

Report for: Cabinet

Date of Meeting:

10 February 2022

Subject:

Annual Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Annual Capital Strategy for 2022/23

Key Decision:

Yes

Responsible Officer:

Dawn Calvert, Director of Finance and Assurance

Portfolio Holder:

Councillor Natasha Proctor - Deputy Leader and Portfolio Holder for Finance and Resources

Exempt:

No

Decision subject to Call-in:

No

Wards affected:

All wards

Enclosures:

Appendix A - Legislation and Regulations Impacting on Treasury Management
Appendix B - Treasury Management Delegations and Responsibilities
Appendix C - Minimum Revenue Provision (MRP) Policy Statement
Appendix D - Interest Rate Forecasts 2021-25
Appendix E - Economic Background
Appendix F – Counterparties: Investment Criteria
Appendix G - Capital Strategy 2022/23
Appendix H - Glossary

Section 1 – Summary and Recommendations

This report sets out the Council's Annual Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement the Annual Investment Strategy and the Annual Capital Strategy for 2022/23.

Recommendations:

Cabinet is asked to recommend to Council that they approve the Treasury Management Strategy Statement for 2022/23 including:

1. Prudential Indicators for the period 2022/23 to 2024/25
2. Minimum Revenue Provision Policy Statement for 2022/23, (see para 2.8 and Appendix C)
3. Annual Investment Strategy for 2022/23
4. Annual Capital Strategy (Appendix G).

Reason: (for recommendations)

To promote effective financial management relating to the Authority's borrowing and investment powers contained in the Local Government Act 2003, and supporting regulations and guidance detailed below:

- the Local Authorities (Capital Finance and Accounting) Regulations 2003 (as amended),
- CIPFA Prudential Code and Treasury Management Code of Practice 2017
- DLUHC (Previously MHCLG) Investment and MRP Guidance 2018

On 20 December 2021, CIPFA published a revised Prudential Code and Treasury Management Code of Practice. CIPFA have stated that formal reporting with regards to the requirements of the revised Codes should be from 2023/24. The Authority will work to implement the requirements of the revised Prudential Code and Treasury Management Code of Practice and accompanying supplementary guidance notes throughout 2022/23 to be able to report formally from 2023/24.

Section 2 – Report

1.0. Introduction

- 1.1. 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.

- 1.2. 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.
- 1.3. 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.
- 1.4. 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."
- 1.5. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code (The Prudential Code for Capital Finance in Local Authorities) and Treasury Management Code (Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes), in setting Treasury and Prudential Indicators for the next three years and in ensuring that the Council's capital investment programme is affordable, prudent and sustainable. This report has been prepared in accordance with the CIPFA Prudential Code and Treasury Management Code of Practice 2017 publications. On the 20 December CIPFA published a revised Prudential Code and Treasury Management Code of Practice. The accompanying Guidance Notes were published in late January 2022. CIPFA have stated that local authorities are required to introduce the formal reporting requirements of the 2021 Prudential Code and Treasury Management Code of Practice for 2023/24. A summary of the changes required by the 2021 CIPFA Codes is included within Appendix A.
- 1.6. The Act, the CIPFA Codes and Department for Levelling Up Housing and Communities (DLUHC formally MHCLG) Investment Guidance (2018) require the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy that establishes the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. A summary of the relevant legislation, regulations and guidance is included as Appendix A.
- 1.7. The budget for each financial year includes the revenue costs that flow from capital financing decisions. Under the Treasury Management Code, increases in capital expenditure should be limited to levels whereby increases in interest

charges, running costs and provision debt repayment are affordable within the Council's budget.

- 1.8. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
- 1.9. The Council recognises that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Reporting Requirements

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

Treasury Management Strategy Statement Report – (this report) The first, and most important report is forward looking and covers:

- the capital plans, (including prudential indicators)
- a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time)
- the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed)

Mid-Year Review Report – This is primarily a progress report presented to Cabinet in December/January and updates Members on the progress of the Capital Programme, reporting on Prudential Indicators to give assurance that the treasury management function is operating within the Treasury Limits and Prudential Indicators set out in the TMSS.

Treasury Management Outturn Report – This is a backward looking review, typically presented to Cabinet in June/July and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the TMSS and Mid-Year Reports.

- 1.11. **Capital Strategy** – In addition to the three main treasury management reports, the CIPFA 2017 Prudential and Treasury Management Codes introduced a requirement for all local authorities to prepare a capital strategy report which provides 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
- 1.12. The aim of the 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. The Capital Strategy Report is set out in Appendix G.

- 1.13. **Scrutiny** – The above reports are required to be adequately scrutinised, normally before being recommended to Cabinet/Council, with the role being undertaken by the Governance, Audit, Risk Management and Standards Committee (GARMS). The Council has complied with the CIPFA Treasury Management Code of Practice to the extent that all Treasury Management reports have been scrutinised though the efficient conduct of the Council's business may require consideration by GARMS subsequent to consideration by Cabinet/Council.
- 1.14. The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Section 151 Officer. The Section 151 Officer chairs the Treasury Management Group (TMG), which monitors the treasury management activity and market conditions monthly. Further details of delegated responsibilities are given in Appendix B.

Options considered

- 1.15. This report has been produced in accordance with the Local Government Act 2003 and the reporting requirements of:
- CIPFA Treasury Management Code of Practice 2017
 - CIPFA Prudential Code 2017
 - DLUHC Investment Guidance 2018
 - DLUHC MRP Guidance 2018

Treasury Management Strategy for 2022/23

- 1.16. The strategy for 2022/23 covers the following areas:

Capital Issues (Section 2)

- Capital Financing Summary
- Capital Programme and Capital Prudential Indicators 2021/22 to 2024/25
- Council's Borrowing Need (Capital Financing Requirement)
- Capital Financing Requirement
- Minimum Revenue Provision (MRP) Policy Statement
- Core funds and expected investment balances

Borrowing (Section 3)

- Current and estimated portfolio position
- Treasury indicators: limits to borrowing activity
- Prospects for interest rates and economic commentary
- Borrowing strategy
- Treasury management limits on activity
- Policy on borrowing in advance of need
- Debt rescheduling
- New financial institutions as a source of borrowing and / or types of borrowing (if applicable)
- Approved sources of long- and short-term borrowing

Annual Investment Strategy (Section 4)

- Investment policy
- Creditworthiness policy
- Country limits
- Annual Investment Strategy
- Investment risk benchmarking
- End of year investment report

Other Treasury Issues (Section 5)

- Policy on the use of financial derivatives
- Brokers
- Member and Officer Training
- Policy on use of external service providers

- 1.17. These Treasury Management elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, DLUHC MRP Guidance, the CIPFA Treasury Management Code and DLUHC Investment Guidance. This Annual Treasury Management Strategy covers only those investments arising from the Council's cash flows and debt management activity. The power to invest is set out in Section 12 of the Local Government Act 2003. In accordance with the Treasury Management Code, Investment Guidance and recognised best practice guidelines, the security and liquidity of funds are placed ahead of investment return/yield.
- 1.18. It is not considered necessary to produce a separate treasury management strategy for the Housing Revenue Account (HRA) in light of the co-mingling of historic debt and investments between HRA and the General Fund. Where appropriate, details of allocations of balances and interest to HRA are contained in this report.

Capital Issues

- 2.0. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.
- 2.1. The figures and tables in this report are based on the final Capital Programme which is set out in a separate report to Cabinet.

Capital Expenditure

- 2.2. 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.
- 2.3. Tables 1 and 2 below summarise the capital expenditure plans of the Authority including how this will be financed, which generates the net financing need for the year (borrowing):

Table 1: Capital Expenditure

Capital expenditure £'000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
- Resources and Commercial	10,044	15,183	2,550	1,850	3,550
- People's	1,645	28,886	0	9,071	0
- Community	30,371	69,656	32,504	28,733	18,214
General Fund	42,060	113,725	35,055	39,654	21,764
HRA	12,537	75,781	34,124	69,920	44,317
Total	54,597	189,506	69,179	109,574	66,081

Table 2: Financing of Capital Expenditure

Financing of capital expenditure £'000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund					
Capital Receipts	1,602				
Capital Grants	6,562	46,955	7,614	13,632	3,113
BCiL	2,824		1,750	3,410	1,650
NCiL	272		500	500	500
Section 106	880		250	500	500
Revenue	60				
External Funding	12,200	46,955	10,114	18,042	5,763
Net financing need for year (GF)	29,860	66,770	24,941	21,611	16,001

HRA

Capital Receipts			3,851	1,782	6,319
Capital Grants	3,695	46,094	14,535	6,142	8,140
Section 106			0	2,736	1,567
Revenue	8,842		10,452	11,528	7,616
External Funding	12,537	46,094	28,838	22,188	23,642
Net financing need for year (HRA)	0	29,687	5,286	47,732	20,675
Total net financing need for year	29,860	96,457	30,227	69,343	36,676

The Council's borrowing need (Capital Financing Requirement)

- 2.4. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.
- 2.5. The CFR includes any other long-term liabilities (e.g. PFI or finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a funding facility and so the Council is not required to borrow separately for them. The Council currently has £17m of such schemes within the CFR.
- 2.6. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

- 2.7. The Council is asked to approve the CFR projections below (included within the Prudential Indicators):

Table 3: Capital Financing Requirement

Capital Financing Requirement £'000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
CFR – General Fund	422,193	467,830	469,513	467,160	459,075
CFR – HRA	150,674	180,361	185,647	233,379	254,054
Total CFR	572,867	648,191	655,160	700,539	713,129
Movement in CFR	11,208	75,324	6,969	45,379	12,590

Movement in CFR represented by					
Net financing need for the year (table 2)	29,860	96,457	30,227	69,343	36,676
Less MRP/VRP and other financing movements	-18,652	-21,133	-23,258	-23,964	-24,086
Movement in CFR	11,208	75,324	6,969	45,379	12,590

Minimum revenue provision (MRP) policy statement

- 2.8. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. The accounting approach is to spread the cost over the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax.
- 2.9. Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) require the Council to approve an MRP Statement setting out what provision is to be made in the General Fund for the repayment of debt, and how the provision is to be calculated. The purpose of the Statement is to ensure the provision is prudent, allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure benefits. The Council is recommended to approve the statement as detailed in Appendix C.
- 2.10. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.
- 2.11. MRP Overpayments - A change introduced by the revised 2018 MHCLG (now DLUHC) MRP Guidance was the allowance that any charges made over the statutory MRP required, referred to as an overpayment and itemised as a voluntary revenue provision (VRP) 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, it is recommended to disclose the cumulative overpayment made each year in a disclosure statement to full Council. At 31 March 2021 the balance of VRP was £6.8m (£7.8m 31 March 2020).

Core funds and expected investment balances

- 2.12. The application of resources (grants, capital receipts etc.) to finance capital expenditure or 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.).

- 2.13. The cash investment balance will be kept at a minimum of £30m. The working capital and borrowing position will be managed to maintain this level of cash balances as a minimum position for the Authority.

Borrowing

- 3.0. The capital expenditure plans set out in Table 1 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

Current portfolio position

- 3.1. The overall treasury management portfolio on 31 March 2021 and corresponding position at 31 December 2021 are shown below for both borrowing and investments.

Table 4: Borrowing Portfolio

Borrowing Portfolio £'000	31-Mar-21			31-Dec-21		
	Principal	Average Rate (%)	Average Life (yrs)	Principal	Average Rate (%)	Average Life (yrs)
- PWLB	348,461	3.45%	36.04	348,461	3.45%	35.28
- Market	73,800	3.53%	41.69	73,800	3.53%	40.94
Total borrowing	422,261	3.46%	37.02	422,261	3.46%	36.27

Table 5: Investment Portfolio

Investment Portfolio £'000	31-Mar-21			31-Dec-21		
	Principal	Average Rate (%)	Average Life (days)	Principal	Average Rate (%)	Average Life (days)
- MMFs	1,616	0.00%	1	1,616	0.02%	1
- Banks	80,838	0.01%	4	116,543	0.01%	4
Total Investments	82,454	0.01%	4	118,160	0.01%	4

- 3.2. The Council maintains upper and lower limits with respect to the maturity structure of its borrowing. This Prudential Indicator, reflecting the earliest date at which a lender can require payment is set to ensure refinancing risk is managed regarding the concentration of loan maturities in any one period. Table 6 below illustrates the actual position on both 31 March 2021 and 31 December 2021, compared to the upper and lower limits in place.

Table 6: Maturity Structure of Borrowing

Maturity structure of borrowing 2021/22	Lower Limit	Upper Limit	Actual 31.03.21	Actual 31.12.21
Under 12 months	0%	40%	5%	6%
12 months to 2 years	0%	30%	1%	0%
2 years to 5 years	0%	30%	0%	0%
5 years to 10 years	0%	40%	5%	5%
10 years and above	30%	100%	89%	89%

- 3.3. 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. The expected change in borrowing has been calculated on the basis of maintaining an under borrowing position of £130m from 2022/23, replicating the actual position as 31 March 2021.

- 3.4. The underborrowing projection for 2021/22 within table 7 is high due to the CFR estimate of £648m which is based on the original capital programme. The Council's Q3 Monitoring Report identifies £108m of slippage in the 2021/22 Capital Programme. The final figure will be reflected in the actual CFR at 31 March 2022 but due to this slippage it is currently anticipated that no new borrowing will be undertaken over the remainder of 2021/22.

Table 7: Gross Debt v Capital Financing Requirement

£'000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
External Debt					
Borrowing at 1 April	422,261	422,261	422,261	510,080	556,558
Expected change in borrowing	0		87,819	46,478	13,586
Other long-term liabilities (OLTL)	18,739	17,570	16,303	15,080	13,981
Expected change in OLTL	-1,169	-1,267	-1,223	-1,099	-996
Actual gross debt at 31 March	439,831	438,564	525,160	570,539	583,129
CFR	572,867	648,191	655,160	700,539	713,129
Under / (over) borrowing	133,036	209,627	130,000	130,000	130,000

- 3.5. 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 2021/22 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.
- 3.6. The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view considers current commitments, existing plans, and the proposals in this budget report.
- 3.7. The Prudential Code framework is a principles-based system whereby the Council should demonstrate that its capital plans are prudent, affordable and sustainable. One of the Prudential Indicators of affordability is the ratio of financing costs to net revenue stream, assessing the actual and estimated cost of capital against the income of the Authority. Table 8 provides the expected trends based on the forthcoming capital programme, for both the General Fund and HRA.

Table 8: Ratio of Financing Costs to Net Revenue Stream

Ratio of financing costs to net revenue stream %	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund	16%	18%	19%	20%	20%
HRA	20%	19%	20%	21%	22%
Total	16%	18%	19%	20%	20%

Treasury Indicators: limits to borrowing activity

The operational boundary

- 3.8. This is the limit beyond which external debt is not normally expected to exceed. The boundary is based on the Council's programme for capital expenditure, capital financing requirement and cash flow requirements for the year.

Table 9: Operational Boundary

Operational boundary £'000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Borrowing	594,393	630,621	638,857	685,459	699,148
Other long term liabilities	18,520	17,570	16,303	15,080	13,981
Total	612,913	648,191	655,160	700,539	713,129

The authorised limit for external debt.

- 3.9. This is a key prudential indicator and 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.
- 3.10. 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.
- 3.11. The Council is asked to approve the following authorised limit:

Table 10: Authorised Limit

Authorised limit £'000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Borrowing	624,393	660,621	668,857	715,459	729,148
Other long term liabilities	28,520	27,570	26,303	25,080	23,981
Total	652,913	688,191	695,160	740,539	753,129

Prospects for Interest Rates

PWLB Consultation

- 3.12. The Council's Treasury Management Adviser, Link Group, provided the following interest rate forecast on 20 December 2021. This includes forecasts for PWLB certainty rates, calculated as gilt yields plus 80 bps.
- 3.13. 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.

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

- 3.14. Inflation concerns, particularly around energy prices is placing additional pressure on the Bank of England to raise Bank Rate faster than previously anticipated. On the 3 February 2022, the Bank of England raised Bank Rate a further 0.25% to 0.50% with CPI Inflation now expected to peak at 7.25% in April 2021 and remain above the 2% target for all of 2022 and 2023.
- 3.15. Investment returns are therefore expected to improve in 2022/23, with markets pricing in a further Bank Rate movements in 2022 and 2023.
- 3.16. 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. In increasing Bank Rate to 0.5% the Bank of England have signalled the start of their approach to unwinding quantitative easing. Borrowing costs remain at low levels.
- 3.17. Additional commentary on the prospects for interest rates, (Appendix D) and economic background, (Appendix E) are contained within the appendices to this report. These commentaries predate the move by the Bank of England to raise Bank Rate on 3 February 2022.
- 3.18. Updates to Link Groups interest rate forecasts are received by officers throughout the year.

Borrowing strategy

- 3.19. As shown in paragraph 3.1 on 31 December 2021 the Council had a debt portfolio of £422.261m, with an average rate of 3.46% and an average life of 36.3 years. Despite historical low borrowing costs there remains a short term cost of carrying excessive debt due to the differential between investment and borrowing costs.
- 3.20. The Council is currently maintaining an under-borrowed position, which was £133m at 31 March 2021. This means that the Capital Financing Requirement has not been fully funded with external loan debt as internal cash balances have been used temporarily to finance the capital programme. In foregoing lost investment income, the Council benefits from the differential between this and the external borrowing cost. This strategy is kept under review by the Director of Finance.
- 3.21. In terms of future borrowing, the Council has a range of funding sources available and will need to base its decisions on optimum borrowing times and periods taking into account current interest rates, forecast movements and the “cost of carry” (the difference between rates for borrowing and rates for investments).

3.22. It may be necessary to use temporary borrowing either from the money markets or from other local authorities to cover mismatches in the timing between capital grants and payments. However, with several Government grants now paid early in the financial year and robust daily monitoring of the cash flow position, the facility is unlikely.

3.23. Against this background and the risks within the economic forecast, caution will be adopted in the 2022/23 treasury management operations. The Treasury Management Group will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. This includes taking advice from Link Group, the Council's Treasury Management Advisers.

- *If it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.*
- *If it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

3.24. The Council has previously adopted a single pooled approach for debt. Allocations to HRA are based on its CFR, with interest charged to HRA at the average rate on all external borrowing. Longer term, the HRA's ability to repay borrowing will depend on future revenues and the capital expenditure programme. New HRA debt taken is maintained in a separate pool.

Policy on borrowing in advance of need

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

3.26. 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.

Debt rescheduling

3.27. Rescheduling of current borrowing in our debt portfolio is unlikely to occur due to the differential in PWLB new borrowing and premature redemption rates and the premiums quoted by market providers in respect of the Councils remaining LOBO loan.

3.28. Any debt rescheduling opportunities will be reviewed and assessed in respect of providing a benefit to the Authority over the remaining life of the loan(s).

3.29. All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

Approved Sources of Long and Short term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	●

Annual Investment Strategy

Investment policy

- 4.0. The Council's investment policy has regard to the following: -
- *DLUHC's (formally MHCLG) Guidance on Local Government Investments 2018 ("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*
- 4.1. 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.
- 4.2. 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: -
- Minimum acceptable **credit criteria** are applied 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.

- **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.
- **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Appendix F under the categories of ‘specified’ and ‘non-specified’ investments.
 - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
 - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

4.3. The Council acknowledges that both specified and non-specified investments may be subject to valuation changes, both positive and negative, prior to maturing. The Director of Finance will take all reasonable steps to ensure that day to day liquidity does not rely on the sale of such investments prior to maturity, and therefore that the Council is not exposed to realising any losses. Moreover, the Director will take measures to ensure that any potential unrealised gains or losses are proportionate to revenue budgets and reserves

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

Creditworthiness policy

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

4.6. 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.

- 4.7. 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 Director of Finance will maintain a counterparty list in compliance with the criteria detailed in Appendix F and will revise the criteria and submit any changes to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.
- 4.8. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits, unless in the opinion of the Director of Finance, or a delegated manager authorised under the Financial Services and Markets Act 2000 (FSMA), there is an overriding reason to favour or disregard a particular agency's view. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, and the institution will fall outside the lending criteria.
- 4.9. Credit rating information is supplied by the Link Group on all active counterparties that comply with the prescribed criteria detailed in Appendix F. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
- 4.10. The Council's criteria for an institution to become counterparty are detailed in Appendix F.

Country Limits

- 4.11. The Council has determined that it will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AA-. The current UK sovereign rating is AA- or equivalent. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Investment Strategy

In-house Funds

- 4.12. The Council's funds are mainly cash derived primarily from the General Fund and HRA. Balances are also held to support capital expenditure. Investments are 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).

- 4.13. Since April 2011, pension fund cash balances have been held separately from those of the Council. However, a separate investment strategy has not been developed for the pension fund and all its cash is held on overnight call account with RBS and in separate money market funds.
- 4.14. As a result of the Council's strategy, cash balances available to invest and the interest rates available the only counterparties actively in use during 2020/21 have been Lloyds, Royal Bank of Scotland Group and Handelsbanken in addition to 2 MMFs Deutsche and Fidelity. When opportunities arise consistent with the Council's policies diversification will be sought.
- 4.15. As a route to diversification, along with additional improved service resilience, economies of scale and improved returns, the Council is considering joining a collective investment arrangement as part of a shared service with the GLA, managed by the GLA's investment subsidiary, London Treasury Limited, which is authorised and regulated by the Financial Conduct Authority.
- 4.16. The Cabinet report dated 15th July 2021, set out a recommendation that the Council becomes a participant in the shared service arrangement operated by the Greater London Authority (GLA) for the provision of treasury management services. This will include the Council transferring its investment balances into the GLA Group Investment Syndicate (GIS).
- 4.17. Work remains ongoing in respect of finalising the associated legal agreement to conclude negotiations to the satisfaction of the Director of Finance and Assurance in consultation with the Portfolio Holder for Finance and Resources together with the Director of Legal and Governance.
- 4.18. The draft pooled investment strategy for this arrangement is included within Appendix F but is subject to the agreement of all participating authorities; the Director of Finance is authorised, having taken proper advice from Link Group or other suitably qualified advisor, to agree amendments to this, provided that the underlying exposures of any amended strategy do not breach the limits set out in Appendix F.
- 4.19. The Authority has previously been given to place funds in 'non-standard investments' up to a value of £10m. This has been replaced by a 10% allocation to strategic investments.

Investment returns expectations

- 4.20. Link Group's Interest Rate Forecast from 20 December 2021 suggests that following the Bank Rate increase from 0.10% to 0.25% in December 2021, a further increase in Bank Rate to 0.5% would take place in 2022. On the 3 February 2022, the Bank of England raised Bank Rate a further 0.50% following inflation concerns which appear higher and more persistent than previously expected. CPI Inflation now expected to peak at 7.25% in April 2021 and remain above the 2% target for all of 2022 and 2023. Markets are currently pricing in an expectation for additional Bank Rate increases in 2022/23.
- 4.21. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

- 2022/23: 0.50%
- 2023/24: 0.75%
- 2024/25: 1.00%
- 2025/26: 1.25%

4.22. These investment return expectations may be revised based on updates to interest rate forecasts in light of the Bank of England's decision to increase Bank Rate to 0.5% on 3rd February 2022.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days

4.23. 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.

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

Upper limit for principal sums invested for longer than 365 days			
£'000	2022/23	2023/24	2024/25
Principal sums invested for longer than 365 days	£60,000	£60,000	£60,000

Investment performance / risk benchmarking

4.25. The Council previously used LIBOR rates for benchmarking purposes. The publication of LIBOR and associated LIBID rates ceased at the end of 2021, as part of a move within financial markets to move to risk free reference rates. For sterling markets LIBOR has been replaced with the Sterling Overnight Index Average (SONIA), published by the Bank of England, which is based on actual transactions between banks, financial institutions, and institutional investors.

4.26. Link Group will provide the Authority with compounded SONIA rates in the same way that they did with LIBOR / LIBID rates for investment benchmarking purposes.

4.27. The Council is a member of a Link Group's investment portfolio benchmarking group through which performance is measured against peer London authorities. The risk of default attached to the Council's portfolio is reported by Link Group on a monthly basis.

End of year investment report

4.28. At the end of the financial year the Council will report on its investment activity as part of the Treasury Management Outturn Report.

Other Treasury Issues

Derivatives

5.0. A financial derivative is a contract, whose value is based on, or 'derived' from, an underlying financial instrument such as a loan. Local Authorities have

previously been able to make use of financial derivatives embedded into loans and investments, both to reduce interest rate risk (e.g. forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

- 5.1. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires local authorities to clearly detail their policy in the use of derivatives in the annual strategy. The Council does not intend to use standalone financial derivatives (such as swaps, forwards, futures and options). No change in strategy will be made without Full Council approval.

Brokers

- 5.2. The Council uses four brokers on a regular basis, as well as dealing directly with leading institutions. Wherever possible the Council will spread its business amongst them on a regular basis, though this may not always be possible. Brokers currently being used are:
 - RP Martins
 - Tradition
 - BGC Sterling
 - Imperial Treasury
- 5.3. The limited function performed by brokers is acknowledged; however, the Council would expect to be informed if a broker had any doubts about an organisation that we were dealing with.

Training

- 5.4. The Treasury Management Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in this area. This especially applies to Members responsible for scrutiny.
- 5.5. The training needs of Treasury Management officers are periodically reviewed as part of the Learning and Development programme with appropriate training and support provided.

External Advisors

- 5.6. The Council has engaged Link Group as its external Treasury Management Adviser.
- 5.7. It also recognises that there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. The Council ensures that the terms of their appointment and the methods by which their value is assessed are properly agreed and documented and subjected to regular review.
- 5.8. However, the Council recognises that responsibility for treasury management decisions always remains with itself and will ensure that undue reliance is not placed upon external service providers.

Implications of the Recommendation

6.0. The recommendations primarily relate to the requirements for the Council to comply with statutory duties. However, the content of the report, covering borrowing and investment strategies, has implications for the Council's ability to fund its capital projects and revenue activities.

7.0. Risk Management Implications

7.1. Risks included on corporate or directorate risk register? **Yes** - Contained on Resources Directorate risk register Risk 9: Loss of an investment/deposit

Separate risk register in place? **No**

The relevant risks contained in the register are attached/summarised below.
Yes/No/n/a

The following key risks should be taken into account when agreeing the recommendations in this report:

Risk Description	Mitigations	RAG Status
Cash not available when needed	<ul style="list-style-type: none"> ▪ Working capital and borrowing position designed to maintain the required level of cash balances ▪ The balance of debt and investment operations ensure liquidity ▪ 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. 	Green
Sums invested result in a loss	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.	Amber
Council's capital investment programme is not affordable, prudent or sustainable	<ul style="list-style-type: none"> ▪ One of the Prudential Indicators of affordability is the ratio of financing costs to net revenue stream, assessing the actual and estimated cost of capital against the income of the Authority. Table 8 ▪ Limits on borrowing activity 	Green

Risk Description	Mitigations	RAG Status
	<ul style="list-style-type: none"> ▪ The Council is currently maintaining an under-borrowed position. This is estimated to be £130m as at 31st March 2022. 	
VFM is not achieved	<ul style="list-style-type: none"> ▪ The Council 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. 	Green
Provision made in the General Fund for debt is not prudent	<ul style="list-style-type: none"> ▪ MRP Statement setting out what provision is to be made in the General Fund for the repayment of debt, and how the provision is to be calculated. The purpose of the Statement is to ensure the provision is prudent, allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure benefits. Appendix C. 	Green
Too many loans mature in one period impacting on ability to refinance risk	<ul style="list-style-type: none"> ▪ The Council maintains upper and lower limits with respect to the maturity structure of its borrowing. This Prudential Indicator, reflecting the earliest date at which a lender can require payment is set to ensure refinancing risk is managed regarding the concentration of loan maturities in any one period. 	Green
Borrowing is undertaken for revenue or speculative purposes	<ul style="list-style-type: none"> ▪ 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 2021/22 and the following two financial years 	Green
Exceptional levels of volatility in PWLB rates	<ul style="list-style-type: none"> ▪ The Council's Treasury Management Adviser, Link Asset Services, has provided an interest rate forecast (Table 11). ▪ There is expected to be little upward movement in PWLB rates over the next two years however from time to 	Amber

Risk Description	Mitigations	RAG Status
	time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.	
Default on Council Loans	<ul style="list-style-type: none"> ▪ The risk of default attached to the Council's portfolio is reported by Link Asset Services on a monthly basis. 	Green

7.2. The identification, monitoring and control of risk are central to the achievement of the treasury objectives. Potential risks are identified, mitigated and monitored in accordance with treasury practice notes approved by the Treasury Management Group.

8.0. Procurement Implications

There are no procurement implications arising from this report.

9.0. Legal Implications

The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. These are contained within this report.

The Act, accompanying statutory guidance and Codes of Practice referred to through capital financing regulations requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. This report assists the Council in fulfilling its statutory obligation under the Local Government Act 2003 to monitor its borrowing and investment activities.

10.0. Financial Implications

In addition to supporting the Council's revenue and capital programmes the Treasury Management interest budget is an important part of the revenue budget. Any savings achieved, or overspends incurred, have a direct impact on the financial performance of the budget.

There is no direct financial impact of paying the London living Wage (LLW) arising from treasury management activity.

11.0. Equalities implications / Public Sector Equality Duty

There is no direct equalities impact.

12.0. Council Priorities

This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Section 3 - Statutory Officer Clearance

Statutory Officer: Sharon Daniels

Signed on behalf of the Chief Financial Officer

Date: 7/02/2022

Statutory Officer: Jessica Farmer

Signed on behalf of the Monitoring Officer

Date: 7/02/2022

Chief Officer: Dawn Calvert

Signed on behalf of the Corporate Director

Date: 7/02/2022

Head of Procurement: Nimesh Mehta

Signed by the Head of Procurement

Date: 7/02/2022

Head of Internal Audit: Susan Dixon

Signed by the Head of Internal Audit

Date: 7/02/2022

Mandatory Checks

Ward Councillors notified: NO, as it impacts on all Wards

EqIA carried out: NO

EqIA cleared by: N/A

Section 4 - Contact Details and Background Papers

Contact: Dawn Calvert, Director of Finance and Assurance
Dawn.Calvert@Harrow.gov.uk

Background Papers: None

Call-in waived by the Chair of Overview and Scrutiny Committee - NO

APPENDIX A

LEGISLATION AND REGULATIONS IMPACTING ON TREASURY MANAGEMENT

The following items numbered 1 - 4 show the sequence of legislation and regulation impacting on the treasury management function. The sequence begins with primary legislation, moves through Government guidance and Chartered Institute of Public Finance and Accountancy (CIPFA) Codes of Practice and finishes with implementation through the Council's own Treasury Management Practices.

1. Local Government Act 2003

Link: [Local Government Act 2003](#)

Below is a summary of the provisions in the Act dealing with treasury management.

In addition the Secretary of State is empowered to define the provisions through further regulations and guidance which he has subsequently done through statutory instruments, Ministry of Housing, Communities and Local Government Guidance and CIPFA Codes of Practice.

Power to borrow

The Council has the power to borrow for purposes relevant to its functions and for normal treasury management purposes – for example, to refinance existing debt.

Control of borrowing

The main borrowing control is the duty not to breach the prudential and national limits as described below.

The Council is free to seek loans from any source but is prohibited from borrowing in foreign currencies without the consent of Treasury, since adverse exchange rate movements could leave it owing more than it had borrowed.

All of the Council's revenues serve as security for its borrowing. The mortgaging of property is prohibited.

It is unlawful for the Council to 'securitise', that is, to sell future revenue streams such as housing rents for immediate lump-sums.

Affordable borrowing limit

The legislation imposes a broad duty for the Council to determine and keep under review the amount it can afford to borrow. The Secretary of State has subsequently defined this duty in more detail through the Prudential Code produced by CIPFA, which lays down the practical rules for deciding whether borrowing is affordable.

It is for the Council (at a meeting of the full Council) to set its own 'prudential' authorised limit in accordance with these rules, subject only to the scrutiny of its external auditor. The Council is then free to borrow up to that limit without Government consent. The Council is free to vary the limit during the year, if there is good reason.

Requirements in other legislation for the Council to balance its revenue budget prevent the long-term financing of revenue expenditure by borrowing. However the legislation does confer limited capacity to borrow short-term for revenue needs in the interests of cash-flow management and foreseeable requirements for temporary revenue borrowing are allowed for when borrowing limits are set by the Council.

The Council is allowed extra flexibility in the event of unforeseen needs, by being allowed to increase borrowing limits by the amounts of any payments which are due in the year but have not yet been received.

Imposition of borrowing limits

The Government has retained reserve power to impose 'longstop' limits for national economic reasons on all local authorities' borrowing and these would override authorities' self-determined prudential limits. Since this power has not yet been used the potential impact on the Council is not known.

Credit arrangements

Credit arrangements (e.g. property leasing, PFI and hire purchase) are treated like borrowing and the affordability assessment must take account not only of borrowing but also of credit arrangements. In addition, any national limit imposed under the reserve powers would apply to both borrowing and credit.

Power to invest

The Council has the power to invest, not only for any purpose relevant to its functions but also for the purpose of the prudential management of its financial affairs.

Guidance

The Act contains a requirement for the Council to have regard to guidance:

- Issued directly by the Secretary of State
 - *DLUHC (formally MHCLG) Investment Guidance*
 - *DLUHC (formally MHCLG) MRP Guidance*
- Other guidance the Secretary of State may refer to through regulations
 - The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
 - *CIPFA Prudential Code*
 - *CIPFA Treasury Management Code of Practice*

2. Ministry of Housing, Communities and Local Government Investment Guidance (2018)

The Guidance recommends that for each financial year the Council should prepare at least one Investment Strategy to be approved before the start of the year. The Strategy must cover:

- **Investment security**

Investments should be managed prudently with security and liquidity being considered ahead of yield

Potential counterparties should be recognised as "specified" and "non-specified" with investment limits being defined to reflect the status of each counterparty

- **Investment risk**
Procedures should be established for monitoring, assessing and mitigating the risk of loss of invested sums and for ensuring that such sums are readily accessible for expenditure whenever needed.
The use of credit ratings and other risk assessment processes should be explained
The use of external advisers should be monitored. The training requirements for treasury management staff should be reviewed and addressed
Specific policies should be stated as regards borrowing money in advance of need
- **Investment Liquidity**
The Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed

The Strategy should be approved by the full Council and made available to the public free of charge. Subject to full Council approval, or approved delegations, the Strategy can be revised during the year.

3. Ministry of Housing, Communities and Local Government Minimum Revenue Provision Guidance (2018)

Minimum Revenue Provision (MRP) is the mechanism by which capital expenditure funded through prudential borrowing is charged to revenue over time. The aim of MRP is to align the charge to revenue over a period which the capital expenditure provides benefit.

Before the start of each financial year the Council is required to approve an MRP Policy Statement specifying how it will make prudent MRP during that year. Subject to full Council approval, the MRP Policy Statement can be revised during the year.

4. Treasury Management in the Public Services: CIPFA Code of Practice (2017) and Guidance Notes (2018)

The primary requirements of the Code are:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy Statement - for the

year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

5. CIPFA Prudential Code (2017) and Guidance Notes (2018)

The CIPFA Prudential Code is a framework developed to support local strategic planning, asset management and options appraisal. The objectives of the Prudential Code are to ensure that the Council's capital expenditure plans are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved.

The Prudential Code sets out a number of indicators which demonstrate the impact of the approved capital programme. The latest published version in 2017 introduced a new requirement for local authorities to produce an annual Capital Strategy, which sets out the long-term context in which capital expenditure and investment decisions are made.

6. CIPFA Treasury Management Code of Practice (2021) and Prudential Code (2021)

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 20 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 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.

APPENDIX B

TREASURY MANAGEMENT DELEGATIONS AND RESPONSIBILITIES

The respective roles of the Council, Cabinet, GARMSC, the Section 151 officer, the Treasury Management Group the Treasury and Pensions Manager and the Treasury Team are summarised below. Further details are set out in the Treasury Management Practices.

Council

Under the Constitution, the Council is responsible for “decisions relating to the control of the Council’s borrowing requirement.”

It agrees the annual Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy.

Cabinet

Under the Constitution, the Cabinet “will exercise all of the local authority functions which are not the responsibility of any other part of the local authority, whether by law or under this Constitution.”

It considers and recommends to Council the annual Treasury Management Strategy Statement and receives a mid-year report and annual outturn report on Treasury Management activities.

Governance, Audit, Risk Management and Standards Committee

GARMSC reviews the Treasury Management Strategy and monitors progress on treasury management in accordance with CIPFA codes of practice.

Director of Finance (Section 151 Officer)

Under S151 of the Local Government Act 1972 the Council “shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs.” At Harrow, this responsibility is exercised by the Director of Finance.

The Director is responsibility for implementing the policies agreed by the Council and Cabinet.

Under the Local Government Finance Act 1988 and the Local Government Act 2003 the Director also has responsibilities in respect of budget arrangements and the adequacy of resources. In terms of Treasury Management this means that the financing costs of the Capital Programme are built into the Revenue Budget as are any assumptions on investment income.

The Director chairs the Treasury Management Group and agrees major treasury management decisions, specifically including any borrowing decisions, delegated to officers.

Treasury Management Group

Comprises Director of Finance, Head of Strategic and Technical Finance (Deputy S151 Officer), Treasury and Pensions Manager, Senior Finance Officer and is responsible for:

- Monitoring treasury management activity against approved strategy, policy, practices and market conditions;
- Ensuring that capital expenditure plans are continually reviewed in line with budget assumptions throughout the year to forecast when borrowing will be required.
- Approving changes to treasury management practices and procedures;
- Reviewing the performance of the treasury management function using benchmarking data on borrowing and investment provided by the Treasury Management Adviser (Link Asset Services);
- Monitoring the performance of the appointed Treasury Management Adviser and recommending any necessary actions
- Ensuring the adequacy of treasury management resources and skills and the effective division of responsibilities within the treasury management function;
- Monitoring the adequacy of internal audit reviews and the implementation of audit recommendations

Treasury and Pensions Manager

Responsible for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Management Strategy Statement and CIPFA's "Standard of Professional Practice on Treasury Management"

Treasury Team

Headed by Senior Finance Officer with responsibility for day-to-day treasury and investment and borrowing activity in accordance with approved Strategy, policy, practices and procedures and for recommending changes to the Treasury Management Group

Minimum Revenue Provision (MRP) Policy Statement

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be the equal annual reduction of 2% of the outstanding debt at 1 April 2015 for the subsequent 50 years.
- For all capital expenditure financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon an asset life method in accordance with Option 3 of the guidance.
- In some cases where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.
- The regulations allow the Council to charge VMRP, which can be used to reduce future MRP by the same amount. A change introduced by the revised MHCLG MRP Guidance is that the voluntary MRP must be disclosed in a statement to the full council in order to reclaim it in future years as deemed necessary and prudent. As at March 2020, the VRP is £6.8m.
- Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.
- Freehold land cannot properly have a life attributed to it, so for the purposes of Asset Life method it will be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate will be used for the land.
- As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.
- Repayments included in annual PFI or finance leases are applied as MRP.

- Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.
- Under Treasury Management best practice the Council may decide to defer borrowing up to the capital financing requirement (CFR) and use internal resources instead. Where internal borrowing has been used, the amount chargeable as MRP may be adjusted to reflect the deferral of actual borrowing.

APPENDIX D

APPENDIX D: Link Group: Interest Rate Forecasts 2021 – 2025.

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

The Link Group forecasts are as at 20.12.21 and will be updated after the MPC meeting on 3.2.22. The Capital Economics forecasts are as at 12.1.22.

Link Group Interest Rate View 20.12.21													
	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	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.30	0.50	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	0.50	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	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	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	1.70	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	1.90	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	1.70	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	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
Capital Economics	0.50	0.75	1.00	1.25	1.25	1.25	1.25	1.25	-	-	-	-	-
5yr PWLB Rate													
Link	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	1.80	1.90	2.10	2.20	2.20	2.30	2.40	2.40	-	-	-	-	-
10yr PWLB Rate													
Link	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	2.00	2.10	2.20	2.30	2.30	2.40	2.50	2.50	-	-	-	-	-
25yr PWLB Rate													
Link	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	2.20	2.30	2.50	2.70	2.70	2.70	2.80	2.90	-	-	-	-	-
50yr PWLB Rate													
Link	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	1.90	2.00	2.20	2.40	2.50	2.60	2.70	2.90	-	-	-	-	-

APPENDIX E

Economic Background

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, similar to the pingdemic in July. 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 16^H 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 from 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.

- **EU.** The slow roll out of vaccines initially delayed **economic recovery** in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery 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.

APPENDIX F

Counterparties and approved investments

Specified Investments

These are sterling investments with high credit quality of a maturity period of not more than 365 days, or those which could be for a longer period but where the lender has the right to be repaid within 365 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. The instruments and credit criteria to be used are set out in the table below.

Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as Specified above). They normally offers the prospect of higher returns but carry a higher risk.

The Director of Finance will make best efforts to maintain at least 50% of all investments in the form of Specified Investments.

Table 1 sets out the range of specified and non-specified investments permitted by the Council. This has been expanded from previous years to give the Council flexibility to join a collective investment arrangement with the GLA should this be agreed. The table uses the following key:

S = Specified

NS = Non Specified

NS* = Non Specified, only used under delegation to a professional manager properly authorised under the Financial Services and Markets Act.

The draft GLA collective investment strategy is as follows:

		Allocation	Expected Rate
Core Liquidity: Managed with a weighted average life of 90 days	Overnight liquidity	10%	0.00%
	Local Authority <12mths	15%	0.10%
	Banks <12mths	30%	0.10%
Medium term: Weighted average life < 3years	Senior RMBS	35%	0.70%
Long term core balance	Other Strategic Investments	10%	4.00%
		100%	0.69%

This is subject to collective agreement by the participating authorities, currently the GLA, the London Fire Commissioner (LFC), the Mayor's Office for Policing and Crime (MOPAC), the London Legacy Development Corporation (LLDC) and the London Pensions Fund Authority (LPFA). Should the Council join,

agreeing the strategy with the other participants is delegated to the Director of Finance, provided the limits in Table 1 are not exceeded.

Subject to the above, this strategy authorises the Director of Finance to invest up to 100% of cash alongside the GLA and also delegates the legal form of such investment to the Director, provided the underlying risk and reward reflects approved instruments.

Investment type	Eligibility criteria	≤ 1 year to maturity at time of investment	> 1 year to maturity at time of investment	Maximum total exposure as a proportion of forecast daily balance
Senior Unsecured Debt, e.g. <ul style="list-style-type: none"> • Deposits • Call Accounts • Notice Accounts • Certificates of Deposit • Loans • Commercial Paper • UK Gilts and T-Bills • All other senior unsecured bonds 	Issuer (and security where separately rated) Investment Grade (IG) defined per Table 3 OR UK Government (including the Debt Management Account Deposit Facility, Local Authorities and bodies eligible for PWLB finance) OR	S	NS	Aggregate 100%, individual limits determined by tables

Investment type	Eligibility criteria	≤ 1 year to maturity at time of investment	> 1 year to maturity at time of investment	Maximum total exposure as a proportion of forecast daily balance
	Issuer not meeting general criteria but instruments explicitly guaranteed by IG entity or sovereign national government meeting acceptable sovereign ratings per Table 2 .			
Money Market Funds	Fitch AAA _{mmf} or above See Table 3 for equivalents from other agencies. Daily liquidity	S	N/A	100% <i>Not more than 20% per fund</i>
Other Collective Investment Schemes e.g. Enhanced Cash Funds	Fitch AAA _r or equivalent from other agencies per Table 3 .	NS	N/A	20%
Senior UK Prime or Buy to Let Residential Mortgage Backed Securities (RMBS)	Bond rating Fitch AA _{sf} or above or equivalent from other agencies per Table 3 .	NS*	NS*	35%
Covered bonds	Bond rating Fitch AA _{sf} or equivalent from other agencies per Table 3	NS*	NS*	20%

Investment type	Eligibility criteria	≤ 1 year to maturity at time of investment	> 1 year to maturity at time of investment	Maximum total exposure as a proportion of forecast daily balance
	<p>AND</p> <p>Issuer rated Fitch A- or above or equivalent from other agencies per Table 3</p>			
Repurchase Agreements (Repo)	<p>Counterparty meets senior unsecured criteria AND proposed collateral (Min 100%) itself meets permitted investment criteria</p> <p>Or</p> <p>Collateralisation is >102% with UK Gilts / T-Bills</p>	<p>S* – UK gilts or T-Bills AND Counterparty meets senior unsecured criteria</p> <p>NS* – other</p>	<i>Not permitted.</i>	<p>S – 100%</p> <p>NS – 20%, and not more than 10% with counterparties not meeting senior unsecured criteria.</p>
Other strategic investments (only to be held within authorised and regulated funds)	Any sterling-denominated investment with risk and return characteristics appropriate to the collective investment arrangement and mutually agreed by all participants.	NS*	NS*	10%

Credit Ratings and Country Limits

Maximum exposures to non-UK financial institutions apply by country, based on the relevant sovereign ratings outlined in the table below:

Table 2 – Country Limits

Max. Aggregate Exposure (%)	Fitch Sovereign Rating	S&P Sovereign Rating	Moody's Sovereign Rating
25	AAA	AAA	Aaa
15	AA+	AA+	Aa1
5	A	A	A

Note: for non-UK, non-financial institutions, or in circumstances such as an instrument being issued through a subsidiary domiciled in one country but guaranteed or otherwise secured by a parent in another, the risks and appropriate country limit (if any, in the case of multinational corporations) in which to aggregate the exposure will be considered on a case by case basis and determined by the Director of Finance or delegated manager.

Table 3 sets out the range of investment grade ratings used by the Council and its investment managers.

Table 2 - Permitted credit ratings and equivalence mappings:

Issuer and/or Senior Unsecured Bond Ratings					
Long term			Short term		
Fitch	Moody's	S&P	Fitch	Moody's	S&P
AAA	Aaa	AAA			
AA+	Aa1	AA+			
AA	Aa2	AA	F1+	P-1	A-1+
AA-	Aa3	AA-			
A+	A1	A+			
A	A2	A	F1	P-1	A-1
A-	A3	A-			
BBB+	Baa1	BBB+			
BBB	Baa2	BBB	F2	P-2	A-2
Structured Finance Ratings					
Fitch		Moody's	S&P		
AAA _{sf}		Aaa (sf)	AAA (sf)		
AA+ _{sf}		Aa1 (sf)	AA+ (sf)		
Money Market Fund Ratings					
Fitch		Moody's	S&P		
AAA _{mmf}		Aaa-mf	AAAm		
Other Permitted Fund Ratings					
Fitch		Moody's	S&P		
AAA _r		Aaa-bf	AAAf		

Lower ratings are balanced by higher ones in order to maintain credit risk on rated instruments that is no greater than a 12 month deposit with AA-institution. This is determined by assigning a credit factor to each rated investment, per **Table 4** and calculating a weighted average portfolio credit factor (PCF). This must remain below 5 and no single instrument may exceed 10.

Table 4 – Credit Factors

Credit Factors based on Issuer Default Rating (Fitch and Fitch Equivalents)									
Use instrument rating or if not rated, rating of Issuer.									
Days	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB
O/N	0.01	0.01	0.01	0.01	0.02	0.03	0.04	0.07	0.10
2-7	0.02	0.04	0.06	0.10	0.15	0.20	0.30	0.50	0.80
8-30	0.10	0.15	0.25	0.40	0.60	0.75	1.30	2.10	3.50
31-60	0.20	0.30	0.50	0.80	1.20	1.50	2.60	4.20	7.00
61-90	0.25	0.50	0.75	1.25	1.50	2.50	5.00	7.50	10.00
91-120	0.35	0.65	1.00	1.50	2.30	3.30	6.60	10.00	13.50
121-150	0.40	0.80	1.25	2.10	2.90	4.20	8.30	12.50	16.50
151-180	0.50	1.00	1.50	2.50	3.50	5.00	10.00	15.00	20.00
181-210	0.60	1.20	1.75	3.00	4.00	5.80	11.70	17.50	23.50
211-240	0.70	1.30	2.00	3.30	4.70	6.60	13.30	20.00	27.00
241-270	0.75	1.50	2.25	3.75	5.25	7.50	15.00	22.50	30.00
271-300	0.80	1.70	2.50	4.20	5.80	8.30	16.70	25.00	33.50
301-330	0.90	1.85	2.75	4.60	6.50	9.20	18.50	27.50	37.00
331-397	1.00	2.00	3.00	5.00	7.00	10.00	20.00	30.00	40.00
398-730	2.70	5.30	8.00	13.00	19.00	27.00	43.00	69.00	106.00

For the purposes of the above, UK Government (including the Debt Management Account Deposit Facility, Local Authorities and bodies eligible for PWLB finance) securities are treated as AAA, reflecting the UK's highly centralised and interdependent public finance regime.

Enhanced limits apply for these counterparties and institutions covered by Link Asset Services' Colour Banding Methodology:

Table 5 – Concentration Limits

Cash Exposure Limits – applied to individual counterparties		
Band	Overnight	> 1 day
UK Sovereign	100%	100%
Yellow	50%	25%
Purple	50%	20%
Orange	25%	15%
Red	25%	10%
Green	10%	5%
No Colour	5%	5%

The Bands above are calculated based on a range of credit ratings data, including published rating Watches and Outlooks.
The Council's own bank has an emergency overnight limit of 100%, to allow for unexpected payment events.

Capital Strategy 2022-23

Contents

Section 1 – Principles of the Capital Strategy

1. Introduction
2. Objectives
3. Background
4. Capital expenditure
5. The link between revenue and capital
6. The purpose of capital investment
7. What are our Council Priorities?
8. Existing capital priorities
9. Use of commercial investment
10. Asset management
11. Capital disposals
12. Multi-year capital projects
13. Use of capitalisation flexibilities

Section 2 – Selecting, Approving and Monitoring Capital Schemes

14. The importance of capital appraisals
15. Information to be considered in decision making
16. Governance of the capital programme
17. In-year capital decisions
18. Monitoring capital projects

Section 3 - Financing the Capital Programme

19. Capital funding
20. Capital resources
21. External funding sources
22. Policy on the use of capital funding
23. Relationship between Capital Strategy and Treasury Management

Section 4 – Risk Management

24. Embedding risk management in the capital programme
25. Knowledge and skills within the organisation

Section 1 – Principles of the CAPITAL STRATEGY

1. Introduction

In December 2017, the Chartered Institute of Public Finance & Accountancy issued a revised Prudential and Treasury Management Code, requiring all local authorities to produce a Capital Strategy report from 2019/20 onwards to show:

- 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

This capital strategy meets the requirement by setting out the Council's capital investment programme and how it contributes to the achievement of strategic priorities being refreshed through the Borough Plan, while considering resource availability and the wider financial context. It is intended to be supportive of the Council's other strategy framework documents.

2. Objectives

The strategy details show how the Council sets out its priorities for Capital investment including links to existing delivery plans and strategy documents. It also considers the ways in which capital expenditure may be financed, including the impact that the Strategy has on the budgets of both the General Fund and the Housing Revenue Account (HRA). The strategy will also set out the links with Treasury Management objectives and determine the authority's approach to risk in those objectives.

This document is part of the Council's business planning process from both a financial and service perspective. It sets out a framework whereby the authority's capital resources can be effectively allocated to those projects which may help the Council achieve wider corporate objectives, protect existing assets and support financial sustainability.

Principles of the Capital Strategy

1. Capital Investment is a vital tool in delivering strategic priorities.
2. The Capital Programme will include only those schemes in accordance with the agreed criteria.
3. The Council will consider schemes purely to generate a commercial return to support the budget.
4. The evaluation of capital schemes for inclusion on the programme will follow an agreed process which allows scrutiny whilst not limiting innovation and adaptability.

5. The funding of the Capital Programme must be considered alongside the revenue budget and balance sheet position as part of the Council's Medium Term Financial Strategy (MTFS).
6. Capital projects will be monitored and reported to Cabinet on a quarterly basis.

3. Background

As part of its wider treasury management objectives the Council must have regard to the “Prudential Code for Capital Finance in Local Authorities” (henceforth to be referred to as the Prudential Code), as produced by the Chartered Institute of Public Finance & Accountancy (CIPFA). The 2017 revision of the Prudential Code introduces the requirement for authorities to produce a Capital Strategy from 2019/20. It is a live document underpinning the Council’s Capital Programme and therefore will be subject to amendment.

4. Capital Expenditure

Capital Expenditure is that which is incurred on the acquisition, creation or enhancement of an asset. These assets can be tangible such as buildings or vehicles, as well as intangible such as software products.

5. The link between Revenue and Capital

Capital and revenue expenditure are separate components of local authority budgets and funding for each is considered separately. However, a vital component of successful financial planning is that revenue and capital budgets are intrinsically linked as the impact of capital expenditure must be reflected in revenue budgets. Therefore this capital strategy should be deemed to form a key part of the authority’s medium term financial planning process.

The impact and affordability of capital expenditure must be considered in the assessment of capital projects at the business case stage. Effective financial planning must fully reflect the impact of capital plans in the revenue budget.

The following table sets out some of the key impacts of capital expenditure upon the revenue budget.

<p>Revenue Savings</p> <ul style="list-style-type: none">•Direct Income from assets•Reduced maintenance costs of new or improved assets•Savings in labour costs <p>Revenue Costs</p> <ul style="list-style-type: none">•Running costs of new assets•Minimum Revenue Provision (loan principal)•Interest costs from borrowing
--

As an indication of the current cost of the existing capital programme, the table below shows the capital financing costs that are already factored into the existing MTFS for 2022/23 to 2024/25 in relation to the existing and historic capital programmes:

Capital Financing Costs as % of the Net Revenue Budget for 2022/23 of £183.3m

	Capital Financing Costs	Capital financing costs as % of 2022/23 Net Budget
	£m	%
2022/23	35.0	19.0%
2023/24	36.1	19.7%
2024/25	36.3	19.8%

6. The Purpose of Capital Investment

Investment through capital expenditure may serve a number of purposes; these can typically be classified as being related to service priorities and commercial investments.

Commercial investments are those which are entered into with the explicit objectives of returning a surplus for Council and therefore improving the financial sustainability of the Council. These may include:

- Acquisition of Property to deliver a commercial return, usually through rental
- Investments in outside organisations with the view to making a return
- Investments which neither deliver a financial return nor achieve a service objective for the Council should not be considered for inclusion on the Capital Programme.

7. Existing Capital Priorities

Service directorates were invited to bid for capital resources, as part of their service proposals for 2022/23 to 2024/25.

In view of the current financial climate and reduced external funding service directorates were asked to limit new capital proposals to the following categories:

- a. Life and Limb/Health and Safety.
- b. Statutory Requirement/legislation.
- c. Schemes fully funded by external sources.
- d. Invest to Save Schemes (the capital expenditure must generate a revenue stream to cover the capital financing costs and make a net contribution to the MTFS).

The updated Capital Programme 2022/23 to 2024/25 will be approved by Cabinet/Council in February 2022.

8. Use of Commercial Investment

The Council took its Investment Property Strategy to Council in December 2015. Under this strategy the Council has incurred £47m to 31 March 2022 on commercial investments. In July 2019 the Council approved £100m Capital Programme borrowing to finance long term commercial investment as part of the 2 Year Budget Strategy 2021/22 to 2021/22. As at 31 March 2020 £6.4m of the £100m approval had been applied to the purchase of commercial property. The remaining £94m was removed from the Capital Programme as reported in the Final Capital Programme report and the Final Revenue Budget report 2021/22 which are both reported to cabinet in February 2021.

9. Asset Management

Asset Management is the process by which the authority considers whether its assets are appropriate to deliver the high quality services demanded by residents. This process may identify a number of different outcomes for assets including:

- Change in use to meet the demands of a service
- Investment is required to improve the condition of an asset
- A new asset is required to better meet the Council priorities
- The need to dispose of the asset to realise its value in monetary terms

The Council will use active asset management to consider both its current asset base and its future asset base. The capital programme will be used to bridge the gap to ensure that the authority has sufficient assets in the long term.

10. Capital Disposals

The asset management process may determine that the value of an asset is best realised through disposal. Sale of assets should be through an open market process to determine the best value.

Cash received from a sale of a property is a capital receipt. The use of these funds is restricted to purchasing new assets or repayment of existing debt. The Council will not make decisions about the ring-fencing of capital receipts before amounts are known and the use of such receipts has been considered in the light of the Council's overall financial position.

The existing General Fund capital programme includes a limited amount of capital receipts in relation to two regeneration schemes – Haslam House and Waxwell Lane. The HRA capital programme includes assumptions on levels of right to buy receipts as well as other capital receipts.

11. Multi-Year Capital Projects

Capital projects deliver assets which will provide services and/or income to the Council for a number of years. As a result of the significance and complexity of a number of these projects they may take a number of years to plan and deliver.

When setting the Capital Programme Council will approve the schemes to be included, the budget for their delivery and the timescale in which they are to be achieved. Unless schemes have clearly defined development and delivery phases with separate objectives, budgets and timescales Council should be asked to approve a budget to cover the whole of the project being delivered. Approval of the entire budget at the point of inception gives certainty for the project and assists officers in ensuring delivery.

The budget for approval will include an expected cash flow projection showing how much of the anticipated project budget will be incurred in each year of the Capital Programme. Any variations in timing of cash flows between years will be reported as part of the budget monitoring process. This should be regarded as part of the normal development of a capital project.

12. Use of capital receipt flexibilities

In the Spending Review 2015, it was announced that to support local authorities to deliver more efficient and sustainable services, the government will allow local authorities to send up to 100% of their fixed asset receipts on the revenue costs of reform projects. This flexibility was initially offered for the three years 2016/17 to 2018/19 but was extended as a part of the 2018/19 Finance settlement for a further 3 years from 2019/20 to 2021/22.

The Department for Levelling Up, Housing and Communities have been contacted and the scheme will continue beyond 2021/22 with announcements in due course. Until such announcements are made, the principles of the existing flexibilities will be assumed.

The Council signified its intent to make use of this flexibility in its final budget report to Cabinet and Council in February 2016. From November 2016, Cabinet approved a number of asset disposals and the capital receipts from these disposals are being applied within the new flexibilities. In 2019/20 £3.1m of capital flexibilities were applied in the budget. For 2020/21 there was no planned use of capital flexibilities set out in the budget. The 2021/22 Final budget report set out the use of £2m for the financial year 2021/22. The final MTFs 2022/23 to 2024/25 does not assume any capital flexibilities being applied to core budget over the three years.

Section 2 – SELECTING, APPROVING AND MONITORING CAPITAL SCHEMES

13. The Importance of Capital Business Cases

The processes described in the following section are to be regarded as the authority's formal procedures for setting and monitoring capital projects. This

process has been developed to ensure that the Council's Capital Programme contains schemes which are in line with objectives, meet its asset management requirements and are both affordable and deliverable. This process will give elected members confidence that decisions they are being asked to make regarding the capital programme have been based on a sound system of decision making.

All capital schemes included in the Capital Programme have been the subject of an evaluation process including a business case to ensure the Council can target its capital resources effectively.

14. Information to be considered in Capital Decision Making

When making decisions as to which schemes are included on the capital programme the presented business case must include information on these main factors.

- Financials – All anticipated costs and potential revenue streams must be set out. This should include risk analysis to show factors which may impact upon those numbers and where appropriate sensitivity analysis to show potential future scenarios.
- Strategic Objectives – As discussed capital schemes must meet Council priorities and the ability of a scheme to impact upon objectives must be clearly demonstrated. This should include the wider social and environmental impact of the capital project. This must be accompanied by evidence supporting the conclusions made.
- Capacity - All capital schemes, even those funded by external sources, require officers within the Council to implement them and this must be considered as part of the appraisal process. Where a project requires the procuring of additional resource to deliver the scheme this detail must be included in the financial analysis.
- Deliverability - The success of capital projects depends not just on the financial and non-financial resources of the Council. External factors which impact on the deliverability of the project should also be considered as part of the planning process.

15. Governance of the Capital Programme

This strategy sets out the governance relationship relating to the Capital Programme and the respective role of Members and Officers in relation to the decision making process. The roles of the various groups are as follows.

Decision making on the Capital Programme is likely to be an iterative and often circular process with information flowing both ways between these respective groups.

As an example the following timescale may be followed for producing the Capital Programme during the main budget setting process.

Council

- Formally agrees the Capital Programme
- Receives budget monitoring reports covering financial and non-financial elements of capital schemes
- Approves commercial capital investments

Capital Forum

- Allows panel a chance to comment on capital schemes before formal approval of releasing the funding approved as part of the Capital Programme

Corporate Team

- Reviews Business Cases submitted
- Performs initial sift of viable schemes
- Approves proposed list of capital schemes

Service Managers / Heads of Service

- Identify priorities and opportunities for capital investment
- Act as, or appoint, project managers to lead on schemes and complete outline business cases

16. In-Year Capital Decisions

Selecting projects to go onto the Capital Programme must remain possible outside of the usual capital budget setting process. The authority needs the flexibility to take advantage of schemes which present themselves at any stage during the year.

17. Monitoring Capital Projects

Effective monitoring of projects is a vital element of good capital governance.

Capital projects are often significant not only in terms of financial resources required but in terms of organisational capacity, impact upon Service delivery and reputational risk. It is therefore vital that there is sufficient monitoring carried out upon schemes to allow stakeholders to be informed of progress and for members and officers to make decisions as required.

In order to meet these requirements the Corporate Team prepare quarterly monitoring report showing the current spend against capital projects, the forecast for the end of the financial year include the underspend or slippage into the following year at the end of each financial quarter, with an outturn report at year-end.

Cabinet receive quarterly information on the progress of capital projects as part of the quarterly finance update.

Section 3 - FINANCING THE CAPITAL PROGRAMME

18. Capital Funding

There are a number of distinct sources of funding which can be utilised to finance capital expenditure. Some funding sources are ring fenced and can only be used for Housing Revenue Account capital expenditure, or a particular capital project. Consideration of funding must be made when projects are at the planning stage. No capital project will be put forward without funding having been identified to complete the project. Where capital schemes are in multiple phases, perhaps requiring an initial development phase to ensure funding for the final phases, this will be considered as part of the planning stage and clearly reported.

Capital funding cannot be used to fund revenue costs which may arise from a capital scheme such as consultant's costs on feasibility before a project is identified.

19. Capital Resources

Capital Receipts

The sale of assets with a value of more than £10,000 generates income known as capital receipts. Legislation requires these to be spent on either new capital investment or the repayment of existing debt. The government is allowing some flexibility in the use of capital receipts up until 31 March 2022 to fund revenue costs of transformation projects where these are expected to generate revenue savings in future years.

HRA Right to Buy compulsory sale of council houses generate receipts that may be retained to cover the cost of transacting the sales and to cover outstanding debt on the property sold, but a proportion of the remainder must be surrendered to Central Government.

All other HRA capital receipts may be retained provided they are spent on affordable housing, regeneration or paying off housing debt.

General Fund capital receipts can be retained in full. These can arise from the sale of land and buildings, vehicles, plant and equipment, and also through the repayment of loans or grants.

An active asset management planning process is needed to review the asset requirements of the Council and therefore to identify surplus assets which may be sold to generate capital receipts.

Prudential Borrowing

The Council is able to borrow money on the money market or from the Public Works Loans Board (PWLB) to fund capital schemes. A preferential Certainty

Rate of interest is allocated to Councils who apply for it and it is the policy of this Council to take advantage of the certainty rate each year.

For all schemes initially funded from borrowing, the Council will have to fund the repayment and interest costs as there is no longer any central government “supported borrowing” allocations and related revenue support.

The Council is only able to borrow for Prudential Borrowing, under the guidance contained in the CIPFA Prudential Code whereby, in summary, the Council is required to ensure that all borrowing is both prudent and affordable. All schemes funded from prudential borrowing are approved by full Council. As part of the Treasury Management Strategy each year full Council approves a limit for affordable borrowing and capital schemes will be considered in the light of that limit.

20. External Funding

Capital Grant from Government or Government Agency

Central government and government agencies provide capital grant funding that can be either ring fenced or non-ring fenced. Examples of ring fenced grants that the Council has received are disabled facilities grants (DFG’s) and Heritage Lottery Fund (HLF) funding.

Community Infrastructure Levy (CIL)

Any monies received from developers for infrastructure from the Community Infrastructure Levy will not be allocated to a specific service but will be allocated under the CIL arrangements (“the Regulation 123 List”) in line with Council’s capital scheme priorities.

The process for allocating CIL funds will be in accordance with the process agreed by Cabinet

Community Infrastructure Levy (CIL) Funding

The Community Infrastructure Levy (CIL) enables the council to raise funds for infrastructure from new development. It is levied on the net increase in floor space arising from new developments and is paid when that development starts. The Community Infrastructure Levy (CIL) is a tool for local authorities to support the development of their area by funding the provision, improvement, replacement, operation or maintenance of infrastructure. However the focus of CIL is on the delivery of new infrastructure to meet and mitigate the impacts of new development in an area.

CIL receipts can be used to fund a wide range of infrastructure including transport, schools, health and social care facilities, libraries, play areas, green spaces and sports facilities. Harrow’s list of strategic infrastructure requirements known as a Regulation 123 list is shown below:

Regulation 123 List

The following table comprises Harrow Council's Regulation 123 List. It includes the strategic infrastructure that the Council currently considers it is likely to apply CIL revenues to. The Regulation 123 List will be kept under review and may change depending upon the following:

- Changes to local or national funding streams in respect of CIL eligible infrastructure; and
- The requirements of the regulations governing the level of the "meaningful proportion" of CIL that is to be passed to local communities.

Infrastructure currently considered likely to benefit from the application of CIL funding	
Education facilities	Early years, primary and secondary schools
Health services	GPs, acute healthcare
Social care	Supported accommodation
Emergency services	Police, Ambulance and Fire Services
Cultural and community facilities	Libraries and community halls
Improvements to public open space	Parks, natural green space, civic space and green corridors and green grid
Improvements to biodiversity	
Public recreation and leisure facilities	Neighbourhood and Youth Play space, sports and leisure centres, swimming pools and playing pitches
Cemeteries and burial space	
Strategic transport facilities	Roads, buses, cycling, rail and underground
Strategic flood mitigation	

Of all CIL monies collected, 85% is used to fund strategic borough wide infrastructure projects, which includes a 5% allowance to cover the administrative costs of CIL. The decisions on where to spend CIL at a borough-wide level is determined by the Council. The remaining 15% is allocated to Neighbourhood CIL (NCIL) and must be spent on projects that have taken account of the views of the communities in which the income was generated and these projects should support the development of the area.

A report was presented to the Major Development Panel (MDP) on 14th November 2017, recommending that the allocation of Borough and Neighbourhood CIL is included as part of the Annual Budget Setting process and included in the Capital Programme report which goes to Cabinet in draft in December and in February in its final version. The recommendations from the Major Development Panel (MDP) report were agreed by Cabinet on 7th December 2017 which agreed:

- *the allocation of the Borough Community Infrastructure Levy (CIL) be included as part of the Annual Budget Setting process and included in the Capital Programme report which is presented to Cabinet every year in December (draft budget) and February (final budget);*
- Specific projects to be funded by Neighbourhood CIL can be put forward by the relevant Directorates / Ward members and assessed against the criteria outlined in the CIL Allocations report agreed by the Major Development Panel in November 2017. The final decision on what projects are funded from the agreed NCIL allocations will be delegated to the Divisional Director – Regeneration and Planning, in consultation

with the Portfolio Holders for Regeneration and Planning, and Finance and Commercialisation

. The recommendation for NCIL was as follows:

- (i) *the broad allocation of Neighbourhood CIL be agreed as part of the Capital Programme (based on available funds at the time and allocated as per 3(i) and 3(ii) above), and included in the Capital Programme report which is presented to Cabinet every year in December (draft budget) and February (final budget).*
- (ii) *Once the broad allocation of NCIL is agreed as part of the Capital Programme, individual projects put forward by the relevant Directorates / Ward Members be assessed against the criteria outlined in section 7 of the MDP report (including the extent of consultation and level of community support), with the final decision on what projects were funded from the agreed CIL allocations being delegated to the Divisional Director of Regeneration and Planning, following consultation with the Portfolio Holders for Regeneration and Planning, and Finance and Commercialisation.*

The Borough CIL element will be used to fund the core Capital programme and can be considered as a funding source for new capital bids as well as existing projects in the Capital programme.

In addition to the principles already reached on how CIL funding should be used to fund the capital programme, in light of the budget gaps in future years, it was recommended by Cabinet in December 2018, that CIL should be **first** be applied to any schemes in the existing capital programme rather than applying it to new schemes. The rationale for this is that if applied to schemes that are currently funded from borrowing, by funding from CIL instead, this will reduce the existing capital financing costs.

Section 106 Agreements

Developer consents may attract Section 106 funding to spend on a particular asset or site as an alternative to CIL.

Capital contributions from partner organisation

When capital projects are devised it is open for project managers to invite funding from a range of partner organisations.

Revenue contributions Services who are leading a capital project may make savings within their revenue budgets during a particular year and in some circumstances use that saving to part-fund a capital project.

21. Policy on use of Capital Funding

The Council will look to use external funding sources where possible to meet the funding requirements of its capital programme.

Where the use of Council resources are required the authority will look to utilise reserves, revenue funding or capital receipts as these create no long term revenue cost implications on the Council.

Borrowing will be used as the last possible source of funding and should be restricted only to those schemes which generate sufficient savings or income to meet the costs of interest and the Minimum Revenue Provision.

Any borrowing incurred to support the provision of new build housing within the Housing Revenue Account must be demonstrated to be affordable over a period of 30 years.

22. Relationship between Capital Strategy and Treasury Management

Treasury management refers to the processes of managing and reporting on the Council's performance in matters of investment and borrowing.

The Council's policy on Treasury Management has numerous links to the Capital Strategy. It is not intended that this Strategy replace the reporting requirements of the Treasury Management Strategy and includes a summary of the major points of that strategy and associated governance processes.

Key Treasury decisions are the responsibility of full Council and are contained within the Treasury Management Strategy.

These include:

- Approved limits on borrowing
- Limits for investment types and counterparty limits
- Planned capital expenditure
- Estimates for the future Capital Financing Requirement
- Policy on the Minimum Revenue Provision

Detailed discussion on these matters is delegated to the GARMS Committee who then makes recommendations to Cabinet. The key impact of a capital programme using borrowing is the creation of a "Capital Financing Requirement" (CFR). The CFR represents the need to borrow external funds as a result of expenditure funded through borrowing. Having a CFR creates the need for a Minimum Revenue Provision (MRP), a sum to be put to one side each year from the General Fund for repayment of debt.

The Council's MRP policy is to make provision for the repayment of debt equally over the life of the asset that the borrowing relates to. The Audit and Standards Committee receive at a minimum a mid-year monitoring report for Treasury management and an end of year outturn report. Where circumstances require,

such as a material fall in the value of investments, a report would be prepared and presented to the next meeting of the Committee by the S151 Officer.

Section 4- RISK MANAGEMENT

23. Embedding Risk Management in the Capital Programme

The Capital Strategy must be considered alongside the principles of risk management. Risks are inevitable within a capital programme, as with all aspects of Council operations, and effective management of risk is a vital part of the capital strategy.

The types of risk the authority is exposed to in the Capital Programme are summarised below:

- Financial Risk – The risk of significant cost overruns or commercial investments not performing as expected. The authority has a low appetite for this risk as it would impact upon available resources. Mitigation will be in the form of close scrutiny of capital spending through the budget monitoring process.
- Strategic Risk – The risk of not delivering key Council priorities or projects. Mitigation will be in the form of careful selection and planning of capital projects before commencement and project managers reviewing project progress and taking corrective action where necessary. Major changes in the outcomes of schemes will be reported to the appropriate Committee.
- Governance risk – The risk of capital spending decisions not being appropriately considered and decisions not being made at the correct level. Mitigation is the governance principles contained within the capital strategy.
- Resourcing risk – The risk that insufficient funds are available to fund the capital programme or that the incorrect type of funds is applied to capital projects. This is mitigated by the financing of capital projects being reviewed by the S151 Officer as part of the budget setting and the outturn.

24. Knowledge and Skills within the organisation

The Property Services team has officers of multiple disciplines who are experienced at leading capital projects, managing the Council's property portfolio and working within the local property market. They have experience of dealing with acquisitions, disposals, new commercial and residential development and redevelopment of brownfield sites.

The Finance team are involved in the development and monitoring of the Capital Programme. They have many years of experience in managing local authority capital programmes.

Legal Services will be provided by the Council's in-house legal team who will form a key part of the decision making around Capital projects. All solicitors are required to complete an annual Statement of Competence to the regulatory body to ensure any professional training needs are identified and addressed.

Where necessary external advice may be sought for all types of financial, property and legal advice. These costs, or at least appropriate estimates, will be included in the business cases of capital schemes.

Officers will work with members to ensure that training needs for elected members are appropriately identified. As a minimum annual training will be provided around the Treasury Management Strategy.

APPENDIX H

Glossary of Terms

- **Annuity** – method of repaying a loan where the payment amount remains uniform throughout the life of loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.
- **Bail-In** – previously, in response to the banking crisis, some governments used taxpayer funds to support banks in danger of failing. The European Union’s Banking Recovery and Resolution Directive (BRRD) requires that, in future, ‘bail in’ will be applied in such a scenario; this means that after shareholders’ equity, depositors’ funds comprising balances over c£85k will be used to support the bank at risk. The £85k threshold is not available to local authorities and therefore all unsecured deposits with banks and building societies will be at risk of ‘bail in’.
- **Base Rate** – minimum lending rate of a bank or financial institution in the UK
- **Bond** – a government or public company’s document undertaking to repay borrowed money usually with a fixed rate of interest.
- **Capital Expenditure** – spend on major items e.g. land and buildings, which adds to and not merely maintains the value of existing fixed assets.
- **Capital Grants** – specific targeted grants to cover capital spend
- **Capital Receipts** – the proceeds from the disposal of land or other assets. Capital receipts can be used to fund capital expenditure but cannot be used to finance revenue.
- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.
- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.
- **Credit Rating** – an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders’ reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor’s and Moody’s. They analyse credit worthiness under four headings:

- **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.
 - **Long Term Rating** – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.
 - **Individual/Financial Strength Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank or national government.
 - **Legal Support Rating** - a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.
 - The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.
- **DMADF and the DMO** – The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.
 - **EIP** – Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal is eroded, and so the total amount reduces with each instalment.
 - **Gilts** – the name given to bonds issued by the UK Government (i.e. the loan instrument by which the Government borrows). Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt, e.g. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as $8\%/1.45 = 5.5\%$.
 - **Lender Option Borrower Option (LOBO)** - LOBOs are a long term borrowing instrument commonly used by banks. It is an alternative lender option to the Government's Public Works Loan Board. In simple terms the instrument gets its name because the lender has an option to set revised interest rates at predetermined dates, and at which point the borrower has the option to accept the revised rates or pay the debt in full without penalty.
 - **LIBID** – The London Interbank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time. The average 7 day rate is the benchmark the Council uses for its own investment performance.
 - **Liquidity** – Relates to the amount of readily available, or short term, investment money which can be used for either day to day or unforeseen

expenses. For example Call Accounts allow instant daily access to invested funds.

- **Market** – The private sector institutions e.g. banks, building societies.
- **Maturity** - Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.
- **Minimum Revenue Provision (MRP)** – A statutory amount charged to the Council's revenue account for the provision to repay the loan principal on debt undertaken to finance the Capital Programme. For the Council this is done on a straight line basis in-line with the asset life and commences the financial year after the asset is operational.
- **Monetary Policy Committee (MPC)** – group that sets the bank base rate for the Bank of England.
- **Money Market Fund (MMF)** – A highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments.
- **Multilateral Development Banks (MDB)** – these are supranational institutions set up by sovereign states, which are their shareholders (e.g. European Investment Bank). Their remits reflect the development aid and cooperation policies established by these states.
- **Policy and Strategy Documents** – Documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.
- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as an Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.
- **Yield** – The amount in cash (in percentage terms) that returns to the owners of an investment e.g. interest earned from a deposit.