CORPORATE GOVERNANCE, AUDIT AND STANDARDS COMMITTEE
15 FEBRUARY 2022

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN2211

TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2021/22

SUMMARY:
This report sets out the main activities of the Treasury Management and non-Treasury Investment Operations during the first half of 2021/22. Prudential indicators for the 2021/22 financial year have been updated for all treasury management and non-treasury activity during the first half of 2021/22.

RECOMMENDATIONS:
Members are requested to:

(i) Note the contents of this report in relation to the treasury management and non-treasury investment operations carried out during the first half of 2021/22.

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operations for the first half of the year 2021/22. This report is a statutory requirement under the CIPFA Code of Practice on Treasury Management.

1.2 The Council originally approved the Annual Treasury Management Strategy and Non-Treasury Investment Strategy for 2020/21 on 25 February 2021. The Council has 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 risk remains central to the Council's treasury management and non-treasury investment strategies.

2. PURPOSE

2.1 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2017 ("the Code"), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members be informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

2.2 The appendices (1 to 4) set out the Treasury Management operations, Non-Treasury Investment Operations and Prudential Indicators for 2021/22 and fulfil key legislative requirements as follows:

<u>Appendix 1</u>

- The **Treasury Management operations** which sets out how the Council's treasury service operated during the first half of 2021/22 in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Treasury Management Borrowing operations** which sets out the Council's borrowing during the first half of 2021/22 in accordance with CIPFA's Code of Practice on Treasury Management, and;
- The **Treasury Management Investment operations** which sets out the Council's Treasury Management investment operations for the first half of 2021/22, in accordance with CIPFA's Code of Practice on Treasury Management.

<u>Appendix 2</u>

- The **Non-Treasury Investment operations** sets out the Council's Non-Treasury investment performance for the first half of 2021/22, in accordance with MHCLG Investment Guidance.

<u>Appendix 3</u>

- the **Prudential indicators forecast** sets out the forecast prudential indicators position at the end of 2021/22 based on 2021/22 half year position relating to treasury/non-treasury activities and capital financing for 2021/22. Performance is compared to the indicators set out in the Annual Capital Strategy for the year 2021/22.

<u>Appendix 4</u>

- Economic commentary from Arlingclose

<u>Appendix 5</u>

- Capital Finance system – Revision to CIPFA Codes and MHCLG improvement to the Capital Finance Framework

3 CONCLUSIONS ON THE TREASURY MANAGEMENT AND NON-TRESURY INVESTMENT OPERATIONS DURING 2021/22

3.1 The Council's treasury team continued to concentrate on the security of investments taking due regard for the returns available.

3.2 With increased levels of borrowing the treasury team continually reviews the borrowing strategy, weighing up interest rate levels and risk of refinancing. During the first half of the 2021/22 financial year short-term interest rates have remained at 0.10% and are forecast to remain low. Borrowing levels have remained the same during the year although the increase in short-term borrowing does increase the refinancing risk. All treasury management decisions are taken with due regard to refinancing risk.

3.3 Total borrowing at 30 September 2021 was £102m, no change from 2020/21 year-end position. Year-end borrowing is forecast to be below estimated levels due to timing capital expenditure (service loans) on Housing Matters. The lower level of borrowing and lower interest rates has resulted in forecast interest cost of borrowing reducing by £0.495m.

3.4 The Council is forecast to have non-treasury investments risk exposure of £137m of which £93.7m is funded via external loans.

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APPENDIX 1

TREASURY MANAGEMENT OPERATION FOR FIRST HALF OF 2021/22

1 INTRODUCTION

1.1 The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure the Council can meet its capital spending obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2 TREASURY MANAGEMENT ADVICE

2.1 The Council continued to engage the services of Arlingclose for independent treasury advice during the year 2021/22. Arlingclose provide specialist treasury support to 25% of UK local authorities. They provide a range of treasury management services including technical advice on debt and investment management and long-term capital financing. They advise on investment trends, developments and opportunities consistent with the Council's Treasury Management Strategy.

2.2 With the exception of pooled funds all investment activity is carried out by the Council's own treasury team with advice from Arlingclose, and having due regard to information from other sources such as the financial press and credit-rating agencies.

2.3 Pooled funds are managed at the discretion of the external fund managers associated with each fund. It should however be noted that whilst the funds are externally managed, the decision as to whether to invest lies solely with the Council in accordance with its Treasury Management Strategy.

2.4 The needs of the Council's treasury management staff for training in investment management are assessed on an ongoing basis and as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. During 2021/22, staff attended relevant virtual workshops provided by Arlingclose and other service providers.

3 EXTERNAL CONTEXT

3.1 The Council's treasury management advisors have provided commentary on the economic background that prevailed during the first half of 2021/22. This commentary is provided at **Appendix 4**.

4 LOCAL CONTEXT

4.1 On 30 September 2021, the Council had net borrowing of £102.0m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes for the 2020/21 financial year is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The projected CFR is summarised in **Appendix C**.

4.2 The treasury management position at 30 September 2021 and the change during the year is shown in Table 1 below.

Table 1: Treasury Management Summary

	Balance 31 March 2021 (£m)	Movement (£m)	Balance 30 Sept 2021 (£m)	Rate % 30 Sept 2021
Long-term borrowing	0.0	25.0	25.0	0.42%
Short-term borrowing	102.0	(25.0)	77.0	0.16%
Total borrowing	**102.0**	**0.0**	**102.0**	
Long-term investments	(21.9)	0.0	(21.9)	4.10%
Short-term investments	0.0	0.0	0.0	
Cash and cash equivalents	(4.8)	(20.2)	(25.0)	0.01%
Total investments	**(26.7)**	**(20.2)**	**(46.9)**	
Net borrowing/(investments)	**75.3**	**(20.2)**	**55.1**	

4.3 **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 CFR, 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.

Table 2: Liability benchmark

	2021/22 Estimate (£m)	2021/22 Forecast (£m)
Outstanding borrowing	154.10	154.10
Investment min	(10.00)	(10.00)
Investments held that can be redeemed	(23.90)	(23.90)
Liability benchmark	131.20	131.20

5 BORROWING ACTIVITY IN 2020/21

5.1 At 30 September 2021 the Council held £102.0m of loans (no change since 31 March 2021) as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 September 2021 are summarised in Table 3 below.

Table 3: Borrowing Position

	Balance 31 March 2021 (£m)	Movement (£m)	Balance 30 Sept 2021 (£m)	Rate % 30 Sept 2021
Long-term borrowing	0	25	25	0.42%
Short-term borrowing	102	(25)	77	0.16%
Total Gross External Debt	**102**	**0**	**102**	

5.2 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

5.3 With short-term interest rates remaining much lower than long-term rates, the Council considered it to be more cost effective in the near term to use short-term loans.

6 INVESTMENT ACTIVITY IN 2021/22

6.1 The Council holds significant invested funds. During the year, the Council's investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	Balance 31 March 2021 (£m)	Movement (£m)	Balance 30 Sept 2021 (£m)	Rate % 30 Sept 2021
Managed in-house:				
Money Market Funds	4.8	20.2	25.0	0.01%
Managed externally:				
Pooled Funds:				
CCLA LAMIT Property Fund	3.9	0.0	3.9	1.92%
M&G Investments Strategic Corporate Bond Fund	4.0	0.0	4.0	1.26%
UBS Multi Asset Fund	5.0	0.0	5.0	2.62%
Aegon (Kames) Diversified Monthly Income Fund	2.0	0.0	2.0	2.97%
Threadneedle Investments	2.0	0.0	2.0	1.24%
Schroder Income Maximiser Fund	5.0	0.0	5.0	4.01%
Total Investments	**26.7**	**20.2**	**46.9**	

6.2 The following chart illustrates the spread of investment by type of investment (figure 1) along with maturity analysis (figure 2).

APPENDIX 1

Figure 1: Type of Counterparty

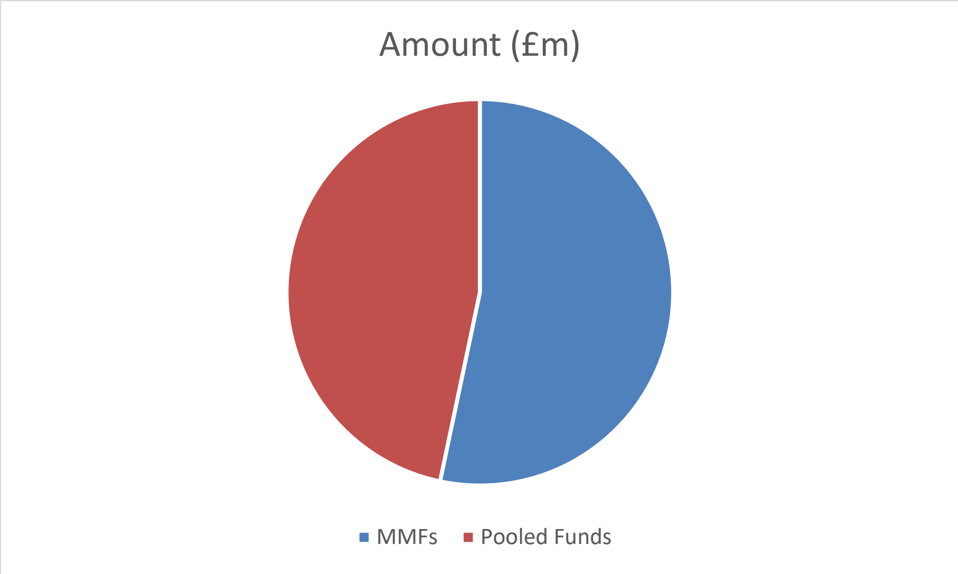


Figure 2: Maturity analysis

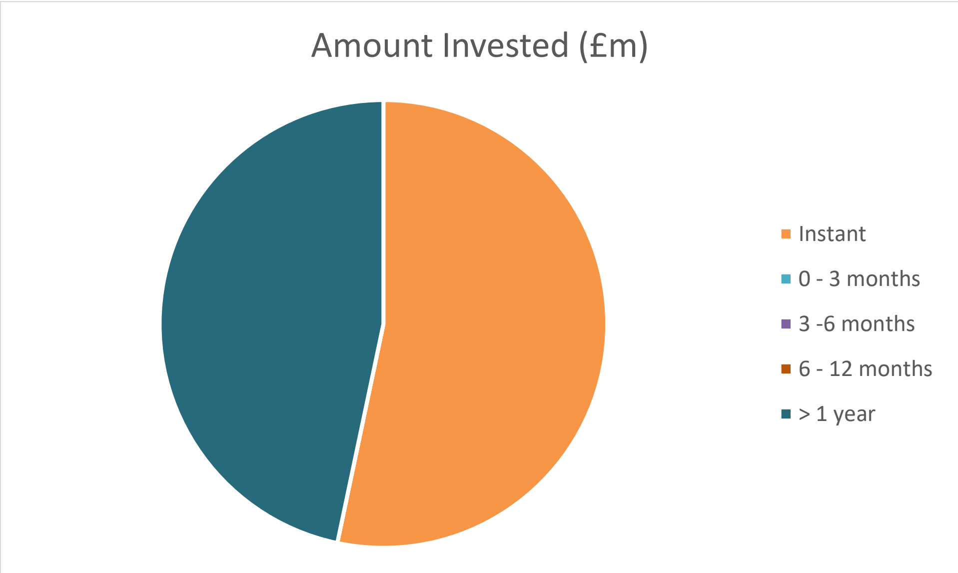


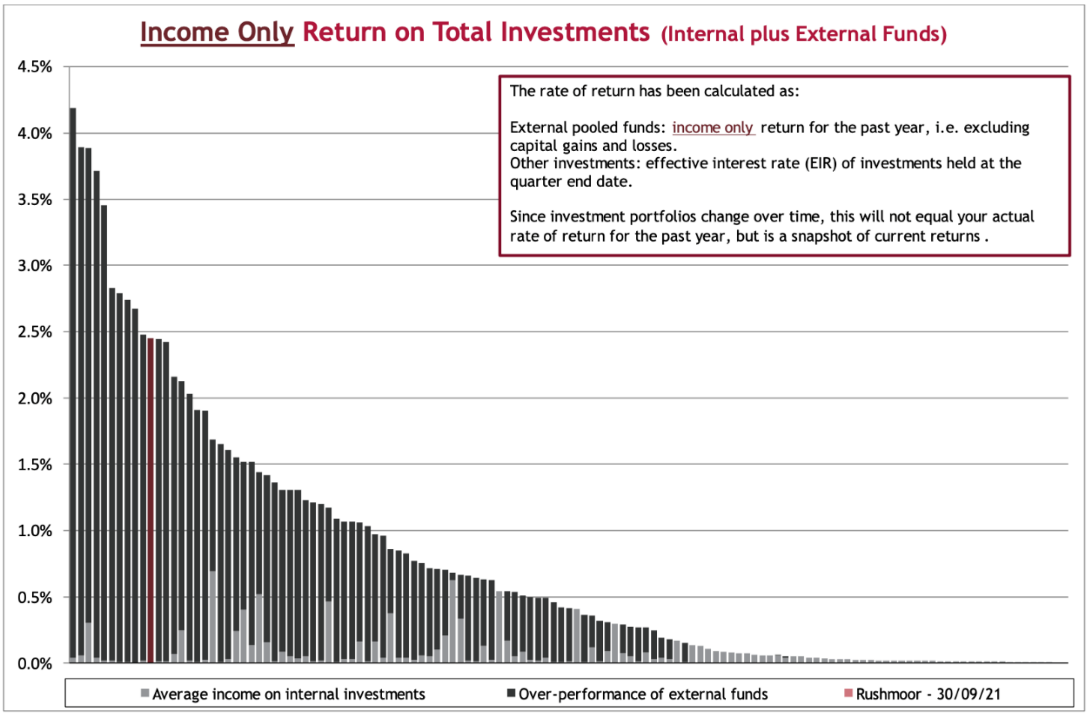
Table 5: Maturity analysis

Maturity Analysis for ALL INVESTMENTS	Type of Counter Party	Amount invested (£m)	% of total investments
Instant	MMF	25.0	53%
0 - 3 months	Pooled Fund	0.0	0%
3 -6 months	Pooled Fund	0.0	0%
6 - 12 months	Pooled Fund	0.0	0%
> 1 year	Pooled Fund	21.9	47%
Total for all duration periods		**46.9**	**100%**

6.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum 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.

6.4 Investment Income Benchmarking: The graph below has been produced by Arlingclose and demonstrates that the Council income only returns on total investment portfolio for the last 12 months up to September 2021 was 4.71%.

Figure 3: Total income return on investment portfolio



6.5 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 6 below.

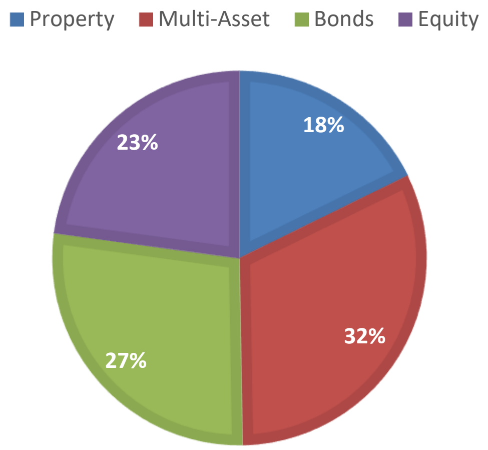
Table 6: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure
31.03.2021 30.09.2021	5.32 4.88	A+ A+	100% 100%
Similar LAs **All LAs**	**4.15**	**A+**	**69%**

External Strategic Pooled Funds

6.6 £21.9m of the Council's investments are held in externally managed strategic pooled equity, multi-asset, bond and property funds where short-term security and liquidity are lesser considerations, and objectives are regular revenue income and long-term price stability. The pooled fund portfolio has generated an average total return during the first half of 2021/22 of 4.71%. Capital returns have increased by 9.69%. A summary of returns and diversification is set out below.

Figure 4: Pooled fund diversification



APPENDIX 1

Table 7: Pooled fund diversification

Type of Pooled Fund	Amount invested £	% of total investments
Property	3,882,128	17.74%
Multi-Asset	7,000,000	31.99%
Bonds	6,000,000	27.42%
Equity	5,000,000	22.85%
Total	**21,882,128**	**100.00%**

Figure 5: Total returns year-on-year comparison

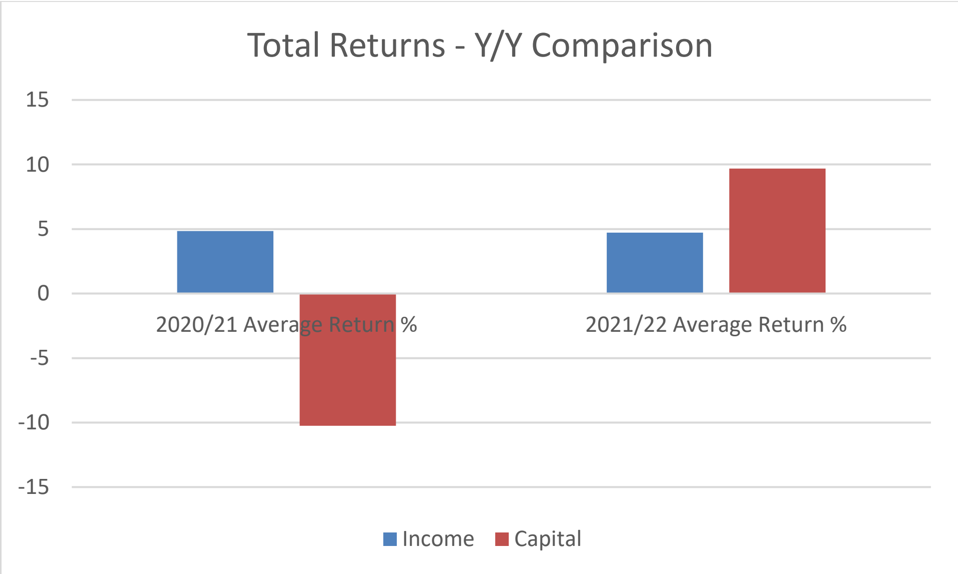


Table 8: Total return breakdown

Type of Return	2020/21 Average Return %	2021/22 Average Return %
Income	4.84	4.71
Capital	-10.25	9.69
Total Returns	**-5.41**	**7.48**

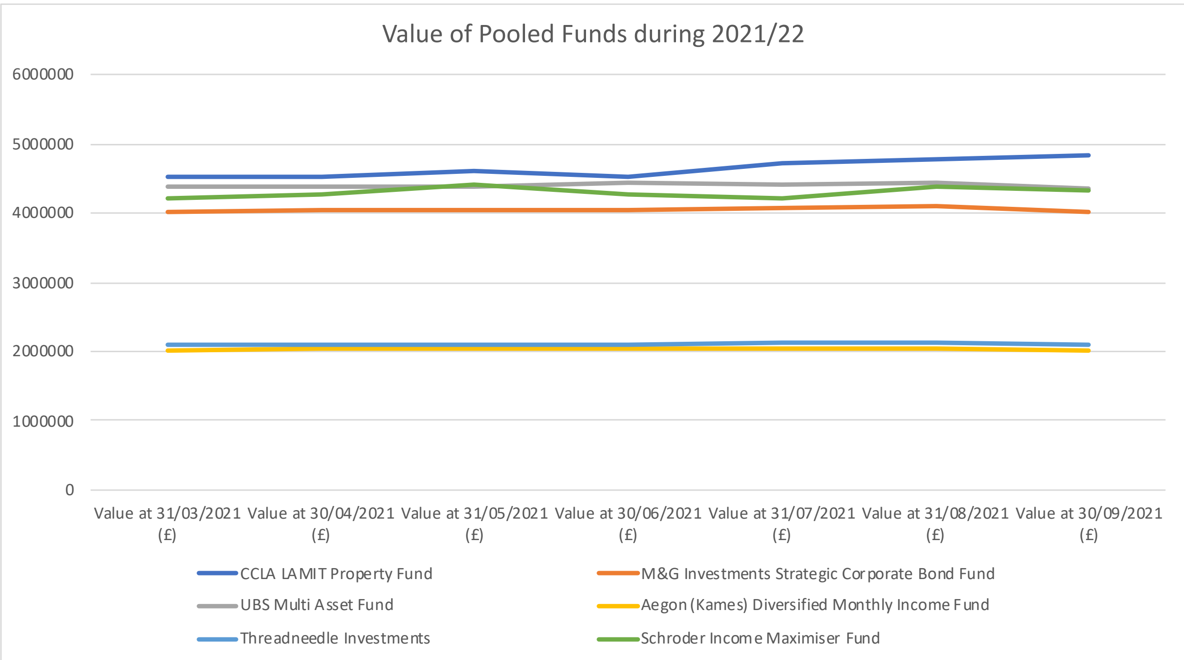
6.7 As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the medium-/long-term and the Council's latest cash flow forecasts, investment in these funds has been increased.

6.8 Details of the Council's investment activity together with returns generated during 2021/22 are outlined as follows:

6.9 **Capital returns** – the Council's pooled fund portfolio has continued to recover during 2021/22. Aggregation of the Council's pooled funds resulted in an overall net increase in fair value for the year 2021/22 of around £772,000 (an aggregate increase of 3.69% of overall pooled funds invested).

6.10 There is variation in performance across the portfolio as shown in figure 6 below.

Figure 6: Movement in capital value of pooled funds during 2021/22



6.11 **Income Returns**_– The income returned by fund for the period to 30 September 2021 is summarised below:

- <u>CCLA's Local Authorities' Mutual Investment Trust</u> - £4.5 million investment at commencement of the year. The Property Fund is designed to achieve long-term capital growth and income from investments in the commercial property sector. The fund has returned 4.45% annualised income during 2021/22.

- UBS Multi-Asset Income Fund - £5 million investment. This fund follows a strategy of reducing volatility exposure levels by spreading investments across a diversified range of asset classes. This fund has returned 4.85% annualised income during 2021/22.

- Threadneedle Strategic Bond Fund - £2 million investment. The fund aims to provide income and capital appreciation through investment grade and high yield bonds. This fund has returned 2.26% annualised income during 2021/22

- M & G Corporate Bond Fund - £4m investment. This fund aims for a target total return of 3-5% from a combination of investment income or capital appreciation. This fund has returned 2.66% annualised income during 2021/22.

- Schroder Income Maximiser Fund - £5m investment made in December 2018. The fund aims to provide both income and capital growth, delivering a target income of 7% per annum. The fund has returned 7.32% annualised during 2021/22.

- Kames Diversified Monthly Income Fund - £2m investment made in February 2019. The fund aims is to provide income with the potential for capital growth over the medium term. The fund has returned 4.52% annualised during 2021/22.

7 TREASURY MANGEMENT COMPLIANCE PERFORMANCE

7.1 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

7.2 **Compliance -** The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy with the exception of current account balance limits.

7.3 Compliance with specific investment limits is demonstrated in table 9 below.

APPENDIX 1

Table 9: Investment Limits

	30 Sept 2021 Actual £m	**2021/22 Limit £m**	**Complied?**
Any group of pooled funds under the same management	**21.9**	**25.0**	Yes
Money Market Funds	**25.0**	**25.0**	Yes

8 TREASURY MANAGEMENT INDICATORS

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

8.2 **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.

	30 Sept 2021 Actual	**2021/22 Target**	**Complied?**
Portfolio average credit rating	A+	A-	YES

8.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each period without giving prior notice.

	30 Sept 2021 Actual £m	**2021/22 Target £m**	**Complied?**
Total sum borrowed in past 3 months without prior notice	0	1.0	YES

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

8.5 **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 all borrowing were:

	30 Sept 21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	80%	100%	0%	YES
12 months and within 24 months	20%	100%	0%	YES
24 months and within 5 years	0%	100%	0%	YES
5 years and within 10 years	0%	100%	0%	YES
10 years and above	0%	100%	0%	YES

8.6 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.

8.7 **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 beyond the period end were:

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£21.9m	£21.9m	£21.9m
Limit on principal invested beyond year end	£90.0m	£90.0m	£90.0m
Complied?	YES	YES	YES

8.8 **Total Investment Yield:** The Council's revised estimates regarding investment yields and costs compared to the actual outturn for 2021/22 is shown in the table below.

Budgeted Income and Forecast Outturn	2021/22 Estimate (£'000)	2021/22 Forecast (£'000)	Variance (£'000)
Interest Receivable	(1,090)	(990)	100
Interest Payable	795	300	(495)
Net Amount	(295)	(690)	(395)

APPENDIX 2

NON-TREASURY INVESTMENT OPERATIONS FOR FIRST HALF OF 2021/22

1 INTRODUCTION

1.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

1.2 The purpose of non-treasury investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

1.3 The second main function of investment management is to generate potential returns and monitor performance of returns on a regular basis.

1.4 The Council also holds £131.2m of such investments at as 30 September 2021 in:

- directly owned property £123.7m
- loans to local businesses and landlords £6.7m
- shareholding in subsidiaries £0.8m

2 PROPORTIONALITY

2.1 The Council is becoming increasingly dependent on profit generating investment activity to achieve a balanced revenue budget. Table 1 below shows the forecast proportion of gross service expenditure funded by investment activity.

Table 1: Proportionality of Investments

	2021/22 Estimate	2021/22 Forecast
Proportion	16.4%	15.6%

3 SERVICE IMPROVEMENT LOANS

3.1 The Council lends money to its subsidiaries, local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enables to development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business.

3.2 The Council performance and upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 2: Loans for service purposes in £ millions

Category of borrower	2021/22 Approved Limit	2021/22 Actual	2021/22 Forecast
Local businesses	6.7	6.7	6.7
Employees	0.1	0.1	0.1
Subsidies and Partnership	6.2	0.8	1.0
TOTAL	**13.0**	**7.6**	**7.8**

Service loans have generated a negligible rate of return (<0.25%) for the Council during the first 6 months of the 2021/22 financial year. The level of return is expected to be at this level for the full financial year. The rate of return is lower than estimated due to the following two events:

- delays in issuing loans to Rushmoor Homes Limited. No additional loan notes have been issued to date during 2021/22
- funding consortium partnership agreement to defer interest payment on loans provided to Farnborough International Limited (FIL) following cancellation of the 2020 Airshow.

4 SERVICE INVESTMENTS: SHAREHOLDING IN SUBSIDIARIES

4.1 The Council invests in the shares of its subsidiary and holds a financial share in a development partnership and Rushmoor Homes to support local public services and stimulate local economic growth.

4.2 The Council performance and upper limits on the sum invested in each category of shares have been set as follows:

Table 3: Shares held for service purposes in £ millions

Category of company	2021/22 Approved Limit	2021/22 Forecast
Subsidiaries and Partnerships	0.6	0.6
TOTAL	**0.6**	**0.6**

5 COMMERCIAL INVESTMENT: PROPERTY

5.1 The Council invests in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services. No additional transactions are planned during 2021/22 in accordance with the Council's Capital Strategy.

Table 4: Property held for investment purposes in £ millions

Property by type	2020/21 Transactions		2021/22 estimated transactions	
	Purchase cost	Year End Value	Purchase cost	Estimated year-end Value
Mixed use	4.5	4.5	0.0	4.5
Industrial units	24.2	24.3	0.0	24.3
Retail	34.3	45.0	0.0	45.0
Offices	51.0	49.9	0.0	49.9
TOTAL	**114.0**	**123.7**	**0.0**	**123.7**

<u>Return on Commercial investment</u>

5.2 Commercial property investments generated £4.5m of net investment income for the Council after taking account of direct costs, cost of borrowing and Minimum Revenue Provision (MRP) representing a rate of return of 3.69%.

5.3 The return on commercial property is forecast to be higher that the reported level in the non-treasury investment strategy to Council in February 2021. This is due to lower cost of borrowing during the year.

APPENDIX 2

6 NON-TREASURY INVESTMENT INDICATORS

6.1 The Council measures and manages its exposures to non-treasury investment risks using the following indicators.

6.2 **Total risk exposure:** This 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.

Table 5: Total investment exposure in £millions

Total investment exposure	2021/22 Estimate	2020/21 Forecast
Treasury management investments	23.9	21.9
Service investments: Loans	13.0	7.8
Service investments: Shares	0.6	0.6
Commercial investments: Property	124.4	123.7
TOTAL INVESTMENTS	161.9	154.0
Commitments to lend	4.9	4.9
TOTAL EXPOSURE	166.8	158.9

6.3 **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, the following 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.

Table 6: Investments funded by borrowing in £millions

	2021/22 Estimate	2021/22 Forecast
Service investments: Loans	8.4	3.2
Service investments: Shares	0.6	0.6
Commercial investments: Property	89.9	89.9
TOTAL FUNDED BY BORROWING	98.9	93.7

6.4 **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 7: Investment rate of return (net of all costs)

	2021/22 Estimate	2020/21 Forecast
Treasury management investments	3.7%	2.6%
Service investments: Loans	2.2%	0.2%
Service investments: Shares	0%	0%
Commercial investments: Property	3.5%	3.7%
ALL INVESTMENTS	3.4%	3.3%

6.5 The above table shows a forecast reduction in Treasury management investments and Service Investment Loans net of all finance costs in 2021/22. This is due to lower service investment returns and lower interest rates on short-term liquid treasury management investments. Commercial Property shows a forecast improvement in return net of all finance costs in 2021/22 due to the reduced cost of borrowing.

APPENDIX 3

PRUDENTIAL INDICATORS

1.1 **Prudential Indicators:_**The following indications are required by the CIPFA “Prudential Code” 2017 edition

1.2 **Estimates of Capital Expenditure:** The Council’s planned capital expenditure and financing may be summarised as follows.

Table 1: Capital Expenditure and Financing in £ million

	2021/22 Estimate	**2021/22 Forecast**
General Fund services	38.5	14.6
TOTAL	38.5	14.6
External sources	10.3	4.6
Own resources	0.0	0.0
Debt	28.2	10.0
TOTAL	**38.5**	**14.6**

1.3 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). 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 2: Replacement of debt finance in £ million

	2021/22 Estimate	**2020/21 Forecast**
Own resources	2.5	2.5

1.4 **Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council’s underlying need to borrow for a capital purpose.

Table 3: Estimates of Capital Financing Requirement in £ millions

	2021/22 Estimate	**2021/22 Forecast**
General Fund services	148.0	125.2
MRP	-2.5	-2.5
IFRIC 4 Lease Adjustment	-0.4	-0.4
TOTAL CFR	**145.1**	**122.3**

1.5 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

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

	2021/22 Estimate	2021/22 Forecast
Debt (incl. leases)	145.1	145.1
Capital Financing Requirement	143.8	143.8
Difference	-1.3	-1.3

1.6 **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.

Table 5: Affordable borrowing limit in £m

	2021/22 limit	2020/21 Forecast
Authorised limit – total external debt	160.1	160.1
Operational boundary – total external debt	155.1	155.1

1.7 **Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Table 6: Ratio of financing cost to net revenue stream

	2021/22 Estimate	2021/22 Forecast
Financing costs (£m)	3.2	2.8
Proportion of net revenue stream	31.8%	26.3%

APPENDIX 4

MARKET COMMENTARY REGARDING THE YEAR 2021/22 FROM THE COUNCIL'S TREASURY MANAGEMENT ADVISORS ARLINGCLOSE

Commentary relates to the economic position in October 2021 and will not take into account changes to the economic climate in Q3 and Q4 of 2021/22.

External Context

Economic background: The economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

Government initiatives continued to support the economy over the quarter but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.

The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to a base effect from a decline in average pay in the spring of last year associated with the furlough scheme.

Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.

The easing of restrictions boosted activity in the second quarter of calendar year, helping push GDP up by 5.5% q/q (final estimate vs 4.8% q/q initial estimate). Household consumption was the largest contributor. Within the sector breakdown production contributed 1.0% q/q, construction 3.8% q/q and services 6.5% q/q, taking all of these close to their pre-pandemic levels.

The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

Financial markets: Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more transitory, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, lead to higher prices.

The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30th September. Over the same period the 10-year gilt yield fell from 0.80% to 0.71% before rising to 1.03% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.37%.

The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.

Credit review: Credit default swap spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back. The gap in spreads between UK ringfenced and non-ringfenced entities continued to narrow, but Santander UK remained an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 53bps and Lloyds Banks Plc the lowest at 32bps. The other ringfenced banks were trading between 37-39bps and Nationwide Building Society was 39bps.

Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

Fitch also revised the outlooks for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable from negative. The rating agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days.

As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

APPENDIX 5

REVISION TO CIPFA CODES

In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
  - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
  - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
  - Excluding investment income from the definition of financing costs.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making

Note: Revised Codes were published by CIPFA in December 2021

APPENDIX 5

MHCLG Improvements to the Capital Finance Framework: MHCLG published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that “while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk”.

The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

A further consultation on these matters is expected soon.

Note: Further consultation on MRP commenced on 30 November 2021 with a closing date for responses of 08 February 2022