

<b>ISLE OF ANGLESEY COUNTY COUNCIL</b>	
<b>Report to:</b>	<b>COUNTY COUNCIL</b>
<b>Date:</b>	<b>10 MARCH 2022</b>
<b>Subject:</b>	<b>TREASURY MANAGEMENT STRATEGY STATEMENT 2022/23</b>
<b>Portfolio Holder(s):</b>	<b>COUNCILLOR R WILLIAMS</b>
<b>Head of Service / Director:</b>	<b>MARC JONES, DIRECTOR OF FUNCTION (RESOURCES) / SECTION 151 OFFICER</b>
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<b>Local Members:</b>	<b>n/a</b>

#### **A –Recommendation/s and reason/s**

- This report is presented to ensure that the Council is implementing best practice in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management. The code recommends that, prior to being presented for adoption, members should scrutinise the Treasury Management Strategy Statement (which includes the Annual Investment Strategy, the annual MRP Policy Statement, the annual Treasury Management Policy Statement and the Treasury Management Scheme of Delegation). This Authority's scheme of delegation charges the Governance & Audit Committee with this function.
- The CIPFA Code of Practice on Treasury Management (Section 7) recommends that the Authority's Treasury Management Practices (TMPs) should be approved, documented and monitored. It goes on to state that the nature and extent of the involvement of an organisation's responsible body in approving and monitoring its TMPs and accompanying schedules is a matter for local decision, and recognises that in some organisations this may be delegated to the responsible officer. In all cases, it should be subjected to scrutiny by the responsible body following recommendations by the responsible officer. This Authority has produced documented TMPs, and were approved by the Governance & Audit Committee on 11 February 2020 and the Executive on 03 March 2022
- In terms of updates to the Treasury Management Strategy Statement, there are no proposed amendment to the core principals and policies of the 2021/22 Statement.
- Under Code of Practice, it is a requirement that the Council prepares a Capital Strategy, which takes a longer-term view as to the capital investment that is required and how that investment will be funded. The County Council will approve this Strategy, along with other budget resolutions. This Treasury Management Strategy sits below the Capital Strategy, and considers the impact of that strategy on the Council's borrowing and investments. It sets out how both strategies will be undertaken in a controlled way, which is in line with a suitable level of risk that the Council wishes to take, bearing in mind the guidance set out in the CIPFA Code of Practice on Treasury Management. Under the revised Code in December 2021, members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS report.
- **Recommendations**
  - To approve and adopt the Treasury Management Strategy for 2022/23.

<b>B – What other options did you consider and why did you reject them and/or opt for this option?</b>	
n/a	
<b>C – Why is this a decision for the County Council?</b>	
<ul style="list-style-type: none"> <li>It is a designated Executive function. In accordance with the Scheme of Delegation, this report was scrutinised by the Governance &amp; Audit Committee on 08 February 2022 and Executive on 03 March 2022.</li> </ul>	
<b>CH – Is this decision consistent with policy approved by the full Council?</b>	
Yes	
<b>D – Is this decision within the budget approved by the Council?</b>	
N/a	
<b>DD – Assessing the potential impact (if relevant)</b>	
1	How does this decision impact on our long term needs as an Island
2	Is this a decision which it is envisaged will prevent future costs / dependencies on the Authority? If so, how:-
3	Have we been working collaboratively with other organisations to come to this decision, if so, please advise whom:
4	Have Anglesey citizens played a part in drafting this way forward? Please explain how:-
5	Note any potential impact that this decision would have on the groups protected under the Equality Act 2010.
6	If this is a strategic decision, note any potential impact that the decision would have on those experiencing socio-economic disadvantage.
7	Note any potential impact that this decision would have on opportunities for people to use the Welsh language and on treating the Welsh language no less favourably than the English language.
<b>E – Who did you consult?</b>	
<b>What did they say?</b>	
1	Chief Executive / Senior Leadership Team (SLT) (mandatory)
2	Finance / Section 151 (mandatory)
3	Legal / Monitoring Officer (mandatory)
4	Human Resources (HR)
5	Property
6	Information Communication Technology (ICT)
7	Procurement
8	Scrutiny
9	Local Members
10	Other
	<p>The Governance and Audit Committee and the Executive resolved to:-</p> <ul style="list-style-type: none"> <li>Recommend to the full Council the approval of the Treasury Management Statement for 2022/23, without any further changes.</li> </ul>

## **F - Appendices:**

1. Treasury Management Policy Statement
2. Treasury Management Key Principles
3. Economic background
4. Interest rate forecasts
5. Loan maturity profile
6. MRP Policy Statement
7. Specified and non-specified investments
8. Counterparty criteria
9. Approved countries for investments
10. Treasury management scheme of delegation and the role of the Section 151 Officer
11. Prudential and Treasury Indicators
12. Explanation of Prudential and Treasury Indicators
13. Glossary of, and information on, Prudential & Treasury Management indicators

## **FF - Background papers (please contact the author of the Report for any further information):**

- 2021/22 Treasury Management Strategy Statement, approved by the full Council on 9 March 2021;
- 2020/21 Treasury Management Outturn Report, presented to the Governance & Audit Committee on 20 July 2021;
- 2020/21 Capital Outturn Report, presented to this Committee on 21 June 2021;
- Capital Budget Monitoring Quarter 2 2021/22, presented to this Committee on 29 November 2021; and
- 2021/22 Treasury Management Mid Year Report, presented to the Governance & Audit Committee on 09 December 2021.

## TREASURY MANAGEMENT STRATEGY STATEMENT

### ANNUAL INVESTMENT STRATEGY, MINIMUM REVENUE PROVISION POLICY STATEMENT AND TREASURY MANAGEMENT POLICY STATEMENT 2022/23

#### 1. INTRODUCTION

- 1.1. CIPFA published the revised codes on 20 December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. The Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy, and also related reports during the financial year, which are taken to full Council for approval.
- 1.2. The revised codes will have a number of implications and members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS report.
- 1.3. In addition, all investments and investment income must be attributed to one of the following three purposes - Treasury Management, Service Delivery and Commercial return. As this Treasury Management Strategy Statement and Annual Investment Strategy deals with treasury management investments, the categories of service delivery and commercial investments will be dealt with as part of the Capital Strategy report.

#### 2. BACKGROUND

- 2.1. CIPFA defines treasury management as:-

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

The Treasury Management Policy Statement defines the policies and objectives of the treasury management activities (see **Appendix 1**).

- 2.2. 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.
- 2.3. 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.
- 2.4. 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 Council's cash reserves.

#### 3. CIPFA CODE OF PRACTICE ON TREASURY MANAGEMENT

- 3.1. The CIPFA Code of Practice on Treasury Management requires the Council to prepare and approve the following documents:-
  - A Capital Strategy Statement which sets out a high level, long term overview of capital expenditure and financing, along with details on any associated risks and how they will be managed, as well as the implications for future financial sustainability. The aim of this capital strategy is to ensure that all elected Members on the full Council fully understand

the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

- A Treasury Management Strategy which sets out the Council's strategy in terms of borrowing and investment which follows on from the Capital Strategy, sets out the constraints on borrowing, determines a set of prudential indicators and determines the Council's risk appetite and strategy in respect of investments. It essentially covers two areas: capital issues and treasury management issues. These elements cover the requirements of the Local Government Act 2003, Welsh Government Investment Guidance and MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

3.2. The key principles of the CIPFA Treasury Management Code of Practice are set out in **Appendix 2**.

#### 4. EXTERNAL CONTEXT

4.1. Setting the Treasury Management Strategy cannot be undertaken in isolation, and consideration must be given to the economic situation as this has an impact on investment interest rates, the cost of borrowing and the financial strength of counterparties. A full summary of the economic outlook is set out in **Appendix 3**, but the main points to consider are as follows:-

- Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022, with significant risks to the forecasts detailed in **Appendix 4**.
- 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.
- Investment returns are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations

4.2. Having considered the available information and having considered the advice from the Council's Treasury Management Advisors, the following table sets out the Council's view on interest rate levels for the following 3 years:-

**Table 1**  
**Prospects for Interest Rates to March 2025**

Annual Average	Bank Rate (%)	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
March 2022	0.25	1.50	1.90	1.70
June 2022	0.50	1.50	2.00	1.80
September 2022	0.50	1.60	2.10	1.90
December 2022	0.50	1.60	2.10	1.90
March 2023	0.75	1.70	2.20	2.00
June 2023	0.75	1.80	2.20	2.00
September 2023	0.75	1.80	2.20	2.00
December 2023	0.75	1.80	2.30	2.10
March 2024	1.00	1.90	2.30	2.10
June 2024	1.00	1.90	2.40	2.20
September 2024	1.00	1.90	2.40	2.20
December 2024	1.00	2.00	2.50	2.30
March 2025	1.25	2.00	2.50	2.30

Information provided by Link Group, Treasury Solutions is attached as **Appendix 4**.

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.

As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

Borrowing interest rates fell to historically very low rates as a result of the Covid crisis and the quantitative easing operations of the Bank of England, and still remain at historically low levels. Despite these low rates, our policy of avoiding new borrowing by running down spare cash balances has served the Authority well over the last few years.

- 4.3.** The current forecast, shown above, includes a forecast for a first increase in Bank Rate in May 2022, though it could come in February. Given the forecast for bank base rates, the suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):-

2022/23: 0.50%;

2023/24: 0.75%;

2024/25: 1.00%;

2025/26: 1.25%;

Long term later years: 2.00%.

## 5. THE COUNCIL'S CURRENT POSITION

### 5.1. Borrowing

**5.1.1.** The Council's current external borrowing is set out in Table 2 below. A full analysis is attached as **Appendix 5**.

**Table 2**

#### **Summary of the Council's Current Outstanding Loans**

<b>PWLB LOANS</b>						
	<b>PWLB / PWLB Maturity</b>	<b>PWLB EIP/ Annuity</b>	<b>Market Loans</b>	<b>PWLB Variable</b>	<b>Total Maturing</b>	
Loan Outstanding	£121,684k	£193k	£0k	£0k	£121,877k	
Average life (years)	30.42	4.63	0.00	0.00	30.38	
Average rate (%)	4.58	9.42	0.00	0.00	4.58	
<b>OTHER LOANS</b>						
	<b>Salix Loan 1</b>	<b>Salix Loan 2</b>	<b>Salix Loan 3</b>	<b>Salix Loan 4</b>	<b>Salix Loan 5</b>	<b>Total</b>
Outstanding Balance	£41k	£182k	£445k	£198k	£2,205k	£3,071k
Repayment Date	2024/25	2025/26	2028/29	2029/30	2031/32	
Interest Rate (%)	0.00	0.00	0.00	0.00	0.00	

### 5.2. Investments

**5.2.1** Any surplus cash is currently invested in short term deposit accounts, call accounts and with other UK local authorities. The balance invested in these accounts changes daily (balance as at 31 December 2021 was £44.7m).

**5.2.2** Under the current treasury management strategy, the Council invests surplus cash ensuring, first of all, the security of the deposit, secondly the liquidity of the deposit and, finally, the return on the investment. In practice, in order to ensure the first and second principles, the rate of return on investments is sacrificed, and the current average return on investments is 0.02% (as at 31 December 2021).

## **6. IMPACT OF FUTURE PLANS ON BORROWING**

**6.1.** Capital expenditure is partly funded from borrowing and the capital programme, as set out in the Capital Strategy, is set out in Table 3 below:-

**Table 3  
Proposed Capital Expenditure Programme 2022/23 – 2024/25**

	2022/23 £'000	2023/24 £'000	2024/25 £'000
<b>Non - HRA</b>	17,177	9,408	8,277
<b>HRA</b>	18,784	22,009	18,550
<b>Commercial Activities / Non Financial Investment</b>	0	0	0
<b>TOTAL EXPENDITURE</b>	35,961	31,417	26,827
<b>Financed By</b>			
<b>Capital Grants</b>	7,662	7,040	5,653
<b>Capital Receipts</b>	600	100	100
<b>Reserves</b>	2,876	0	0
<b>Revenue</b>	10,099	9,849	10,290
<b>Balance Funded from Borrowing</b>	14,724	14,428	10,784

- 6.2. An important factor to consider is the impact of borrowing on the Council's Capital Financing Requirement (CFR). The CFR is the measure of the Council's underlying borrowing need. Borrowing is not limited to external borrowing from PWLB but also the use of the Council's own cash balances (internal borrowing) which have been used to fund capital expenditure.
- 6.3. Capital expenditure will increase the CFR but only by the sum that is not funded from grants, capital receipts, reserves or revenue. The CFR will also reduce annually by the sum of the Minimum Revenue Provision (MRP) which is charged to revenue. The level of the CFR is an important measure to ensure that the Council does not commit itself to unaffordable levels of borrowing.
- 6.4. In order to ensure that the Council has sufficient funds available to repay debt as it falls due, the Council is required to make a charge to the revenue account each year, and this charge is known as the Minimum Revenue Provision (MRP). Regulations require that the Council approves a MRP statement in advance of each financial year. The policy for 2022/23 is set out in **Appendix 6**. The Council's MRP was substantially revised in 2018, but there are no changes from that revised policy for 2022/23. By making the MRP charge each year, the Council's cash balances are replenished and that, in turn, reduces the level of internal borrowing.
- 6.5. The policy will provide an equal charge on borrowing up to 31 March 2018 and, for all borrowing after that date, the MRP charge will be based on the useful life of the asset which has been funded from borrowing, e.g. if £1m is borrowed to fund the capital expenditure on an asset that has an asset life of 20 years, the annual MRP in respect of that loan would be £50k per annum. As new borrowing is undertaken, it will increase the MRP charge over time and this increase in costs is allowed for in the Council's budgets. The Council may choose to pay more MRP in any given year. These overpayments of MRP (which in the Council's case, are to ensure enough cash for loan repayments), can, if needed, be reclaimed in later years. Up until 31 March 2021, the total overpayments were £289k, and related specifically to the Salix loans where the MRP charged to the revenue account has been calculated on the basis of the life of the loan rather than on the life of the asset which was funded by the loan. This ensures that the Council has sufficient cash to repay the loans when they become due for repayment.
- 6.6. The impact of the Council's capital expenditure plans and the MRP charge on the CFR and level of external and internal borrowing is shown in Table 4 below:-

**Table 4**  
**Capital Financing Requirement and Borrowing 2021/22 to 2024/25**

	2021/22 £'000	2022/23 £'000	2023/24 £'000	2024/25 £'000
<b>Capital Financing Requirement (CFR)</b>				
<b>Opening Balance of CFR</b>	<b>136,560</b>	<b>140,949</b>	<b>151,515</b>	<b>161,470</b>
Capital Expenditure	39,068	35,961	31,417	26,827
External Capital Grants	(18,416)	(7,662)	(7,040)	(5,653)
Capital Receipts	(521)	(600)	(100)	(100)
Revenue Contribution & Reserves	(12,206)	(12,975)	(9,849)	(10,290)
Minimum Revenue Provision	(3,536)	(4,158)	(4,473)	(4,696)
<b>CLOSING BALANCE OF CFR</b>	<b>140,949</b>	<b>151,515</b>	<b>161,470</b>	<b>167,558</b>
<b>External Borrowing</b>				
<b>Opening Balance of External Borrowing</b>	<b>124,524</b>	<b>132,283</b>	<b>144,335</b>	<b>156,112</b>
Borrowing to Fund Capital Expenditure	7,925	14,724	14,428	10,784
Borrowing to Fund Loan Repayments	0	0	0	0
Borrowing to Replace Internal Borrowing	0	0	0	0
Loan Repayments	(166)	(2,672)	(2,651)	(382)
<b>Closing Balance of External Borrowing</b>	<b>132,283</b>	<b>144,335</b>	<b>156,112</b>	<b>166,514</b>
<b>Internal Borrowing</b>				
<b>Opening Balance of Internal Borrowing</b>	<b>12,036</b>	<b>8,666</b>	<b>7,180</b>	<b>5,358</b>
Replacement of Internal Borrowing	0	0	0	0
Funding Loan Repayments from External Borrowing	0	0	0	0
External Loan Repayments	166	2,672	2,651	382
Borrowing to Fund Capital Expenditure	0	0	0	0
Minimum Revenue Provision	(3,536)	(4,158)	(4,473)	(4,696)
<b>Closing Balance of Internal Borrowing</b>	<b>8,666</b>	<b>7,180</b>	<b>5,358</b>	<b>1,044</b>
<b>TOTAL BORROWING</b>	<b>140,949</b>	<b>151,515</b>	<b>161,470</b>	<b>167,558</b>

## **7. BORROWING STRATEGY**

**7.1.** The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This approach is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered. As part of this strategy, the ability to externally borrow to repay the reserves and balances, if needed, is important. Table 4 indicates that £8.666m may need to be externally borrowed if urgently required. This is the amount of Council reserves and balances used in the past to fund the capital programme instead of taking out borrowing.

**7.2.** Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:-

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

### **7.3. External v Internal Borrowing**

**7.3.1** Current conditions indicate a need for a flexible approach to the choice between internal and external borrowing. Many of the factors which lay behind previous policies to externalise all borrowing remain valid, e.g.:-

- With a continuing historically abnormally low Bank Rate and PWLB rates, there remains a unique opportunity for local authorities to actively manage their strategy of undertaking new external borrowing.

**7.3.2** However, it remains the case that there are certain limitations to this approach, as previously noted, e.g.:-

- The policy can cause exposure to credit risk (e.g. risk of the bank defaulting on the debt), so this aspect must be very carefully managed;
- Careful on-going consideration needs to be given to the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

**7.3.3** In favour of internalisation, over the medium term, investment rates are expected to continue to be below long term borrowing rates. This means that value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure, or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

**7.3.4** However, short term savings by avoiding new long term external borrowing in 2022/23 must also be weighed against the potential for incurring additional long term extra costs, by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be higher. Additionally, the cash flow implications of internalising borrowing require regular review and will limit the potential extent of internalising borrowing.

## **7.4. Borrowing in Advance of Need**

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

**7.4.2** In determining whether borrowing will be undertaken in advance of need, the Council will:-

1. ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
2. ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets, have been considered;
3. evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
4. consider the advantages and disadvantages of alternative forms of funding;
5. consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use; and
6. consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

**7.4.3** 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.

## **7.5. Debt Rescheduling**

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

**7.5.2** The reasons for any rescheduling to take place will include:-

- the generation of cash savings and/or discounted cash flow savings;
- helping to fulfil the treasury strategy; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

**7.5.3** Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

**7.5.4** All rescheduling will be reported to the Governance & Audit Committee at the earliest practicable meeting following its action.

## **7.6. Debt Profile**

**7.6.1.** As can be seen from **Appendix 5**, the existing borrowing is due to be repaid in various years up to 2068/69. As part of any decision on future borrowing, the Council will aim to ensure that the repayment date is arranged so as to smooth out repayments as far as possible, but priority will be given to the interest rate payable when determining the type of loan (maturity or annuity) and the length of the loan.

## 8. INVESTMENT STRATEGY

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

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

### 8.2. Management of Risk

8.2.1 CIPFA has extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments (as managed by the Treasury Management Team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy (a separate report).

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

- Welsh Government's Guidance on Local Government Investments ("the Guidance");
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code");
- CIPFA Treasury Management Guidance Notes 2018.

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

8.2.4 The above guidance from the Welsh Government and CIPFA place a high priority on the management of risk. This Authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:-

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration, the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.
3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This 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 7** under the categories of 'specified' and 'non-specified' investments.
  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.
  - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year and/or are more complex instruments which require greater consideration by Members and officers before being authorised for use.
5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments by ensuring that no non-specific investment is undertaken without the prior consent of the Council. The Council does not hold any non-specified investments, nor does it intend to during 2022/23 (see **Appendix 7**).
6. **Lending limits** (amounts and maturity) for each counterparty will be set through applying the matrix table as set out in the Creditworthiness section of this strategy.
7. **Transaction limits** are set for each type of investment in **Appendix 8**.
8. This Authority will set a limit for the amount of its investments which are invested for **longer than 365 days** (see **Appendix 11**).
9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating** (see **Appendix 9**).
10. This Authority has engaged **external consultants** to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Authority in the context of the expected level of cash balances and need for liquidity throughout the year.
11. All investments will be denominated in **sterling**.
12. As a result of the change in accounting standards for 2022/23 under **IFRS 9**, this Authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. The Welsh Government has passed a statutory override to allow Welsh local authorities time to adjust their portfolio of all pooled investments by delaying implementation of IFRS 9 for five years until 31.03.23.

### 8.3. Creditworthiness Policy

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

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

- 8.3.2** The Section 151 Officer will maintain a counterparty list in compliance with the criteria set out in **Appendix 8** and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.
- 8.3.3** Credit rating information is supplied the Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
- 8.3.4** As an additional layer to the minimum credit rating criteria described above, this Council also employs the creditworthiness service provided by Link Group. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:-
- Credit watches and credit outlooks from credit rating agencies;
  - Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings;
  - Sovereign ratings to select counterparties from only the most creditworthy countries.
- 8.3.5** This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads from which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council, at the discretion of the Section 151 Officer, to assist in determining the duration for investments. The Council will, therefore, normally use counterparties within the following durational bands:-
- Yellow: 5 years \*
- Dark pink : 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink : 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple: 2 years
- Blue: 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange: 1 year
- Red: 6 months
- Green: 100 days
- No colour: not to be used
- 8.3.6** The Link creditworthiness service uses a wider array of information than just primary ratings and, by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.
- 8.3.7** Typically, the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

- 8.3.8** All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.
- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
  - In addition to the use of credit ratings, the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
- 8.3.9** Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information and information on any external support for banks to help support its decision making process.
- 8.3.10** Significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.
- 8.3.11** Although bank CDS prices (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

#### **8.4. Country Limits**

- 8.4.1** The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 9**. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

### **9. GOVERNANCE AND CONTROL**

- 9.1.** The Prudential Code reflects a move towards self regulation for local authorities and effective corporate governance is one of the key elements to the successful implementation of the Code.
- 9.2.** Corporate Governance includes the following elements:-
- A formal role for the Section 151 Officer;
  - Setting and monitoring of Prudential and Treasury Indicators;
  - A scheme of delegation and a process of formal approval;
  - Reporting on Treasury Management matters to Members.
- 9.3. Role of the Section 151 Officer and Members**
- 9.3.1** The Section 151 Officer is responsible for ensuring that matters relating to Treasury Management and Capital Financing are taken into account and reported to the Executive / full Council for consideration and that procedures are established to monitor performance.

- 9.3.2** The Section 151 Officer must ensure that prudential indicators are set and monitored in order to demonstrate the legislative requirement that the Council's financial plans are affordable.
- 9.3.3** Members also play an important role in not just authorising the relevant decisions but also in scrutinising treasury management processes, decisions and performance. In order to undertake this role, the CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. In order to support the scrutiny role of the members of the Governance & Audit Committee, the Committee's members received training in treasury management, delivered by the appointed treasury management consultants on 7 November 2019. Further training will be arranged when required. The training needs of treasury management officers are regularly reviewed and addressed.
- 9.3.4** The Treasury Management Scheme of Delegation and a fuller explanation of the role of the Section 151 Officer is set out in **Appendix 10**.

#### **9.4. Treasury Management Advice**

- 9.4.1** The Council uses Link Group, Treasury Solutions as its external treasury management advisors. The Council exercised the option to extend the services provided by Link Group as per the contract conditions for two years, ending 31 March 2021. In accordance with procurement regulations, the Council retendered this service during early 2021 for the period 1 April 2021 to 31 March 2024 with an option to extend for two years, with Link Group, Treasury Solutions being the successful tender.
- 9.4.2** The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers. Final responsibility for treasury management decisions remains with the Council.
- 9.4.3** It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

#### **9.5. Prudential and Treasury Indicators**

- 9.5.1.** The Prudential and Treasury Indicators set out in **Appendix 11** cover affordability, prudence and sets out limits for capital expenditure, external debt and the structure of the debt. It is for the Council to set the Prudential Indicators and it is important to not just consider the indicators for each individual year in isolation, but also to consider the past performance and the future forecasts. A fuller explanation of the purpose of each indicator is set out in **Appendix 12**.

#### **9.6. Reporting**

- 9.6.1** The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Governance & Audit Committee.
- 9.6.2** Prudential and Treasury Management Indicators and Treasury Strategy - the first and most important report (this report) is forward looking and covers:-
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury management indicators;
  - an Investment Strategy (the parameters on how investments are to be managed);
  - a Minimum Revenue Provision (MRP) Policy (how residual capital expenditure is charged to revenue over time);

- a Treasury Management Policy Statement (definition of the policies and objectives of the treasury management function); and
- the capital plans (including the associated prudential indicators).

**9.6.3** A Mid-Year Treasury Management Report - this will update Members with the progress of the capital position, amending prudential indicators as necessary and whether the treasury strategy is meeting its objectives or whether any policies require revision.

**9.6.4** An Annual Treasury Report - this is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

**Treasury Management Policy Statement**

1. CIPFA defines its treasury management activities as: “The management of the Authority’s 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”.
2. This organisation 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, and any financial instruments entered into to manage these risks.
3. This organisation acknowledges 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.

## The CIPFA Treasury Management in the Public Services: Code of Practice

The key principles of CIPFA's *Treasury Management in the Public Services: Code of Practice (2021 Edition)*, as described in Section 4 of that Code are as follows:-

### Key Principle 1:

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

### Key Principle 2:

Their policies and practices should make clear that the effective management and control of risks are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

### Key Principle 3:

They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that, within the context of effective risk management, their treasury management policies and practices should reflect this.

The Code then goes on to say that:-

“In framing these recommendations, CIPFA acknowledges the difficulties of striving for effective risk management and control, whilst at the same time pursuing value for money. This code does not seek to be prescriptive about how this issue should be handled, particularly since it covers such a wide variety of organisations. However, where appropriate, the sector specific guidance notes give suitable advice. CIPFA recognises that no two organisations in the public services are likely to tackle this issue in precisely the same manner but success in this area of treasury management is likely to be viewed, especially in value for money terms, as an indicator of a strongly performing treasury management function.”

“It is CIPFA's view that throughout the public services the priority is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate nor possible. However, a balance must be struck with a keen responsibility for public money.”

Accordingly, the Authority will adopt, as part of the standing orders, the following four clauses:-

1. The Authority will create and maintain, as the cornerstones for effective treasury management:-
  - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities; and
  - suitable treasury management practices (TMPs) setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the Policy Statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Authority. Such amendments will not result in the Authority materially deviating from the Code's key principles.

2. The County Council, Executive Committee and the Governance & Audit Committee will receive reports on the Authority's treasury management policies, practices and activities, including: an annual strategy and plan in advance of the year, a mid-year review report and an annual report after its close, in the form prescribed in the TMPs.
3. The County Council/Executive Committee are responsible for the implementation of the Authority's treasury management policies and practices in accordance with the Treasury Management Scheme of Delegation. The Section 151 Officer is responsible for the execution and administration of treasury management decisions, who will act in accordance with the Authority's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
4. The Authority nominates the Governance & Audit Committee to be responsible for ensuring effective scrutiny of treasury management strategy and policies.

## 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 pandemic 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 16TH 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.

*Rhan o gyngor dderbyniwyd gan / An extract from advice received from: Link Group, Treasury Solutions*

## Rhagolygon Graddfeydd Llog 2021/2025 Interest Rate Forecasts 2021/2025

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

*The Link 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 Ra 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
<b>BANK RATE</b>	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
<b>Bank Rate</b>													
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	0.75	1.00	1.25	1.25	1.25	1.25	-	-	-	-	-
<b>5yr PWLB Rate</b>													
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	-	-	-	-	-
<b>10yr PWLB Rate</b>													
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	-	-	-	-	-
<b>25yr PWLB Rate</b>													
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	-	-	-	-	-
<b>50yr PWLB Rate</b>													
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	-	-	-	-	-

*Rhan o gyngor dderbyniwyd gan / An extract from advice received from: Link Group, Treasury Solutions*

### Significant risks to the forecasts

- Mutations of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns. 25% of the population not being vaccinated is also a significant risk to the NHS being overwhelmed and lockdowns being the only remaining option.
- Labour and supply shortages prove more enduring and disruptive and depress economic activity.
- The Monetary Policy Committee acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- The Monetary Policy Committee tightens monetary policy too late to ward off building inflationary pressure
- The Government acts too quickly to cut expenditure to balance the national budget.
- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- Longer term US treasury yields rise strongly and pull gilt yields up higher than forecast
- Major stock markets e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- Geopolitical risks, for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

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

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

### **Forecasts for Bank Rate**

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

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.
- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.
- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

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

<b>DADANSODDIAD BENTHYCIADAU PWLB YN AEDDFEDU 2022/23 YMLAEN / PWLB LOANS MATURITY ANALYSIS 2022/23 ONWARDS</b>						
	<b>Aeddfedu PWLB Maturity</b>	<b>Blwydd-dal PWLB EIP/ Annuity</b>	<b>Benthyciadau Marchnad/ Market Loans</b>	<b>Amrywiol/ PWLB Variable</b>	<b>Cyfanswm yn Aeddfedu/ Total Maturing</b>	<b>%Yn Aeddfedu o'r Cyfran yn sefyll/ Maturing of Total Outstanding</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>%</b>
2022/23	2,285	15	0	0	2,300	1.9
2023/24	1,854	16	0	0	1,870	1.5
2024/25	0	18	0	0	18	0.0
2025/26	0	20	0	0	20	0.0
2026/27	1,382	22	0	0	1,404	1.2
2027/28	2,165	24	0	0	2,189	1.8
2028/29	262	26	0	0	288	0.2
2029/30	1,538	21	0	0	1,559	1.3
2030/31	451	15	0	0	466	0.4
2031/32	1,941	9	0	0	1,950	1.6
2032/33	315	7	0	0	323	0.3
2033/34	637	0	0	0	637	0.5
2034/35	624	0	0	0	624	0.5
2035/36	611	0	0	0	611	0.5
2036/37	599	0	0	0	599	0.5
2037/38	587	0	0	0	587	0.5
2038/39	225	0	0	0	225	0.2
2039/40	5,000	0	0	0	5,000	4.1
2040/41	3,500	0	0	0	3,500	2.9
2042/43	1,000	0	0	0	1,000	0.8
2043/44	1,020	0	0	0	1,020	0.8
2044/45	1,010	0	0	0	1,010	0.8
2045/46	11,464	0	0	0	11,464	9.4
2050/51	2,000	0	0	0	2,000	1.6
2052/53	28,238	0	0	0	28,238	23.2
2054/55	3,000	0	0	0	3,000	2.5
2055/56	3,500	0	0	0	3,500	2.9
2056/57	5,000	0	0	0	5,000	4.1
2057/58	8,513	0	0	0	8,513	7.0
2059/60	1,763	0	0	0	1,763	1.4
2064/65	10,000	0	0	0	10,000	8.2
2066/67	6,200	0	0	0	6,200	5.1
2068/69	15,000	0	0	0	15,000	12.3
	<b>121,684</b>	<b>193</b>	<b>0</b>	<b>0</b>	<b>121,877</b>	<b>100.0</b>
Cyfartaledd bywyd (blynyddoedd)/ Average life (years)	30.42	4.63	0.00	0.00	30.38	
Cyfartaledd graddfa (%)/ Average rate (%)	4.58	9.42	0.00	0.00	4.58	

**PROFFIL AD-DALU BENTHYCIADAU ERAILL 2022/23 YMLAEN /**

**OTHER LOANS REPAYMENT PROFILE 2022/23 ONWARDS**

	<b>Benthyciad Salix Loan 1</b>	<b>Benthyciad Salix Loan 2</b>	<b>Benthyciad Salix Loan 3</b>	<b>Benthyciad Salix Loan 4</b>	<b>Benthyciad Salix Loan 5</b>	<b>Cyfanswm / Total</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
2022/23	16	46	64	26	220	372
2023/24	16	46	64	26	220	372
2024/25	9	45	64	26	220	364
2025/26	0	45	64	26	220	355
2026/27	0	0	63	27	220	310
2027/28	0	0	63	27	220	310
2028/29	0	0	63	27	221	311
2029/30	0	0	0	13	221	234
2030/31	0	0	0	0	221	221
2031/32	0	0	0	0	222	222
<b>Cyfanswm / Total</b>	<b>41</b>	<b>182</b>	<b>445</b>	<b>198</b>	<b>2,205</b>	<b>3,071</b>

**Minimum Revenue Provision Policy Statement 2022/23**

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

The Welsh Government regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options is provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-

For capital expenditure incurred between 1 April 2008 and 31 March 2018, financed by supported borrowing, the MRP policy will be to charge MRP on the Equal Instalment method, Asset Life basis over 50 years. The MRP on capital expenditure funded by unsupported borrowing during this period has already been charged using the Equal Instalment method, Asset Life basis using the estimated lives of the assets, based on information available at that time. This change in policy realigns the MRP policies for assets funded by supported borrowing and assets funded by unsupported borrowing.

From 1st April 2018 for all supported and unsupported borrowing (including PFI and finance leases), the MRP policy will also be the Equal Instalment Annuity Method, the Asset Life basis. However, the estimated life periods, will be set by the Section 151 Officer based upon advice received from the relevant officers and will have regard to Welsh Government guidance in relation to MRP and asset lives. Where land is purchased, the asset life will be based on the asset life of the asset placed on the land, which in the majority of cases will be 50 years in line with the asset life for buildings.

MRP charges based on asset life would not be charged until the year the asset becomes operational. The Section 151 Officer may postpone the MRP charge until the financial year following the one in which the asset becomes operational. The estimated asset life of the asset would be determined in the year the MRP commences and would not change over the life of the asset. The estimated life periods will be set by the Section 151 Officer based upon advice received from the relevant officers and will have regard to Statutory requirements and Welsh Government guidance in relation to MRP and asset life. Where land is purchased, the asset life will be based on the asset life of the asset placed on the land, which in the majority of cases will be 50 years in line with the asset life for buildings.

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. In addition, 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.

The Council retains the right to make additional voluntary payments to reduce debt if deemed prudent.

The Housing Revenue Account share of the CFR is subject to a 2% MRP charge, based upon the closing CFR for the previous year, in line with the approved 30-year business plan.

Any repayments included in annual PFI or finance leases are applied as MRP and will be consistent with the asset life basis over the life of the lease or PFI scheme.

## Specified and Non-Specified Investments

The Welsh Government 'Guidance on Local Government Investments' (Effective from 1 April 2010) provides the definition of specified and non-specified investments.

Paragraph 5.1 of the 'Guidance' states that an investment is specified if all of the following apply:-

- (a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling; and
- (b) the investment is not a long-term investment (\*); and
- (c) the making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]; and
- (ch) the investment is made with a body or in an investment scheme of high credit quality (\*\*); or with one of the following public-sector bodies:
  - (i) the United Kingdom Government;
  - (ii) a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland;
  - (iii) a parish or community council.

The 'Guidance' also states that any investment not meeting the definition of paragraph 5.1 is classified as a non-specified investment.

During 2022/23 the Council does not intend to make any investments in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation (such as company shares). Non-specified investments will therefore be limited to (i) long-term investments; and (ii) deposits with the Council's own banker for transactional purposes if it fails to meet the basic credit criteria; in this instance balances will be minimised as far as is possible

The table in Appendix 8 set out the investment criteria and limits for the categories of investments intended for use during 2022/23 and, therefore, form the basis for the approved lending list.

Any proposed revisions or amendments during the year to the categories of specified and non-specified investments to be used and / or to the associated credit rating criteria / investment limits will be subject to prior approval by the County Council.

\* Section 2.4 of the 'Guidance' defines a long term investment as "any investment other than (a) one which is due to be repaid within 12 months of the date on which the investment was made or (b) one which the local authority may require to be repaid within that period."

\*\* For the purposes of high credit quality the 'Guidance' states that "for the purposes of paragraph 5.1(d), Welsh ministers recommend that the Strategy should define high credit quality (and where this definition refers to credit ratings, paragraph 6.1 (\*\*\*) is relevant)."

\*\*\* Paragraph 6.1 of the 'Guidance' recommends that "the Strategy should set out the authority's approach to assessing the risk of loss of investments, making clear in particular:

- (a) to what extent, if any, risk assessment is based upon credit ratings issued by one or more credit rating agencies;
- (b) where credit ratings are used, how frequently credit ratings are monitored and what action is to be taken when ratings change; and
- (c) what other sources of information on credit risk are used, additional to or instead of credit ratings."

The table in Appendix 8 of this strategy sets out what this Council defines as high credit quality and the associated investment criteria and limits and section 7.3 of this strategy sets out the Council's creditworthiness approach.

## Counterparty Criteria

Category	Short Term Credit Rating (Fitch)	Short Term Credit Rating (Moody's)	Short Term Credit Rating (Standard & Poor's)	Long Term Credit Rating (Fitch)	Long Term Credit Rating (Moody's)	Long Term Credit Rating (Standard & Poor's)	Cash Limit	Time Limit
Bank and Building Societies (not nationalised or part nationalised)	F1+	P-1	A-1+	AAA	Aaa	AAA	£10m	5 years
	F1+	P-1	A-1+	AA	Aa2	AA	£10m	3 years
	F1+	P-1	A-1+	AA-	Aa3	AA-	£10m	364 days
	F1	P-1	A-1	A	A2	A	£7.5m	6 months
Nationalised / Part Nationalised UK Banks	n/a	n/a	n/a	n/a	n/a	n/a	£10m	364 days
NatWest Bank (Part Nationalised)	n/a	n/a	n/a	n/a	n/a	n/a	£30m	364 days
UK Central Government (irrespective of credit rating)	n/a	n/a	n/a	n/a	n/a	n/a	No maximum	No maximum
UK Local Authorities*	n/a	n/a	n/a	n/a	n/a	n/a	£5m	364 days
Money Market Funds	n/a	n/a	n/a	AAA	AAA	AAA	£5m	6 months

\*as defined in the Local Government Act 2003

**Notes and Clarifications****(1) Cash Limit**

- (i) The cash limits apply both to the individual counterparty and to the overall group to which it belongs (e.g. for the banks within the Lloyds Banking Group plc (being Bank of Scotland plc and Lloyds Bank plc), the investment limit applies to those banks individually and the banking group as a whole);
- (ii) The overall cash limit for deposits over 364 days is £15m.

**(2) Time Limit**

- (i) This up to and including the period indicated.

**(3) Foreign Countries**

- (i) Investments in foreign countries will be limited to those that hold a sovereign credit rating of (Fitch) AA- or equivalent (from the agencies referred to in section 4.3 of this strategy) sovereign credit rating (based upon the lowest common denominator), and to a maximum of £10 million per foreign country.
- (ii) Investments in countries whose lowest sovereign rating is not AA- or above will not be permitted. No country limit will apply to investments in the UK, irrespective of the sovereign credit rating.
- (iii) Subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain's Banco Santander) will be classed as a UK bank due to its substantial UK franchises and the arms-length nature of the parent-subsidary relationships.
- (iv) Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

**(4) Credit Rating Downgrade**

Should a credit rating downgrade place a counterparty below the minimum credit rating criteria for investment, the counterparty will cease to be used as soon as practicable.

If the Section 151 Officer wishes to continue investing with that counterparty approval will be sought from the Chair of the Governance & Audit Committee plus one other member of the Chair's choosing, who both must approve the action. This will then be reported as appropriate at the next available opportunity.

**Approved countries for investments [correct as at 21 December 2021]**

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

***Based on lowest available rating***

## AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

## AA+

- Canada
- Finland
- U.S.A.

## AA

- Abu Dhabi (UAE)
- France

## AA-

- Belgium
- Hong Kong
- Qatar
- **U.K.**

## Treasury management scheme of delegation

### (i) County Council

- budget approval;
- approval of the annual Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy, annual Treasury Management Policy Statement and amendments thereto;
- approval of amendments to the Council's adopted clauses;
- receiving and reviewing monitoring reports on treasury management policies, practices and activities; and
- acting on recommendations received from the Governance & Audit Committee and/or Executive Committee.

### (ii) Executive Committee

- budget consideration;
- approval of the division of responsibilities;
- approval of the selection of external service providers and agreeing terms of appointment;
- receiving and reviewing monitoring reports on treasury management policies, practices and activities and making recommendations to the County Council as appropriate; and
- acting on recommendations received from the Governance & Audit Committee.

### (iii) Governance & Audit Committee

- Scrutiny of Treasury Management matters as required by CIPFA's Code of Practice on Treasury Management and the Council's Treasury Management Policy. This includes:-
  - scrutinising the annual Treasury Management Strategy Statement, Annual Investment Strategy, Annual MRP Policy, Annual Treasury Management Policy and Treasury Management Practices and making recommendations to the Executive Committee and County Council as appropriate;
  - scrutinising proposals for amendments to the annual Treasury Management Strategy Statement, Annual Investment Strategy, Annual MRP Policy, Annual Treasury Management Policy and Treasury Management Practices and to the adopted clauses and making recommendations to the Executive and County Council as appropriate;
  - receiving and scrutinising any other proposals relating to the treasury management which require a decision by the Executive or County Council; and
  - receiving and scrutinising monitoring reports on treasury management policies, practices and activities and make recommendations to the Executive and County Council as appropriate.

## The Treasury Management role of the Section 151 Officer

### The Section 151 (responsible) Officer's role includes:-

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;

- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- responsibility for the execution and administration of its Treasury decisions, including decision on borrowing, investment and financing, have been delegated to the Section 151 Officer, who will act in accordance with the Council's policy statements and TMP's;
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Authority;
- ensure that the Authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the Authority does not undertake a level of investing which exposes the Authority to an excessive level of risk compared to its financial resources;
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision to Members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that Members are adequately informed and understand the risk exposures taken on by the Authority;
- ensuring that the Authority has adequate expertise, either in house or externally provided, to carry out the above;
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following: -
  - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
  - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
  - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
  - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
  - Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

**PRUDENTIAL & TREASURY INDICATORS  
BUDGET SETTING 2022/23**

**APPENDIX 11**

No.	Indicator	2020/21 out-turn	2021/22 estimate	2022/23 proposal	2023/24 proposal	2024/25 proposal
<b>Affordability</b>						
<b>1,2</b>	Estimates of [or actual] ratio of financing costs to net revenue stream:					
	Council Fund	4.75%	4.55%	4.40%	4.43%	4.44%
	Housing Revenue Account (inclusive of settlement)	16.52%	9.04%	13.40%	14.12%	13.83%
	Total	6.12%	5.08%	5.42%	5.57%	5.56%
<b>Prudence</b>						
<b>3</b>	Gross debt and the Capital Financing Requirement (CFR)	✓	✓	✓	✓	✓
	<i>Is the gross external debt &lt; the CFR for the preceding year plus the estimates of any additional CFR for the current and the next two financial years?</i>			✓	✓	✓
<b>Capital Expenditure</b>		<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>4,5</b>	Estimates of [or actual] capital expenditure					
	Council Fund	20,507	25,427	17,177	9,408	8,277
	Housing Revenue Account	12,622	13,641	18,784	22,009	18,550
	Total	<b>33,129</b>	<b>39,068</b>	<b>35,961</b>	<b>31,417</b>	<b>26,827</b>
<b>6,7</b>	Estimates of [or actual] Capital Financing Requirement					
	Council Fund	97,360	102,531	107,867	109,195	110,728
	Housing Revenue Account	39,200	38,415	43,646	52,273	56,828
	Total	<b>136,560</b>	<b>140,946</b>	<b>151,513</b>	<b>161,468</b>	<b>167,556</b>
<b>External Debt</b>		<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>8</b>	Authorised Limit					
	: General Borrowing	175,000	175,000	180,000	190,000	198,000
	: Other long term liabilities	5,000	5,000	5,000	5,000	5,000
	: Total	<b>180,000</b>	<b>180,000</b>	<b>185,000</b>	<b>195,000</b>	<b>203,000</b>

9	Operational Boundary					
	: General Borrowing	170,000	170,000	175,000	185,000	193,000
	: Other long term liabilities	5,000	5,000	5,000	5,000	5,000
	: Total	175,000	175,000	180,000	190,000	198,000
10	Actual External Debt	124,524				
<b>Treasury Management</b>		<b>2020/21 out-turn</b>	<b>2021/22 estimate</b>	<b>2022/23 proposal</b>	<b>2023/24 proposal</b>	<b>2024/25 proposal</b>
11	The Local Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services	✓	✓	✓	✓	✓
		<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
12	Gross and net debt	100%	100%	100%	100%	100%
	<i>The upper limit on the net debt as a proportion of gross debt</i>					
13	The upper limit on fixed rate exposures: ( net principal outstanding)	155,000	155,000	160,000	170,000	178,000
14	The upper limit on variable rate exposures: ( net principal outstanding)	20,000	20,000	20,000	20,000	20,000
15	The limit for total principal sums invested for periods longer than 364 days (any long term investments carried forward from previous years will be included in each year's limit)	15,000	15,000	15,000	15,000	15,000
				<b>2022/23 upper limit</b>	<b>2022/23 lower limit</b>	
16	The upper and lower limits for the maturity structure of fixed rate borrowing					
	• under 12 months			20%	0%	
	• 12 months and within 24 months			20%	0%	
	• 24 months and within 5 years			50%	0%	
	• 5 years and within 10 years			75%	0%	
	• 10 years and above			100%	0%	
				no change	no change	

## Information on Prudential & Treasury Management indicators

### A) Affordability

#### 1 & 2 Ratio of financing costs to net revenue stream

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

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

### B) Prudence

#### 3 Gross Debt and the CFR

The Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

### C) Capital expenditure

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.

#### 4 & 5 Estimates of Capital Expenditure

This is the forecast Capital Expenditure from 2021/22 to 2024/25, and is based on the Capital Programme for 2021/22 and the Capital Strategy for 2022/23.

#### 6 & 7 The Council's borrowing need (the Capital Financing Requirement)

Another 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 underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £nil of such schemes within the CFR.

## CH) External Debt

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

The Section 151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

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

## Glossary

### **CAPITAL EXPENDITURE**

Capital expenditure is expenditure on the purchase of a non-current asset, which will be used in providing services beyond the current financial year, or expenditure which adds to, and not merely maintains, the value of an existing non-current asset. Examples include: the building of a new school, the purchase of IT equipment, a major refurbishment of a care home.

### **CAPITAL FINANCING**

Funds that are available to pay for capital expenditure. There are various methods of financing capital expenditure including borrowing, leasing, direct revenue financing, usable capital receipts, capital grants, capital contributions, revenue reserves and earmarked reserves.

### **CAPITAL FINANCING REQUIREMENT**

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 underlying borrowing need.

### **CAPITAL PROGRAMME**

The capital schemes the Council intends to carry out over a specific period of time.

### **CAPITAL RECEIPTS**

Capital receipts represent the proceeds from the disposal of land or other non-current assets. Proportions of capital receipts can be used to finance new capital expenditure, within rules set down by the government, but they cannot be used to finance revenue expenditure.

### **CIPFA**

This is The Chartered Institute of Public Finance and Accountancy, the lead professional and regulatory body for local Authority accounting.

### **HOUSING REVENUE ACCOUNT (HRA)**

The HRA is a separate account to the Council Fund, and includes the income and expenditure arising from the provision of housing accommodation by the Council.

### **INTEREST RECEIVABLE OR PAYABLE**

The effective interest rate method is used to measure the carrying value of a financial asset or liability measured at cost less accumulated amortisation, and to allocate associated interest income or expense to the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to equal the amount at initial recognition. The effective interest is adjusted to the actual interest payment or receipt through the Movement in Reserves Statement to ensure only actual interest is charged to Council Tax. For financial assets and liabilities carried at cost because the effective rate of interest is the same as the carrying rate of interest, the carrying value is adjusted for accrued interest.

### **MINIMUM REVENUE PROVISION (MRP)**

The minimum amount which must be charged to the revenue account each year in order to provide for the repayment of loans and other amounts borrowed by the Council.

### **NET DEBT**

The Net Debt is the Council's borrowings less cash and liquid resources.

**PUBLIC WORKS LOANS BOARD (PWLB)**

A Central Government Agency which provides loans for one year and/or more to authorities at interest rates only slightly higher than those at which the government can borrow itself.

**REVENUE EXPENDITURE FUNDED BY CAPITAL UNDER STATUTE (REFCUS)**

Expenditure which can be properly deferred (i.e. treated as capital in nature), but which does not result in, or remain matched with, a tangible asset. Examples of deferred charges are grants of a capital nature to voluntary organisations.

**REVENUE SUPPORT GRANT**

A grant paid by Central Government to authorities, contributing towards the general cost of their services.

**SUPPORTED BORROWING**

The Council borrows money to fund part of its capital programme. This borrowing is recognised by Central Government in its calculation of formula funding for the Council.

**TEMPORARY BORROWING**

Money borrowed for a period of less than one year.

**UNSUPPORTED BORROWING**

The Council can borrow additional money to the borrowing supported by Government to finance its capital expenditure as long as it is affordable and sustainable. This power is governed by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code, with which the Council fully complies.