Audit and Governance Committee

21st January 2022

Title of Report	Strategy Reports 2022/23.
Purpose of Report	To provide the Committee with the proposed Capital Strategy, Treasury Management Strategy Statement and Investment Strategy for 2022/23 and the Minimum Revenue Provision Policy.
Recommendations	To consider, and comment as appropriate, on the proposed strategies for 2022/23, including the Minimum Revenue Provision Policy.
Officers	Paul Blacker: Director of Finance (01452) 328999 paul.blacker@gloucestershire.gov.uk Kathryn Oakey: Finance Manager: (01452) 328915 kathryn.oakey@gloucestershire.gov.uk

Report

The Chartered Institute for Public Finance and Accounting (CIPFA) 2020 Prudential Code, Treasury Management Code of Practice and Ministry of Housing Communities and Local Government (MHCLG) 2018 guidance requires the Council to produce:

- A Capital Strategy (Annex 1),
- A Treasury Management Strategy (Annex 2) and
- An Investment Strategy covering non-treasury investments (included in Annex 2).

These strategies are included within the Medium Term Financial Strategy (MTFS) for approval by full Council in February 2022.

Annex 1

Capital Strategy 2022/23

Introduction

1 This capital strategy 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.

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

Capital Expenditure and Financing

3 Capital expenditure is where the Council 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. Subject to all Financial Regulations and Accounting Instructions, Directors have the authority to incur expenditure provided in the capital programme approved by the County Council.

4 Expenditure may not be incurred if it is contrary to, or not wholly in accordance with, the Policy Framework or Capital Programme. Virements and changes to approved capital schemes can be made in accordance with the Accounting Instructions.

5 In 2022/23, the Budget set for planned capital expenditure is £226.3 million. £6.5m of the capital expenditure in 2022/23 arises from a change in the accounting for leases and does not represent cash expenditure.

Table 1: Estimates of Capital Expenditure

Estimates of Capital Expenditure	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
General Fund services	114.081	153.295	219.526	256.256	40.271
PFI and Finance Leases	0.000	0.000	6.500	0.000	0.000
TOTAL	**114.081**	**153.295**	**226.026**	**256.256**	**40.271**

Governance:

6 For the majority of service areas service managers bid annually to include projects in the Council's capital programme. The Council's project appraisal process will be the methodology employed to evaluate schemes included in the MTFS. The elements are:

- Scheme description
- Fit against the Council's priorities
- Costs including whole life costs and scheme phasing
- Available funding and source

- Revenue consequences
- Risk assessment
- VAT issues
- Planning and site issues
- Target dates

7 Analysis of existing approved schemes will be carried out at each MTFS refresh to identify all “non-committed” schemes. If necessary, these will be re-prioritised against other priority schemes awaiting approval. Capital resources will be made available to deliver schemes that meet the Council’s “invest to save” criteria.

8 All Highway related projects, with a few limited exceptions are subjected to a mathematical assessment process applicable to the area of the service involved. The exceptions are the allocations that are set aside for reactive works which relates to urgent work necessary to keep the network in a safe and operational state, Community Offer where we match contributions from the community and low-cost minor works where we react on a local basis to needs.

9 The Council has a statutory obligation to ensure there are sufficient local school places available across the County. The capital and grant funding it receives is prioritised against schemes which have been identified to meet forecast growth (basic need) in areas where additional places are required and where the condition of the school’s infrastructure needs updating and replacing. Annual monitoring of pupils forecasts and housing, together with annual inspections of school site and premises ensure the information is up to date to inform planned decisions. The Council produced a draft School Places Strategy document (2021- 2026). The strategy, which was approved by Cabinet in March 2021, is a key framework document for the Council in considering any statutory proposals for changes to school organisation including the commissioning of new schools and will inform future capital investment priorities.

10 The final capital programme is presented to Cabinet in January and to Council in February each year.

11 Full details of the Council’s current capital programme can be found in the MTFS: https://www.gloucestershire.gov.uk/council-and-democracy/performance-and-spending/budget-and-medium-term-financial-strategy/

Financing Capital Expenditure

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

Table 2: Financing the Capital Programme

Capital Financing	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
External Sources	79.863	97.088	144.246	206.734	3.689
Internal Resources, Capital	17.751	20.193	13.526	9.507	6.753
Internal Resources, Revenue	4.215	7.671	3.443	0.960	0.044
Debt	12.252	28.343	58.311	39.055	29.785
Sub Total	**114.081**	**153.295**	**219.526**	**256.256**	**40.271**
PFI and Finance Leases	0.000	0.000	6.500	0.000	0.000
Total	**114.081**	**153.295**	**226.026**	**256.256**	**40.271**

* £6.5m of debt financing in 2022/23 arises from a change in the accounting for leases and does not represent new payments

13 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 the minimum revenue provision (MRP) and leased PFI assets are financed via lease payments. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP. PFI and lease payments are as follows (there are no plans to use capital receipts in this way at the current time):

Table 3: Replacement of Prior Years' Debt Finance

Replacement of Debt Finance	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Minimum Revenue Provision	7.079	7.568	8.281	9.900	11.040
PFI and Finance Leases	3.823	3.662	3.952	4.013	4.333
Total	**10.902**	**11.230**	**12.233**	**13.912**	**15.373**

14 MRP is increasing due to additional unfunded capital spend included as part of the approved capital programme, details of which can be found in the MTFS. The Council's full MRP statement is available within the Treasury Management Strategy, Annex 10 of the MTFS.

15 The Council'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 payments and capital receipts used to replace debt. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Capital Financing requirement

Capital Financing Requirement	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
General Fund services	297.694	318.469	368.239	397.134	415.619
PFI and Finance Leases	156.701	153.040	149.087	145.335	141.262
TOTAL CFR	**454.396**	**471.509**	**517.326**	**542.469**	**556.881**

Asset management:

16 To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. This document seeks to align the asset portfolio with the needs of the Council. The Council's asset management strategy

is available on the Council's website, www.gloucestershire.gov.uk

Asset disposals:

17 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.

18 Since 2016/17 new capital receipts can also be used to fund the revenue costs of transformation projects designed to generate ongoing revenue savings in the delivery of public services and / or to transform service delivery in a way that reduces costs or demand for services in the future. The proposed budget 2022/23 does not anticipate the use of capital receipts in this way, however given the on going transformation programme and the financial challenges faced by the Council as a result of the COVID-19 pandemic it may become necessary to consider using capital receipts in this flexible manner in future. Using capital receipts in this way will require the approval of the County Council.

19 Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £21.4 million of capital receipts in the coming financial year as follows:

Table 5: Capital Receipts

Capital receipts	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Asset sales	7.291	13.626	21.351	8.550	4.550
Investment Platform	0.055	0.008	0.000	0.000	0.000
TOTAL	**7.346**	**13.634**	**21.351**	**8.550**	**4.550**

Treasury Management

20 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council'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 Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

21 Due to decisions taken in the past, the Council is currently projected to have £246.7 million borrowing as at the end of March 2022 at an average interest rate of 4.65% and £286.6 million treasury investments at an average rate of 1.44%, projected as at the end of March 2022.

Borrowing strategy:

22 The Council is currently holding all new long term external borrowing requirements internally. However, should the Council need to externalise this debt or take short term debt for cash flow purposes the main objectives when borrowing will be to achieve a low but certain cost of finance, while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.1%) and long-term fixed rate loans where the future cost is known but

higher (currently 1.5 to 2.5%).

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

Table 6: Gross Debt and the Capital Financing Requirement

Gross Debt and the Capital Financing Requirement	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Debt (incl. Other Liabilities)	418.524	406.218	394.845	382.833	372.000
Capital Financing Requirement	454.396	471.509	517.326	542.469	556.881

24 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 Council expects to comply with this in the medium to longer term.

Liability benchmark:

25 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing minimum level of borrowing required to keep investments at a minimum level. This benchmark is currently -£41.0 million as a result of the historical borrowing portfolio of the Council and the level of balances and reserves. The benchmark is forecast to increase to £78.9 million over the next three years due to the additional borrowing proposed within the capital programme. In effect, this is saying that if we had no additional investment balances / surplus cash during 2021/22 the Council would not need to borrow currently to support the capital programme as investment balances are sufficiently high.

Table 7: Borrowing and the Liability Benchmark

Borrowing and the Liability Benchmark	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Outstanding borrowing	261.823	246.678	239.778	231.778	225.278
Liability benchmark	-91.108	-41.970	14.960	52.115	78.859

26 The table shows that the Council expects to remain borrowed above its liability benchmark in the medium term. This is because the Council has a large historic debt portfolio, and due to the high premiums that would be incurred on the early repayment of this debt, it is not currently feasible to reduce the level of borrowing. Any new debt requirements are currently held internally, reducing the cost of carry and this additional debt results in the Council being above the liability benchmark from 2021/22. This new debt would only be externalised if it becomes uneconomical to hold it internally.

27 The purpose of the liability benchmark is to assist the Council when making decisions about affordability of the capital programme and the need to borrow in the future.

Affordable borrowing limit:

28 The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line

with statutory guidance, a lower “operational boundary” is also set as a warning level should debt approach the limit.

Table 8: Authorised Limit and Operational Boundary for External Debt

Authorised limit and operational boundary	2020/21 Limit £m	2021/22 Limit £m	2022/23 Limit £m	2023/24 Limit £m	2024/25 Limit £m
Total Authorised Limit for Debt and Other Liabilities	**510.000**	**540.000**	**570.000**	**595.000**	**605.000**
Split: Debt	353.299	380.460	414.933	443.945	458.278
Other Liabilities	156.701	159.540	155.067	151.055	146.722
Total Operational Boundary for Debt	**490.000**	**520.000**	**550.000**	**575.000**	**585.000**
Split: Debt	333.299	360.460	394.933	423.945	438.278
Other Liabilities	156.701	159.540	155.067	151.055	146.722

29 Further details on borrowing are available within the treasury management strategy at Annex 2 below.

Treasury Investment strategy:

30 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 however DLUHC guidance requires that a non treasury management Investment Strategy is maintained and can be included as part of the Treasury Management Strategy.

31 The Council’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.

32 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. The Council may request its money back at short notice, however the business model is to hold money in strategic pooled funds for the longer term, for a period of at least five years.

Table 9: Treasury Manasgement Investments

Treasury Management Investments	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Near-term investments	220.2	163.6	99.8	54.7	21.4
Longer-term investments	132.7	125.0	125.0	125.0	125.0
TOTAL	**352.9**	**288.6**	**224.8**	**179.7**	**146.4**

Risk management:

33 The effective management and control of risk are prime objectives of the Council’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. Further details on treasury deposits are within the Treasury Management and Investment strategy, Annex 2.

Governance:

34 Decisions on treasury management deposits and borrowing are made daily and are therefore delegated to the Section 151 Officer and staff, who must act in line with the treasury management strategy approved annually by Council in February. Regular reports on treasury management activity are presented to Audit and Governance Committee. The Audit and Governance Committee is responsible for scrutinising treasury management decisions.

Investments for Service Purposes

35 The Council can make investments to assist local public services; this could include making loans to local service providers, small businesses to promote economic growth and Council subsidiaries that provide services. In light of the public service objective, the Council is willing to take more risk than with treasury investments, however, should these types of investments be made the objective would be for such investments to break even after all costs.

Governance:

36 Decisions on service investments are made by the relevant service manager in consultation with the Section 151 Officer and must meet the criteria and limits laid down in Accounting Regulations and the Treasury Management and Investment Strategy. Most loans and shares are capital expenditure and significant purchases will be approved as part of the capital programme.

37 Further details on service investments are within the Treasury Management and Investment Strategy, Annex 10.

Commercial Activities

38 With central government financial support for local public services declining, many local authorities have invested in commercial property for financial gain.

39 With financial return being the main objective, Council's will generally accept higher risk on commercial investment, in line with business cases, than it would for treasury investments. The principal risk exposure includes gaps in rental income, falls in capital value, delays in occupation. Should the Council choose to pursue commercial activities, the risks will be managed in line with a comprehensive business case.

Governance:

40 Decisions on commercial investments will be made by the Section 151 Officer in line with the criteria and limits approved by full Council in the Treasury Management and Investment Strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

41 Further details on commercial activities are within the Treasury Management and Investment Strategy, Annex 2.

Liabilities

42 In addition to the debt detailed above, the Council is committed to making future payments to cover its pension fund deficit and has also set aside money to cover risks of major provisions.

Governance:

43 Any new discretional liabilities are fully reviewed before any commitment is taken as part of the MTFS process. A full risk register is maintained and monitored to ensure that the risk of liabilities crystallising and requiring payment is fully monitored and reported.

Revenue Budget Implications

44 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP payments 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. The reason for the large increase is the Waste contract liability.

Table 10: Proportion of financing costs to net revenue stream

	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Proportion of Financing Costs to Net Revenue Stream	5.20%	5.13%	5.32%	5.61%	5.86%

* £6.5m of the increase in financing costs in 2022/23 arises from a change in the accounting for leases and does not represent additional cost to the Council

45 Further details on the revenue implications of capital expenditure are within Annex 8 of the MTFS.

Sustainability:

46 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 Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because new schemes are robustly challenged through the capital bid process.

Knowledge and Skills

47 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council pays for staff to study towards relevant professional qualifications.

48 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers.

49 Asset valuations are co-ordinated internally by the Council's Valuation Service Team, with valuations carried out through a combination of the Council's internal

valuers and, where necessary, external valuers (RICS qualified). The Valuation Service Team ensures all valuations are carried out in accordance with the methodologies and bases for estimation set out in the professional standards of the Royal Institution of Chartered Surveyors.

Annex 2

Treasury Management and Investment Strategy Statement 2022/23

Introduction

1 Treasury management is the management of the Councils cash flows, borrowing and investments, and the associated risks. The Council 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 Council's prudent financial management.

2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2020 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3 Investments held for service purposes or for commercial profit are considered within this Strategy as per DLUHC guidance.

External Context

Economic background

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

5 The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme. Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

6 UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%. In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%.

The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs

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

Credit Update

8 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 have steadily edged down throughout the year to almost pre-pandemic levels. The 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.

9 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 upgrades.

10 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 Council's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Council's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest Rate Forecast

11 The Council's treasury advisors, Arlingclose, is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

12 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.

13 Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.9%, and 1.15% respectively. The risks around the 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. As ever, there will almost certainly be short-term volatility due to economic and political uncertainty and events.

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

Local Context

15 At 31st March 2021 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) is £454.4million, while usable reserves and working capital which are the underlying resources available for investment were £388.8 million. 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.

16 As at 31st March 2021 the Council had £261.8 million of external borrowing, a £156.7 million lease liability (including PFI and the Waste liability) and £341.1 million of internal investments. This is set out in further detail at Appendix B, and forecasts changes in these sums are shown in the balance sheet analysis at Table 1 below.

17 The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2022/23.

Table 1: Balance Sheet Summary and Forecast

Balance Sheet Summary	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
General Fund CFR	454.396	471.509	517.326	542.469	556.881
Less: Other debt liabilities	156.701	159.540	155.067	151.055	146.722
Loans CFR	**297.694**	**311.969**	**362.259**	**391.414**	**410.159**
Less: External borrowing	261.823	246.678	239.778	231.778	225.278
Internal (over) borrowing	**35.871**	**65.291**	**122.481**	**159.636**	**184.881**
Less: Balance Sheet Resources	388.803	354.200	347.300	341.300	335.300
(Investments) or New borrowing	**(352.932)**	**(288.909)**	**(224.819)**	**(181.664)**	**(150.419)**

* leases and PFI liabilities that form part of the Council's total debt
** shows only loans to which the Council is committed and excludes optional refinancing

Liability benchmark

18 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated and presented in the Capital Strategy, showing the lowest risk level of borrowing. This benchmark is currently -£42.2 million and is forecast to rise to £78.9 million over the next three years as the Council seeks to hold new capital borrowing requirements internally.

Borrowing Strategy

19 The total borrowing requirement at the end of 2021/22 is forecast to be £471.5 million (equivalent to the CFR). This is financed by historic external and a lease liability. The Council's aim is to both repay maturing debt, and where possible some of the existing debt when opportunities to do this arise. The Council also

considers new borrowing where it can be shown to be prudent and financial beneficial to do so. In 2021/22 £15.1 million maturing external debt was repaid with £6.9 million being forecast to be repaid in 2022/23.

20 The Councils chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Councils long-term plans change is a secondary objective.

21 The Councils 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 that in the event that the Council needed to borrow it would be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

22 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as official interest rates remain low, it is unlikely to be sustained in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this ‘cost of carry’ and breakeven analysis.

23 The Council may borrow short-term loans (normally for up to three month) to cover unexpected cash flow shortages.

Sources of Borrowing and Portfolio Implications

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

- HM Treasury’s Public Works Loan Board (PWLB) lending facility (PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans).
- UK local authorities
- 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 Gloucestershire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues

25 Capital finance may also 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.

26 The Council has previously raised the majority of its long-term borrowing from the PWLB, but it continues to investigate other sources of finance, such as local Council loans, the UK Municipal Bonds Agency and bank loans, that may be available at more favourable rates. The UK Municipal Bonds Agency is a more complicated source of finance so any decision to borrow from this source will be the subject of a separate report to Audit and Governance Committee.

27 The Council holds £33.050 million of Lender's Option Borrower's Option (LOBO) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBO's have options during 2022/23, however lenders are unlikely to exercise their options in the current low interest rate environment. The situation with these LOBOs will be kept under regular review and the Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Previously a further £8.0 million of loans with Barclays were classified as LOBOs, however Barclays have now fixed the interest rates on these loans until maturity. These are now classified as fixed rate market loans.

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

Debt Rescheduling

29 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. Some bank lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

30 Borrowing and rescheduling activity will be reported to the Audit and Governance Committee in the Annual Treasury Management Report, the Mid Year Report and any other treasury management reports presented to Audit & Governance Committee.

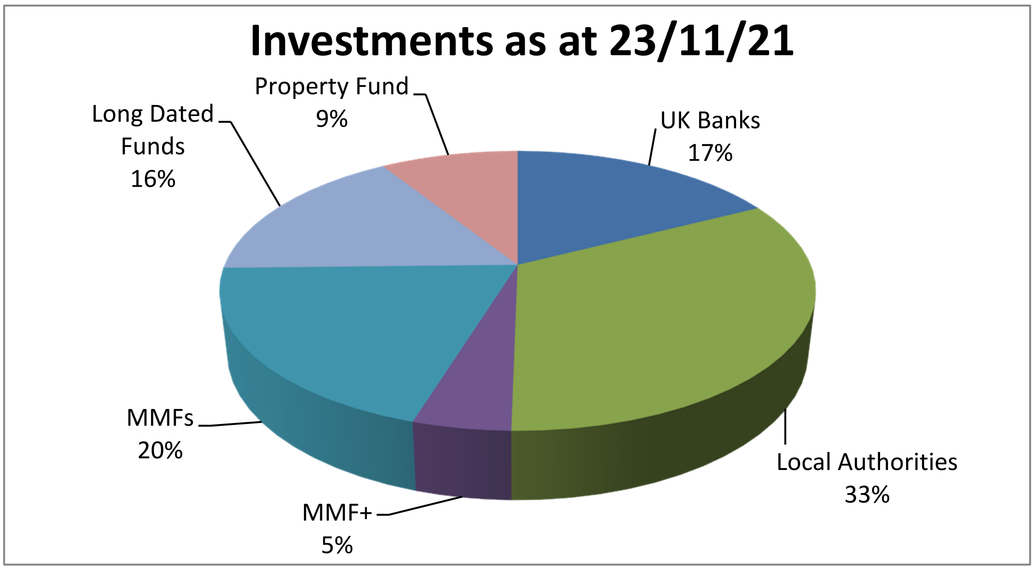
Treasury Investment Strategy

31 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2021/22 the Council's internal treasury investment balance has ranged between £304.5 million and £371.3 million. Balances are expected to start falling as internal borrowing starts to become a feature of future years.

32 The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of

incurring losses from defaults and the risk receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

33 Rates from traditional treasury investments in banks, building societies and with other local authorities have been at an all time low during 2021/22. To add value to the portfolio the Council has continued to diversify into more secure and / or higher yielding asset classes and this is expected to continue during 2022/23. This is especially the case for funds available for longer-term investment. The pie chart below shows how the Councils surplus cash is currently invested.



34 Under the IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its 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.

35 The Council money held in long dated funds and property funds (strategic pooled funds) is considered to be long term investments due to the fluctuations that occur in the underlying capital value of the deposits. The Council will hold these deposits for at least five years and will not mature these deposits unless the capital value is close to the original principal value deposited. All of the strategic pooled funds held provide regular dividend income to the Council.

36 The Council may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty), the time limits shown and the Responsible Investment Policy incorporated as part of the Treasury Management Policies.

Table 2: Approved Investment Counterparties

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£15m	Unlimited
Secured investments *	25 years	£30m	Unlimited
Banks (unsecured) *	13 months	£15m	Unlimited
Building societies (unsecured) *	13 months	£15m	£30m
Registered providers (unsecured) *	5 years	£15m	£30m
Money market funds *	n/a	£30m / fund	Unlimited
Strategic pooled funds	n/a	£30m / fund	£150m
Real estate investment trusts	n/a	£30m	£30m
Other investments *	5 years	£15m	£30m

* 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-

37 Table 2 should be read in conjunction with the notes below:

- **Credit Rating:**
  Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. 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 £100,000 per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

- **Government:**
  Loans, 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 Central Government may be made in unlimited amounts for up to 50 years.

- **Secured Investments:**
  These investments are secured on the borrower's assets, which limits the potential losses in the event of insolvency. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank 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.

- **Registered Providers (unsecured)**:
Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England). 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 Council 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 offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly. These accounts are treated as long term investments due to the variability of the capital value of the investment and will be held for a period of at least 5 years.

- **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. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

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

- **Operational bank accounts:**
The Council may incur operational exposures, for example though current 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 to a minimum. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

- **Risk assessment and credit ratings:**

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

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

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

Other information on the security of investments:

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

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

Investment Limits

39 The Council's holds general revenue reserves which would be available to cover investment losses. However, in order to limit this 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 £30.0 million. 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 3: Investment Limits

	Cash limit
Any group of pooled funds under the same management	£60m per manager
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£30m per country

Liquidity management:

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

41 The Council will spread its liquid cash over at least three 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

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

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

Credit risk indicator	Target
Portfolio average credit rating	A-

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

Liquidity risk indicator	Target
Total cash available within 3 months	£50m

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

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise / fall in interest rates	£853,000

46 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.

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

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	25%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

48 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.

49 **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 will be:

	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Upper Limit for total principal sums invested over 364 days	132.700	200.000	200.000	200.000	200.000

The Council's Approach to Responsible Investment

50 Following the Motion agreed by Council in November 2019 the Council has developed and implemented a Responsible Investment Policy, which rules out new investments in pooled funds that invest in fossil fuel companies.

51 For future Treasury Management investment the Council will follow the approach below.

i. For direct investments, the Council will seek to ensure that counterparties (excluding the UK Government and other UK Local Authorities) have no direct investment in Fossil Fuel companies prior to investing.
ii. For additional investments into Pooled Funds the Council will seek to ensure that any fund used does not have direct exposure to Fossil Fuel investments prior to investing.

Non Treasury Investment Strategy

52 The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments),
- to support local public services by lending to or buying shares in other

organisations (service investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

53 This section of the report is concerned with meeting the requirements of statutory guidance issued by the government in January 2018 and focuses on the second and third of these categories, service and commercial investments.

Service Investments: Loans

54 The Council can lend money to support local public services and stimulate local economic growth. The Council does not currently have any service investments.

Service Investments: Shares

55 The Council holds shares costing £1 in Ubico Ltd. The fair value of the council's interest in the company at 31st March 2022 is considered to be nil, since it is a wholly local authority owned not-for-profit 'Teckal' company. As a 'Teckal' company it is treated as if it were an in-house department and the shareholder councils are able to enter into service contracts with the company without undertaking an EU compliant procurement process.

Commercial Investments: Property

56 The Council has not invested in Commercial Property to date. Should the Council invest in property and in accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

57 The Council will assess the risk of loss before entering into and whilst holding property investments by producing a comprehensive business plan and monitoring performance on an ongoing basis.

Loan Commitments and Financial Guarantees

58 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. The Council has guaranteed to cover the liabilities associated with the pensions of ex- employees following the transfers of council services to external bodies. These arrangements are monitored and assessed to ensure that any provision for possible liabilities are made and included within the Statement of Accounts.

Capacity, Skills and Culture

59 The Council provides training from our Treasury Management Advisors to members of the Audit and Governance Committee on an annual basis, to ensure that they are fully aware of the investments included in the Treasury Management Strategy and Investment Strategy. This training will also cover the requirements of the Capital Strategy and the non-Treasury Management investments. This

ensures that members can take informed decisions on the investments being included in the strategies and have the opportunity to challenge their use to ensure that they fully understand the implications of the investment.

60 Where commercial deals are to be negotiated, Finance will be involved to ensure that the core principles of the prudential framework and of the regulatory regime within which local authorities operate is taken into account.

Investment Indicators

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

62 The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans, if any. It assumes that balances for treasury investments reduce as reserves reduce.

63

Total investment exposure	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Treasury management investments	352.9	288.9	224.8	179.7	146.4
Service investments: Loans	0.0	0.0	0.0	0.0	0.0
Commercial investments: Property	0.0	0.0	0.0	0.0	0.0
Total Exposure	**352.9**	**288.9**	**224.8**	**179.7**	**146.4**

64 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.

Investments funded by borrowing	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Treasury management investments	-35.9	-65.3	-122.5	-159.6	-184.9
Commercial investments: Property	0.0	0.0	0.0	0.0	0.0
Total Funded by Borrowing	**-35.9**	**-65.3**	**-122.5**	**-159.6**	**-184.9**

65 **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. Where a negative return is shown, this has occurred as costs are greater than investment income received.

Investments net rate of return	2020/21 Actual %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %
Treasury management investments	1.53	1.43	1.40	1.40	1.40
Service investments: Loans	0.00	0.00	0.00	0.00	0.00

Other items

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

Financial Derivatives

67 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 CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

68 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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

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

Markets in Financial Instruments Directive

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

2022/23 Minimum Revenue Provision Statement

72 Where the Council finances capital expenditure by debt, it must put aside resources

to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to MHCLG (now DLUHC) Guidance most recently issued in 2018.

73 The broad aim of the 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.

74 The Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates the options recommended in the Guidance.

75 In line with Council policy on the repayment of debt, and with the continuation of capital grants by government, the Council has not borrowed externally to fund the capital programme since 2010. Opportunities are now limited for the repayment of debt early due to the low interest rate environment, meaning that high premiums would need to be paid should the Council wish to restructure or repay external debt early. Maturing debt will continue to be redeemed over the next few years, and where opportunities present to repay internal borrowing this will be by way of a voluntary revenue provision.

76 In order to ensure that the MRP charge remains prudent, the Council regularly reviews its Capital Financing Requirement. To reduce the amount of excess MRP set aside, the Council changed its policy for supported capital expenditure in 2015/16. The method used is similar to other local authorities and sets aside a fixed sum of MRP each year. For GCC the fixed sum is currently £6.2 million. This charge still allows for a prudent provision for the repayment of existing debt and ensures that Prudential Indicators are not breeched.

77 The asset life of capital assets obtained through the capital programme will form the basis of calculating an annual MRP provision for any new borrowing requirement going forward. For any commercial related investments a business case review will be carried out and an appropriate provision for the repayment of any debt taken, set aside.

78 MRP in respect of PFI and finance leases brought on Balance Sheet under the IFRS-based Code of Practice will match the annual principal repayment for the associated deferred liability. Where former operating leases have been brought onto the balance sheet on 1st April 2022, due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.

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

Arlingclose's Economic and Interest Rate Forecast

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

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

Underlying Assumptions:

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.

- Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.

- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.

- These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.

- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.
- Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.
- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Forecast:

- The MPC will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.
- Arlingclose therefore expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside, but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.
- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.
- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.
- The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

Appendix B

EXISTING PORTFOLIO PROJECTED FORWARD

	Portfolio 23-Nov-21 Actual £m	Average Rate %	31-Mar-22 Estimate £m	31-Mar-23 Estimate £m	31-Mar-24 Estimate £m	31-Mar-25 Estimate £m
External Borrowing						
Fixed Rate – PWLB	213.773	4.70	205.628	198.728	190.728	184.228
Fixed Rate – Market	33.050	4.24	33.050	33.050	33.050	33.050
Variable Rate – PWLB	0.000	0.00	0.000	0.000	0.000	0.000
Variable Rate – Market	8.000	5.00	8.000	8.000	8.000	8.000
Total External Borrowings	**254.823**	**4.65**	**246.678**	**239.778**	**231.778**	**225.278**
Other long-term liabilities (PFI)	159.540		159.540	155.067	151.055	146.722
Total External Debt	**414.363**		**406.217**	**394.845**	**382.832**	**372.000**
Treasury Investments:						
Managed in house						
- Short term deposits and monies on call and Money Market Funds	215.280	0.43	186.937	128.626	89.571	59.786
- Long Term investments (over 12 months)	35.000	0.58	50.000	50.000	50.000	50.000
Managed externally / Strategic Funds	85.000	4.14	85.000	85.000	85.000	85.000
Total Investments	**335.280**	1.37	**321.937**	**263.626**	**224.571**	**194.786**
Net (Borrowing) / Investment Position	**(79.083)**		**(84.280)**	**(131.219)**	**(158.261)**	**(177.214)**