

# Crawley Borough Council

## Report to Overview & Scrutiny Commission 31 January 2022

### Report to Cabinet 2 February 2022

## Treasury Management Strategy 2022/2023

Report of the Head of Corporate Finance – **FIN/557**

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### 1. Purpose

1.1 The Strategy for 2022/23 covers two main areas:

#### Capital Issues

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

#### Treasury Management Issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

### 2. Recommendations

2.1 To the Overview and Scrutiny Commission:

That the Commission considers the report and decides what comments, if any, it wishes to submit to the Cabinet.

2.2 To the Cabinet

The Cabinet is requested to recommend to Full Council the approval of:-

- a) the Treasury Prudential Indicators and the Minimum Revenue Provision (MRP) Statement contained within Section 5;
- b) the Treasury Management Strategy contained within Section 6;
- c) the Investment Strategy contained within Section 7;

### **3. Reasons for the Recommendations**

- 3.1 The Council's financial regulations, in accordance with the CIPFA Code of Practice for Treasury Management, requires a Treasury Management Strategy to be approved for the forthcoming financial year. This report complies with these requirements.

### **4. Background**

- 4.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 4.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 4.3 The contribution the treasury management function makes to the Council is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
- 4.4 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.
- 4.5 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.”*
- 4.6 This report takes into account the revenue and capital implications arising in the 2022/23 Budget and Council Tax report (FIN/549).

## 5. The Capital Prudential Indicators 2022/23 – 2024/25

### 5.1 The Capital Expenditure Plans

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

5.1.2 **Capital expenditure.** This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital Expenditure £'000	2020/21 Actual	2021/22 Estimate	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast
New Town Hall – joint responsibility	17,734	21,826	5,910	0	0
Cabinet	0	191	500	200	339
Environment Services & Sustainability	310	600	566	57	0
Housing General Fund	842	4,156	3,993	3,265	1,700
Planning & Economic Development	153	509	4,790	7,776	0
Resources	153	678	1,841	20	0
Wellbeing	322	1,273	1,245	0	0
<b>General Fund</b>	<b>19,514</b>	<b>29,233</b>	<b>18,845</b>	<b>11,318</b>	<b>2,039</b>
<b>HRA</b>	<b>22,703</b>	<b>17,341</b>	<b>35,060</b>	<b>29,197</b>	<b>22,130</b>
Non-financial investments *	0	0	0	0	0
<b>Total</b>	<b>42,217</b>	<b>46,574</b>	<b>53,905</b>	<b>40,515</b>	<b>24,169</b>

\* Non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties, etc.

5.1.3 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of Capital Expenditure £'000	2020/21 Actual	2021/22 Estimate	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast
Capital receipts	13,016	20,028	2,305	6,770	980
Capital reserves	3,556	1	1,102	0	0
1-4-1 receipts	2,828	3,094	4,485	6,742	3,488
Revenue	210	1,147	1,834	0	339
Capital grants	7,155	1,876	7,604	2,779	720
Major Repairs Reserve	15,452	15,928	31,075	24,224	18,642
<b>Net financing need for the year</b>	<b>0</b>	<b>4,500</b>	<b>5,500</b>	<b>0</b>	<b>0</b>

### 5.2 The Council's borrowing need (the Capital Financing Requirement).

5.2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital

expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so it'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.

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

5.2.3 The Council is asked to approve the CFR projections below:

<b>£'000</b>	<b>2020/21 Actual</b>	<b>2021/22 Estimate</b>	<b>2022/23 Forecast</b>	<b>2023/24 Forecast</b>	<b>2024/25 Forecast</b>
<b>Capital Financing Requirement</b>					
CFR – General Fund	0	23,422	28,110	27,182	26,187
CFR - HRA	260,325	240,625	240,625	237,325	234,325
CFR – Non-financial investments	0	0	0	0	0
<b>Total CFR</b>	<b>260,325</b>	<b>264,047</b>	<b>268,735</b>	<b>264,507</b>	<b>260,512</b>
<b>Movement in CFR</b>	<b>0</b>	<b>3,722</b>	<b>4,688</b>	<b>(4,228)</b>	<b>(3,995)</b>

<b>Movement in CFR represented by</b>					
Net financing need for the year (above)	0	4,500	5,500	0	0
IFRS16 Leases	0	0	44	0	0
Less MRP/VRP and other financing movements	0	(778)	(856)	(4,228)	(3,995)
<b>Movement in CFR</b>	<b>0</b>	<b>3,722</b>	<b>4,688</b>	<b>(4,228)</b>	<b>(3,995)</b>

5.2.4 The above table includes the impact of transferring the garages from the HRA to the General Fund as set out in the Cabinet report FIN/511 Appropriation of Garages from the HRA to the General Fund.

5.2.5 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the Council's overall financial position. The capital expenditure figures shown in 5.1.2 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Council's remaining activity.

### **5.3 Core funds and expected investment balances**

5.3.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances. This is taken from the Budget Report and Capital Strategy elsewhere on this agenda. The borrowing shows the repayment of the PWLB loans that were taken out for the HRA self-financing.

<b>Year End Resources £'000</b>	<b>2020/21 Actual</b>	<b>2021/22 Estimate</b>	<b>2022/23 Forecast</b>	<b>2023/24 Forecast</b>	<b>2024/25 Forecast</b>
<b>Total CFR</b>	<b>260,325</b>	<b>264,047</b>	<b>268,735</b>	<b>264,507</b>	<b>260,512</b>
Less: External borrowing*	(260,325)	(260,325)	(249,325)	(237,325)	(224,325)
<b>Under/over borrowing</b>	<b>0</b>	<b>3,722</b>	<b>19,410</b>	<b>27,182</b>	<b>36,187</b>
Less: Usable reserves	(77,418)	(56,042)	(43,947)	(36,756)	(43,645)
Less: Working Capital**	(31,676)	(30,000)	(25,000)	(20,000)	(20,000)
<b>Expected investments</b>	<b>(109,094)</b>	<b>(82,320)</b>	<b>(49,537)</b>	<b>(29,574)</b>	<b>(27,458)</b>

\* shows only loans to which the Council is committed and excludes optional refinancing

\*\* Working capital balances shown are estimated year-end; these may be higher mid-year

5.3.2 Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table in 5.3.1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

<b>£'000</b>	<b>2020/21 Actual</b>	<b>2021/22 Estimate</b>	<b>2022/23 Forecast</b>	<b>2023/24 Forecast</b>	<b>2024/25 Forecast</b>
<b>Total CFR</b>	<b>260,325</b>	<b>264,047</b>	<b>268,735</b>	<b>264,507</b>	<b>260,512</b>
Less: Usable reserves	(77,418)	(56,042)	(43,947)	(36,756)	(43,645)
Less: Working Capital	(31,676)	(30,000)	(25,000)	(20,000)	(20,000)
<b>Net loans requirement</b>	<b>151,231</b>	<b>178,005</b>	<b>199,788</b>	<b>207,751</b>	<b>196,867</b>
Plus: Liquidity allowance	10,000	10,000	10,000	10,000	10,000
<b>Liability benchmark</b>	<b>161,231</b>	<b>188,005</b>	<b>209,788</b>	<b>217,751</b>	<b>206,867</b>

#### 5.4 Minimum revenue provision (MRP) policy statement

5.4.1 Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The *Local Government Act 2003* requires the Council to have regard to the former Ministry of Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

5.4.2 The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement only incorporates options recommended in the Guidance. The Council is recommended to approve the following MRP Statements in 5.4.3 to 5.4.7.

- 5.4.3 For unsupported capital expenditure incurred after 31<sup>st</sup> March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.
- 5.4.4 Where former operating leases have been brought onto the balance sheet on 1<sup>st</sup> April 2022 due to the adoption of the *IFRS 16 Leases* accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.
- 5.4.5 No MRP will be charged in respect of assets held within the Housing Revenue Account.
- 5.4.6 Capital expenditure incurred during 2022/23 will not be subject to a MRP charge until 2023/24.

Based on the Council's latest estimate of its capital financing requirement (CFR) on 31<sup>st</sup> March 2022, the budget for MRP has been set as follows:

	<b>31.03.2022 Estimated CFR £'000</b>	<b>2022/23 Estimated MRP £'000</b>
Unsupported capital expenditure after 31.03.2008	24,200	(856)
Leases and Private Finance Initiative	0	0
Voluntary overpayment (or use of prior year overpayments)	(778)	0
<b>Total General Fund</b>	<b>23,422</b>	<b>(856)</b>
Assets in the Housing Revenue Account	0	0
HRA subsidy reform payment	240,625	0
<b>Total Housing Revenue Account</b>	<b>240,625</b>	<b>0</b>
<b>Total</b>	<b>264,047</b>	<b>(856)</b>

- 5.4.7 Overpayments: In earlier years, the Council has not made voluntary overpayments of MRP that are available to reduce the revenue charges in later years. It is planned to make a £0.778m overpayment in 2022/23.

<b>MRP Overpayments</b>	<b>£'000</b>
Actual balance 31.03.2021	0
Approved overpayment 2021/22	778
Expected balance 31.03.2022	778
Planned overpayment/drawdown 2022/23	0
Forecast balance 31.03.2023	778

## 6. Borrowing

6.1 The capital expenditure plans set out in Section 5 provide details of the service activity of the Council. The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.28%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%).

### 6.2 Current portfolio position

6.2.1 The Council's treasury portfolio position at 31 March 2022, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2020/21 Actual	2021/22 Estimate	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast
<b>External Debt</b>					
Debt at 1 April	260,325	260,325	260,325	261,325	259,325
Expected change in Debt	0	0	1,000	(2,000)	(3,000)
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
<b>Actual gross debt at 31 March</b>	<b>260,325</b>	<b>260,325</b>	<b>261,325</b>	<b>259,325</b>	<b>256,325</b>
The Capital Financing Requirement	260,325	264,047	268,735	264,507	260,512
(Under) / over borrowing	0	(3,722)	(7,410)	(5,182)	(4,187)

6.2.2 Within the above figures the level of debt relating to commercial activities / non-financial investment is:

	2020/21 Actual	2021/22 Estimate	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast
<b>External Debt for commercial activities / non-financial investments</b>					
Actual debt at 31 March £m	0	0	0	0	0
Percentage of total external debt %	0	0	0	0	0

6.2.3 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year

plus the estimates of any additional CFR for 2022/23 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

- 6.2.4 The Head of Corporate Finance 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 this budget report.

### 6.3 Treasury Indicators

- 6.3.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

#### 6.3.1 Affordable borrowing limit

The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower “operational boundary” is also set as a warning level should debt approach the limit.

Operational boundary £'000	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	260,325	261,325	261,325	259,325
Other long term liabilities	0	44	31	19
Total	260,325	261,369	261,356	259,344

- 6.3.2 The Council is asked to approve the following Authorised Limit:

Authorised limit £'000	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	270,325	271,325	271,325	269,325
Other long term liabilities	0	44	31	19
Total	270,325	271,369	271,356	269,344

#### 6.3.3 Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating	A

#### 6.3.4 Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a one week period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 1 week	£3m

- 6.3.5 **Interest rate exposures:** This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£1,000,000
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£1,000,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.

#### 6.3.6 Maturity structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Maturity Structure of fixed interest rate borrowing 2022/23		
	Lower	Upper
Under 12 months	0%	20%
12 months to 2 years	0%	20%
2 years to 5 years	0%	30%
5 years to 10 years	0%	40%
10 years to 20 years	0%	50%
20 years to 30 years	0%	10%
30 years to 40 years	0%	10%
40 years to 50 years	0%	10%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

- 6.3.6 **Principal sums invested for periods longer than a year.** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities greater than one year will be:

Price risk indicator	2022/23	2023/24	2024/25
Limit on principal invested greater than 1 year	£20m	£20m	£20m

## 6.4 Prospects for Interest Rates

- 6.4.1 The Council has appointed Arlingclose Limited as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. A more detailed economic and interest rate forecast table provided by Arlingclose is attached below with assumptions and forecast detail at Appendix 1.

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
<b>Official Bank Rate</b>													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>3-month money market rate</b>													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
<b>5yr gilt yield</b>													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
<b>10yr gilt yield</b>													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
<b>20yr gilt yield</b>													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
<b>50yr gilt yield</b>													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

PWLB certainty rate = relevant gilt yield + 0.80%

6.4.2 The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the Bank of England to move away from emergency levels of interest rates.

6.4.3 Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

6.4.4 Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

## 6.5 Borrowing Strategy

6.5.1 The Council currently holds £260.325 million of loans as part of HRA self-financing. The table in 6.2.1 shows that the Council expects to borrow up to £4.5m in 2021/22. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £270.369 million. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

- 6.5.2 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
- 6.5.3 Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Council has previously raised all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

## **6.6 Related Matters**

### **6.6.1 Financial Derivatives**

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to.

Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

#### **6.6.2 Housing Revenue Account**

On 1<sup>st</sup> April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured as an average over year and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk

#### **6.6.3 Markets in Financial Instruments Directive**

The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Head of Corporate Finance believes this to be the most appropriate status.

### **6.7 Debt rescheduling**

6.7.1 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

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

## **6.8 Other sources of debt finance**

6.8.1 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

## **6.9 Municipal Bonds Agency**

UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Full Council.

## **6.10 Short-term and variable rate loans**

These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

## **6.11 Approved Sources of Long and Short Term Borrowing**

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except West Sussex Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

## **7. Treasury Investment Strategy**

7.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's treasury investment balance has ranged between £108.188 and £153.936 million, and lower levels are expected in the forthcoming year due to planned expenditure in the capital programme.

### **7.1.1 Objectives**

The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be

invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

#### 7.1.2 **Negative interest rates**

The Covid-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

#### 7.1.3 **Strategy**

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to diversify into more secure and/or higher yielding asset classes during 2022/23. This is especially the case for the estimated £20 that is available for longer-term investment. A dwindling proportion of the Council's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This diversification will represent a substantial change in strategy over the coming year.

#### 7.1.4 **Business models**

Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

#### 7.1.5 **Approved counterparties**

The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the limits shown.

<b>Sector</b>	<b>Time limit</b>	<b>Counterparty limit</b>	<b>Sector limit</b>
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£10m	Unlimited
Secured investments *	25 years	£10m	Unlimited
Banks (unsecured) *	13 months	£10m	Unlimited
Building societies (unsecured) *	13 months	£5m	£10m
Registered providers (unsecured) *	5 years	£5m	£10m

Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£10m	£20m
Real estate investment trusts	n/a	£10m	£20m
Other investments *	5 years	£5m	£10m

This table must be read in conjunction with the notes below

**\* Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

#### 7.1.6 **Government**

Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

#### 7.1.7 **Secured investments**

Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

#### 7.1.8 **Banks and building societies (unsecured)**

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

#### 7.1.9 **Registered providers (unsecured)**

Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

#### 7.1.10 **Money market funds**

Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

#### 7.1.11 **Strategic pooled funds**

Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

#### 7.1.12 **Real estate investment trusts (REIT's)**

Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

#### 7.1.13 **Other investments**

This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Council's investment at risk.

#### 7.1.14 **Operational bank accounts**

The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore aimed to be kept below £1,000,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

#### 7.1.15 **Risk assessment and credit ratings**

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “negative watch”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

#### 7.1.16 Other information on the security of investments

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

#### 7.1.17 Investment limits

The Council’s revenue reserves available to cover investment losses are forecast to be £17.3 million on 31<sup>st</sup> March 2022. In order that no more than 60% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £1,000,000 in operational bank accounts count against the relevant investment limits.

Limits are also placed on fund managers, investments in brokers’ nominee accounts and foreign countries as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

##### *Additional investment limits*

	<b>Cash limit</b>
Any group of pooled funds under the same management	£25 m per manager
Negotiable instruments held in a broker’s nominee account	£25m per broker
Foreign countries	£10m per country

### **7.1.18 Liquidity management**

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

The Council will spread its liquid cash over at least two providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

## **7.2 Ethical Investment Policy**

7.2.1 The Council will not undertake direct investment or borrowing activities with organisations whose core activities include:

- Armaments – weapon systems
- Gambling
- Pornography
- Tobacco
- Pay-day loans
- Companies that generate more than 10% of their revenue from the extraction of coal, oil or gas.

7.2.2 In order to comply with treasury management guidance, the Council's investments will prioritise security, liquidity and yield in that order. The Ethical Investment Policy thereby becomes a fourth consideration in the decision making process.

7.2.3 The core activities in the Ethical Investment Policy above has been chosen after careful consideration of the Policy direction of the administration, the officer time in implementing the policy, the cost of external resources, and the timeliness of investment decisions.

## **7.3 Investment strategy**

7.3.1 The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments),
- to support local public services by lending to or buying shares in other organisations (service investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

This investment strategy meets the requirements of statutory guidance issued by the government in January 2018 and focuses on the second and third of these categories.

### 7.3.2 Commercial Investments: Property

Contribution - The Council has invested in local commercial property with the intention of making a profit that will be spent on local public services.

#### CURRENT INVESTMENT PROPERTIES

	Market value 31.03.2021 £m
Ashdown House	9.170
49-51 High Street	1.183
Atlantic House	4.909
	-----
	<b>15.262</b>
	-----

### 7.3.3 Investment Indicators

The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

### 7.3.4 Total risk exposure

The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third party loans.

#### *Total investment exposure*

Total investment exposure	31.03.2021 Actual £000	31.03.2022 Forecast £000	31.03.2023 Forecast £000
Treasury management investments	109,094	82,320	49,537
Commercial investments: Property	15,262	15,262	15,262
<b>TOTAL INVESTMENTS</b>	<b>124,356</b>	<b>97,582</b>	<b>64,799</b>
Commitments to lend	0	400	0
<b>TOTAL EXPOSURE</b>	<b>124,356</b>	<b>97,982</b>	<b>64,799</b>

### 7.3.5 How investments are funded

Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, no investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

### 7.3.6 Rate of return received

This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

*Investment rate of return (net of all costs)*

<b>Investments net rate of return</b>	<b>2020/21 Actual</b>	<b>2021/22 Forecast</b>	<b>2022/23 Forecast</b>
Treasury management investments	0.40%	0.34%	0.60%
Commercial investments: Property	5.36%	4.74%	5.85%
<b>ALL INVESTMENTS</b>	<b>1.20%</b>	<b>1.10%</b>	<b>1.62%</b>

## **8. Implications**

- 8.1 The budget for investment income in 2022/23 is £455,569 (£260,350 General Fund; £195,219 HRA), based on an average investment portfolio of £76 million at an interest rate of 0.60%. The budget for debt interest paid in 2022/23 is £8.3 million, based on an average debt portfolio of £261.325 million at an average interest rate of 3.19%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.
- 8.2 There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the public services, the Local Government Investment Guidance provides that the council's investments are and will continue to be, within its legal powers conferred under the Local Government Act 2003.

## **9. Background Papers**

[Treasury Management Strategy for 2021/2022 – Cabinet, 3 February 2021 \[report FIN/517 refers\].](#)

[Treasury Management Mid-Year Review 2021/2022 – Cabinet, 24 November 2021 \[report FIN/538 refers\].](#)

[Appropriation of Garages from the HRA to the General Fund – Cabinet, 25 November 2020 \[report FIN/511 refers\].](#)

2022/2023 Budget and Council Tax – Cabinet, 2 February 2022 [report FIN/549 refers].

“Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes”, 2021 Edition – Chartered Institute of Public Finance and Accountancy.

“The Prudential Code for Capital Finance in Local Authorities”, 2021 Edition – Chartered Institute of Public Finance and Accountancy.

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**Interest Rate Forecasts December 2021****Underlying assumptions:**

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.
- Despite relatively buoyant activity survey data, official Gross Domestic Product (GDP) data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, Purchasing Managers Index (PMI) increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.
- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.
- These factors prompted Monetary Policy Committee (MPC) to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.
- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.
- Longer-term government bond yields remain relatively low despite the more hawkish signals from the Bank of England and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.
- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

**Forecast:**

- The MPC will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.
- Arlingclose therefore expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside, but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.

- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.
- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.
- The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

### Economic Background

The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Council's treasury management strategy for 2022/23.

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% y/y in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than

previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

### **Credit outlook**

Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

**Treasury Management Scheme of Delegation**

**(i) Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

**(ii) Cabinet**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

**(iii) Overview and Scrutiny Commission**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

## The Treasury Management Role of the Section 151 Officer

### The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe.
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council
- ensure that the Council has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the Council does not undertake a level of investing which exposes the Council to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees.
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the Council 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.*