Appendix A - Bromsgrove Capital Strategy Report 2022/23

Introduction

This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

Decisions made this year on capital and treasury management will have financial consequences for the Authority for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

Capital Expenditure and Financing

Capital expenditure is where the Authority spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Authority has some limited discretion on what counts as capital expenditure, for example assets costing below £10k are not capitalised and are charged to revenue in year.

In 2022/23, the Authority is planning capital expenditure of £2.4m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
General Fund services	3.4	7.5	2.4	1.4	1.9
Regeneration Schemes	0	11.6	10.3	8.4	0
TOTAL	3.4	19.1	12.7	9.8	1.9

The main General Fund capital projects being delivered over the 3 year Medium Term Financial Strategy (MTFS) period include the fleet replacement programme which totals £1.0m and funding for DFG's £4.4m. The Authority also plans to incur £30.3m of capital expenditure on regeneration schemes, which are detailed later in this report but consist of the Burcot Housing Development started in 2021/22 and the "Levelling Up" Fund work which the Council successfully bid for in 2021.

The Council does not hold any Capital investments, include loans and shares made for service purposes, and property held primarily for financial return in line with the definition in the CIPFA Treasury Management Code.

Governance: Service managers bid annually in November to include projects in the Authority's capital programme. Bids are collated by finance who calculate the financing cost (which can be nil if the project is fully externally financed). The final capital programme is then presented to Cabinet and Council in February each year.

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
External sources	1.8	1.4	10.1	7.6	0
Own resources	1.6	4.7	0	0	0
Debt	0	0	2.6	2.2	1.9
TOTAL	**3.4**	**6.1**	**12.7**	**9.8**	**3.7**

Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP) or by taking out new borrowing. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance in £ millions

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
Own resources	0.8	1	0	0	0

The Authority's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £1.2m during 2022/23. Based on the above figures for expenditure and financing, the Authority's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
General Fund services	22.3	25.5	26.8	27.1	27.9
Regeneration Schemes	3.2	13.2	13.1	13.6	13.3
TOTAL CFR	**25.5**	**38.7**	**39.9**	**40.7**	**41.2**

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Authority is currently also permitted to spend capital receipts on service transformation projects until 2022/23. Appendix D sets out that capital receipts are not required for this purpose in 2022/23. Repayments of capital grants, loans and investments also generate capital receipts. The Authority is expecting to receive capital receipts in late 2022/23 for part of the Burcot development.

Treasury Management

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Authority's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Authority at the moment is cash rich in the short-term as revenue income is received before it is spent, and in the long-term as capital expenditure incurred has been financed internally and not through debt financing. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing to zero as at 31st March 2022.

Due to decisions taken in the past, the Authority has an underlying need to borrow for capital purposes, which has in recent years been met through short dated borrowing. As of 15 March 2022 the authority borrowing of £16.3m was internally financed and £7m of treasury investments are delivering an average rate of 0.13%.

Borrowing strategy: The Authority'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 Authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.10%), long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%), and the use of internal resources.

Projected levels of the Authority's total outstanding debt (which comprises borrowing, PFI liabilities, leases and transferred debt) are shown below, compared with the capital financing requirement (see above).

Table 4: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2021 actual	31.3.2022 forecast	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
Debt (incl. PFI & leases)	18.2	19.6	22.2	24.4	26.3
Capital Financing Requirement	25.5	38.7	39.9	40.7	41.2

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from Table 6, the Authority expects to comply with this in the medium term.

Liability benchmark: To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £0.2m at each year-end. This benchmark is currently £33.2m and is forecast to rise to £37.3m over the next three years.

Table 5: Borrowing and the Liability Benchmark in £ millions

	31.3.2021 actual	31.3.2022 forecast	31.3.2023 forecast	31.3.2024 forecast	31.3.2025 forecast
Forecast external borrowing	18.2	19.6	22.2	24.4	26.3
Liability benchmark	14.0	27.7	33.2	35.5	37.3

The table shows that the Authority expects to remain borrowed below its liability benchmark. This is because cash outflows to date have been below the assumptions made when the loans were borrowed.

Affordable borrowing limit: The Authority 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.

Table 6: Prudential Indicators: Authorised limit and operational boundary for external debt in £000

	2021/22 limit	2020/23 limit	2023/24 limit	2024/25 limit
Authorised limit – borrowing	40,000	50,000	55,000	60,000
Authorised limit – PFI and leases	500	1,000	1,000	1,000
Authorised limit – total external debt	40,500	51,000	56,000	61,000
Operational boundary – borrowing	30,000	45,000	50,000	55,000
Operational boundary – PFI and leases	500	1,000	1,000	1,000
Operational boundary – total external debt	30,500	46,000	51,000	56,000

The Authorised Limit must not be breeched with a combination of long and short term financing - if they are Full Council needs to be informed. The Operational Boundary can be breeched but only for short periods. Councils must set these boundaries taking into account long term financing requirements, leasing and short term borrowing requirements due to cash flow requirements.

Treasury investment strategy: Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

The Authority's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation, although no long term investing is planned at present. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Authority may request its money back at short notice.

Table 9: Treasury management investments in £millions

	31.3.2021 actual	31.3.2022 forecast	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
Near-term investments	0	7	3	3	3
Longer-term investments	0	0	0	0	0
TOTAL	**0**	**7**	**3**	**3**	**3**

- Further details on treasury investments are in the Treasury Management Strategy which is Appendix B.

Risk management: The effective management and control of risk are prime objectives of the Authority's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

- The treasury management *prudential* indicators are in the Treasury Management Strategy which is Appendix B.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Executive Director of Finance and staff, who must act in line with the treasury management strategy approved by council. Three Reports on Treasury Management activity will be made to Council the initial strategy, a half yearly update and an outturn report on treasury management activity. The Audit Committee is responsible for scrutinising treasury management decisions.

Investments for Service Purposes

The Authority may make investments to assist local public services, including potentially making loans to the Authority's subsidiaries that provide services. In light of the public service objective, the Authority is willing to take more risk than with treasury investments, however it still plans for such investments to at least break even after all costs.

Total investments for service purposes are currently valued at £2.4m for 22/23 and are set out in the Capital Programme.

Governance: Decisions on service investments are made by the relevant service manager in consultation with the Executive Director of Finance and must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

- Further details on service investments are in Capital Programme in the MTFS reported in February 2022.

Commercial Activities

With central government financial support for local public services declining, and changes to the Capital Financing rules in 2021 in relation to the use of using debt to finance investment for return, Councils must ensure that commercial activities do not make investment primarily for yield. If this was the case it would mean that the Authority could not Public Works Loan Board debt instruments in the future, which are much more advantageous than private sector debt financing.

The Authority will invest in regeneration schemes such at Burcot and the "Levelling Up" programme but not for purely commercial reasons.

Governance: Decisions on commercial investments, including for Regeneration reasons, are made in line with the criteria and limits approved by council in the investment strategy. Property and most other commercial investments are also capital expenditure and decisions will therefore also be approved as part of the capital programme.

Liabilities

The Authority is committed to making future payments to cover its pension fund deficit, which it does on a 3 yearly basis. The next payment will be in 2024 and will be circa £10m. It has also set aside £2.4m to cover risks of business rates appeals against rateable value, and £183k to cover the potential cost of employee benefits.

Governance: Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Executive Director of Finance. The risk of liabilities crystallising and requiring payment is monitored by finance and reported as required.

- Further details on liabilities and guarantees are set out in the Statement of Accounts.

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 7: Prudential Indicator: Proportion of financing costs to net revenue stream

	2021/22 forecast	2022/23 budget	2023/24 budget	2024/24 budget
Financing costs (£m)	1.3	1.0	1.0	1.0
Proportion of net revenue stream	10.7%	11.3%	11.6%	11.3%

- Further details on the revenue implications of capital expenditure are in the MTFS Reported in February 2022.

Sustainability: Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Executive Director of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable because of the current MTFP forecasts which show that the council is financially sustainable and taking it into account.

Knowledge and Skills

The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Executive Director of Finance is a qualified accountant with more than 30 years' experience. The Authority pays for junior staff to study towards relevant professional qualifications including CIPFA and AAT.

Where Authority staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Authority currently employs Arlingclose Limited as treasury management advisers, Briton & Knowles as property consultants and other as needed. This approach is more cost effective than employing such staff directly,and ensures that the Authority has access to knowledge and skills commensurate with its risk appetite.

Appendix B - Treasury Management Strategy Statement 2022/23

Introduction

Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

External Context

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 Authority's treasury management strategy for 2022/23.

The Bank of England's (BoE) increased Bank Rate to 0.25% in December 2021 and again in February 2022 to 0.5% and also announced a tailing down of its erstwhile Quantitative Easing programme. The Monetary Policy Committee (MPC) voted 5-4 to raise rates by 0.25% at the February meeting, the four dissenters had voted for an 0.5% rise at this meeting which means a very high likelihood of further rate rises in 2022.

At the time of the MPC meeting in November 2021, the economic uncertainty surrounding the Omicron variant of coronavirus was much more prevalent and the forecast for growth was depressed as a result. Since then, the uncertainty surrounding this variant had declined and the negative effects that it might have had on the global economy were shown to be less damaging and more short lived than previously expected. On the other hand, exceptionally strong demand for goods combined with supply chain disruptions and rising energy prices have weighed on activity throughout the early parts of Q1 2022.

In its February 2022 Monetary Policy Report the Bank of England noted 12-month CPI inflation for December was 5.4% which is 1% above the expectations set out in its previous Report in November 2021. Rising energy prices and core goods prices are the leading drivers of this inflation.

The MPC projects CPI inflation will continue its upward trajectory in the coming months to around 6% in February and March before peaking at 7.25% in April. 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%.

The most recent Labour Force Data for the period to November 2021 shows that the labour market continues to recover. The number of job vacancies in Q4 2021 rose to a new record of 1,247,000, and the unemployment rate fell to 4.1%.

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%. Looking ahead, Q4 growth (data for which will be released in February) is expected to be soft.

According to a first estimation of annual growth for 2021, GDP increased by 5.2% in both the euro area and the EU. Core CPI inflation was 5.1% y/y in December. 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 6.9% in Q4 2021. CPI rose 7% in 2021, the largest 12-month increase since June 1982. 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.

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, 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.

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 1.20%, 1.35%, and 1.55% 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.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 0.15%, and that new long-term loans will be borrowed at an average rate of 2.7%.

<u>Local Context</u>

On 15 January 2022, the Authority held £0m of borrowing and £5m of treasury investments. This is set out in further detail at ***Appendix B***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.21 Actual £m	31.3.22 Estimate £m	31.3.23 Forecast £m	31.3.24 Forecast £m	31.3.25 Forecast £m
General Fund CFR	22.3	25.5	26.8	27.1	27.9
Regeneration CFR	3.2	13.2	13.1	13.6	13.3
Total CFR	**25.5**	**38.7**	**39.9**	**40.7**	**41.2**
Less: External borrowing **	**4.5**	**0**	**0**	**0**	**0**
Internal (over) borrowing	7.4	19.1	17.7	16.3	15.0
Less: Usable reserves	**-8.6**	**-8.1**	**-3.8**	**-2.3**	**-1**
Less: Working capital	-3.1	-3.1	-3.1	-3.1	-3.1
Treasury investments (or New borrowing)	**4.3**	**-7.9**	**-10.8**	**-10.9**	**-10.9**

** shows only loans to which the Authority is currently committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow or use internal resources over the forecast period.

CIPFA's Prudential Code for Capital Finance in Local *Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2022/23.

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 1 above, but that cash and investment balances are kept to a minimum level of £0.2m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	31.3.21 Actual £m	31.3.22 Estimate £m	31.3.23 Forecast £m	31.3.24 Forecast £m	31.3.25 Forecast £m
CFR	25.5	38.7	39.9	40.7	41.2
Less: Usable reserves	-8.6	-8.1	-3.8	-2.3	-1
Less: Working capital	-3.1	-3.1	-3.1	-3.1	-3.1
Plus: Minimum investments	0.2	0.2	0.2	0.2	0.2
Liability Benchmark	**14.0**	**27.7**	**33.2**	**35.5**	**37.3**

Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing each year, minimum revenue provision on new capital expenditure based on a 50 year asset life and income, expenditure and reserves all increasing in line with the MTFP.

Borrowing Strategy

The Authority currently holds £0 million of long term loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not expect to need to borrow/expects to borrow in 2022/23. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.

Objectives: The Authority'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 Authority's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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 Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term 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 Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority 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 Authority has previously raised little 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 Authority intends to avoid this activity in order to retain its access to PWLB loans. Alternatively, the Authority 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.

Alternatively, the Authority 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 Authority may borrow short-term loans to cover unplanned cash flow shortages.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- 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 Worcestershire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: 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

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.

Short-term and variable rate loans: These loans leave the Authority 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).

Debt rescheduling: 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 Authority 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.

Treasury Investment Strategy

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's treasury investment balance has ranged between £3 and £25 million, and similar levels are expected to be maintained in the forthcoming year

Objectives: The CIPFA Code requires the Authority 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 Authority'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 Authority 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.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding asset classes during 2022/23. This is especially the case for the estimated £7m that is available for longer-term investment. The majority of the Authority's surplus cash is currently invested in short-term unsecured bank deposits or with the central bank. This diversification will represent a continuation of the approved strategy.

Business models: Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed 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.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3 m 5 years	£3m 20 years	£3m 50 years	£3m 20 years	£1m 20 years
AA+	£3m 5 years	£3m 10 years	£3m 25 years	£3m 10 years	£1m 10 years
AA	£3m 4 years	£3m 5 years	£3m 15 years	£3m 5 years	£1m 10 years
AA-	£3m 3 years	£3m 4 years	£3m 10 years	£3m 4 years	£1m 10 years
A+	£3m 2 years	£3m 3 years	£3m 5 years	£3m 3 years	£1m 5 years
A	£3m 13 months	£3m 2 years	£3m 5 years	£3m 2 years	£1m 5 years
A-	£3m 6 months	£3m 13 months	£3m 5 years	£3m 13 months	£1m 5 years
None	£1.5m 6 months	n/a	£3m 25 years	£1m 5 years	£500k 5 years
Pooled funds and real estate investment trusts		£2.5m per fund or trust			

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 either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £0.5m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

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.

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.

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.

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.

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 Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

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 Authority 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 Authority's investment objectives will be monitored regularly.

Real estate investment trusts: 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.

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 Authority's investment at risk.

Operational bank accounts: The Authority may incur operational exposures, for example though 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 be kept below £500,000 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 Authority maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority'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 on the next working day 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.

Other information on the security of investments: The Authority 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 Authority'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 Authority 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 Authority'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.

Investment limits: The Authority's revenue reserves available to cover investment losses are forecast to be £11.9 million on 31st March 2022. In order that no more than 42% 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 £5 million. A group of banks 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 £500,000 in operational bank accounts count against the relevant investment limits

Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors 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.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£5m per country
Registered providers and registered social landlords	£2.5m in total
Unsecured investments with building societies	£2.5m in total
Loans to unrated corporates	£1m in total
Money market funds	£20m in total
Real estate investment trusts	£2.5m in total

Liquidity management: The Authority uses detailed spreadsheets 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

The Authority will spread its liquid cash over at least four 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.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority 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*

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£2.5m

Interest rate exposures: This indicator is set to control the Authority'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% rise in interest rates	£500,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£500,000

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.

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

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

As the Council holds no external debt, this maturity structure allows the Council this highest level of flexibility for future debt.

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.

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Authority'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 beyond the period end will be:

Price risk indicator	2020/21	2021/22	2022/23

Limit on principal invested beyond year end	£1.5m	£1.0m	£0.5m

Related Matters

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

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 Authority 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 Authority 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. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

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

Markets in Financial Instruments Directive: The Authority has retained retail client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a smaller range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Executive Director of Finance believes this to be the most appropriate status.

Financial Implications

The budget for investment income in 2022/23 is £0.1m given the low level of interest rates, based on an average investment portfolio of £4.4 million. The budget for debt interest paid in 2020/21 is £0.3 million, based on an average debt portfolio of circa £40 million at an average interest rate of 1.5%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then 50% of the revenue savings will be transferred to a treasury management reserve to cover the risk of capital losses or higher interest rates payable in future years.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Executive Director of Finance, having consulted the Portfolio Holder for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast – February 2022

Underlying assumptions:

- The post COVID global economy has entered a higher inflationary phase, driven by a combination of resurgent demand and supply bottlenecks in goods and energy markets. Geopolitics are also playing a role, driving energy prices upwards which are being passed onto consumers. Tighter labour markets due to reduced participation rates have prompted concerns about wage-driven inflation, leading central banks to tighten policy to ensure inflation expectations remain anchored.
- Global inflation is riding high. While some indicators suggest supply bottlenecks in goods markets are easing, oil and gas prices have risen significantly and threaten a more sustained level of uncomfortably high inflation than previously expected. In the UK, Ofgem has confirmed a significant rise in retail energy prices, which will maintain relatively high CPI rates throughout 2022.
- Supply constraints are also evident in the labour market. Underlying wage growth is running above pre-COVID levels despite employment being lower now than in early 2020. Evidence suggests that labour pools have diminished. Higher wage growth will be a contributory factor to sustained above-target inflation this year.
- The lower severity of Omicron means that the economic impact should be limited. The UK economy had a weak Q4 2021 due to the virus, but growth is likely to bounce back in Q1 2022.
- However, higher inflation will dampen demand. In the UK, households face a difficult outlook. Fiscal and monetary headwinds alongside a sharp reduction in real income growth will weigh on disposable income, ultimately leading to slower growth.
- The Bank of England will tighten policy further over the next few months to ensure that aggregate demand slows to reduce business pricing power and labour wage bargaining power. Markets have priced in a significant rise in Bank Rate, but we believe the MPC will be more cautious given the medium term outlook, assessing the impact of the first round of rises rather than following the market higher.
- Bond yields have risen sharply to accommodate tighter monetary policy, including the run off of central bank bond portfolios. The interplay between slowing growth and falling inflation, and tightening policy, will likely keep yields relatively flat.

Forecast:

- The MPC will raise Bank rate further to dampen aggregate demand and reduce the risk of sustained higher inflation.
- Arlingclose therefore expects Bank Rate to rise to 0.75% in March and 1.0% in May. Despite this expectation, risks to the forecast remain weighted to the upside for 2022, becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.
- Gilt yields will remain broadly flat from current levels, which have risen sharply since mid-December 2021. Significant volatility is, however, likely which should offer tactical opportunities for borrowing and investment.
- The risks around the gilt yield forecasts are broadly balanced. While gilt yields may face downward pressure as Bank Rate expectations ease from current levels, the run off of the Bank's corporate bond portfolio, and later the gilt portfolio, as it reverses QE, could impact some upward pressure on yields.

	Feb-22	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	**0.50**	**0.75**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
3-month money market ra													
Upside risk	0.00	0.05	0.20	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	**0.50**	**0.85**	**1.20**	**1.25**	**1.15**	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.35	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
Arlingclose Central Case	**1.22**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.15**	**1.15**	**1.15**	**1.15**	**1.15**	**1.15**
Downside risk	0.00	-0.20	-0.25	-0.25	-0.30	-0.35	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
10yr gilt yield													
Upside risk	0.00	0.40	0.45	0.55	0.60	0.65	0.65	0.70	0.70	0.70	0.70	0.70	0.70
Arlingclose Central Case	**1.37**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**
Downside risk	0.00	-0.20	-0.30	-0.35	-0.40	-0.45	-0.50	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60
20yr gilt yield													
Upside risk	0.00	0.40	0.45	0.50	0.55	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Arlingclose Central Case	**1.54**	**1.55**	**1.55**	**1.55**	**1.55**	**1.55**	**1.55**	**1.55**	**1.55**	**1.55**	**1.55**	**1.55**	**1.55**
Downside risk	0.00	-0.30	-0.35	-0.40	-0.40	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
50yr gilt yield													
Upside risk	0.00	0.40	0.45	0.50	0.55	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Arlingclose Central Case	**1.22**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**
Downside risk	0.00	-0.30	-0.35	-0.40	-0.40	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B – Existing Investment & Debt Portfolio Position

	31/03/2022 **Actual Portfolio** **£m**	31/03/2022 **Average Rate** **%**
External borrowing: **Total external borrowing**	**0**	**0**
Treasury investments: Banks & building societies (unsecured) Government (incl. local authorities)	7	0.13
Total treasury investments	7	0.13
Net investments	7	0.13

Appendix C - Minimum Revenue Provision Statement 2022/23

Annual Minimum Revenue Provision Statement 2022/23

Where the Authority 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 Authority to have regard to the 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.

The MHCLG Guidance requires the Authority to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance and a locally determined approach to loans to third parties and asset backed capital expenditure where there are detailed plans in place to demonstrate that all expenditure will be recovered from income streams generated by the expenditure in an appropriate timeline.

- For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset as the principal repayment on an annuity with an annual interest rate of 4%, 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.

- For assets acquired by leases, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

- There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial year

- For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the MHCLG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred on the loan is fully funded over the life of the assets.

- Where the council makes a capital contribution or loan to another entity or where responsibility for a council asset with borrowing attached is transferred to a third party, then no MRP will be set aside if:

    - the payments are appropriately covered by assets

    - there are detailed plans demonstrating that all the expenditure will be recovered in an appropriately short time frame

To ensure that this remains a prudent approach the Council will review the expenditure and income regularly to determine if the income or asset values have decreased to the point that MRP needs to be provided for. Should evidence emerge which suggests the expenditure will no longer be recovered MRP will be provided for.

- Where the council uses internal borrowing and receipts of rental income are greater than the MRP calculated then as there are sufficient revenues to repay the capital cost no MRP will be set aside.

Capital expenditure incurred during 2022/23 will not be subject to a MRP charge until 2023/24.

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

	31.03.2022 Estimated CFR £m	**2022/23 Estimated MRP £**
Unsupported capital expenditure after 31.03.2008	38.7	1,081,000
Leases		
Total	**38.7**	**1,081,000**

Appendix D - Policy for Flexible use of Capital Receipts Purpose

1. This report reviews the statutory guidance on the flexible use of Capital Receipts and its application within this authority.

Background

2. Capital receipts can only be used for specific purposes and these are set out in Regulation 23 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 made under Section 11 of the Local Government Act 2003. The main permitted purpose is to fund capital expenditure and the use of capital receipts to support revenue expenditure is not permitted by the regulations.

3. The Secretary of State is empowered to issue Directions allowing expenditure incurred by local authorities to be treated as capital expenditure. Where such a direction is made, the specified expenditure can then be funded from capital receipts under the Regulations.

4. The Secretary of State for Communities and Local Government has issued guidance in March 2016, giving local authorities greater freedoms with how capital receipts can be used to finance expenditure. This Direction allows for the following expenditure to be treated as capital,

"expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years for any of the public sector delivery partners."

5. In order to comply with this Direction, the Council must consider the Statutory Guidance issued by the Secretary of State. This Guidance requires authorities to prepare, publish and maintain a Flexible Use of Capital Receipts Strategy with the initial strategy being effective from 1st April 2016 with future Strategies included within future Annual Budget documents.

6. There is no prescribed format for the strategy, the underlying principle is to support local authorities to deliver more efficient and sustainable services by extending the use of capital receipts to support the revenue costs of reform projects

7. The Statutory Guidance for the Flexible Use of Capital Receipts Strategy states that the Strategy should include a list of each project which plans to make use of the capital receipts flexibility, together with the expected savings that the project will realise. The Strategy should also include the impact of this flexibility on the affordability of borrowing by including updated Prudential Indicators.

Flexible Use of Capital Receipts Strategy

8. The Flexible Use of Capital Receipts Strategy is set out below

9. Government has provided a definition of expenditure which qualifies to be funded from capital receipts. This is: "Qualifying expenditure is expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years for any of the public sector delivery partners. Within this definition, it is for individual local authorities to decide whether or not a project qualifies for the flexibility."

10. **The Council's does not intend to apply the flexible use of capital receipts in 2022/23**.

Impact on Prudential Indicators

11. The guidance requires that the impact on the Council's Prudential Indicators should be considered when preparing a Flexible Use of Capital Receipts Strategy.

12. The indicators that will be impacted by this strategy are none. The scheme is currently funded from capital receipts and the new planned use of capital receipts will be funded from capital receipts which are currently unallocated.

13. The Prudential Indicators show that this Strategy is affordable and will not impact on the Council's operational and authorised borrowing limits.

Appendix E - Investment Strategy Report 2022/23

Introduction

The Authority 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. This is likely to be updated in 2022/23 by DLUHC.

Investment Strategy also need to take account of HM Treasury Guidance in relation to the use of the PWLB to fund debt.

Treasury Management Investments

The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £3m and £25m during the 2022/23 financial year.

Contribution: The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

Further details: Full details of the Authority's policies and its plan for 2022/23 for treasury management investments are covered in a separate document, the treasury management strategy.

Service Investments: Loans

Contribution: The Council may in future lend money to its subsidiaries and local businesses to support local public services and stimulate local economic growth.

Security: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes in £ millions

Category of borrower	31.3.2021 actual			2022/23
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Subsidiaries	0	0	0	5

Local businesses	0	0	0	0.5
TOTAL	**0**	**0**	**0**	**5.5**

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts are shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk assessment: The Authority assesses the risk of loss before entering into and whilst holding service loans by using specialist advice to understand the market and the potential future demands of the market and the customers in it. It will also use benchmarking data from the market to determine future potential risks which need to be planned for. External advice is only sought from credible sources eg acknowledged experts in their fields, and officers ensure that they fully understand any information given to them before decision or advice is taken.

Commercial Investments: Property

Contribution: The Authority will invest in regeneration schemes such at Burcot and the Levelling up programme but not for purely commercial reasons. Decisions on commercial investments, including for Regeneration reasons, are made in line with the criteria and limits approved by council in the investment strategy. Property investments are also capital expenditure and decisions will therefore also be approved as part of the capital programme.

Table 2: Property held for investment purposes in £ millions

Property	Actual	31.3.2021 actual		31.3.2022 expected	
	Purchase cost	Gains or (losses)	Value in accounts	Gains or (losses)	Value in accounts
No Present Investments	0	0	0	-	-
TOTAL	**0**	**0**	**0**	**-**	**-**

Security: In accordance with government guidance, the Authority considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

Risk assessment: The Authority assesses the risk of loss before entering into and whilst holding property investments by involving specialist advisors with expertise in the type of property being purchased, looking at historic data and speaking to other councils undertaking similar activities.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority ensures that properties purchased are in an active market where there is demonstrable demand to ensure that the authority does not purchase assets which it will not be able to sell on at a later date.

Proportionality

The Authority does not plan to become dependent on profit generating investment activity to achieve a balanced revenue budget.

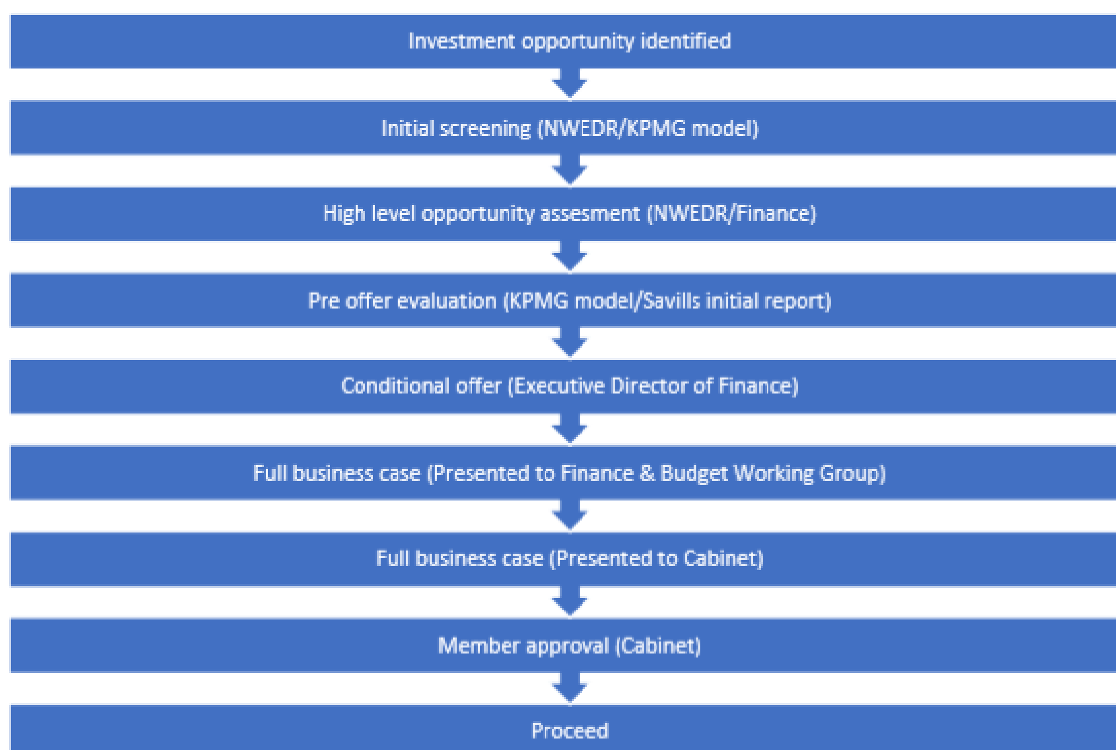
Capacity, Skills and Culture

Elected members and statutory officers: Member training will take place annually as part of the induction process. External advisors will provide reports to support investment decisions with officers ensuring that they fully understand them and can relate them to the strategic objectives and risk profile of the authority.

Commercial deals: Significant work has been undertaken using external advisors and relevant training courses have been attended to ensure that officers are fully aware of the code and statutory requirements of a local authority which is investing.

KPMG have developed a modelling tool for the authority to use when assessing potential purchases as a precursor to engaging with external consultants to ensure that potential purchases are likely to make sense from the perspective of the authority before incurring advisor costs. However, following an internal review of policy, it has been decided that the council may wish to make purchases which do not make a financial return or may indeed make a loss in the short term. On these occasions a business case will be developed which specifies the non-financial benefits of the investment. These are likely to be regenerative schemes for the greater good of the area with an intended long term impact. The regenerative and redevelopment benefits which will flow from the investment will be taken into account in the development of the business case, so if the net investment yield falls below 0.75% it can still proceed if these benefits are deemed to outweigh the lower than target yield.

Corporate governance: when investment decisions are to be made, they are to be led by the Council’s Executive Director of Finance in consultation with the Corporate Management Team. They will assess the potential investment opportunity, consulting North Worcestershire Economic Development and Regeneration (NWEDR) and using the KPMG finance appraisal model, and should they decide it presents a strong opportunity for the authority and complies with the relevant criteria a conditional offer can be made. A business case will then be developed and presented ensuring that once greater detail is included, it makes a satisfactory income yield and/or economic redevelopment and regeneration impact. When the business case is completed, if it is still compliant with the council criteria, it will be presented to Cabinet for approval before purchase is completed.



Once a purchase has been made the Executive Director of Finance will provide quarterly updates, in line with budget monitoring reports, on the status of the investment.

Investment Indicators

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

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

Table 3: Total investment exposure in £millions

Total investment exposure	31.03.2021 Actual	31.03.2022 Forecast	31.03.2023 Forecast
Treasury management investments	0	7	3
Service investments: Loans	0	0	0
Commercial investments: Property	0	0	0
TOTAL INVESTMENTS	0	7	3
TOTAL EXPOSURE	0	0	0

How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

Table 4: Investments funded by borrowing in £millions

Investments funded by borrowing	31.03.2019 Actual	31.03.2020 Forecast	31.03.2021 Forecast
Treasury management investments	0	0	0
Service investments: Loans	0	0	0
Commercial investments: Property	0	0	0
TOTAL FUNDED BY BORROWING	0	0	0

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.

Table 5: Investment rate of return (net of all costs) %

Investments net rate of return	2020/21 Actual	2021/22 Forecast	2022/23 Forecast	Minimum return
Treasury management investments	0.13	0.13	0.2	0.1
Service investments: Loans	0	0	0	0
Commercial investments: Property	0	0	0	0
ALL INVESTMENTS	0.13	0.13	0.2	0.1

Table 8: Other investment indicators

Indicator	2020/21 Actual	2021/22 Forecast	2022/23 Forecast
Debt to net service expenditure ratio	154%	164%	183%
Commercial income to net service expenditure ratio	0	0	0