ASSEMBLY

2 March 2022

Title: Treasury Management Strategy Statement 2022/23	
Report of the Cabinet Member for Finance, Performance and Core Services	
Open Report	**For Decision**
Wards Affected: None	**Key Decision:** Yes
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Summary

This report deals with the Treasury Management Annual Strategy Statement (TMSS), Treasury and Prudential Indicators, Annual Investment Strategy (AIS) and borrowing limits, in compliance with Section 15(1)(a) of the Local Government Act 2003.

The production and approval each year of a TMSS and AIS are requirements of the Council under Section 15(1) of the Local Government Act 2003. It is also a requirement of the Act to set an authorised borrowing limit for the forthcoming financial year.

The Local Government Act 2003 also requires the Council to have regard to the Prudential Code, and to set prudential indicators which consider the Council's capital investment plans for the next three years.

Revisions to the Prudential Code were made in 2017. The main change was the inclusion of the Capital Strategy 2022/23. The Capital Strategy is largely driven by the Council's Investment and Acquisition Strategy, which will be revised in April 2022 and will be based on the Be First Business Plan, which is due to come to Cabinet in April 2022. Changes to the Prudential Code and Treasury Management were published in December 2021. There are a number of key changes, including reporting changes, and these will be fully implemented for the 2023/24 TMSS.

This report was considered and endorsed by the Cabinet at its meeting on 21 February 2022.

Recommendation(s)

The Assembly is recommended to adopt the Treasury Management Strategy Statement for 2022/23 and, in doing so, to:

(i) Note the current treasury position for 2022/23 in section 4 and prospects for interest rates, as referred to in section 8 of the report;

(ii) Approve the Annual Investment Strategy 2022/23 outlining the investments that the Council may use for the prudent management of its investment balances, as set out in Appendix 1 to the report;

(iii) Approve the Council's Borrowing Strategy 2022/23 to 2024/25, as set out in Appendix 2 to the report;

(iv) Note that the Capital Strategy 2022/23, incorporating the Investment and Acquisitions Strategy, shall be updated and presented for approval in April 2021;

(v) Approve the Capital Prudential and Treasury Indicators 2021/22 – 2024/25, as set out in Appendix 3 to the report;

(vi) Approve the Operational Boundary Limit of £1.60bn and the Authorised Borrowing Limit of £1.70bn for 2022/23, representing the statutory limit determined by the Council pursuant to section 3(1) of the Local Government Act 2003, as referred to in Appendix 3 to the report;

(vii) Approve the Minimum Revenue Provision Policy Statement for 2022/23; the Council's policy on repayment of debt, as set out in Appendix 4 to the report;

(viii) Note that changes made to the Prudential Code and Treasury Management code, published in December 2021, will be fully implemented for the 2023/24 TMSS; and

(ix) Delegate authority to the Finance Director, in consultation with the Cabinet Member for Finance, Performance and Core Services, to proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement to consider the increase in short-term cash held from borrowing.

Reason(s)

To enable the Council to accord with the requirements of the Local Government Act 2003.

1. Introduction and Background

1.1 The Council is required to operate a balanced budget, with cash raised during the year sufficient to meet the Council's cash expenditure. Treasury management supports the Council by seeking to ensure its cash flow is adequately planned, with cash being available when it is needed. Surplus cash is invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate security and liquidity while also considering the investment return.

1.2 A second function of treasury management is funding 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.

1.3 The Council is responsible for its treasury decisions, activity and risk appetite. The successful identification, monitoring and control of risk are integral elements of treasury management, including credit and counterparty risk, liquidity risk, market risk, interest risk, refinancing risk and legal and regulatory risk. The Council is statutorily required to approve the Treasury Management Strategy Statement (TMSS) prior to the new financial year.

2. Treasury Management Reporting Requirements

2.1 The Council is required to receive and approve at least three main treasury reports each year. These reports are required to be adequately scrutinised by Cabinet before being recommended to the Council. The three main treasury reports are:

i. **The TMSS** is the most important report and considers the impact of the Council's proposed Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position, the Prudential Indicators (PIs) and the outlook for interest rates. In addition, the current market conditions are factored into any decision-making process.
ii. **A Mid-Year Treasury Management Report** to update Members on the progress of the capital position, amending PIs and investment strategy as necessary.
iii. **An Annual Treasury Report** which outlines the actual PIs, treasury indicators and treasury operations compared to the estimates within the strategy.

2.2 As the Council is responsible for housing, PIs relating to capital expenditure, financing costs and the Capital Financing Requirement (CFR) are split between the Housing Revenue Account (HRA) and the General Fund (GF). The impact of new capital investment decisions on housing rents will also need to be considered.

2.3 This report provides an explanation of the key elements of the Council's TMSS, its Minimum Revenue Provision (MRP) Strategy, the Annual Investment Strategy (AIS) for 2022/23 and the Borrowing Strategy, which are set out in detail in the appendices attached to this report

3. Treasury Management Strategy Statement for 2022/23

3.1 The strategy for 2022/23 covers two main areas, including Treasury Management and Capital Strategy Reporting issues. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Ministry of Housing, Communities and Local Government's (MHCLG) MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

3.2 Treasury Management Issues

- Current Portfolio Position at 31 December 2021 (section 4);
- Medium Term Capital Finance Budget (section 5);
- Treasury Position at 31 December 2021; forward projections 2024/25 (section 6);
- Economic Update (section 7);
- Interest rate forecast (section 8);
- Investment and Borrowing Rates (section 9);
- The Capital Expenditure Plans 2021 to 2024/25 (section 10);
- Treasury Management Advisors (section 11);
- Minimum Revenue Provision Policy Statement (section 12);
- Appendix 1 – Annual Investment Strategy 2022/23;
- Appendix 2 - Borrowing Strategy 2022/23 to 2025/26;
- Appendix 3 – The Capital Prudential and Treasury Indicators 2022/23 – 2025/26;

- Appendix 4 – Minimum Revenue Provision Policy Statement 2022/23; and
- Appendix 5 – Scheme of Delegation and Section 151 Officer Responsibilities

3.3 Capital Strategy Reporting Requirements

3.3.1 The CIPFA revised 2017 Prudential and Treasury Management Codes require all local authorities to prepare an additional report, a Capital Strategy Report (CSR), which will provide 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; and the implications for future financial sustainability.

3.3.2 The aim of this CSR is to ensure that Members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

3.3.3 The Council already has an IAS, which forms the basis of the CSR. In addition to the IAS, the Capital Strategy includes a Borrowing Strategy (appendix 2) and an MRP Policy (appendix 4), that include additional details on the borrowing and debt repayment. These documents provide details of the Capital Strategy and includes:

- 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.

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

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

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

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

3.3.8 On 20 December 2021, updates to the Prudential Code and Treasury Code were published and is effective from the publish date, and includes borrowing for yield, which is now no longer allowed. The implementation of the changes can be within the 20223/24 TMSS and this is the approach that this Council will follow.

3.3.9 Overall the impact of the changes will require addition reporting but the impact on the Council will be limited as the Council does not invest for yield, with any commercial purchases part of regeneration within the borough. Advice is being obtained on the income strip deals the Council holds, although the changes are not retrospective.

4. Current Portfolio Position at 31 December 2021

4.1 The Council holds cash balances from its operational activities, which are offset by expenditure to run services. The timing of these cash flows can result in surplus cash which is then invested. Cash balances are also affected by working capital.

4.2 These balances are made up of the following sources of cash:

- Capital grants and Section 106 funds received in advance of expenditure;
- General Fund, HRA and School cash balances;
- Earmarked Reserves, provisions, Capital Receipts and Working Capital;
- Borrowing (Financial Institutions and PWLB)

4.3 Table 1 shows the Council's investments, loans and borrowing at 31 December 2020 and 31 December 2021, including Average Life and Average Rate of Return.

Table 1: Treasury Position at 31 December 2020 and 31 December 2021

	Principal £000s	Return %	Average Life (yr)		Principal £000s	Return %	Average Life (yr)
General Fund Fixed Rate Long Term Borrowing							
PWLB	512,490	2.06	25.83		635,780	1.92	29.27
European Invest. Bank	79,363	2.21	23.3		76,820	2.21	22.26
DEXIA BANK LOBO	10,000	3.98	56.5		10,000	3.98	55.53
L1 RENEWABLES	6,803	3.44	25.76		6,782	3.44	24.76
Total GF Debt	**608,656**	**2.13**	**26**		**729,382**	**1.99**	**28.85**
General Fund Fixed Rate Short Term Borrowing							
Local Authority ST	**92,000**	**0.20**	**0.11**		**55,000**	**0.03**	**0.13**
Total GF Debt	**700,656**	**1.87**	**22.6**		**784,382**	**1.85**	**26.83**
HRA Fixed Rate Borrowing							
PWLB	265,912	3.50	35.1		265,912	3.50	34.05
Market Loans	30,000	4.03	44.96		30,000	4.03	43.99
Total HRA Debt	**295,912**	**3.55**	**36.06**		**295,912**	**3.55**	**35.06**
Total Borrowing	**996,568**	**2.37**	**26.6**		1,080,294	2.32	29.09
MMF / Cash	76,490	0.10	-		74,200	0.24	28.85
Local Authority Deposit	163,250	1.65	1.07		95,250	1.64	0.76
Bank Deposit	15,500	1.52	0.89		55,500	0.81	0.80
Loans	132,379	4.20	Various		167,289	3.57	Various
Total Investments	**387,619**	**2.21**	**Various**		**392,239**	**2.08**	**Various**

4.4 The debt is split between HRA and GF borrowing to match the two pool approach the Council has adopted for borrowing. The Council invests all cash in one investment pool, with interest distributed between the HRA, schools and GF. The elevated short-term cash position is due to £100m borrowed towards the end of December 2021, which will reduce as short-term borrowing is repaid.

5. Medium Term Capital Finance Budget

5.1 A key part of the Council's budget strategy is the medium-term capital finance budget shown in Table 2. It is a statutory requirement that the level of borrowing is kept under review and is affordable. Due to the Council's IAS, it is likely that the Council's cash position will significantly reduce over the next few years as a result of utilising the Council's reserves and using cash balances to fund property investments. Table 2 also includes the MRP budget, IAS and HRA interest costs.

5.2 The significant increase in GF Interest Payable is due to the borrowing required to fund the Council's IAS. The medium-term capital financing budget to 2024/25 is shown in table 2. The investment strategy income is a fixed amount currently, but this potentially will change as schemes become operational. MRP excludes the IAS and PFI schemes, with MRP being replaced by debt repayment of loans to Reside or from the lease cashflows. In future reports this will be included as a separate line in the table below. Interest costs are expected to net off as borrowing increases but interest income from the IAS nets it off. The figures below do not include capitalised interest.

Table 2: Medium Term Capital and Treasury Budget

£'000s	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
MRP	8,658	9,058	9,458	9,858
Net Interest Budget	7,090	6,890	6,690	6,490
Investment Income	-6,587	-6,587	-6,587	-6,587
Net GF Cost	**9,161**	**9,361**	**9,561**	**9,761**
HRA Interest Payable	10,059	10,059	10,059	10,059
Total Cost	**19,220**	**19,420**	**19,620**	**19,820**

** Additional MRP for operational residential schemes will offset against and increase in investment income*

6. Treasury Position Forward Projections to 2024/25

6.1 The Council's treasury forward projections are summarised in table 3. The table shows the estimated external debt against the underlying CFR, highlighting any over or under borrowing. The CFR and gross debt includes a significant increase in borrowing to fund the IAS. To ensure borrowing is only for a capital purpose Gross Debt should, except in the short term, be below the CFR over the period.

Table 3: Treasury Position at 31 December 2019, with Forward Projections

Gross Debt Movement 2022/23 to 2024/25	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
External Debt	**£000s**	**£000s**	**£000s**
Debt at 1 April	1,063,850	1,313,850	1,613,850
Expected Change in Debt	250,000	300,000	200,000
Finance Lease and PFI	200,365	270,365	266,906
Gross Debt at 31 March	**1,514,215**	**1,884,215**	**2,080,756**
CFR	1,722,650	1,972,571	2,087,833
Under / (Over) Borrowing	**-138,434**	**-91,815**	**-10,845**

7. Economic Update (from Link Asset Management)

7.1.1 United Kingdom

COVID-19 vaccines. These were the game changer during 2021 which raised hopes that the UK would be able to return to normal in the second half of the year. However, the Omicron mutation at the end of November dashed such hopes and raises the spectre again that a fourth wave of the virus could overwhelm hospitals in early 2022. Rather than go for full lockdowns which heavily damage the economy, the government strategy this time is focusing on getting as many people as possible to have a booster vaccination as a booster has been shown to restore a high percentage of immunity to Omicron. There is a race on between how quickly boosters can be given to limit the spread, and how quickly will hospitals fill up and be unable to cope. In the meantime, workers have been requested to work from home and restrictions have been placed on large indoor gatherings and hospitality venues. With some household saving rate having been high since the first lockdown, there is pent-up demand and purchasing power for services in sectors like restaurants, travel, tourism and hotels which had been hit hard during 2021, but could now be hit hard again by either, or both, of government restrictions and/or consumer reluctance to leave home. Growth will also be lower due to people being ill and not working. The economy faces headwinds although some sectors have learned how to cope well with Covid, with the biggest impact on growth from another lockdown. The big question remains as to whether any further mutations could 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.

7.1.2 **US.** Shortages of goods and intermediate goods have fuelled increases in prices and reducing economic growth potential. In November, **CPI inflation hit a near 40-year record level of 6.8%** but with energy prices then falling, this may be the peak. The biggest problem for the Fed is the mounting evidence of a strong pick-up in cyclical price pressures e.g., in rent which has hit a decade's high. Inflation hitting 6.8% and the feed through into second round effects, meant that it was near certain that the **Fed's meeting of 15th December** would take aggressive action against inflation. Accordingly, the rate of tapering of monthly $120bn QE purchases announced at its November 3rd meeting. was doubled so that all purchases would now finish in February 2022. In addition, Fed officials had started discussions on running down the stock of QE held by the Fed. Fed officials also expected three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy. The first increase could come as soon as March 2022.

Shortages of labour have also been driving up wage rates sharply; this also poses a considerable threat to feeding back into producer prices and then into consumer prices inflation. It now also appears that there has been a sustained drop in the labour force which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023 while core inflation is likely to remain elevated at around 3% in both years instead of declining back to the Fed's 2% central target.

7.1.3 **EU.** The slow role out of vaccines initially delayed **economic recovery** in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery was then within 0.5% of its pre Covid size. However, the arrival of Omicron is now a major headwind to growth in quarter 4 and the expected downturn into weak growth could well turn negative, with the outlook for the first two months of 2022 expected to continue to be very weak.

November's inflation figures breakdown shows that the increase in price pressures is not just due to high energy costs and global demand-supply imbalances for durable goods as services inflation also rose. Headline inflation reached 4.9% in November, with over half of that due to energy. However, oil and gas prices are expected to fall after the winter and so energy inflation is expected to plummet in 2022. Core goods inflation rose to 2.4% in November, its second highest ever level, and is likely to remain high for some time as it will take a long time for the inflationary impact of global imbalances in the demand and supply of durable goods to disappear. Price pressures also increased in the services sector, but wage growth remains subdued and there are no signs of a trend of faster wage growth which might lead to *persistently* higher services inflation - which would get the ECB concerned. The upshot is that the euro-zone is set for a prolonged period of inflation being above the ECB's target of 2% and it is likely to average 3% in 2022.

ECB tapering. The ECB has joined with the Fed by also announcing at its meeting on 16th December that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases for over half of next year. However, as inflation will fall back sharply during 2022, it is likely that it will leave its central rate below zero, (currently -0.50%), over the next two years. The main struggle that the ECB has had in recent years is that inflation has been doggedly anaemic in sticking below the ECB's target rate despite all its major programmes of monetary easing by cutting rates into negative territory and providing QE support.

The ECB will now also need to consider the impact of **Omicron** on the economy, and it stated at its December meeting that it is prepared to provide further QE support if the pandemic causes bond yield spreads of peripheral countries, (compared to the yields of northern EU countries), to rise. However, that is the only reason it will support peripheral yields, so this support is limited in its scope.

The EU has entered into a **period of political uncertainty** where a new German government formed of a coalition of three parties with Olaf Scholz replacing Angela Merkel as Chancellor in December 2021, will need to find its feet both within the EU and in the three parties successfully working together. In France there is a presidential election coming up in April 2022 followed by the legislative election in June. In addition, Italy needs to elect a new president in January with Prime Minister Draghi being a favourite due to having suitable gravitas for this post. However, if he switched office, there is a significant risk that the current government coalition could collapse. That could then cause differentials between Italian and German bonds to widen when 2022 will also see a gradual running down of ECB support for the bonds of weaker countries within the EU. These political uncertainties could have repercussions on economies and on Brexit issues.

7.1.4 **CHINA.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of **2020**; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021.

However, the pace of economic growth has now fallen back in **2021** after this initial surge of recovery from the pandemic and looks likely to be particularly weak in 2022. China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns, which depress economic growth. Chinese consumers wary about leaving home and spending money on services. However, with Omicron having now spread to China, and being much more easily transmissible, this strategy of sharp local lockdowns to stop the virus may not prove so successful in future. In addition, the current pace of providing boosters at 100 billion per month will leave much of the 1.4 billion population exposed to Omicron, and any further mutations, for a considerable time. The **People's Bank of China** made a start in December 2021 on cutting its key interest rate marginally to stimulate economic growth. However, after credit has already expanded by around 25% in just the last two years, it will leave the heavy lifting in supporting growth to fiscal stimulus by central government.

7.1.5 **JAPAN.** 2021 has been a patchy year in combating Covid. However, recent business surveys indicate that the economy has been rebounding rapidly in 2021 once the bulk of the population had been double vaccinated and new virus cases had plunged. However, Omicron could reverse this initial success in combating Covid. The Bank of Japan continues its **loose monetary policy** but with little prospect of getting inflation above 1% towards its 2% target, indeed inflation was negative in July. New Prime Minister Kishida, having won the November general election, brought in a supplementary budget to boost growth, but it is unlikely to have a major effect.

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

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

8. Interest rate forecast

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

8.2 Downside risks to current forecasts for UK gilt yields & PWLB rates include:

- **Mutations of the virus** render current vaccines ineffective, resulting in further national lockdowns or severe regional restrictions.
- **Labour/supply shortages** depress economy activity.
- **BoE acts too quickly, or too far**, to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation.
- **A resurgence of the Eurozone sovereign debt crisis.**
- **Weak capitalisation of some European banks**, which could be undermined further depending on the extent of credit losses resulting from the pandemic.
- **German general election**. Germany now has a new three-party coalition.
- **Other minority EU governments**. Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile and, therein, impact markets.
- Geopolitical risks, e.g. in Ukraine, Russia, Iran, China, and North Korea, but also in Middle Eastern countries, which could lead to increasing safe-haven flows.

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

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

9. Investment and borrowing rates

9.1 **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.

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

On 25 November 2020, 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)

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

- How close changes in gilt yields correlate to changes in US treasury yields?
- Will the Fed counter increasing treasury yields if they rise beyond a certain level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a certain level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact 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 high volatility be focused on the short or long-end of the yield curve, or both?

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

9.2 <u>Borrowing:</u> the interest rate forecast is provided in table 4 below:

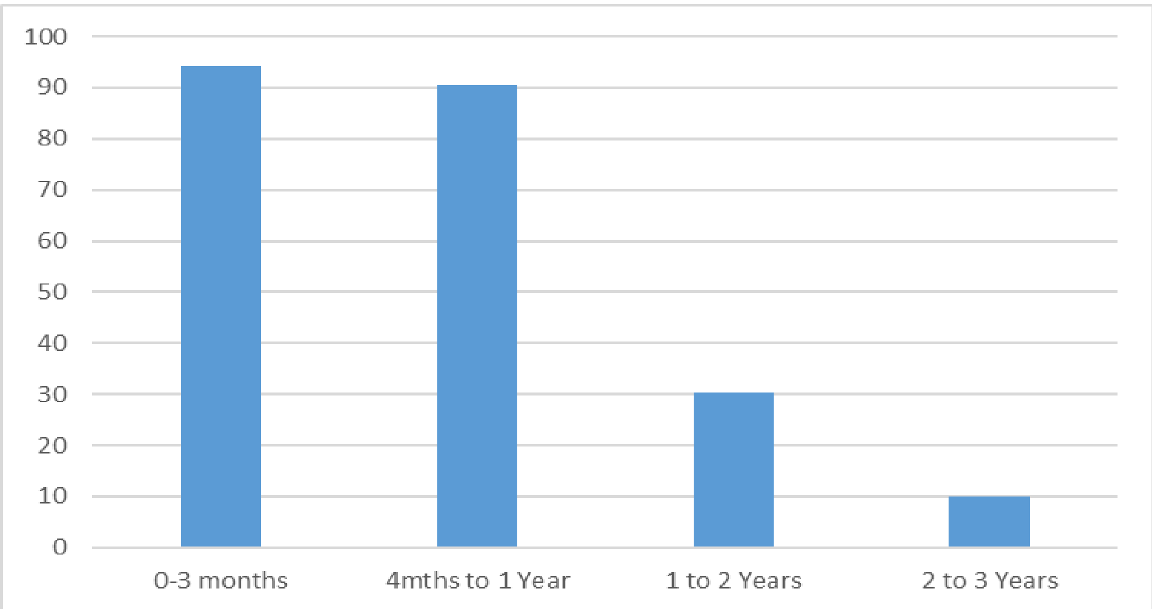
Table 4: Interest Rate Forecast for the BOE Base Rate and PWLB

Link Group Interest Rate View 20.12.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

9.3 <u>Treasury Investment Returns</u>

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. Due to the very low reinvestment rates for the majority of 2021/22, cash was used to fund capital spend, although £100m of long-term borrowing was taken in December 2021, following a drop in the Gilt rate.

Overall, the Council's cash holding will likely reduce to an average of approximately £130m over the next couple of years, with treasury investments being replaced with loans and long leases to Reside. The maturity profile of the Council's current treasury investments is provided below:



9.4 **Return Target 2022/23 to 2024/25**

9.4.1 To achieve the interest target, the following average returns need to be achieved:

2022/23 1.30 on an average cash balance of £130m (£1.7m)
2023/24 1.30 on an average cash balance of £130m (£1.7m)
2024/25 1.40 on an average cash balance of £130m (£1.8m)

9.4.2 The return reflects the current investment positions (i.e. most of the return has already been secured) but if opportunities are available to secure competitive rates then further investments will be made.

9.5 **HRA Investments**

9.5.1 Cash balances held by the HRA will be invested as part of the Council's overall treasury strategy. Cash balances will generally earn the average short-term rate of the Council's investments, which will be calculated at the financial year end.

9.5.2 Where there is agreement by the S151 Officer, individual investments can be ring-fenced for the HRA, with the allocations made within the Council's overall treasury strategy requirements. For further details please refer to the HRA Business Plan.

10. The Capital Expenditure Plans 2022/23 – 2024/25

10.1 The Council's HRA and GF capital expenditure plans, together with Balances and Reserves, are the key drivers of treasury management activity. The estimates for Capital expenditure, and its funding based on current proposed Revenue Budget and Capital Programmes, are reflected in prudential indicators, which are designed to assist Member's overview and confirm capital expenditure plans. The Prudential Indicators are included in Appendix 3.

10.2 Table 5 below shows the proposed CFR to 2024/25. The Prudential Code requires Councils to ensure that capital expenditure remains within sustainable limits and to consider the impact on Council Tax and, for the HRA, housing rent levels.

Table 5: Proposed Capital Expenditure 2021/22 to 2024/25

Capital Expenditure	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s
Capital Financing Requirement				
Opening CFR - General Fund	744,379	1,022,738	1,407,915	1,657,837
Net financing need for the year	337,512	405,887	265,922	132,262
MRP & Financing	-59,153	-20,710	-16,000	-17,000
Total General Fund CFR	**1,022,738**	**1,407,915**	**1,657,837**	**1,773,098**
CFR - Housing	314,734	314,734	314,734	314,734
Net financing need for the year	-	-	-	-
Total HRA CFR	**314,734**	**314,734**	**314,734**	**314,734**
Total CFR	**1,337,472**	**1,722,649**	**1,972,571**	**2,087,832**
Movement in CFR	**278,359**	**385,177**	**249,922**	**115,262**

10.3 A portion of the net financing need has already been borrowed to fund properties held by Reside. The increased financing need reflects IAS borrowing requirement.

10.4 Headroom has been included within the Authorised Limit on external borrowing to ensure that any major capital investment projects resulting from the IAS are not restricted by this statutory limit. The limit also covers any short-term borrowing for cash flow purposes and long-term borrowing for capital projects, finance leases, PFI and any unforeseen incidences where expected capital receipts are not forthcoming due to unexpected economic factors.

11. Treasury Management Advisors

11.1 The Council uses Link Asset Services, 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.

11.2 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..

12. Minimum Revenue Provision Policy Statement

12.1 In accordance with Statutory Instrument 2008 number 414 and new guidance issued by the Government under section 21 (1A) of the Local Government Act 2003 a statement on the Council's policy for its annual Minimum Revenue Provision (MRP) needs to be approved before the start of the financial year.

12.2 The Council are asked to approve the Minimum Revenue Provision Statement set out in Appendix 4.

13. Financial Implications

Implications completed by: Philip Gregory, Finance Director

13.1 The financial implications are discussed in detail in this report.

14. Legal Implications

Implications completed by: Dr. Paul Feild, Senior Governance Solicitor

14.1 It is a statutory requirement under the Local Government Finance Act 1992 for the Council to set out what the Council has to base its budget calculations upon. Furthermore, it is a legal requirement for the Council to set a balanced budget with regard to the advice of its Chief Finance Officer. However, what is meant by 'balanced' is not defined in law and this has means that the Council must rely upon the professional judgement of its finance team to ensure that the local authority's budget is robust and sustainable.

14.2 The Local Government Act 2003 requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The Council must 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.

14.3 Part 1 of the Local Government Act 2003 (the "Act") requires ELWA as a joint local authority body to each year set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

15. Other Implications

15.1 **Risk Management:** This report has risk management issues for the Council, primarily that a counterparty could cease trading or risk that interest rates would rise adversely. The mitigation of these is contained in this report.

15.2 **Corporate Policy and Equality Impact -** The TMSS seeks to support the Council's investment aims to unlock regeneration and economic growth opportunities within the borough. There are no equality or diversity implications arising from this report.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- Appendix 1 – Annual Investment Strategy 2022/23
- Appendix 2 - Borrowing Strategy 2022/23 to 2025/26
- Appendix 3 – The Capital Prudential and Treasury Indicators 2022/23 to 2025/26
- Appendix 4 – Minimum Revenue Provision Policy Statement 2022/23
- Appendix 5 – Scheme of Delegation and Section 151 Officer Responsibilities