ARUN DISTRICT COUNCIL

REPORT TO AUDIT AND GOVERNANCE COMMITTEE ON 22 February 2022

REPORT

SUBJECT: Treasury Management Strategy Statement and Annual Investment Strategy 2022/23

REPORT AUTHOR: Sian Southerton – Senior Accountant (Treasury)
DATE: January 2022
EXTN: 01903 737861
AREA: Corporate Support

EXECUTIVE SUMMARY:

The purpose of this report is to present the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy (AIS) 2022/2023 to 2024/2025 and to enable the Audit and Governance Committee to scrutinise the report prior to making comment to Full Council (9 March 2022).

RECOMMENDATIONS:

The Committee is requested to recommend Full Council to:

(i) Approve and adopt the Treasury Management Strategy Statement for 2022/23 to 2024/25.

(ii) Approve and adopt the Annual Investment Strategy for 2022/23 to 2024/25, including the addition of new counterparties; JP Morgan Chase Bank and National Australia Bank.

(iii) Approve the Prudential Indicators within the TMSS and AIS for 2022/23 to 2024/25 as contained in appendix 1 and the body of the report.

1. BACKGROUND:

The Council is required as part of its governance to consider certain reports on Treasury Management.

As a minimum, three main reports should be presented each year, incorporating a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by Committee before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.

- **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) (2.0);
  - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time) (2.4);
  - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators (3.0); and
  - an investment strategy (the parameters on how investments are to be managed) (4.0).
- **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. The Audit and Governance Committee will receive a mid-year report at its November meeting prior to approval by Full Council.
- **An Annual Treasury Report** – This is a backward looking review document providing details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy which the Audit and Governance Committee will receive at its July meeting prior to approval by Full Council.

2. PROPOSAL(S):

This report has the Treasury Management Strategy for 2022/23 appended. The strategy for 2022/23 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management Issues

- the current treasury position;
- treasury indicators which will 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
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, DLUHC (Department for Levelling Up, Housing and Communities) Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

3. OPTIONS:

The Treasury Management Strategy is legislative and under the Local Government act 2003 and therefore the only option is to recommend the Treasury Strategy be recommended for approval by Full Council.

4. CONSULTATION:

Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		✓
Relevant District Ward Councillors		✓
Other groups/persons (please specify)	✓ Treasury Advisors	

5. ARE THERE ANY IMPLICATIONS IN RELATION TO THE FOLLOWING COUNCIL POLICIES: (Explain in more detail at 6 below)	**YES**	**NO**
Financial	✓	
Legal		✓
Human Rights/Equality Impact Assessment		✓
Community Safety including Section 17 of Crime & Disorder Act		✓
Sustainability		✓
Asset Management/Property/Land		✓
Technology		✓
Other (please explain)		

6. IMPLICATIONS:

Financial

The Treasury Management Strategy will inform borrowing and investment decisions. In addition, it is viewed as sound governance to have a Strategy in place.

7. REASON FOR THE DECISION:

To ensure that the Treasury Management Strategy 2022/23 is considered before approval by Full Council. The decision sets statutory limits and safeguards the Council against financial loss.

8. BACKGROUND PAPERS:

- The Local Government Act 2003
- CIPFA'S Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (2017) *(Link not available as copyright)*
- The Prudential Code for Capital Finance in Local Authorities (2017)
- Cipfa Treasury Management Guidance notes (2018) *(Link not available as copyright)*
- DLUHC's Guidance on Local Government Investments ("the Guidance")

Arun District Council

Treasury Management Strategy Statement and Annual Investment Strategy 2022/23

Arun District Council
Treasury Management and Investment Strategy 2022/23

1 Introduction

2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact on future TMSS/AIS reports and the risk management framework;-

CIPFA published the revised codes on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. This Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to Full Council for approval.

The revised codes will have the following implications:

- a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;

- clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;

- address ESG issues within the Capital Strategy;

- require implementation of a policy to review commercial property, with a view to divest where appropriate;

- create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);

- ensure that any long term treasury investment is supported by a business model;

- a requirement to effectively manage liquidity and longer term cash flow requirements;

- amendment to TMP1 (Treasury Management Practice) to address ESG policy within the treasury management risk framework;

- amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;

- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

In addition, all investments and investment income must be attributed to one of the following three purposes: -

Treasury management
Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

Service delivery
Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".

Commercial return
Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not borrow to invest primarily for financial return.

As this Treasury Management Strategy Statement and Annual Investment Strategy deals soley with treasury management investments, the categories of service delivery and commercial investments will be dealt with as part of the Capital Strategy report.

Members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS report.

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 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.

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."*

It will be important to keep the Treasury Management Strategy under review during the year due to the current economic climate. Government policy and guidance may need to change in light of the costs and challenges of Covid-19.

1.2 Reporting Requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital 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 strategy requirements, governance procedures and risk appetite.

This capital 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.

1.2.2 Treasury Management reporting

The Council is currently required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.

- **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) (2.0);
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- **An Annual Treasury Report** – This is a backward looking review document providing details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy which the Audit and Governance Committee will receive at its July meeting prior to approval by Full Council.

1.3 Treasury Management Strategy for 2022/23

The strategy for 2022/23 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

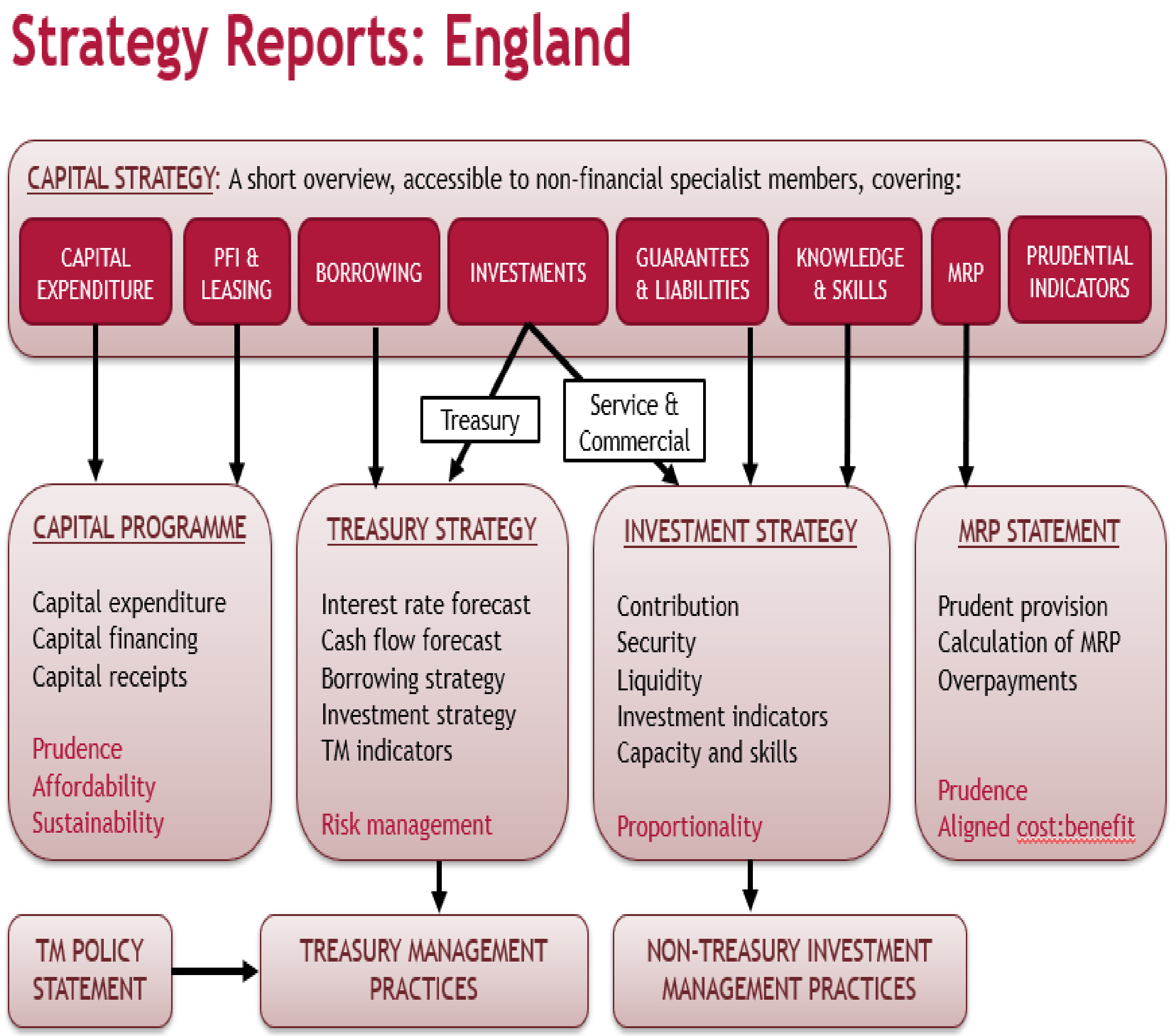
Treasury management Issues

- the current treasury position;
- treasury indicators which will 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
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, DLUHC (Department for Levelling Up, Housing and Communities) Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

A Voluntary Repayment Provision (VRP) is sufficient as Arun’s external debt is all HRA. However, there is a possibility that the Council may wish to borrow for General Fund purposes at some point in the future.

The diagram below shows how Capital expenditure affects the Treasury Management Strategy



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. Accordingly, all members were invited to attended a workshop presented by Link Group (Treasury advisors) explaining the roles and responsibilities of elected members and giving them an economic update. The last session was held on 13th July 2021 where 14 members attended.

The training needs of treasury management officers are reviewed periodically and senior officers attend seminars at least once a year. Since Covid 19 there have been more bite size webinars from various organisations, which are attended by Treasury officers regularly.

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 the services of external 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 1 commercial type investment (East Preston Depot).
Any further commercial type investments will require specialist advisers in relation to this activity.

2 The Capital Prudential Indicators 2022/23 to 2024/25 (Appendix 1)

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

2.1 Capital Expenditure.

This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The Council's capital expenditure is considered as part of the budget setting process and a report for approval is going to Full Council on 23rd February 2022.

Currently Arun's only borrowing relates to the HRA self-financing settlement. However, the Council has a significant capital programme including HRA acquisition/new builds and smaller projects such as work to carparks, public convenience's, cemeteries, and some infrastructure projects. Much of this programme will be funded from capital receipts and revenue resources but it is possible that additional borrowing will be required at some point in the future, however the source has not yet been identified.

The need to borrow is reviewed annually as part of the Treasury Management Strategy and budget setting process and will be dependent on the HRA Business Plan and the Capital programme.

The table below summarises the 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;

Capital Expenditure	Actual 2020/21 £'000	Current Estimate outturn 2021/22 £'000	Estimate 2022/23 £'000	Estimate 2023/24 £'000	Estimate 2024/25 £'000
Non HRA	2,930	3,851	3,939	2,446	2,142
HRA	6,472	8,488	8,351	6,560	6,774
HRA settlement	-	-	-	-	-
Total	**9,402**	**12,339**	**12,290**	**9,006**	**8,916**
Financed by:					
Capital receipts (1-4-1)	1,589	1,194	1,500	0	0
Capital grants	2,668	3,109	1,400	1,400	1,400
Capital reserves	1,823	3,051	5,336	4,430	5,244
Revenue	37	756	567	1,276	972
	6,117	**8,110**	**8,803**	**7,106**	**7,616**
Net financing need for the year	**3,285**	**4,230**	**3,487**	**1,900**	**1,300**

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 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 its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, 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 borrowing need in line with each asset's life, and so charges the economic consumption of capital assets as they are used. The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council does not have any PFI schemes within the CFR but does have finance leases.

The Council is asked to approve the CFR projections in Appendix 1 also shown below:

CFR at 31 March	**Actual 2020/21 £,000**	**Current Estimate 2021/22 £,000**	**Estimate 2022/23 £,000**	**Estimate 2023/24 £,000**	**Estimate 2024/25 £,000**
Capital Financing Requirement					
General Fund	(4,223)	(4,442)	(3,655)	(3,742)	(3,830)
HRA	52,973	49,347	54,475	61,852	61,010
Total CFR	**48,750**	**44,905**	**50,820**	**58,110**	**57,180**
Movement in CFR	**394**	**(3,845)**	**5,915**	**7,289**	**(930)**

Movement in CFR represented by					
Leasing arrangements (GF)	0	0	0	0	0
HRA unfinanced / Internally financed	3,285	0	7,565	8,913	1,300
Leasing arrangements (HRA)	947	0	0	0	0
Repayments	0	0	0	0	0
Less MRP/VRP	(3,837)	(3,845)	(1,650)	(1,624)	(2,230)
Movement in CFR	**394**	**(3,845)**	**5,915**	**7,289**	**(930)**

2.3 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 £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**
Fund balance	15.91	13.95	10.47	11.11	11.15
Earmarked Reserves	29.16	14.71	14.27	13.83	13.39
Capital Receipts	1.93	1.82	0	0	0
Provisions	3.0	3.36	2.26	2.26	2.26
Total core funds	**50.00**	**33.84**	**27.00**	**27.20**	**26.80**
Other cashflow sums	12.17	17.16	21.00	13.25	7.11
Expected investments	**62.17**	**51.00**	**48.00**	**40.45**	**33.91**

2.4 Minimum revenue provision (MRP) policy statement

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

DLUHC (Department for Levelling Up, Housing and Communities) 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 MRP Statement in Appendix 2.

The Council does not currently have any General Fund external debt and therefore is not statutorily required to make Minimum Revenue Provision (MRP) in respect of its CFR, but there is a requirement for a charge for depreciation to be made.

It is considered prudent to make VRP in respect of the PWLB maturity loans funding the HRA self-financing settlement payment. The table in 2.2 above shows the VRP reducing the CFR. The VRP is incorporated in the HRA Business Plan and in the 2022/2023 HRA budget. If borrowing is taken out for general fund in 2022/23, the current MRP policy will need to be reviewed.

MRP Overpayments

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 (VRP) 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 there were no VRP overpayments.

2.5 Affordability Prudential Indicators

This report covers 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 indicator contained in Appendix 1.

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.

	Actual 2020/21 %	Estimate 2021/22 %	Estimate 2022/23 %	Estimate 2023/24 %	Estimate 2024/25 %
Non-HRA	(1.96)%	(1.90)%	(1.88)%	(2.05)%	(2.05)%
HRA	31.84%	32.32%	15.58%	16.32%	15.72%

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 Current Portfolio Position

The Council's Treasury Investment and debt portfolio position at 31 March 2021 and 31 December 2021 summarised below;

TREASURY PORTFOLIO				
	actual **31.3.21**	actual **31.3.21**	current **31.12.21**	current **31.12.21**
Treasury investments	**£000**	**%**	**£000**	**%**
banks	47,175	76%	61,110	71%
building societies – unrated	2,000	3%	4,000	5%
building societies – rated	0	0%	0	0%
local authorities	2,000	3%	3,000	4%
DMADF (H.M.Treasury)	0	0%	0	0%
money market funds	4,000	7%	10,450	12%
certificates of deposit	0	0%	0	0%
Total managed in house	**55,175**	**89%**	**78,560**	**92%**
diversified funds	2,000	3%	2,000	2%
property funds	5,000	8%	5,000	6%
Total treasury investments	**62,175**	**100%**	**85,560**	**100%**
Treasury external borrowing				
local authorities	0	0%	0	0%
PWLB	44,320	100%	44,320	100%
LOBOs	0	0%	0	0%
Total external borrowing	**44,320**	**100%**	**44,320**	**100%**
Net treasury investments / (borrowing)	**17,855**	**0**	**41,240**	**0**

The investments held at 31st December 2021 are shown in Appendix 3.

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
External Debt					
Debt at 1 April (HRA)	**44.32**	**44.32**	**36.21**	**39.84**	**47.27**
Expected change in Debt	0.00	0	3.1	7.1	1.3
Re-payments (HRA debt)	0.00	(8.86)	0.00	0.00	0.00
Other long-term liabilities (OLTL)	0.00	0.75	0.53	0.33	0.25
Actual gross debt at 31 March	**44.32**	**36.21**	**39.84**	**47.27**	**48.82**
Capital Financing requirement – HRA	52.97	49.35	54.48	61.85	60.01
Capital Financing requirement - GF	(4.22)	(4.44)	(3.65)	(3.74)	(3.83)
The Capital Financing Requirement	**48.75**	**44.91**	**50.82**	**58.11**	**57.18**
Under / (over) borrowing	4.43	8.70	10.98	10.84	8.36

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 Council's only external borrowing relates to the HRA Self-Financing settlement (initially £70.9m on 28/3/2012 now £44.32m but to reduce to £35.46 on 28/3/2022). Prior to this borrowing being undertaken, the Council had a negative CFR of £2.6m which has arisen over a number of years and was due more to changes in the capital accounting regulations rather than to any specific policy decision. As a result, Arun's gross debt is not expected to exceed its CFR.

The Interim Group Head of Corporate Support reports that the Council complied with the prudential indicators 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 the budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

3.2.1 **The Operational Boundary.**

This is the limit beyond which external debt is not normally expected to exceed. 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.

The Council is requested to approve an operational boundary of £53M in Appendix 1 (2022/23).

3.2.2 **The Authorised Limit for external debt.**

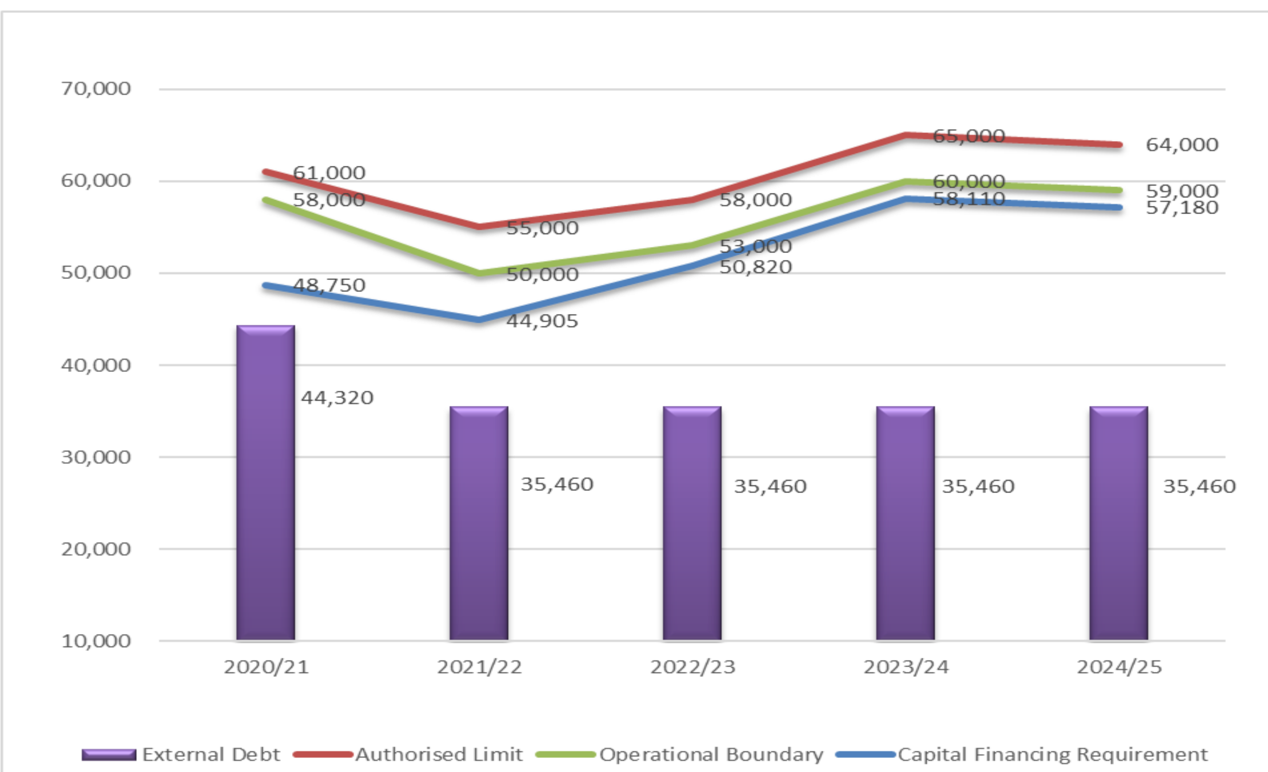
This is a key prudential indicator represents a control on the maximum level of borrowing.

This represents a legal 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.

i. 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.

ii. The Council is asked to approve an Authorised Limit of £58M appendix 1 (2022/23).

3.2.3 The chart below shows the Councils projection of CFR and borrowing.



The bars in the chart above show the actual external debt (£44M-35M) and does not include any potential future borrowing. The Authorised limit and operational boundary factor in up to £23m potential borrowing (in 2022/23) which allows for expenditure on sheltered accommodation, new acquisitions, garages and works to the Arun Leisure Centre. The debt repayment on 28 March 2022 is shown in 2021/22 (reducing the borrowing from £44M to £35M at this date).

3.3 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 20th December 2021. These are forecasts for certainty rates, gilt yields plus 80 bps.

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

Over the last two years, 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 until raising it to 0.25% at its meeting on 16th December 2021. A further rise to 0.50% took place on 3rd February 2022.

As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in December 2021 to 0.25%, then 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%. Link Group will update this forecast in light of the February rate rise.

Forecasts for Bank Rate (Link Group on 20th December 2021)
It is not expected that 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%. 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: -

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.

- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose 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 looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.

- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.

- 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, we expect to have to revise our forecasts again - in line with whatever the new news is.

It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields
Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.

A new era for local authority investing
– 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.

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 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 Group'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. In addition, there are also some cheap alternative sources of long-term borrowing if an authority is seeking to avoid a "cost of carry" but also wishes to mitigate future re-financing risk

3.4 Borrowing Strategy

3.4.1 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 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

The Council has a significant capital programme including HRA acquisition/new build. The level of expenditure within the HRA will almost certainly require additional borrowing which will be reflected in the HRA 30 year financial model which will form an integral part of the Business Plan. The HRA business plan will include a programme of new build/stock acquisition, in addition to ongoing maintenance and decent homes programme.

The source of any new borrowing has not been identified at the time of writing, but this would need to be dependent on a viable business case which fully justifies the investment.

The Council's borrowing strategy will give consideration to new borrowing in the following order or priority;

- Internal borrowing;

  By running down cash balances and foregoing interest earned at historically low rates, as this is the cheapest form of borrowing, however, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years;

- External borrowing;

  - the PWLB Certainty Rate is available to the Council at 0.2% below the normal terms (the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing) or;

  - local authorities and the Local Government Association Municipal Bonds Agency who may from time to time offer options to borrow more cheaply than from the PWLB, and therefore will be considered.

- Following the decision by the PWLB to reduce its rates to gilts + 80 basis points, its rates are now competitive. However, consideration will also need to be given to sourcing funding at cheaper rates from the following:

On Balance Sheet	Fixed	Variable
Banks	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Local Bonds	●	
Negotiable Bonds	●	●

Some options have been added for the 2022-23 strategy to ensure the best funding option can be selected should the Council require external borrowing.

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

There may be an occasional need to borrow for liquidity purposes especially as the Council no longer has an overdraft facility. The facility was removed as banking costs made it very expensive and rather than incurring any costs for the facility, the treasury team now maintain an approximate £200k balance in the account daily. Since the coronavirus outbreak, this balance has not been earning any interest but is now achieving the base rate less 10bp (0.15% prior to the rate hike in February).

3.4.2 **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 treasury indicators and limits in Appendix 1 also shown below:

Maturity structure of fixed interest rate borrowing 2022/23			
	Actual at 31/3/22	**Lower**	**Upper**
Under 12 months	0%	0%	40%
12 months and within 24 months	0%	0%	40%
24 months and within 5 years	0%	0%	50%
5 years and within 10 years	25%	0%	60%
10 years and above	75%	0%	100%

The Council currently has no variable rate borrowing.

3.5 Policy of 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.

3.6 Debt Rescheduling

The only loans that the Council currently hold are those taken to fund the housing reform payment.

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of PWLB rates over gilt yields was reduced by 100 bps in November 2020.

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

4 Annual Investment Policy and Strategy

4.1 Investment Policy – Management of risk

The Department of Levelling Up, Housing and Communities (DLUHC - this was 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 treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

The Council’s investment policy has regard to the following: -

- DLUHC’s Guidance on Local Government Investments (“the Guidance”)
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
- CIPFA Treasury Management Guidance Notes 2018

The Council’s investment priorities will be security first, portfolio liquidity second and 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, where the rates are exceptionally low and, in some cases, negative, it is considered appropriate to keep investments short to cover cash flow needs, which are not always clear with the current pandemic. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in longer periods 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 banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 6 under the categories of 'specified' and 'non-specified' investments.

    - **Specified investments;** (these are considered low risk assets where the possibility of loss of principal or investment income is small) 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 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. **Lending limits**, (amounts and maturity), for each counterparty category will be set. (Appendix 6).

6. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (Appendix 1).

7. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (Appendix 8).

8. The Council 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.

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

10. The Council may invest in investments that are termed **“alternative investments”.** These include, but are not limited to, things such as renewable energy bonds (Solar farms). These are asset backed bonds, offering good returns, and will enable the Council to enter new markets, thus furthering the diversification of our investment portfolio with secured investments and enhancing yield. Any investments entered into of this type will be subject to a full due diligence review prior to investment. (Category 8, Appendix 6)

11. The Council may invest in **Open Ended Investment Companies (OEICs)** such as diversified funds (currently the CCLA property fund and diversified fund) subject to some form of due diligence. These funds diversify the risk and offer enhanced returns (Category 11 & 12, Appendix 6)

12. As a result of the change in accounting standards for 2022/23 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Department of Levelling Up, Housing and Communities, (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.

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

The Council does not strictly adhere to the advisor’s suggested lending list and durations, but does take account of the advice offered before making any investment decisions. The Council will take advantage of any attractive rates available from counterparties of high creditworthiness for longer periods while interest rates remain extremely low. Rates are set to stay low till at least March 2025, increasing only to 1.25%

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 Council achieves a high credit quality by using a minimum rating criteria (where rated). It does not use the approach suggested by CIPFA of using the lowest common denominator method of selecting counterparties as some rating agencies are more aggressive in giving low ratings than others. The Council applies a majority rule where a counterparty would be removed immediately from the lending list if 2 or more rating agencies downgrade the counterparty below the minimum criteria. The Council's minimum criteria can be seen in Appendix 7.

Additional requirements under the Code require the Council to supplement credit rating information, which the Council achieves using the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's.

The credit ratings of counterparties are supplemented with the following overlays:

- watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

All credit ratings are monitored weekly and the Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

The current list of approved counterparties is included in Appendix 7. Lloyds being the incumbent bank, has no limit however the Council will only invest up to £11M in term deposits with them.

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.

Non-specified treasury management investment limit. The Council has determined that it will limit the maximum total exposure to non-specified investments as being £24M (22/23) of the total treasury management investment portfolio.

Country limits. The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent) as per the creditworthiness policy. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 7. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

The exception to this policy is the UK, which is currently rated AA- by 2 of the rating agencies. If the UK's credit rating should fall below the minimum criteria set above, investment will continue to be made in UK financial institutions if after careful consideration it is deemed appropriate to do so.

No more than 25% will be placed with any individual non-UK country or 50% total non-UK at any time.

Sector limits. The Council does not currently use sector limits e.g. banks v. building societies due to the limited number of quality counterparties available. The Council has a limit of between £4M and £12M (see Appendix 6 and 7 for investment categories) which can be invested with a single counterparty (or group) depending on the credit quality of the counterparty.

Every effort will be made to spread the maturity profile of investments to compensate for the lack of sector or country spreads (due to limited counterparties).

4.4 Investment Strategy

The Council does not utilise external fund managers, but reserves the option to do so in the future should this be deemed to be appropriate, although it does invest in pooled funds. Should consideration be given to exercising the option of external fund managers in the future, the relevant Committee will be advised of the reason for doing so.

The Council's funds are therefore all managed in-house although £7m is invested in pooled funds - £5m in a property fund and £2m in a diversified fund run by CCLA (Churches, Charities and Local Authorities).
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 for longer periods. 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.

The average level of funds available for investment purposes is currently £77M (as at 31 December 2021). These funds are partially cash-flow derived and there is a core balance of approximately £50M which is available for investments over a year (maximum 5 years or 25 years for property funds). The core balance is comprised of funds that are available due to a number of factors including the setting aside of funds to repay the HRA loans (£1.36M from 22-23 - previously £3.5M) for when they become repayable, the Earmarked Reserves, Capital Receipt, General Fund and HRA balances which were £29.16, £1.93m, £10.08m and £8.83m at 31 March 2021 respectively.

The Council has the following spanning the financial year and there are no forward commitments (deals) for the financial year 2022/23;

- £5m invested in the CCLA property fund
- £2m invested in the CCLA diversified fund

Investment returns expectations.
The current forecast shown in paragraph 3.3, includes a forecast for a first increase in Bank Rate in May 2022, though it could come in February.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year, (based on a first increase in Bank Rate in quarter 2 of 2022), are as follows.:

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

For its cash flow generated balances, the Council will seek to utilise its call accounts notice accounts, money market funds and short-dated deposits, in order to benefit from the compounding of interest.

The Council's budgeted rate of return for 2022/23 is 0.84% based on 0.48% of funds that are already invested; 3.9% for the property fund (£5M), 2.9% for the diversified fund (£2m), 0.34% for the remaining core balances; and 0.18% for short term cash flow derived balances. The total investment income budget for 2022/23 is £370k (compared to £332k in 2021/22) which highlights a slight expected improvement in the rates contributing to the returns.

The Council currently uses three types of Pooled Funds; property Funds, diversified funds and MMFs. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns particulary in the case of the property and diversified funds.

MMFs are used for short term daily surpluses of cash as they provide instant liquidity with high quality counterparties, but due to the pandemic, like other institutions, the rates are extremely low (0.06% - 0.13%).

The MMFs are “triple A” rated, liquid, and are currently all LVNAV (Low Volatility net asset value). This is a change from the previous constant net asset value (CNAV) as a result of the MMF reform where typically for every pound of principal invested you got a pound back. It is not guaranteed, but LVNAV offers better protection than using the VNAV (Variable net asset value) MMFs.

LVNAV MMFs are permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the fund does not deviate from the dealing NAV by more than 20 basis points.

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 limits in appendix 1 (shown below- top line):

Upper limit for principal sums invested for longer than 365 days			
£m	**2022/23**	**2023/24**	**2024/25**
Principal sums invested for longer than 365 days	£24m	£22m	£18m
Current investments as at 31/12/21 in excess of 1 year	£7m	£7m	£7m

4.5 Changes from last year

This report includes additions to the counterparty lending list (appendix 7) in the way of JP Morgan Chase Bank and National Australia Bank. They both adhere to the minimum credit criteria in category 1 and have been added for diversification/to offer further options in this low interest rate environment.

Also 3.4.1 – further borrowing options have been added to ensure the best funding source can be selected should the Council require external borrowing.

4.6 Investment risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of O/N SONIA (Sterling Overnight Index Average) compounded rate. The Council previously used the 7 day LIBID rate, but this ceased at the end of 2021.

The SONIA is a risk-free rate for sterling markets administered by the Bank of England. It is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and institutional investors.

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.

The Council has also subscribe to Link's Investment Benchmarking Club to review the investment performance and risk of the portfolios.

4.7 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.

4.8 Scheme of delegation

Please see Appendix 9.

4.9 Role of the section 151 officer

Please see Appendix 10.

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Prudential and treasury indicators

APPENDIX 1

1. PRUDENTIAL INDICATORS	2020/21	2021/22	2022/23	2023/24	2024/25
Extract from budget and rent setting report	**Actual**	**Probable outturn**	**Original**	**Original**	**Original**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure					
Non – HRA	2,930	3,851	3,939	2,446	2,142
HRA	6,472	8,488	8,351	6,560	6,774
TOTAL	**9,402**	**12,339**	**12,290**	**9,006**	**8,916**
Ratio of financing costs to net revenue stream					
Non – HRA	(1.96)%	(1.90)%	(1.88)%	(2.05)%	(2.05)%
HRA	31.84%	32.32%	*15.58%	16.32%	15.72%
Capital Financing Requirement as at 31 March					
Non – HRA	(4,223)	(4,442)	(3,655)	(3,742)	(3,830)
HRA	52,973	49,347	54,475	61,852	61,010
TOTAL	**48,750**	**44,905**	**50,820**	**58,110**	**57,180**
Annual change in Cap. Financing Requirement					
Non – HRA	(214)	(219)	787	(87)	(88)
HRA	*608	(3,626)	5,128	7,377	(842)
TOTAL	**394**	**(3,845)**	**5,915**	**7,289**	**(930)**

* Reduced VRP for HRA debt

2. TREASURY MANAGEMENT INDICATORS	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Probable outturn	Original	Original	Original
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	60,000	54,000	53,000	60,000	59,000
Other long term liabilities	1,000	1,000	5,000	5,000	5,000
TOTAL	**61,000**	**55,000**	**58,000**	**65,000**	**64,000**
Operational Boundary for external debt					
Borrowing	57,000	49,000	48,000	55,000	54,000
other long term liabilities	1,000	1,000	5,000	5,000	5,000
TOTAL	**58,000**	**50,000**	**53,000**	**60,000**	**59,000**
Actual external debt	44,320	35,460	35,460	35,460	35,460
Upper limit for total principal sums invested for over 365 days (£m)	**18,000**	**18,000**	**24,000**	**22,000**	**18,000**

2022/23 potentially up to £7m of borrowing for garages and sheltered accommodation. (Plus £1m internal borrowing for Arun Leisure centre works)

2023/24 potentially up to £9m of borrowing for garages, Sheltered accommodation and new HRA acquisitions.

Maturity structure of fixed rate borrowing - upper & Lower limits	Actual at 31/3/22	lower limit	upper limit
under 12 months	0%	0%	40%
12 months and within 24 months	0%	0%	40%
24 months and within 5 years	0%	0%	50%
5 years and within 10 years	25%	0%	60%
10 years and above	75%	0%	100%

APPENDIX 2

Minimum Revenue Provision Policy

1. Introduction

1.1 DLUHC Guidance on Minimum Revenue Provision (fourth edition -issued in 2018) is currently out for consultation. It places a duty on local authorities to make a prudent provision for debt redemption. Where the Council finances capital expenditure by debt it must set aside resources to repay that debt in later years. The amount charged to revenue for the repayment of this debt is known as the Minimum Revenue Provision (MRP). The MRP charge is the means by which capital expenditure which has been funded by borrowing is paid for by council taxpayers.

1.2. From 2007/08 onwards there has been no statutory minimum and the requirement is simply for local authorities to make a prudent level of provision, and the government has instead issued statutory guidance, which local authorities are required to 'have regard to' when setting a prudent level of MRP. The guidance gives local authorities more freedom to determine what would be a prudent level of MRP.

1.3. The DLUHC guidance requires the authority to approve an annual MRP statement, and recommends 4 options for calculating a prudent amount of MRP, for approval by Full Council in advance of the year to which it applies. Any subsequent revisions to that policy should also be approved by Full Council.

2. Details of DLUHC Guidance on MRP

2.1. The statutory guidance issued by DLUHC sets out the broad aims of a prudent MRP Policy as being "to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of the grant." It then identifies four options for calculating MRP and recommends the circumstances in which each option should be used, but states that other approaches are not ruled out.

2.2. The four MRP options available are:

- **Option 1**: Regulatory Method - is the previous statutory method, which is calculated as 4% of the Council's General Fund Capital Financing Requirement, adjusted for smoothing factors from the transition to the prudential capital financing regime in 2003.

- **Option 2**: CFR Method - Option 2 differs from Option 1 only in that the smoothing factors are removed. Option 2 has been included by DLUHC to provide a simpler calculation for those councils for whom it would have a minimal impact, but the draft guidance does not expect it to be used by councils for whom it would significantly increase MRP.

- **Option 3**: Asset Life Method – MRP is charged over the expected useful life of the asset either in equal instalments or using an annuity method whereby the MRP increases in later years.

- **Option 4**: Depreciation Method - MRP is charged over the expected life of the asset in accordance with depreciation accounting. This would mean that the rate at which the MRP is charged could increase (or, more rarely, decrease) from year to year.

  The guidance clearly states this does not preclude other prudent methods to provide for the repayment of debt principal.

2.3 Under the statutory guidance, it is recommended that local authorities use Options 3 or 4 for all prudential borrowing and for all borrowing to fund capitalised expenditure (such as capital grants to other bodies and capital expenditure on IT developments). Authorities may use any of the four options for MRP for their remaining borrowing to fund capital expenditure.

2.4. For balance sheet liabilities relating to finance leases and PFI schemes, the guidance recommends that one prudent approach would be for local authorities to make an MRP charge equal to the element of the annual rental which goes to write down the balance sheet liability. This would have the effect that the total impact on the bottom line would be equal to the actual rentals paid for the year. However the guidance also mentions that Option 3 could be used for this type of debt.

2.5 The guidance also allows authorities to take an MRP Holiday where assets do not become operational for perhaps 2 or 3 years or longer. It proposes that MRP would not be charged until the year following the one in which the asset became operational.

3. Details of Statute - Part 4 Section 23 b of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

3.1 In deciding on the appropriate level of MRP to charge and the most appropriate method of financing the capital programme, the Council needs to have regard to the wider legislation regarding the use of capital receipts.

3.2 Statute gives local authorities the option to apply capital receipts to fund the payment of any liabilities relating to finance leases and PFI schemes. This is a reflection of the fact that such schemes are being treated in accounting terms as the acquisition of fixed assets, and the liability represents the amount being paid towards the purchase of the asset itself, rather than interest or service charges payable.

3.3 Local authorities may also use capital receipts to repay any borrowing that was incurred to fund capital expenditure in previous years.

4. MRP Policy

It is recommended the Council adopt the following MRP policy:

- MRP will be charged utilising **option 3** for assets which have been funded from prudential borrowing.
- MRP will only be charged in the year following the asset becoming operational.
- If capital receipts are utilised to repay debt in year, the value of MRP chargeable will be reduced by the value of the receipts utilised.
- Whether an annuity or equal instalment method is adopted for option 3 will be dependent on the most financially beneficial method as determined by the Chief Financial Officer
- For PFI and Finance lease liabilities an MRP charge will be made to match the value of any liabilities that have not been funded from capital receipts.
- The Chief Finance Officer will determine annually the most prudent use of Capital Receipts, taking into account forecasts for future expenditure and the generation of further receipts.
- There is no requirement for the HRA to make debt repayments but it has opted to make voluntary repayments relating to debt inherited due to HRA self-financing settlement and provision has been made within the business plan to show that it can pay down the remaining debt over the life of the business plan.
- Any major revisions to this policy will be presented to Full Council for approval.

INVESTMENTS at 31st December 2021

Appendix 3

Type of Investment/Deposit	Reference no.	Counterparty	Issue Date	Maturity Date	Nominal	Current Interest Rate
Fixed Term Deposit	777	Goldman Sachs	15/01/2021	14/01/2022	£1,000,000.00	0.085
Fixed Term Deposit	783	Qatar National Bank	01/04/2021	01/04/2022	£1,000,000.00	0.535
Fixed Term Deposit	784	Qatar National Bank	06/04/2021	07/03/2022	£3,000,000.00	0.505
Fixed Term Deposit	786	Goldman Sachs	07/04/2021	07/01/2022	£1,000,000.00	0.31
Fixed Term Deposit	787	Qatar National Bank	26/04/2021	21/03/2022	£2,000,000.00	0.505
Fixed Term Deposit	789	Qatar National Bank	04/05/2021	21/03/2022	£1,000,000.00	0.485
Fixed Term Deposit	791	Goldman Sachs	21/05/2021	23/05/2022	£7,000,000.00	0.325
Fixed Term Deposit	792	Qatar National Bank	07/06/2021	06/06/2022	£1,000,000.00	0.56
Fixed Term Deposit	796	Thurrock Council	15/06/2021	15/02/2022	£3,000,000.00	0.12
Fixed Term Deposit	797	Close Brothers	10/08/2021	10/08/2022	£1,000,000.00	0.45
Fixed Term Deposit	799	Close Brothers	03/09/2021	05/09/2022	£3,000,000.00	0.45
Fixed Term Deposit	801	Standard Chartered Bank	07/07/2021	21/03/2022	£1,000,000.00	0.15
Fixed Term Deposit	802	Qatar National Bank	03/08/2021	02/08/2022	£1,000,000.00	0.585
Fixed Term Deposit	803	NatWest Bank	16/07/2021	16/03/2022	£2,000,000.00	0.09
Fixed Term Deposit	804	Standard Chartered Bank	24/08/2021	28/03/2022	£2,000,000.00	0.12
Fixed Term Deposit	805	Close Brothers	26/10/2021	21/03/2022	£2,000,000.00	0.20
Fixed Term Deposit	806	Close Brothers	09/11/2021	21/03/2022	£2,000,000.00	0.20
Fixed Term Deposit	807	Yorkshire Building Society	20/10/2021	20/10/2022	£4,000,000.00	0.56
Fixed Term Deposit	808	Standard Chartered Bank	28/10/2021	08/04/2022	£4,000,000.00	0.30
Fixed Term Deposit	809	Standard Chartered Bank	03/11/2021	06/04/2022	£2,000,000.00	0.35
Fixed Term Deposit	810	DBS	10/11/2021	06/04/2022	£4,000,000.00	0.20
Fixed Term Deposit	811	Goldman Sachs	22/11/2021	22/11/2022	£2,000,000.00	0.825
Fixed Term Deposit	812	DBS	25/11/2021	07/02/2022	£3,000,000.00	0.12
Fixed Term Deposit	814	DBS	07/12/2021	07/02/2022	£2,000,000.00	0.11
Fixed Term Deposit	815	Standard Chartered Bank	23/12/2021	31/03/2022	£1,000,000.00	0.20
Call Account	44447	Lloyds			£1,110,000.00	0.01
Callable deposit	44443	Santander 95DN			£11,000,000.00	0.40
Property Fund	140000	CCLA (Churches, Charities and LA's)			£5,000,000.00	*3.46
Diversified Fund	140500	CCLA (Churches, Charities and LA's)			£2,000,000.00	*2.39
Money Market Fund	99999	Fidelity			£2,550,000.00	0.06
Money Market Fund	120000	Aberdeen Standard			£3,900,000.00	0.06
Money Market Fund	100500	CCLA (Churches, Charities and LA's)			£4,000,000.00	0.132
					£85,560,000.00	

* rates at December

Interest Rate Forecast 2021- 2025

APPENDIX 4

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 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
Bank Rate														
Link	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
Capital Economics	0.25	0.25	0.50	0.75	0.75	0.75	0.75	1.00	1.00	-	-	-	-	-
5yr PWLB Rate														
Link	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
Capital Economics	1.40	1.40	1.50	1.50	1.60	1.70	1.70	1.80	1.90	-	-	-	-	-
10yr PWLB Rate														
Link	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
Capital Economics	1.60	1.60	1.70	1.70	1.80	1.80	1.90	2.00	2.00	-	-	-	-	-
25yr PWLB Rate														
Link	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
Capital Economics	1.80	1.80	1.90	1.90	2.00	2.10	2.10	2.20	2.30	-	-	-	-	-
50yr PWLB Rate														
Link	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
Capital Economics	1.40	1.50	1.60	1.70	1.80	1.90	2.00	2.20	2.30	-	-	-	-	-

APPENDIX 5

5.3 ECONOMIC BACKGROUND (Link Group)

COVID-19 vaccines.

These were the game changer during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, the bursting onto the scene of the Omicron mutation at the end of November, rendered the initial two doses of all vaccines largely ineffective in preventing infection. This has dashed such hopes and raises the spectre again that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that this mutation is very fast spreading with the potential for total case numbers to double every two to three days, although it possibly may not cause so much severe illness as previous mutations. Rather than go for full lockdowns which heavily damage the economy, the government strategy this time is focusing on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection, as a booster has been shown to restore a high percentage of immunity to Omicron to those who have had two vaccinations. There is now a race on between how quickly boosters can be given to limit the spread of Omicron, and how quickly will hospitals fill up and potentially be unable to cope. In the meantime, workers have been requested to work from home and restrictions have been placed on large indoor gatherings and hospitality venues. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in sectors like restaurants, travel, tourism and hotels which had been hit hard during 2021, but could now be hit hard again by either, or both, of government restrictions and/or consumer reluctance to leave home. Growth will also be lower due to people being ill and not working. The economy, therefore, faces significant headwinds although some sectors have learned how to cope well with Covid. However, the biggest impact on growth would come from another lockdown if that happened. The big question still remains as to whether any further mutations of this virus could develop which render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- In December, the Bank of England became the first major western central bank to put interest rates up in this upswing in the current business cycle in western economies as recovery progresses from the Covid recession of 2020.
- The next increase in Bank Rate could be in February or May, dependent on how severe an impact there is from Omicron.
- If there are lockdowns in January, this could pose a barrier for the MPC to putting Bank Rate up again as early as 3rd February.
- With inflation expected to peak at around 6% in April, the MPC may want to be seen to be active in taking action to counter inflation on 5th May, the release date for its Quarterly Monetary Policy Report.

- The December 2021 MPC meeting was more concerned with combating inflation over the medium term than supporting economic growth in the short term.
- Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022.
- However, the MPC will want to normalise Bank Rate over the next three years so that it has its main monetary policy tool ready to use in time for the next down-turn; all rates under 2% are providing stimulus to economic growth.
- We have put year end 0.25% increases into Q1 of each financial year from 2023 to recognise this upward bias in Bank Rate - but the actual timing in each year is difficult to predict.
- Covid remains a major potential downside threat in all three years as we ARE likely to get further mutations.
- How quickly can science come up with a mutation proof vaccine, or other treatment, – and for them to be widely administered around the world?
- Purchases of gilts under QE ended in December. Note that when Bank Rate reaches 0.50%, the MPC has said it will start running down its stock of QE.

MPC MEETING 16H DECEMBER 2021

- The Monetary Policy Committee (MPC) voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.

- The MPC disappointed financial markets by not raising Bank Rate at its November meeting. Until Omicron burst on the scene, most forecasters, therefore, viewed a Bank Rate increase as being near certain at this December meeting due to the way that inflationary pressures have been comprehensively building in both producer and consumer prices, and in wage rates. However, at the November meeting, the MPC decided it wanted to have assurance that the labour market would get over the end of the furlough scheme on 30th September without unemployment increasing sharply; their decision was, therefore, to wait until statistics were available to show how the economy had fared at this time.

- **On 10th December we learnt of the disappointing 0.1% m/m rise in GDP** in October which suggested that economic growth had already slowed to a crawl even before the Omicron variant was discovered in late November. Early evidence suggests growth in November might have been marginally better. Nonetheless, at such low rates of growth, the government's "Plan B" COVID-19 restrictions could cause the economy to contract in December.

- **On 14th December, the labour market statistics** for the three months to October and the single month of October were released. The fallout after the furlough scheme was smaller and shorter than the Bank of England had feared. The single-month data were more informative and showed that LFS employment fell by 240,000, unemployment increased by 75,000 and the unemployment rate rose from 3.9% in September to 4.2%. However, the weekly data suggested this didn't last long as unemployment was falling again by the end of October. What's more, the 49,700 fall in the claimant count and the 257,000 rise in the PAYE measure of company payrolls suggests that the labour market strengthened again in November. The other side of the coin was a further rise in the number of vacancies from 1.182m to a record 1.219m in the three months to November which suggests that the supply of labour is struggling to keep up with demand, although the single-month figure for November fell for the first time since February, from 1.307m to 1.227m.

- These figures by themselves, would probably have been enough to give the MPC the assurance that it could press ahead to raise Bank Rate at this December meeting. However, the advent of Omicron potentially threw a spanner into the works as it poses a major headwind to the economy which, of itself, will help to cool the economy. The financial markets, therefore, swung round to expecting no change in Bank Rate.

- **On 15th December we had the CPI inflation** figure for November which spiked up further from 4.2% to 5.1%, confirming again how inflationary pressures have been building sharply. However, Omicron also caused a sharp fall in world oil and other commodity prices; (gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies).

- **Other elements of inflation are also transitory** e.g., prices of goods being forced up by supply shortages, and shortages of shipping containers due to ports being clogged have caused huge increases in shipping costs. But these issues are likely to clear during 2022, and then prices will subside back to more normal levels. Gas prices and electricity prices will also fall back once winter is passed and demand for these falls away.

- Although it is possible that the Government could step in with some **fiscal support for the economy**, the huge cost of such support to date is likely to pose a barrier to incurring further major economy wide expenditure unless it is very limited and targeted on narrow sectors like hospitality, (as announced just before Christmas). The Government may well, therefore, effectively leave it to the MPC, and to monetary policy, to support economic growth – but at a time when the threat posed by rising inflation is near to peaking!

- This is the adverse set of factors against which the MPC had to decide on Bank Rate. For the second month in a row, the MPC blind-sided financial markets, this time with a **surprise increase in Bank Rate from 0.10% to 0.25%.** What's more, the hawkish tone of comments indicated that the MPC is now concerned that inflationary pressures are indeed building and need concerted action by the MPC to counter. This indicates that there will be more increases to come with financial markets predicting 1% by the end of 2022. The 8-1 vote to raise the rate shows that there is firm agreement that inflation now poses a threat, especially after the CPI figure hit a 10-year high this week. The MPC commented that "there has been significant upside news" and that "there were some signs of greater persistence in domestic costs and price pressures".

- On the other hand, it did also comment that **"the Omicron variant is likely to weigh on near-term activity".** But it stressed that at the November meeting it had said it would raise rates if the economy evolved as it expected and that now "these conditions had been met". It also appeared more worried about the possible boost to inflation form Omicron itself. It said that "the current position of the global and UK economies was materially different compared with prior to the onset of the pandemic, including elevated levels of consumer price inflation". It also noted the possibility that renewed social distancing would boost demand for goods again, (as demand for services would fall), meaning "global price pressures might persist for longer". (Recent news is that the largest port in the world in China has come down with an Omicron outbreak which is not only affecting the port but also factories in the region.)

- On top of that, there were no references this month to inflation being expected to be below the **2% target in two years' time,** which at November's meeting the MPC referenced to suggest the markets had gone too far in expecting interest rates to rise to over 1.00% by the end of the year.

- These comments indicate that there has been a material reappraisal by the MPC of the inflationary pressures since their last meeting and the Bank also increased its forecast for inflation to peak at 6% next April, rather than at 5% as of a month ago. However, as the Bank retained its guidance that only **a "modest tightening"** in policy will be required, it cannot be thinking that it will need to increase interest rates that much more. A typical policy tightening cycle has usually involved rates rising by 0.25% four times in a year. "Modest" seems slower than that. As such, the Bank could be thinking about raising interest rates two or three times next year to 0.75% or 1.00%.

- In as much as a considerable part of the inflationary pressures at the current time are indeed **transitory,** and will naturally subside, and since economic growth is likely to be weak over the next few months, this would appear to indicate that this tightening cycle is likely to be comparatively short.

- As for the timing of the next increase in Bank Rate, the MPC dropped the comment from November's statement that Bank Rate would be raised "in the coming months". That may imply another rise is unlikely at the next meeting in February and that May is more likely. However, much could depend on how adversely, or not, the economy is affected by Omicron in the run up to the next meeting on 3rd February. Once 0.50% is reached, the Bank would act to start shrinking its stock of QE, (gilts purchased by the Bank would not be replaced when they mature).

- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
    - Raising Bank Rate as "the active instrument in most circumstances".
    - Raising Bank Rate to 0.50% before starting on reducing its holdings.

- Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

- **US.** Shortages of goods and intermediate goods like semi-conductors, have been fuelling increases in prices and reducing economic growth potential. In November, **CPI inflation hit a near 40-year record level of 6.8%** but with energy prices then falling sharply, this is probably the peak. The biggest problem for the Fed is the mounting evidence of a strong pick-up in cyclical price pressures e.g., in rent which has hit a decades high.
- **Shortages of labour** have also been driving up wage rates sharply; this also poses a considerable threat to feeding back into producer prices and then into consumer prices inflation. It now also appears that there has been a sustained drop in the labour force which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023 while core inflation is likely to remain elevated at around 3% in both years instead of declining back to the Fed's 2% central target.
- Inflation hitting 6.8% and the feed through into second round effects, meant that it was near certain that the **Fed's meeting of 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 as the chairman of the Fed stated his view that the economy had made rapid progress to achieving the other goal of the Fed – "maximum employment". The Fed forecast that inflation would fall from an average of 5.3% in 2021 to 2.6% in 2023, still above its target of 2% and both figures significantly up from previous forecasts. What was also significant was that this month the Fed dropped its description of the current level of inflation as being "transitory" and instead referred to "elevated levels" of inflation: the statement also dropped most of the language around the flexible average inflation target, with inflation now described as having exceeded 2 percent "for some time". It did not see Omicron as being a major impediment to the need to take action now to curtail the level of inflationary pressures that have built up, although Fed officials did note that it has the potential to exacerbate supply chain problems and add to price pressures.
  See also comments in paragraph 3.3 under PWLB rates and gilt yields.

- **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, in line with the ECB's latest projection.
- **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.

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

- However, the pace of economic growth has now fallen back in **2021** after this initial surge of recovery from the pandemic and looks likely to be particularly weak in 2022. China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. Chinese consumers are also being very wary about leaving home and so spending money on services. However, with Omicron having now spread to China, and being much more easily transmissible, this strategy of sharp local lockdowns to stop the virus may not prove so successful in future. In addition, the current pace of providing boosters at 100 billion per month will leave much of the 1.4 billion population exposed to Omicron, and any further mutations, for a considerable time. The **People's Bank of China** made a start in December 2021 on cutting its key interest rate marginally so as to stimulate economic growth. However, after credit has already expanded by around 25% in just the last two years, it will probably leave the heavy lifting in supporting growth to fiscal stimulus by central and local government.
- Supply shortages, especially of coal for power generation, were causing widespread power cuts to industry during the second half of 2021 and so a sharp disruptive impact on some sectors of the economy. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

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

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

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

Specified and Non-Specified Investments **APPENDIX 6**

	specified	non-specified	Minimum Credit Criteria Fitch (and equivalent) / Minimum Criteria	Maximum Investment per Institution	Max. maturity period
Term deposits – Local Authorities **(category 1)**	✓	✓	--	£12M	5 years
Term deposits – banks and building societies **(category 1)**	✓	✓	Short-term F1+ Long-term AA-	£12M	5 years
Term deposits – banks and building societies **(category 2)**	✓	✓	Short-term F1 Long-term A+	£11M	3 years
Term deposits – banks and building societies **(category 3)**	✓	✓	Short-term F1 Long-term A-	£8M	2 years
Term deposits – building societies **(Category 4)**	✓	✓	Assets in Excess of £10 billion	£4M	1 year
Council's bank (for term deposits use appropriate category 1 to 3) **(category 5)**	✓	✓	n/a	No limit *Although category limit for term deposits*	As category 1 to 3
Term deposits – UK part nationalised banks **(category 6)**	✓	✓	Short-term F3 Long term BBB-	£11M	3 years
Callable deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Forward deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Alternative Investments – Asset Backed Bonds **(Category 8)**		✓	--	£4M	25 years
Debt Management Agency Deposit Facility **(category 9)**	✓	✓	--	No limit	Liquid

Bonds Issued by multilateral development banks **(category 10)**		✓	Long term AAA	£4M	5 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)					
Money Market Funds (CNAV, LVNAV & VNAV) Government Liquidity Fund **(Category 7)**	✓		AAA	£4M	liquid
Property funds **(Category 11)**		✓		£6M	25 years
Multi-Asset Funds **(Category 12 –** diversified funds**)**		✓	--	£6M	10 - 15 years

Part nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. In particular, as they are no longer separate institutions in their own right, however, these institutions have effectively taken on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. It is therefore proposed to continue to keep the category of UK part nationalised banks for both specified and unspecified investments (category 6).

There are currently no counterparties within this section. National Westminster Bank and the Royal Bank of Scotland are part nationalised but their ratings adhere to category 2.

APPENDIX 7

LIST OF AUTHORISED COUNTERPARTIES

Category 1 - Limit of £12 million for each institution - Maximum investment period - 5 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**AA-**	**F1+**
	Moody	**Aa3**	**P-1**
	S&P	**AA-**	**A-1+**

All Local Authorities

Bank of Nova Scotia (CAN)
DBS Bank Ltd (SING)
National Australia Bank
Oversea-Chinese Banking Corp Ltd (SING)
Handelsbanken Plc (UK)
JP Morgan Chase
United Overseas Bank Ltd (SING)
First Abu Dhabi Bank (U.A.E)

Category 2 - Limit of £11 million for each institution - Maximum investment period - 3 Years

		Long Term	Short Term
Min Criteria			
	Fitch	**A+**	**F1**
	Moody	**A1**	**P-2**
	S&P	**A+**	**A-1**

Barclays Bank plc (RFB & NRFB) (UK)
Bank of Scotland PLC (RFB) (Lloyds Banking Group)
Goldman Sachs International Bank (UK)
HSBC Bank plc (UK)
Standard Charted Bank (UK)
Qatar National Bank (Qatar)
National Westminster Bank PLC (RFB) (UK)
Royal Bank of Scotland PLC (RFB) (UK)
Santander (UK)

Category 3 - Limit of £8 million for each institution - Maximum investment period - 2 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**A-**	**F1**
	Moody	**A3**	**P-2**
	S&P	**A-**	**A-1**

Nationwide Building Society (UK)
Close Brothers (UK)

Category 4 - Limit of £4 million for each institution - Maximum Investment period - 1 year
Building Society with Assets greater than £10 billion

Coventry Building Society (UK)
Leeds Building Society (UK)
Principality Building Society (UK)
Skipton Building Society (UK)
Yorkshire Building Society (UK)

Category 5 - Council's Bank
NO LIMIT - appropriate category 1 to 3 (Max of £11M term deposit)

Lloyds Bank Plc (RFB) (Cat 2)
Lloyds Bank Corporate Markets Plc (NRFB) (Cat 2)

Category 6 - Limit of £11 million for each institution - Maximum investment period - 3 Years
banks effectively nationalised by UK government

		Long Term	Short Term
Min Criteria	**Fitch**	**BBB-**	**F3**
	Moody	**Baa3**	**P-3**
	S&P	**BBB-**	**A-3**

Category 7 - Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)

	Fitch	NAV
• Money Market Funds (MMF's), (CNAV, LVNAV, VNAV) & Enhanced MMF's • Government Liquidity Funds		

Limit of £4million for each institution

Aberdeen Standard (GBP)	AAA	LVNAV
CCLA Public sector deposit fund (PSDF)	AAA	LVNAV
Deutsche Banking Group	AAA	LVNAV
Federated Investors Ltd	AAA	LVNAV
Fidelity (GBP)	AAA	LVNAV
Northern Trust	AAA	

Category 8 - Alternative Investments (Asset Backed Bonds) - 25 Years
Maximum investment £4 million

Category 9 - Debt Management Office
Debt management Account - NO LIMIT (UK Govt)

Category 10 - Bonds issued by multilateral development banks - 5 Years
Maximum investment £4 million AAA

Category 11 – Property Funds - 25 Years
Maximum investment £6 million

CCLA

Category 12 - Multi-Asset Funds - 15 Years
Maximum investment £6 million

CCLA - Diversified Income Fund

Appendix 8

Approved countries for investments

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest of 2 or more rating agencies) 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 Asset Services credit worthiness service.

Based on a majority rule of available ratings.

AAA

- Australia
- Canada (Fitch AA+)
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.S.A. (S&P AA+)

AA+

- Finland

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium (S&P AA)
- Hong Kong
- Qatar
- **U.K.** (S&P AA)

APPENDIX 9

Treasury management scheme of delegation

(i) Full Council

- receiving and reviewing monitoring and outturn reports on treasury management.
- approval of annual Treasury Management Strategy Statement and Annual Investment Strategy
- approval of MRP Statement

(ii) Policy and Finance Committee

- approval of amendments to the annual treasury management strategy once approved by Full Council between its review in consultation with the Interim Group Head of Corporate Support.
- budget consideration and approval
- approval of the division of responsibilities;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit and Governance Committee (responsibility for scrutiny)

- reviewing the treasury management policy and procedures and making recommendations to Full Council (the responsible body).
- Scrutiny of annual strategy prior to adoption by Full Council
- Scrutiny of monitoring and outturn reports
- receiving and reviewing reports on treasury management policies, practices and activities

APPENDIX 10

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.