CABINET

20 February 2023

Title: Treasury Management Strategy Statement 2023/24	
Report of the Cabinet Member for Finance, Growth and Core Services	
Open Report	**For Decision**
Wards Affected: None	**Key Decision:** Yes
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Accountable Strategic Director: Fiona Taylor, Acting Chief Executive	

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.

CIPFA published the updated Treasury Management and Prudential Codes on 20 December 2021 and stated that Local Authorities are expected to fully implement the required reporting changes within their TMSS/AIS reports from 2023/24. This report complies with these reporting requirements.

The Capital Strategy is largely driven by the Council's Investment and Acquisition Strategy, which will be revised in March 2023 and will be based on the Be First Business Plan, which is due to come to Cabinet in March 2023.

Recommendation(s)

The Cabinet is asked to recommend the Assembly to adopt the TMSS for 2023/24 and, in doing so, to:

(i) Note the current treasury position for 2023/24 in section 4 and prospects for interest rates, as referred to in section 8 of the report;

(ii) Approve the Annual Investment Strategy 2023/24 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 2023/24 to 2025/26, as set out in Appendix 2 to the report;

(iv) Note that the Capital Strategy 2023/24, incorporating the Investment and Acquisitions Strategy, shall be updated and presented for approval in April 2023;

(v) Approve the Capital Prudential and Treasury Indicators 2022/23 – 2024/25, as set out in Appendix 3 to the report;

(vi) Approve the Operational Boundary Limit of £1.85bn and the Authorised Borrowing Limit of £1.95bn for 2023/24, 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 revised Minimum Revenue Provision Policy Statement for 2023/24; 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, have been fully implemented for the 2023/24 TMSS;

(ix) Note the Liability benchmark data in section 11 of the report, including the impact of schemes agreed in 2022 but also the impact of pipeline schemes on the amount of borrowing required by the Council; and

(x) Delegate authority to the Strategic Director, Finance and Investment, in consultation with the Cabinet Member for Finance, Growth 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.

1.4 CIPFA published the updated Treasury Management and Prudential Codes on 20 December 2021 and stated that Local Authorities are expected to fully implement the required reporting changes within their TMSS/AIS reports from 2023/24. The main objective of the Codes was to respond to the expansion of local authority investment activity over the past few years into the purchase of non-financial investments, particularly property. The Codes require an authority to ensure that it:

- defines its risk appetite and its governance processes for managing risk.
- sets out its investment policy in relation to environmental, social and governance.
- adopts a liability benchmark treasury indicator to support the financing risk management of the capital financing requirement; with material differences between the liability benchmark and actual loans to be explained.
- does not borrow to finance capital spend to invest primarily for commercial return
- increases in the CFR and borrowing are solely for purposes directly and primarily related to the functions of the authority. Where any financial returns are related to the financial viability of the project, they should be incidental to its primary purpose.
- has an annual review conducted to evaluate if commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt.
- capital plans and investment plans are affordable and proportionate.
- all borrowing/other long-term liabilities are within prudent and sustainable levels.
- commercial investments risks are proportionate to overall financial capacity.
- treasury management decisions are in accordance with good professional practice.
- reporting to members is done quarterly, including updates of prudential indicators.
- should assess the risks and rewards of significant investments over the long term, to ensure the long-term financial sustainability of the authority.
- has access to the appropriate level of expertise to be able to operate safely in all areas of investment and capital expenditure, and to involve members adequately in making properly informed decisions on such investments.

1.5 This report covers the above points, outlining the key risks, borrowing requirement, assets invested in and the pipeline schemes. The Council's IAS has a long-term view of over 50 years and this report will outline the forecast income and expenditure over this time frame, although there will be a focus on the next three years as the likely performance and cashflows are more relevant and are more accurate, with longer term forecasts based on a number of assumptions.

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. 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 2023/24 and the Borrowing Strategy, which are set out in detail in the appendices attached to this report

3. Treasury Management Strategy Statement for 2023/24

3.1 The strategy for 2023/24 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 2022 (section 4);
- Medium Term Capital Finance Budget (section 5);
- Treasury Position at 31 December 2022; forward projections 2024/25 (section 6);
- Economic Update (section 7) and Interest rate forecast (section 8);
- Investment and Borrowing Rates (section 9);
- The Capital Expenditure Plans 2021 to 2024/25 (section 10);
- Liability Benchmarks and Loan Repayments (section 11)
- Treasury Management Advisors (section 12);
- Minimum Revenue Provision Policy Statement (section 13);
- Appendix 1 – Annual Investment Strategy 2023/24;
- Appendix 2 - Borrowing Strategy 2023/24 to 2025/26;
- Appendix 3 – The Capital Prudential and Treasury Indicators 2023/24 – 2025/26;
- Appendix 4 – Minimum Revenue Provision Policy Statement 2023/24; 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.

4. Current Portfolio Position at 31 December 2022

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 results 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 31/12/2021 and 31/12/2022, including Average Life and Average Rate of Return. It shows an increase in medium and short-term borrowing, a decrease in treasury investments (deposits and cash) and the increase in loans. The increase in loans is after the sale of Muller and reflects the loans to Reside from new operational schemes.

Table 1: Treasury Position at 31 December 2021 and 31 December 2022

	Principal £000s	Return %	Average Life (yr)		Principal £000s	Return %	Average Life (yr)
General Fund Fixed Rate Long Term Borrowing							
PWLB	635,780	1.92	29.27		617,887	1.91	28.59
European Invest. Bank	76,820	2.21	22.26		74,220	2.21	21.26
DEXIA BANK LOBO	10,000	3.98	55.53		6,752	3.44	23.76
L1 RENEWABLES	6,782	3.44	24.76		10,000	3.98	54.53
Total GF Debt	**729,382**	**1.99**	**28.85**		**708,859**	**1.99**	**28.14**
General Fund Fixed Rate Short Term Borrowing							
GF ST Borrowing	**55,000**	**0.03**	**0.13**		**146,228**	**2.99**	**0.12**
GF MT Borrowing					**30,000**	**0.77**	**1.64**
Total GF ST/MT Borrowing	**55,000**	**0.03**	**0.13**		**176,228**	**2.61**	**0.38**
Total GF Debt	**784,382**	**1.85**	**26.83**		**885,087**	**2.11**	**22.61**
HRA Fixed Rate Borrowing							
PWLB	265,912	3.5	35.1		265,912	3.50	33.05
Market Loans	30,000	4.03	44.96		30,000	4.03	42.99
Total HRA Debt	**295,912**	**3.55**	**35.06**		**295,912**	**3.55**	**34.06**
Total Borrowing	1,080,294	2.32	29.09		**1,180,999**	**2.47**	**25.48**
MMF / Cash	74,200	0.24	28.85		21,400	2.73	0.17
Local Authority Deposit	95,250	1.64	0.76		45,250	1.63	0.33
Bank Deposit	55,500	0.81	0.8		20,000	4.94	0.73
Loans	167,289	3.57	Various		177,223	3.93	30.08
Total Investments	**392,239**	**2.08**	**Various**		**263,873**	**3.52**	**20.32**

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 and increased borrowing costs, 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 the IAS. Table 2 also includes the MRP budget, IAS and HRA interest costs.

5.2 The GF interest budget is the net position between interest payable on borrowing and interest received from loans and treasury investments. It is forecast for this to remain stable as borrowing costs will increase but interest income will also increase from loan made on operational schemes. The interest payable is also capitalised during the development phase 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	2022/23 Budget	2023/24 Budget	2024/25 Budget	2025/26 Budget
MRP net of Self Financing and Leases	12,021	10,274	10,900	11,527
GF Net Interest Budget	8,178	8,178	8,178	8,178
Investment Income	-6,587	-6,587	-6,587	-6,587
Net GF Cost	**13,612**	**11,865**	**12,491**	**13,118**
HRA Interest Payable	10,059	10,059	10,059	10,059
Total Cost	**23,671**	**21,924**	**22,550**	**23,177**

6. Treasury Position Forward Projections to 2025/26

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 2022, with Forward Projections

Gross Debt Movement 2023/24 to 2024/25	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
External Debt	£000s	£000s	£000s
Debt at 1 April	1,180,294	1,430,294	1,630,294
Expected Change in Debt	250,000	200,000	150,000
Finance Lease and PFI	275,362	271,068	266,444
Gross Debt at 31 March	**1,705,656**	**1,901,362**	**2,046,738**
CFR	1,822,378	1,961,730	2,041,556
Under / (Over) Borrowing	**-116,722**	**-60,368**	**5,182**

7. Economic Update (from Link Asset Management)

7.1 Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

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

	UK	Eurozone	US
Bank Rate	3.00%	1.50%	3.75%-4.00%
GDP	-0.2%q/q Q3 (2.4%y/y)	+0.2%q/q Q3 (2.1%y/y)	2.6% Q3 Annualised
Inflation	11.1%y/y (Oct)	10.0%y/y (Nov)	7.7%y/y (Oct)
Unemployment	3.6% (Sep)	6.6% (Sep)	3.7% (Aug)

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

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

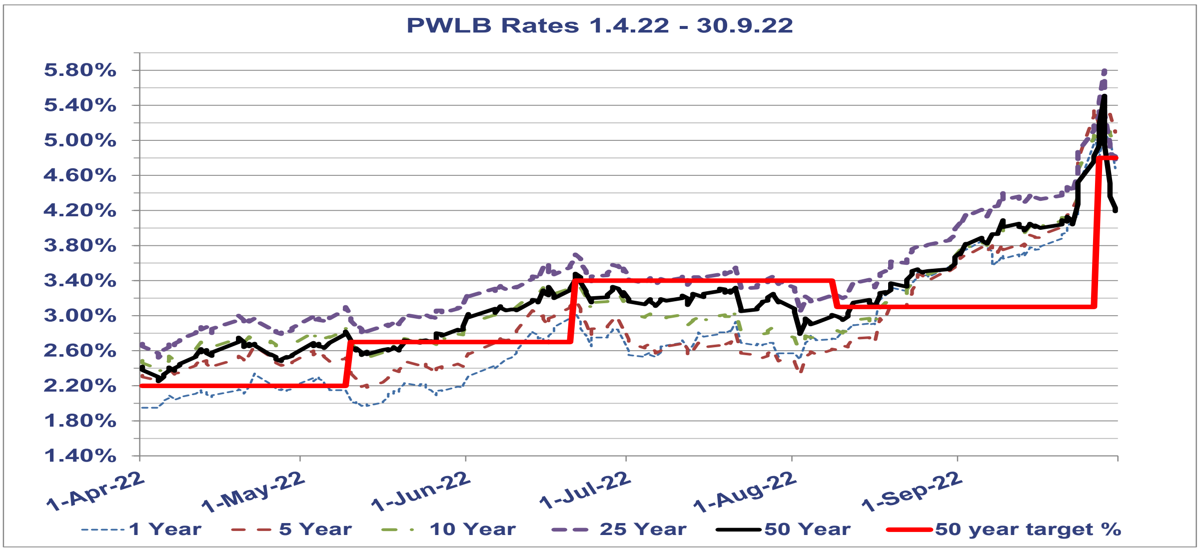
7.5 In Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3% in November and 4.0% in February 2023.

7.6 Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and December. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng. Their Autumn Statement of 17th November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

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

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

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



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

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

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

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

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

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

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

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:

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).
- **The Bank of England** acts too quickly, or too far, over the next two years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than currently anticipate.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates an even more rapid series of increases in Bank Rate faster than currently expect.
- **The Government** acts too slowly to increase taxes and/or cut expenditure to balance the public finances, in the light of the cost-of-living squeeze.
- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer term **US treasury yields** rise strongly, if inflation numbers disappoint on the upside, and pull gilt yields up higher than currently forecast.

9. Investment and borrowing rates

9.1 LINKS central forecast reflects a view that the MPC will be keen to demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022, but the new Government's policy of emphasising fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.

9.2 Further down the road, LINK anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures have lessened – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

9.3 The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market. Wage increases, excluding bonuses, are currently running at 5.7%.

9.4 Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present. This approach will prevent any further disruption to the longer end of the curve following on from the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy.

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

9.6 On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB RATES

9.7 Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.50%. The medium to longer part of the yield curve is currently inverted (yields are lower at the longer end of the yield curve compared to the short to medium end).

9.8 LINK view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook but markets are volatile and further whipsawing of gilt yields across the whole spectrum of the curve is possible. 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

9.9 The interest rate forecast is provided in table 4. The interest rate view for LINK for the previous year has been included in table 5 to show the significant increase in short-term rate assumptions over the past year, with rates being higher by over 3% in some quarters. This sudden change in rates, especially over the short-term rates, is a key pressure for the treasury strategy, with the main drivers being a very loose monetary policy followed by high energy costs leading to very high levels of inflation, which has then required the BoE to increase its base rate.

Table 4: Interest Rate Forecast for the BOE Base Rate and PWLB (as at 8/11/2022)

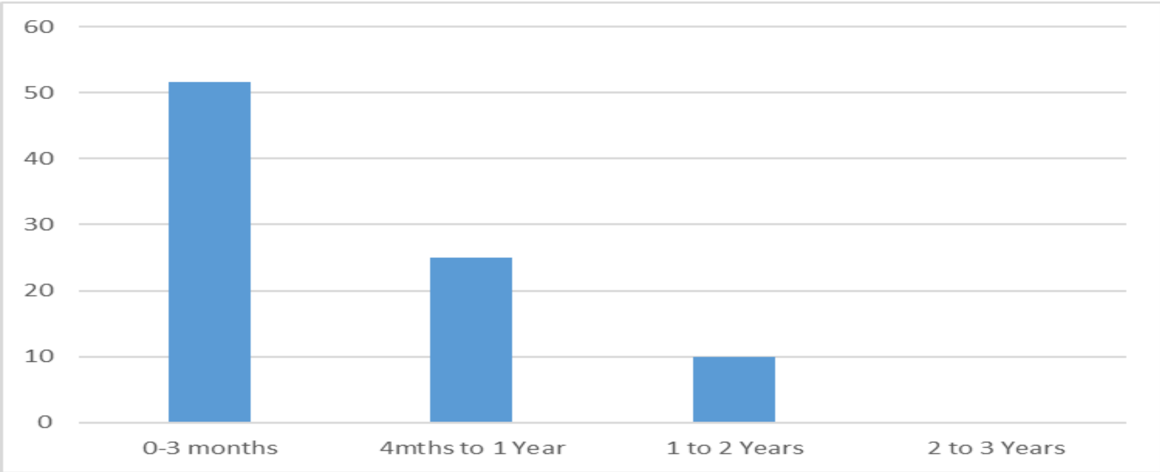
Link Group Interest Rate View	08.11.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

Table 5: Interest Rate Forecast for the BOE Base Rate and PWLB (as at 20/12/2021)

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

Treasury Investment Returns

9.10 Investment returns are expected to remain elevated in 2023/24, with an average return expected of around 4% but on a much-reduced cash balance of approximately £30m to £50m. The maturity profile of the Council's treasury investments is below:



Return Target 2020/21 to 2023/24

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

2023/24 4.0% on an average cash balance of £50m (£2.0m)
2023/24 3.0% on an average cash balance of £40m (£1.2m)
2024/25 2.5% on an average cash balance of £40m (£1.0m)

9.12 The return reflects the current investment positions but if opportunities are available to secure competitive rates then further investments will be made.

HRA Investments

9.13 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.

9.14 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 2023/24 – 2025/26

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. Table 6 below shows the proposed CFR to 2025/26. 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 6: Proposed Capital Expenditure 2022/23 to 2024/25

Capital Expenditure	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s
Capital Financing Requirement				
Opening CFR as at 1 April	**1,369,844**	**1,660,797**	**1,822,378**	**1,961,730**
Change in Year – General Fund	290,953	161,580	139,353	79,825
Net movement in CFR	**290,953**	**161,580**	**139,353**	**79,825**
Total CFR as at 31 March	**1,660,797**	**1,822,378**	**1,961,730**	**2,041,556**
Net financing need for the year	**308,748**	**249,180**	**158,353**	**101,825**
Less: MRP and Capital Receipts	-17,795	-87,600	-19,000	-22,000
Movement in CFR	**290,953**	**161,580**	**139,353**	**79,825**

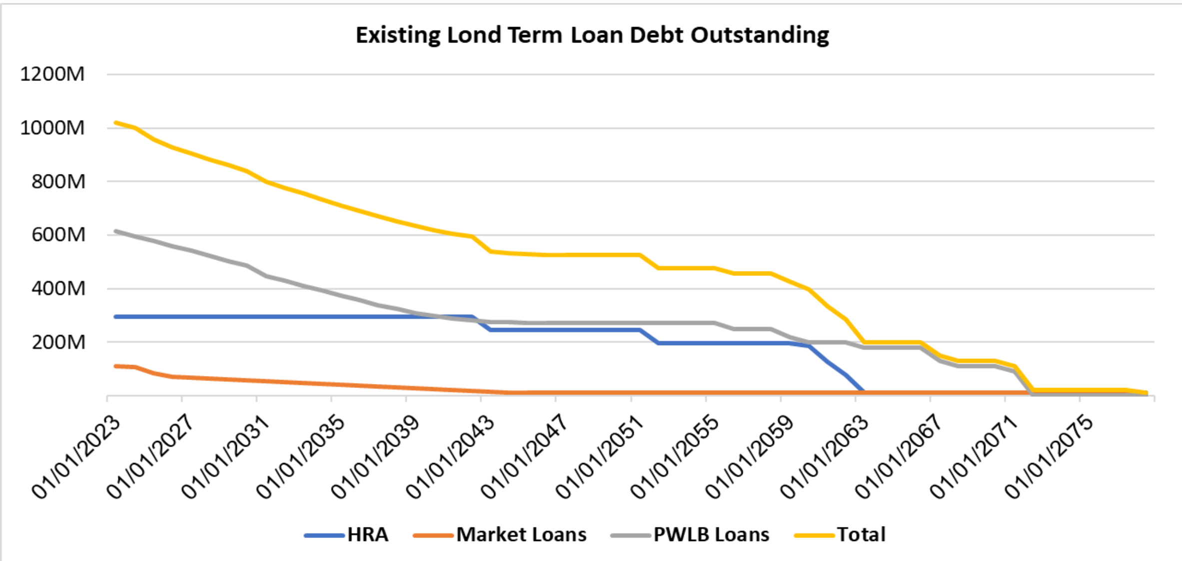
10.3 A portion of the net financing need has already been borrowed to fund properties held by Reside. The increased financing need reflects IAS borrowing requirement.

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. Liability Benchmark Treasury Indicator

11.1 The Council should estimate and measure the liability benchmark over the full debt maturity profile and must have a strong grasp of both its existing debt maturity profile and also how MRP and other cash flows affect future debt requirement. For the Council's liability benchmark data, the full debt and MRP profile has been used, which captures the full repayment period of the Council's IAS. Key figures in each chart will be identified to highlight the impact on borrowing costs, debt repayment and MRP.

11.2 <u>Existing Loan Debt Outstanding</u>: the Council's existing loans are split into HRA and General Fund and into PWLB and other, with all loans being fixed rate.



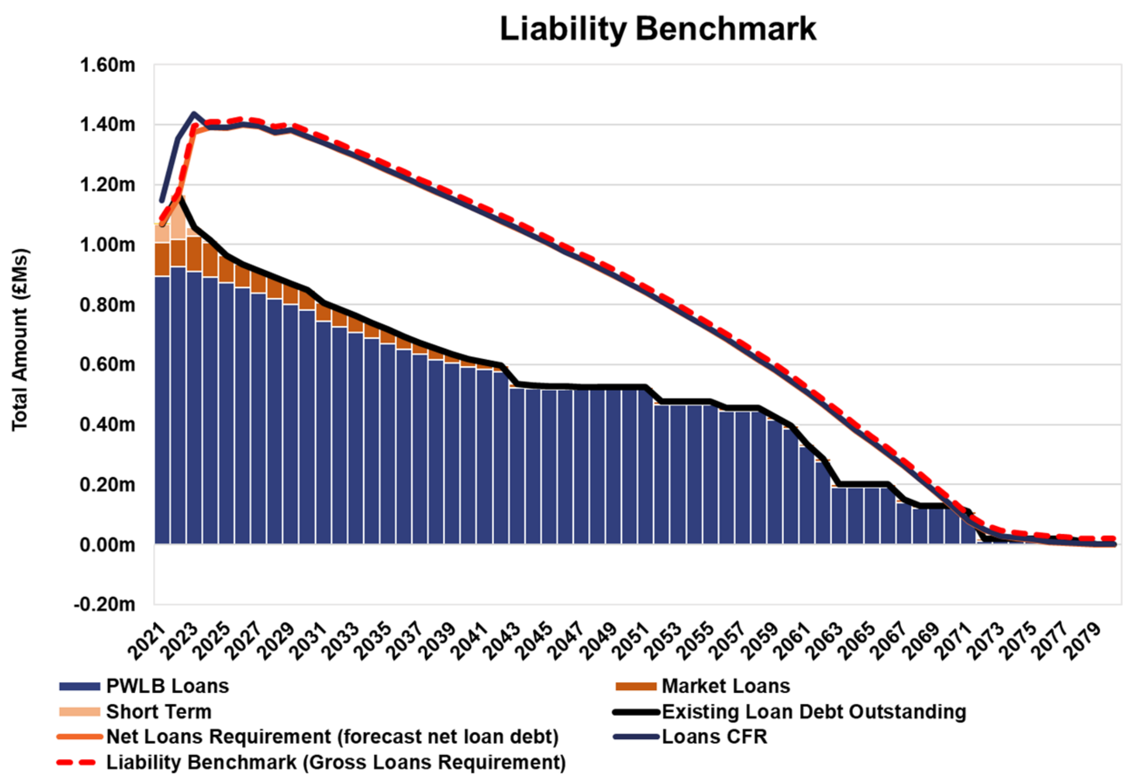
11.3 The chart below is based on no new borrowing and shows the repayment profile for the HRA and General Fund. The HRA has a more stepped repayment schedule, with GF PWLB and other borrowing having a smoother steady repayment schedule based on the debt repayment of the underlying asset it is funding. Repayment of debt is important, especially with the link to the repayment by the asset, but this does result in the Council having to borrow to cover repayments during the development period.

11.4 For the liability benchmark, three charts have been produced. The first chart is based on the schemes that were agreed as at 31 December 2021, with the subsequent charts showing the impact of schemes that were agreed in 2022 and then pipeline schemes. This will highlight the impact of the current and future schemes on the borrowing and repayment requirement.

11.5 For each chart the borrowing does not change as this is the actual borrowing, with the liability benchmark showing the gap between the borrowing requirement and loans. As most of the borrowing is for schemes that will be developed over a number of years there will always be a gap between the borrowing requirement and the actual borrowing. Generally, this gap is fairly small but this has increased over the past year due to the high costs of borrowing and also due to the number of schemes that are currently being developed. There is the potential for capital receipts from a number of sales to fund part of this shortfall and some of the commercial assets may be sold over the next few years, which will reduce the borrowing requirement.

11.6 For the charts, treasury investments have been removed as they will be used to fund the developments. Leases have also been removed to just show the borrowing requirements. If leases were added the total CFR would be nearer £1.65bn.

Liability Benchmark as at 31/12/2021

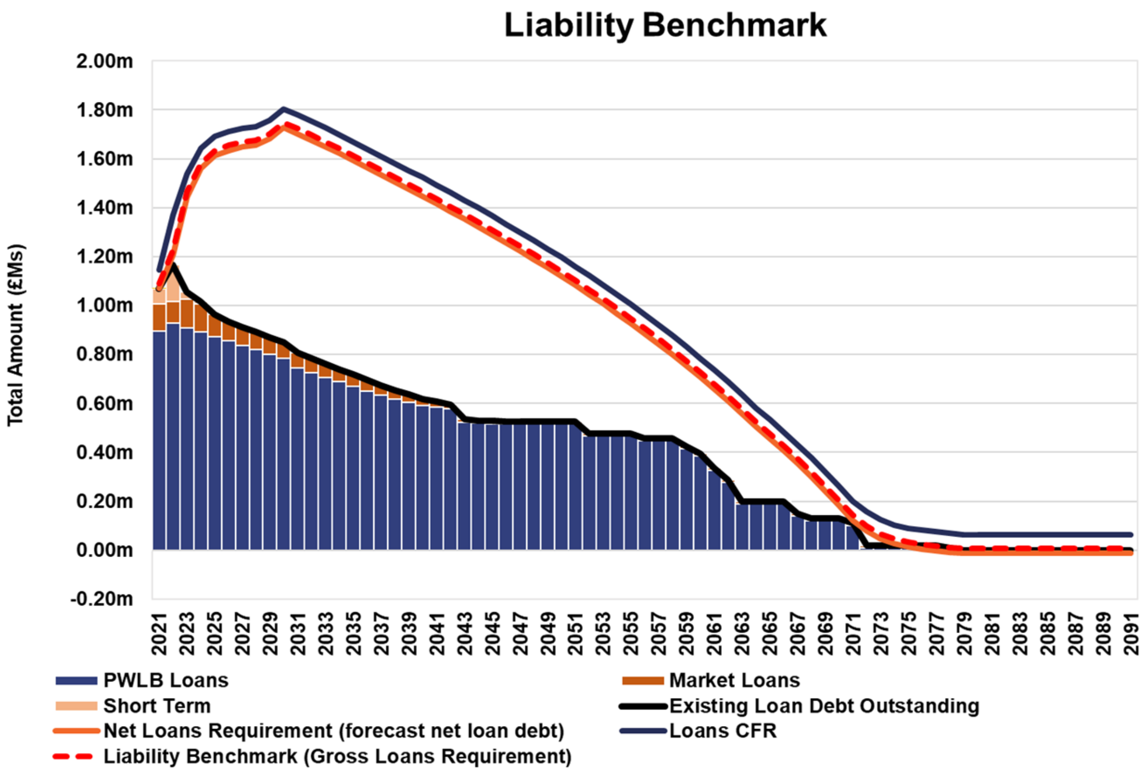


11.7 Overall the borrowing gap was approximately £200m to £250m. Short-term borrowing has been used to cover part of the funding gap. There is a risk to the Council as this gap still requires borrowing but this has been factored into model assumptions, up to an average borrowing cost of 5% for the additional borrowing. The borrowing requirement peaks at around £1.4bn in 2025. The borrowing requirement could reduce from the capital receipts from the sale of Welbeck and Pondfield, the sale of other commercial holdings, repayment of loans to subsidiaries and ending the prepayment to the pension fund. In total this could reduce the borrowing requirement to £150m by 2025.

Liability Benchmark as at 31/12/2022

11.8 In 2022 a number of large schemes were agreed and signed off, including Beam Park, Gascoigne East 3b and Roxwell. The impact of these agreements, at a time when interest rates increased significantly, was to increase the borrowing requirement from a peak of £1.4bn in 2025, to £1.8bn by 2030.

11.9 This increase means that Council needs to borrow £800m to £1bn over the next 8 years. There may be some opportunities to lock in competitive rates in the future but currently this is a risk for the Council. For the new schemes agreed, higher borrowing rates have been assumed, which should provide protection to the Council. However, one of the large schemes, Gascoigne East 3b, is forecasting significant losses and the option to use a higher interest rate is much reduced.

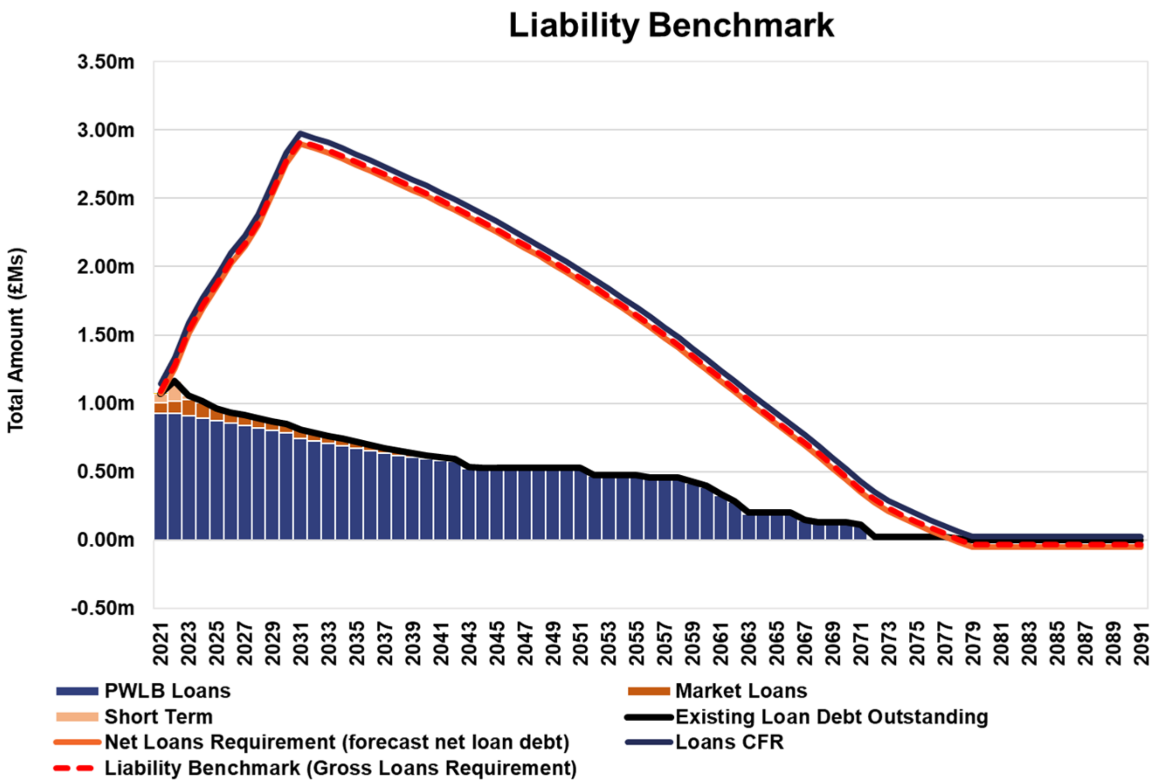


11.10 The chart above is the liability benchmark for the current capital programme, excluding leases. The impact of borrowing £1.8bn to fund schemes will require the Council and Reside to be able to absorb these large increases in asset management, financial monitoring and control as well as the large cashflows. Key statistics are that interest at 2.5% on £1.8bn is £45m per year, MRP peaks at around £40m per year, a 1% increase or decrease in return against the amount borrowed can result in £18m surpluses or deficits, with some of the drivers for these changes, such as rent increases (especially for social rents) and regulatory requirements having a large impact on returns and being out of the Council's control.

11.11 To accommodate these potential fluctuations and potential risks, the Council has built up a large reserve, driven mainly by outperformance within treasury, to be able to cover any losses or pressures from financing costs. The reserves have been set aside to provide the investment strategy with some protection and if they are used to cover shortfalls in other services then this will impact the strategy.

Liability Benchmark including pipeline schemes

11.12 There are a number of pipeline schemes that are significant in size, including Barking Riverside, Dagenham Heathway/ Millard Terrace, Gascoigne East Phase 4, Heath Park, Hepworth Gardens, Ibbscott, Padnall & Reynolds and the Rest of Gascoigne West. These schemes could potentially increase the Council's borrowing requirement to £3bn by 2033, with all schemes included in the Be First Business Plan for 2023.



11.13 The chart above shows the borrowing requirement to progress these schemes, with a further £1.2bn of borrowing required. Interest payments at 2.5% for £3bn of total borrowing would be £75m and £90m at 3.0%. MRP repayments would peak at £68m in 2070. Again the Council and Reside would need to be able to absorb the increases from both asset management, cashflows and financial controls.

11.14 The cashflows in the chart does not include any further schemes, including Thames Road, Vicarage Field, Barking Town Centre and these very large schemes, if funded by the Council, would increase the borrowing significantly.

11.15 The liability benchmark data will be provided as part of the quarterly reporting of the IAS and Treasury.

12. Treasury Management Advisors

12.1 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 the Council's external service providers.

12.2 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.

13. Minimum Revenue Provision Policy Statement

13.1 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.

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

14. Environmental, Social & Governance (ESG) Considerations

14.1 ESG is becoming a more more and more imporant, with around two thirds of councils declaring a "climate emergency" to date but not translating this into the incorporation of something more formal within their treasury-related Annual Investment Strategy. Changes to the CIPFA TM Code 2021 will see ESG incorporated into Treasury Management Practice 1 (TMP), with the Code stating:

"The organisation's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations. This is a developing area, and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level." and

"ESG issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits,

and there is a diversity of market approaches to ESG classification and analysis. This means that a consistent and developed approach to ESG for public service organisations is currently difficult. Organisations are therefore recommended to consider their credit and counterparty policies in light of ESG information and develop their own ESG investment policies and treasury management practices consistent with their organisation's own relevant policies, such as environmental and climate change policies."

14.2 ESG is currently not a factor in agreeing if a deposit or loan is with a certain counterparty but this will be reviewed as part of a review of the TMP.

15. Financial Implications

Implications completed by: Philip Gregory, Strategic Director, Finance & Investment

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

16. Legal Implications

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

16.1 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.

16.2 The Local Government Act 2003 (the "Act") 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.

16.3 The Act requires the Council 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 these to be approved before the next municipal financial year.

17. Other Implications

17.1 **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.

17.2 **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 2023/24
- Appendix 2 - Borrowing Strategy 2023/24 to 2025/26
- Appendix 3 – The Capital Prudential and Treasury Indicators 2023/24 to 2025/26
- Appendix 4 – Minimum Revenue Provision Policy Statement 2023/24
- Appendix 5 – Scheme of Delegation and Section 151 Officer Responsibilities