 6-3.
- After the Governor and other MPC members had made speeches prior to the MPC meeting in which they stressed concerns over inflation, (the Bank is now forecasting inflation to reach 5% in April when the next round of capped gas prices will go up), thus reinforcing the strong message from the September MPC meeting, financial markets had confidently built in an expectation that Bank Rate would go up from 0.10% to 0.25% at this meeting. However, these were not messages that the MPC would definitely increase Bank Rate at the first upcoming MPC meeting as no MPC member can commit the MPC to make that decision ahead of their discussions at the time. The MPC did comment, however, that Bank Rate would have to go up in the short term. It is, therefore, relatively evenly balanced as to whether Bank rate will be increased in December, February or May. Much will depend on how the statistical releases for the labour market after the end of furlough on 30<sup>th</sup> September 2021 turn out.
- Information available at the December MPC meeting will be helpful in forming a picture but not conclusive, so this could cause a delay until the February meeting. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would, therefore, need to wait until the May meeting (although it also meets in March) when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation expected around that time. If the statistics show the labour market coping well during the next six months, then it is likely there will be two increases in these three meetings.
- Over the next year the MPC will be doing a delicate balancing act of weighing combating inflation being higher for longer against growth being held back by significant headwinds. Those headwinds are due to supply shortages (pushing prices up and holding back production directly), labour shortages, surging fuel prices and tax increases. However, those headwinds could potentially be offset – at least partially - by consumers spending at least part of the £160bn+ of “excess savings” accumulated during the pandemic. However, it is also possible that more affluent people may be content to hold onto elevated savings and investments and, therefore, not support the economic recovery to the extent that the MPC may forecast.
- The latest forecasts by the Bank showed inflation under-shooting the 3 years ahead 2% target (1.95%), based on market expectations of Bank Rate hitting 1% in 2022. This implies that rates don't need to rise to market expectations of 1.0% by the end of next year.
- It is worth recalling that the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement after the MPC

meeting in September yet at its August meeting it had emphasised a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. On balance, once this winter is over and world demand for gas reduces - so that gas prices and electricity prices fall back - and once supply shortages of other goods are addressed, the MPC is forecasting that inflation would return to just under the 2% target.

- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
  1. Raising Bank Rate as "the active instrument in most circumstances".
  2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
  3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
  4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.
- **COVID-19 vaccines.** These have been the game changer which have enormously boosted confidence that **life in the UK could largely return to normal during the summer** after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread. There is also a potential for the winter flu season combined with Covid to overwhelm NHS hospitals so the UK is not entirely in the clear yet.
- **Since the September MPC meeting**, the economy has been impacted by rising gas and electricity prices which are now threatening to close down some energy intensive sectors of industry – which would then further impact the supply chain to the rest of the economy. Ports are also becoming increasingly clogged up with containers due to a shortage of lorry drivers to take them away. The labour market statistics for August released in mid-October showed a sharp rise in employment but also a continuing steep rise in vacancies. The combination of all these factors is a considerable headwind to a recovery of economic growth in the months ahead.

**US.** Shortages of goods and intermediate goods like semi-conductors, are fuelling increases in prices and reducing economic growth potential. It now also appears that there has been a sustained drop in the labour force which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023 while core inflation is likely to remain elevated at around 3% in both years instead of declining back to the Fed's 2% central

target. This could well cause the Fed to focus on supporting economic growth by delaying interest rate rises, rather than combating elevated inflation i.e., there may be no rate rises until 2023.

*See also comments in paragraph 3.3 under PWLB rates and gilt yields.*

**EU.** The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery is nearly complete although countries dependent on tourism are lagging. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

German general election. With the CDU/CSU and SPD both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SPD-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.

**China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. Supply shortages, especially of coal for power generation, which is causing widespread power cuts to industry, are also having a sharp disruptive impact on the economy. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

**Japan.** 2021 has been a patchy year in combating Covid. However, recent business surveys indicate that the economy is rebounding rapidly now that the bulk of the population is fully vaccinated and new virus cases have plunged. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was actually negative in July. New Prime Minister Kishida had promised a large fiscal stimulus package after the November general election which his party has now won.

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

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

### **Forecasts for PWLB Rates, Gilt and Treasury Yields**

As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

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

- How strongly will changes in gilt yields be correlated to changes in US treasury yields (see below). Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures actually turn out to be in both the US and the UK and so put upward pressure on treasury and gilt yields?

- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the “taper tantrums” in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

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

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden’s, and the Democratic party’s, determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the COVID-19 pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package already passed in December 2020. This was then followed by additional Democratic ambition to spend \$1trn on infrastructure, which has just been passed by both houses, and an even larger sum on an American families plan over the next decade; this is still caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy has been growing strongly during 2021.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash strong inflationary pressures. This could then force the Fed to take much earlier action to start increasing the Fed rate from near zero, despite their stated policy being to target average inflation.

**At its 3<sup>rd</sup> November Fed meeting**, the Fed decided to make a start on tapering QE purchases with the current \$80bn per month of Treasury securities to be trimmed by \$10bn in November and a further \$10bn in December. The \$40bn of MBS purchases per month will be trimmed by \$5bn in each month. If the run-down continued at that pace, the purchases would cease entirely next June but the Fed has reserved the ability to adjust purchases up or down. This met market expectations. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that Treasury yields would rise as a consequence over the taper period, all other things being equal. However, on the inflation front it was still insisting that the surge in inflation was “largely” transitory. In his post-meeting press conference, Chair Jerome Powell claimed that “the drivers of higher inflation have been predominantly connected to the dislocations caused by the pandemic” and argued that the Fed’s tools cannot address supply constraints. However, with the Fed now placing major

emphasis on its mandate for ensuring full employment, (besides containing inflation), at a time when employment has fallen by 5 million and 3 million have left the work force, resignations have surged due to the ease of getting better paid jobs and so wage pressures have built rapidly.

With wage growth at its strongest since the early 1980s, inflation expectations rising and signs of a breakout in cyclical price inflation, particularly rents, the FOMC's insistence that this is still just a temporary shock "related to the pandemic and the reopening of the economy", does raise doubts which could undermine market confidence in the Fed and lead to higher treasury yields.

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

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

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

#### **A New Era – A Fundamental Shift in Central Bank Monetary Policy**

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

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.
- **For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.**
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices,

the rise of the gig economy and technological changes, will all help to lower inflationary pressures.

- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

## APPENDIX D

### TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The DLUHC issued Investment Guidance in 2018, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the code on 01/03/2010 and will apply its principles to all investment activity. In accordance with the Code, the Assistant Director of Finance, Business Support and Property Services has produced its treasury management practices (TMPs). This part, TMP 1 (1) covering investment counterparty policy requires approval each year.

Annual investment strategy – The key requirement of both the Code and investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

**Strategy guidelines** – The main strategy guidelines are contained in the body of the treasury strategy statement.

**SPECIFIED INVESTMENTS:** These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. They also include investments which were originally classed as being non-specified investments, but which would have been classified as specified investments apart from originally being for a period longer than 12 months, once the remaining period to maturity falls to under twelve months. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

- 1) The UK Government (such as Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
- 2) Supranational bonds of less than one year's duration
- 3) A local authority, housing association, parish council or community council
- 4) Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard & Poors, Moody's and/or Fitch rating agencies

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are set out in the main report.

**NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the specified investment criteria. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investment would include any sterling investments with:

	<b>Non Specified Investment Category</b>	<b>Limit £</b>
A	<b>Gilt Edged Securities</b> with a maturity of greater than one year. These are Government Bonds and so provide the highest security of investment and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£5m
B	<b>The Council's own banker</b> if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as possible	£1m
C	<b>Any Bank or Building Society</b> that has a minimum long term credit rating of AA, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£2m
D	Enhanced Money Market Funds AA rated	£2m
E	Corporate Bond Funds	£2m
F	Local/Community Bonds	£2m
G	Local Authority Property Asset Fund	£4m
H	Certificates of Deposit	£2m

I	Covered Bonds	£1m
J	Property Funds – The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using	£4m

This Authority will seek further advice on the appropriateness and associated risks with investments in these categories.

The monitoring of investment counterparties – The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Assistant Director of Finance, Business Support and Property Services, and if required new counterparties which meet the criteria will be added to the list.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

## APPENDIX E

### APPROVED COUNTRIES FOR INVESTMENTS (As at 10.11.2021)

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

#### ***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 F**

### **TREASURY MANAGEMENT SCHEME OF DELEGATION**

#### **(i) Full Council**

- Receiving and reviewing reports on treasury management policies, practices and activities;
- Approval of annual Treasury Management Strategy and Mid-Year Review Treasury Management Indicators.

#### **(ii) Corporate Policy and Resources Committee**

- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- Approval of the division of responsibilities;
- Receiving and reviewing regular monitoring reports and acting on recommendations;
- Approving the selection of external service providers and agreeing terms of appointment.
- Mid-Year Review of Treasury Management Indicators

#### **(iii) Governance and Audit Committee**

- Review and scrutiny of the Treasury Management Strategy, policy and procedures and making recommendations to the full Council.

## APPENDIX G

### THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- Submitting regular treasury management policy reports;
- Submitting budgets and budget variations;
- Receiving and reviewing management information reports;
- Reviewing the performance of the treasury management function;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- Preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- Ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- Ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- Ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- Ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- Ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- Provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- Ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- Ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- Creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following: -
  - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
  - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
  - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements

for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;

- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

## **APPENDIX H**

### **CAPITAL INVESTMENT STRATEGY 2022/23 – 2026/27**

#### **1. Introduction**

The Council is required to approve a Capital Investment Strategy in accordance with the Prudential Code for Capital Finance in Local Authorities.

The Capital Investment Strategy provides a high level overview of how capital investment, capital financing and treasury management activity supports the provisions of services. It considers associated risks and how they are managed and ensures that future financial implications are identified to inform future year's budgets and financial sustainability.

The Strategy forms part of the Council's overall Corporate Planning Framework. It provides a mechanism by which the Council's capital investment and financing decisions can be aligned with the Council's corporate priorities and objectives over a medium term (five year) planning horizon and ensures that the revenue implications of investments are both affordable and sustainable.

The strategy provides a framework for determining the relative importance of individual capital projects. It defines how the capital programme is to be formulated, and it identifies issues and options that influence revenue and capital spending, and sets out how the resources will be managed.

Key elements of the strategy;

- Ensures investments meet our Corporate Plan objectives
- Incorporates the requirements of the Asset Management Plan
- Enables the development of a Capital Investment Programme over the medium term (5 years)
- A framework which will identify priorities for the use of resources for investment.
- Decisions are based on sound business cases.
- Risks are identified and mitigated where possible
- Directly links to the Treasury Management Strategy ensuring an affordable and sustainable Capital Investment Programme in adherence to legislation and the Prudential Code.
- Informs the Medium Term Financial Plan by identifying the revenue impacts of investment decisions.
- Incorporates an annual review to ensure the programme still meets our priorities.
- Considers innovative solutions to funding.

#### 1. Principles Supporting the Capital Investment Strategy

##### a) Strategy Principles

- The investment programme will support the Council's strategic priorities, therefore, the capital investment programme will link to all key strategic

planning documents: specifically the Corporate Plan, Executive Business Plan, Medium Term Financial Plan and the Asset Management Plan.

- Schemes within the programme will be prioritised on an authority wide basis and the process of assessing investments, against specific criteria, will optimise the benefit and relative importance of potential schemes.
- Responsible Investing (RI) - investing in opportunities that seek to generate both financial value and sustainable growth,
- Socially responsible investing (SRI), also known as sustainable, socially conscious, "green" or ethical investing (ESG), as well as any investment strategy which seeks to consider both financial return and social good.

#### b) Capital Investment Policy

The Capital Investment Strategy will be underpinned by a Land and Property Investment Policy. The policy does not describe detailed operational investment activity but does describe the framework, and principal [underlying] considerations, which the Council will follow when reviewing and subsequently agreeing investment opportunities. It is designed to support the goals and objectives as outlined in the Corporate Plan, the general objectives of a UK public sector service provider and the very specific aims; goals and aspirations of the Council members; executive officers and their teams.

#### c) Finance Principles

- The overarching principal is the commitment to achieve affordable capital investments over the longer term.
- To pursue all available external funding options and opportunities for leverage of external resources.
- Ensure evaluation for value for money investments by whole life costing (where applicable) and by having robust Business Cases with full financial modelling, and appropriate due diligence in estimates in order to inform the full financial implications
- To develop partnerships, including the pursuit of shared services, joint ventures and community arrangements, where appropriate, to achieve the Council's investment aspirations and value for money.
- Monitoring and evaluation of approved budgets will form part of the quarterly budget monitoring reports.
- Monitoring and evaluation of approved Programmes and projects will form part of Performance Management.
- Encourage community engagement by informing on priorities and consultation on proposals.
- To invest in non-treasury activities to support ongoing sustainability in the delivery of services.
- Regularly review Business Cases as schemes are developed and update financial models to inform future budget impacts.

#### d) Asset Management Principles

### **The Asset Management Policy ensures that;**

- We will take all reasonable and practical steps to ensure the health, safety and wellbeing of staff, visitors and contractors who use or visit our buildings, land or property and who use or are in contact with supporting asset infrastructure.
- We will ensure that all our buildings and land and property assets are fully compliant with current legal requirements, are fit for purpose and managed and maintained in accordance with best practice.
- We will ensure that infrastructure supporting our physical assets is safe and fully compliant with relevant legislative and regulatory requirements.
- All activity on our assets will be carried out in compliance with relevant legislative and statutory requirements.
- We will assess asset related risks and manage such risk in accordance with our corporate risk management policy or in accordance with procedures relevant to the specific asset, its use and function.
- We will retain and/or acquire physical assets which are appropriate to our business and function and dispose of those assets which are not fit for purpose or which cannot support our business or investment criteria.
- We shall continue to actively develop our asset management systems; processes and procedures in a way which is appropriate; efficient; transparent and sustainable and which supports the best management outcomes for our physical assets.
- We shall continue to train and develop staff across the asset management discipline and apply technology and innovation where practical.
- We shall seek continual improvement of our management capability and activities to ensure value for money for all stakeholders.

### **3. Capital Investment Priorities**

The Council's proposed Capital Investment Programme 2022/23 will support the Corporate Plan's key themes;

- Our People – Health and Wellbeing, Leisure, Skills, Vulnerable Groups and Communities
- Our Place – Economic Growth, External Investment, Social Regeneration, Infrastructure, Enhanced Environment
- Our Council – Finances, Structures, Partnerships, Policies, Governance

The Council's financial planning process ensures that the decisions about the allocation of capital and revenue resources are taken to achieve a corporate and consistent approach. The key corporate documents and relevant linkages with this strategy include;

- The Corporate Plan – priorities for the medium term
- The Medium Term Financial Plan - incorporates the Financial Strategy, revenue budget financial impacts of capital investment decisions.
- The Reserves Strategy- prioritises the use of reserves for capital and revenue purposes.
- The Treasury Management Strategy (including Investment Strategy) informs the affordability and sustainability of prudent investment decisions.
- The Commercial Portfolio Strategy – informs how acquisitions of investment properties will be made on a risk based approach
- The Value for Money Strategy – Ensuring VFM is achieved from investment decisions.
- The Housing Strategy – Supporting housing growth and regeneration within the district.
- The Land and Property Investment Strategy -
- The Asset Management Policy – Investment needs of our own land and property holdings
- Service Plans – Investment need for delivery of quality services

#### 4. The Capital Investment Strategy Process

The strategic approach to revenue and capital investment decisions needs to be formalised to ensure that our resources are directed to the most appropriate schemes which both deliver our corporate priorities and which are based on sound business cases. Assessment and prioritisation of capital investments schemes are based on uniform criteria.

Therefore the Capital Investment Strategy Process has been developed which will ensure that prioritisation of investments are directed to deliver Corporate Objectives and delivery of the Executive Business Plan and Service Business Plans in addition to generating returns to support delivery of core services.

The process for includes:

- Review existing Capital Programme, timing, budget requirements etc.
- Annual review of existing Projects
- Asset Management Plan – detailed costs of required investment in property portfolio and property assets to be disposed.
- Review of asset replacement programmes
- Consideration of financing availability i.e. Earmarked Reserves, Grant funding, Capital Receipts and Prudential Borrowing
- Business Planning – identifying new schemes and projects for evaluation both capital and revenue.
- Evaluation of all proposed schemes against scoring matrix.
- Consider core service funding requirements and opportunities to invest in non-Treasury assets to generate returns

The final approved Capital Investment Programme and its financial implications, are included within the Medium Term Financial Plan, submitted to the Council annually in March for approval.

Fully costed and appraised business cases for each scheme will be presented to a relevant Board for consideration prior to any decision being made.

The Capital Programme consists of 4 levels of activity;

Pre-Stage 1 – Business Case in preparation

Stage 1 – Budget approved – requires full business case

Stage 2 – Business case approved in principal or awaiting funding

Stage 3 and Business as Usual (BAU) – Approved to spend and funding secured

The investment and the ongoing revenue implications of each scheme are ascertained from the financial implications and appraisals within the business case.

The Capital Investment Value is assessed against the capital definition, and deminimis limits (£10k).

Revenue Implications – include the impact on revenue budgets for running costs/additional staffing etc. and the impact of the cost of borrowing or loss of investment interest if capital receipts and revenue reserves are to be utilised.

## 5. Governance of the Capital Investment Programme

In accordance with the Constitution and governance arrangements, the Council reviews its capital requirements and determines its Capital Programme within the framework of the MTFP and as part of the annual budget process. Resource constraints mean the Council continually needs to prioritise expenditure in light of its aims and priorities and considers alternative solutions.

To ensure that available resources are allocated optimally, capital programme planning is determined in parallel with service and revenue budget planning processes within the frame work of the MTFP.

New programmes of expenditure will be appraised following a clearly defined Business Case gateway process.

The Council will approve in principal the Capital Investment Programme, and will approve the release of funding for replacement and renewal programmes. This is undertaken annually in March as part of budget setting and the approval of the Medium Term Financial Plan.

The Governance and Audit Committee will provide assurance on this Capital Investment Strategy.

Corporate Policy and Resources Committee will be responsible for approving release of funding for the Capital Investment Programme and will therefore receive reports for each scheme detailing the business case, cost, proposed funding and revenue implications.

Corporate Policy and Resources Committee will receive quarterly monitoring and update reports which may include details of;

- New capital investment schemes
- Slippage in programme delivery
- Programmes removed or reduced
- Virements (budget movements) between schemes
- Revisions in spend profile
- Overspending
- Capital acquisitions and disposals
- Loan advances and outstanding loan balances

Progress on specific programmes will also be monitored in relation to projects through the Performance Monitoring reporting framework.

The Programme Board will receive monthly highlight reports

The Management Team will receive quarterly monitoring reports and any exception reporting.

Budget Managers will receive monthly monitoring reports.

## 6. Capital Financing

The funding of Capital schemes can come from a number of resources, the use of external resources will take precedent;

- Prudential borrowing
- Revenue contributions and Earmarked Reserves
- Capital Receipts
- External grants and contributions (including S106 and Community Infrastructure Levies (CiL))
- Leasing
- Other sources – i.e. partnerships or private sector involvement

This strategy, the outcomes of which will inform the MTFP, is intended to consider all potential funding options available to the Council and to maximise the financial resources available for investment in corporate priorities and service provision and improvement.

To deliver our strategic objectives, especially in relation to economic and housing growth, regeneration, in addition to investment in commercial property which is designed to provide a revenue return, significant levels of investment will be required, which will result in a borrowing need.

## 7 Prudential Borrowing

The Council has discretion to undertake Prudential borrowing to fund capital projects with the full cost of that borrowing (interest and minimum revenue provision) being funded from Council revenue resources and/or capital receipts. This discretion is subject to complying with the Code's regulatory framework which essentially requires any such borrowing to be prudent, affordable and

sustainable. Prudential borrowing provides an option for funding additional capital development however it has to be funded each year from within the revenue budget and by generating additional ongoing income streams from the investment.

Given the pressure on the Council's revenue budget in future years, prudent use will be made of this discretion in cases and only where there is a clear financial benefit, such as "invest to save", "invest to earn". Consideration will only be given to commercial investments where returns are expected to be higher than the revenue costs of the debt, provision of loans where principal repayments will be utilised as proxy for MRP, borrowing or major regeneration schemes which do not increase revenue expenditure levels in the longer term but provide a beneficial economic and or social impact.

The Council will remain cautious and prudent in the extent of prudential borrowing undertaken to fund new capital investment.

Where prudential borrowing is utilised to fund Capital Investment, financial implication considerations will be provided including the risks and opportunities of the investment over both the payback period and over the repayment period of any debt taken out.

## 8 Revenue Contributions and Earmarked Reserves

Our continued prudent approach is to set aside revenue resources to fund capital replacement programmes and asset management funding.

New Homes Bonus Grant will continue to be set aside for the purpose of investment in growth and regeneration (economic and housing) and this strategy has been included in the MTFP.

We will consider future Earmarking of Reserves for service investment needs, invest to save and invest to earn projects and enhancements to our own property assets, in addition to consideration of revenue contingencies, volatility and budget smoothing.

Our own resources will therefore be utilised to fund those schemes which provide a Socio-Economic return on investment, invest to save schemes which achieve efficiencies, and investment in our operational service asset needs.

## 9 Capital Receipts

Capital receipts generated from the following sources and where appropriate utilised as detailed.

- Loans principal repayments – used to repay prudential borrowing
- Receipts from Asset Disposal (operational property assets or surplus land)
- Commercial Portfolio Properties – repayment of borrowing
- Share of RTB Housing Transfer Agreement – future investment
- Insurance settlements – replacement of asset

## 10 External Grants and contributions (incl S106 and Community Infrastructure Levy (CiL))

The Council will actively pursue grants and contributions and other innovative solutions to funding of capital investment schemes. This funding will be utilised in the first instance.

## 11 Leasing

The use of leasing will be undertaken where alternative funding is not available for vehicles or minor equipment and the revenue budget does not allow for a full capital repayment. Where there is a robust business case then the option of leasing may be considered.

## 12 Other Sources of Funding

There are a range of other potential funding sources which may be generated locally either by the Council itself or in partnership with others i.e. a growing number of private organisations are showing interest where clear joint benefits exist. Each case will be subject to specific financial appraisals and appropriate governance arrangements.

## 13. Investment in Commercial Properties (Non Treasury Investments)

Any acquisition of Commercial Properties will be in accordance with the Commercial Portfolio Strategy and are being acquired to support delivery of services in a financially sustainable organisation. Up to £30m has been approved for investment in Commercial Property in support and protection of Council Services.

Appropriate experts are engaged as required.

All assets will be assessed against a set criteria and the Chief Executive and the Leader of the Council have delegated Authority to complete on the acquisition of assets which score 50 or more out of 70. Any asset which falls below this threshold or registers a zero against any criteria may still be considered but specific justification will need to be provided and the decision to proceed taken to the Corporate Policy and Resources Committee for approval.

An annual review will be undertaken of the Commercial Property Portfolio to ascertain whether its fair value is sufficient to provide security against loss against the capital investment, and therefore adequate to meet the cost of outstanding borrowing.

Under the Minimum Revenue Provision (MRP) Policy, there will be no annual MRP charge for borrowing undertaken to finance Commercial Properties. However voluntary MRP will be considered on an annual basis if appropriate.

A Valuation Volatility Earmarked Reserve has been created with a target balance of 5% of purchase price of the portfolio, which will reduce to 3% over

the medium term, reflecting the introduction of an annual MRP charge to reduce outstanding prudential borrowing. This will help mitigate any financial loss of investment upon the sale of an asset should there be any shortfall against outstanding debt. A proportion of the annual revenue income generated from the investment will be allocated for risk provision.

A Commercial Contingency revenue base budget is also included within the MTFP to mitigate the risk of not achieving the desired level of yield from the Portfolio in year.

These investment assets are not deemed to be liquid over the short term but are likely to be held for the medium term of 5-10 years.

A number of prudential indicators in relation to these investments are contained within the Treasury Management Strategy and will be monitored throughout the year.

#### 14. Risk

All capital projects have a risk register, with all risks affecting the project considered.

A specific risk of capital investment is the impact on the Council's VAT partial exemption (recovery of exempt VAT up to 5% of overall VAT). If exempt VAT exceeds 5% the whole amount is then irrecoverable. Each scheme is therefore assessed for its impact

#### 15. Conclusion

The Capital Investment Strategy is a working document, which enables the Council to make informed rational capital investment decisions to achieve its corporate priorities and objectives. It provides a framework for determining the relative importance of individual projects.

The strategy will be reviewed annually to ensure that it remains relevant and effective.