Full Council

7th December 2021

Report of: Service Director: Finance

Title: Treasury Management Mid-Year Report 2021/22

Ward: City Wide

Member Presenting Report: Deputy Mayor – Finance, Governance and Performance

Recommendation
That the Mid-Year Treasury Management report for 2021/22 is noted.

Summary
This report meets the treasury management regulatory requirement that the Council receive a Mid-Year Treasury review report. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans.

The significant issues in the report are:
There are no policy changes to the TMSS; the details in this report update the position in light of the updated economic position and budgetary changes. The authority has a net borrowing requirement of £260m over the next five years but is not planning on undertaking any new borrowing during the financial year while the Council hold's adequate treasury investments to meet the liquidity requirements of the Council. However, should there be a risk that borrowing costs will rise quicker than expected the Council will consider borrowing to reduce the Council's internal borrowing position and reduce its interest rate risk exposure.

Policy

1. There are no policy implications as a direct result of this report.

Consultation

2. **Internal**
   Strategic & Service Directors.
3. **External**
   The Council's Treasury Management advisers

Purpose / Context of the report:

4. This report meets the treasury management regulatory requirement that the Council receive a mid-year treasury review report. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs).
5. That the mid-year report is structured to highlight:
   - The economic outlook;
   - The actual and proposed treasury management activity (borrowing and investment);
   - The key changes to the Council's capital activity (the prudential indicators {PIs}).

Background

6. Treasury management is defined as:

   "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
7. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Treasury management operations aim to ensure that cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.
8. 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 operations. The management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Introduction

9. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised in 2017) has been adopted by this Council. The primary requirements of the Code are:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;

- Receipt by the Full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year;
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions;
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated bodies are Overview and Scrutiny Management Board and Audit Committee.

10. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the 2021/22 financial year to 30 September 2021;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken or planned during 2021/22;
- The Council's capital expenditure and prudential indicators;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

Key Changes to the Treasury and Capital Strategies

11. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes.
12. The 2021–2026 Treasury Strategy (approved 23rd February 2021) identified a medium term net borrowing requirement of £260m to support the existing and future Capital Programme with the debt servicing costs met from revenue savings from capital investment and the economic development fund. The Council's agreed policy is to defer borrowing while it has significant levels of treasury cash balances (£221m at September 2021, £100m estimated for March 2022).
13. However the Council will undertake long term borrowing when rates are deemed advantageous to reduce the Council's exposure to interest rate risk. No borrowing has been undertaken during the year and it is currently planned that no new borrowing will be undertaken during the remainder of the year. Further borrowing could be taken if:
    - short term investments fall at a higher pace than expected increasing the liquidity risk of the authority and or;
    - there is another significant change in markets and long term borrowing is deemed advantageous the authority will borrow over periods determined as the most appropriate to reduce the authorities exposure to interest rate risk.

Analysis of Debt and Investments

14. A summary of the of the Council's debt and Investment position as at 30th September 2021 (including forecast at 31st March 2022) compared with 31st March 2021 is shown in the table below:

Debt & Investments	31st March 2021		31st September 2021		31st March 2022	
	Actual		Actual		Forecast	
	£m	Rate%*b	£m	Rate%*b	£m	Rate%*b
Long Term Debt – PWLB Fixed	331	4.63	331	4.63	331	4.63
Long Term Debt – Market LOBO*a	70	4.09	70	4.09	70	4.09
Long Term Debt – Market Fixed	50	4.04	50	4.04	50	4.04
Estimated "New" Short Term Borrowing	-	-	-	-	-	-
Total Debt	**451**	**4.48**	**451**	**4.48**	**451**	**4.48**
Investment	207	0.30	221	0.08	100	0.08
Net Borrowing Position	**244**	**-**	**230**		**351**	

*a Lender option Borrower option, *b reflects the average rate for the year taking account of new loans and repayments.

We are currently achieving a return of 0.08% on our investments for the period to 30 September 2021. The return for the year is expected to be similar, circa 0.08% due to the base rate remaining at 0.10% along with high levels of liquidity in the financial markets depressing investment rates further. Bank rate is expected to remain at 0.10% for the remainder of the financial year.

The authority's advisors are forecasting the base rate to remain flat (0.10%) at least until 2nd Quarter of 2022. Long term interest rates (PWLB) are expected to remain at or around 2% (for 25 – 50 year term) for the remainder of the year and rise marginally over the medium term.

Economic Update

15. **UK. MPC meeting 24th September 2021** - The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

    There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had indicated that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery too early by an increase in Bank Rate. The meeting "flagged" a potential danger of labour shortages that could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. The MPC discounted sharp increases in monthly inflation in the pipeline for late 2021 as these were largely caused by the events of a year ago including the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system and the MPC were prepared to look through the "temporary" spike in inflation.

16. However, in September the MPC's "words" indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. The MPC emphasised its concern about inflationary pressures and reaffirmed its commitment to the 2% inflation target in its statement, indicating that it was now willing to look through the "flagging" economic recovery during the summer to prioritise bringing inflation down next year.

    This suggests a reversal of its priorities as set out in previous meetings, that indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. In August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021. However, the concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

17. Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks "unlikely" as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

    The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

    - Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
    - Raising Bank Rate to 0.50% before starting on reducing its holdings.
    - Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
    - Once Bank Rate had risen to at least 1%, it would start selling its holdings.

18. **COVID-19 vaccines.** These have been the "game changer" which have boosted confidence that *"life in the UK could largely return to normal during the summer"* after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of "pent-up" demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

19. **EU**. The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these

as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

20. **China**. After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth.

21. **World growth**. World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

22. **Supply shortages**. The pandemic and extreme weather events have been disruptive of extended worldwide supply chains. At the current time there are queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping along with a shortage of raw materials has had a disruptive impact on production in many countries. Many western countries are also having difficulty in filling job vacancies. It is expected that these issues will be gradually resolved, but they are currently contributing to an upward spike in inflation and shortages of materials and goods on shelves.

Interest rate forecasts

23. The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Group Interest Rate View 29.9.21										
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

PWLB rates are certainty rates, gilt yields plus 180bps

24. The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

25. As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 23/24 and a third one to 0.75% in quarter 4 of 23/24.

26. **Significant risks to the forecasts**

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term impact to the economy.
- The Government implements an austerity programme that supresses GDP growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding Quantitative Easing.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets risks
- Geo-political risks

27. **The balance of risks to the UK economy: -**

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

28. **Forecasts for Bank Rate**

Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the rise to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons: -

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to how to act.
- Will current key supply shortages impact economic activity in some sectors.
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. In addition the Government's upcoming budget in October could also end up in reducing consumer spending power.
- Consumers are holding around £200bn of excess savings from the pandemic so when will these sums be spent?
- There are 1.6 million people coming off furlough at the end of September; how

many of those will not have jobs on 1st October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months and alleviate the MPC's current concerns.

- There is a risk that there could be further unwelcome impacts from Covid front, in addition to the flu season this winter, which could depress economic activity.

In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon.

It also needs to be noted that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis in March 2020. At any time, the MPC could decide to take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

29. **Forecasts for PWLB rates and gilt and treasury yields**

As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Federal Reserve take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of Quantitative Easing purchases of their national bonds, without causing a "panic" reaction in financial markets.
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

These forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period and that there are no major problems in international relations that would have a major impact on international trade and world GDP growth.

30. **Bond yields / PWLB rates**.

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates.

US – The US approved a significant stimulus package that "unsettled" the financial markets as it was much bigger than other western economies, at a time in the US when: -

- A fast vaccination programme has enabled a rapid opening up of the economy.
- The economy had already been growing strongly during 2021.
- It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to cause inflationary pressures more in the US than in other countries.
- And the Federal Reserve was still providing monetary stimulus through monthly Quantity Easing purchases.

These factors could cause an excess of demand in the economy which could then cause stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Federal Reserve to take much earlier action to start tapering monthly Quantitative Easing purchases and/or increasing the Federal Reserve rate from near zero.

As the US financial markets are the biggest financial markets in the world, any trend upwards in the US may impact and influence financial markets in other countries, noting movement in US treasury yield have in the past correlated with gilt yields. This is a significant **UPWARD RISK** exposure to the above forecasts for longer term PWLB rates. However, gilt yields and US treasury yields do not always move in unison.

There are also possible **DOWNSIDE RISKS** from the large sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will unfold when the Bank of England begins not reinvesting maturing gilts and then later selling gilts remains to be seen.

The balance of risks to medium to long term PWLB rates: -

- There is a balance of upside risks to forecasts for medium to long term PWLB rates.

31. **A new era – a fundamental shift in central bank monetary policy**

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Federal Reserve, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target, to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US before consideration would be given to increasing rates.

- The Federal Reserve has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.

For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.

Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt. On the flip side, higher levels of inflation will help to erode the real value of total public debt.

Investment Portfolio 2021/22

32. In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in the "Economic Update" it is now impossible to earn the level of interest rates commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%, while some entities, including more recently the Debt Management Account Deposit Facility (DMADF), a government agency, are offering negative rates of return in some shorter time periods.

    Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before mid-2023, investment returns are expected to remain low.

33. The Council held £221m of Treasury investments as at 30th September 2021 (£207m at 31 March 2021) with an average maturity of 61 days. These investments are predominately with local authorities, money market funds and UK banks. The investment portfolio yield for the first six months of the year was 0.08%. The standard comparator for investment performance is the benchmark 7 day rate (LIBID)[1,] which for the period was "negative" 0.08%. The benchmark for 1 and 3 month deposits were (0.07%) and (0.05%) respectively.

    1LIBID – London Interbank Bid rate is a recognised reference rate to benchmark short-term investment interest rates.

34. The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.

35. The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function

Borrowing

36. The Capital Financing Requirement (CFR) denotes the Council's underlying need to borrow for capital purposes. The Council's CFR at 31 March 2022 is estimated to be £929m. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing).

37. The balance of borrowing between external and internal is generally driven by market conditions and forecasts of future cash flows and interest rates. At the 31st March 2021 the Council had external borrowings of £584m and has utilised £341m of internal cash in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require on-

going monitoring in the event that upside risk to gilt yields prevails.

38. However, internal borrowing is a temporary measure that takes advantage of low interest rates and will ultimately be replaced by more expensive external borrowing as the cash used is required elsewhere. The timing and amount of new external borrowing is therefore dependent on capital spending decisions, future cash flows and forecasts of interest rates.

39. The Council does have an underlying need to borrow for capital purposes, along with the Council expecting to hold significant treasury investments for the remainder of the year to meet liquidity purposes. The Council is therefore not planning on any further borrowing for the remainder of the year. This will reduce the net financing costs of the authority along with reducing the Council's exposure to counterparty risk.

    However, should there be a risk that borrowing costs will rise quicker than expected the Council will consider borrowing to reduce the Council's internal borrowing position and reduce its interest rate risk exposure.

40. PWLB rates dropped slowly during April and July and then rose sharply during September as a result of inflation concerns. The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date.

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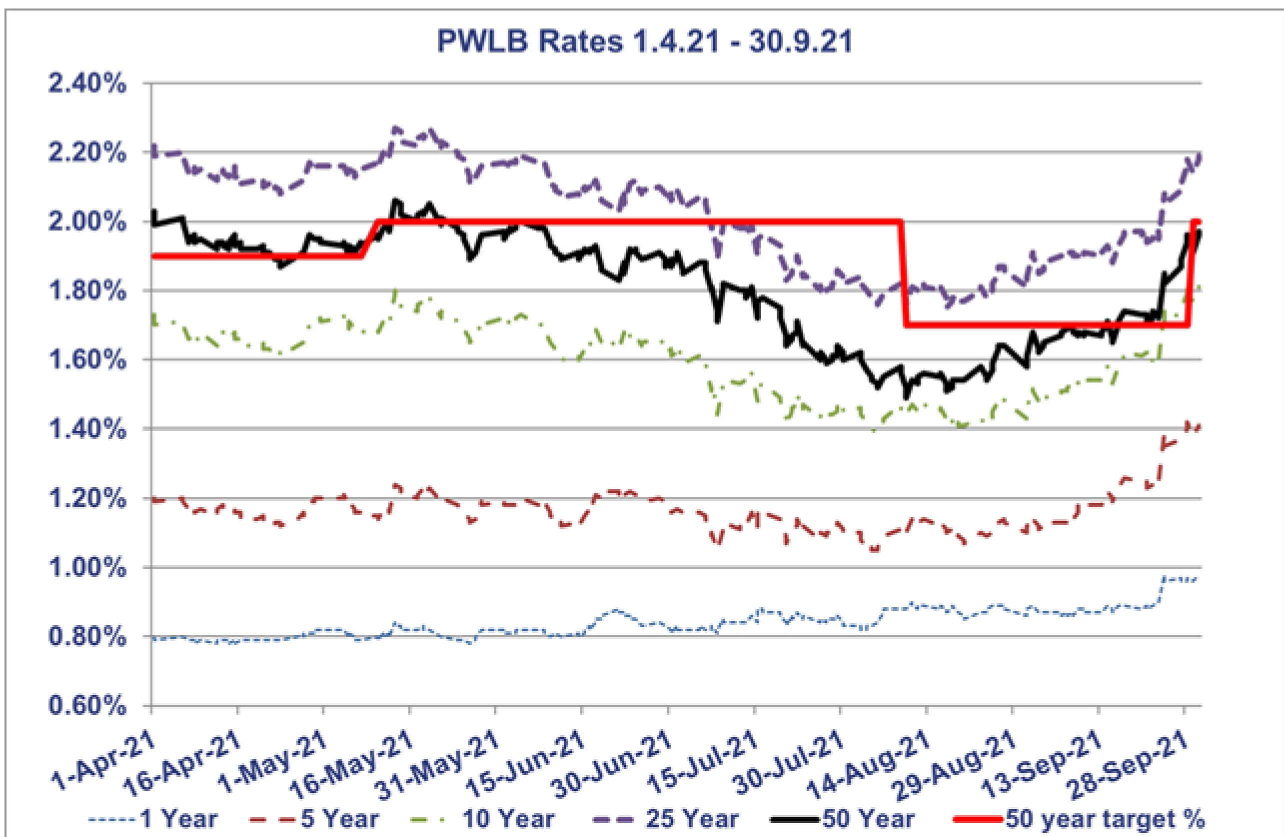

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

Debt Rescheduling

41. Debt rescheduling opportunities have been limited in the current economic climate given the consequent structure of interest rates. The authority's debt portfolio is made up of long dated loans (PWLB £331m, Market Debt (LOBOS) £70m and Market Debt (Fixed) (£50m) averaging 32 years. The estimated penalty to repay the PWLB loans early is £270m, taking the total cost to £601m. In respect of the market loans, where indicative prices have been provided, a similar level of penalty has been quoted.

42. The total life cycle cost of rescheduling loans on a discounted cash-flow basis has been reviewed with no loans providing a positive cash-flow benefit to the authority. This would in part be due to large early repayment penalties that the authority will incur.

43. For these reasons no debt rescheduling has been undertaken during the first six months of the year and none is anticipated for the remainder of the year.

Ethical Policy

44. An Ethical Investment Policy is incorporated within the Treasury Management Practice Statements (TMPS). The City Council currently invest surplus funds with Banks and Building Societies either directly or via the Money Markets in the form of instant access cash deposit accounts, money market funds or on fixed term deposit and with other local authorities. The City Council's ethical investment policy is based on the premise that the City Council's choice of where to invest should reflect the ethical values it supports in public life. The City Council will not knowingly invest in organisations whose activities include practices which directly pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the mission and values of the City Council.

The Council's Capital Position (Prudential Indicators)

45. This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

46. This table shows the latest estimates for capital expenditure:

Capital Expenditure by Service	2021/22 Approved Programme £m	2021/22 Period 6 Forecast £m
Non-HRA	210	185
HRA	111	87
Total	**321**	**272**

47. The latest capital monitoring report for the end of September 2021 sets out a capital forecast of £272m detailed within the period 6 monitoring report presented to Cabinet in November 2021.

Financing of the Capital Programme

48. The table below draws together the capital expenditure plan and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	**2021/22 Approved Programme £m**	**2021/22 Period 6 Forecast £m**
Total spend	**321**	**272**
Financed by:		
Capital receipts	85	85
Capital grants	92	100
Revenue / Reserves	13	3
HRA – Self Financing	40	28
Prudential Borrowing – Increase in Capital Financing Requirement	91	56
Total financing	**321**	**272**

Capital Financing Requirement (CFR) & Operational Boundary

49. The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose and it also shows the expected debt position over the period. This is termed the Operational Boundary.

Capital Financing Requirement	2021/22 Original Estimate £m	2021/22 Latest Estimate £m
CFR – non housing	738	684
CFR – housing	245	245
Total CFR	**983**	**929**

External Debt (Operational Boundary)	2021/22 Approved Indicator £m
Borrowing	561
Other long term liabilities*	132
Total debt 31 March	**693**

** On balance sheet PFI schemes and finance leases etc.*

50. The revised Capital Financing Requirement is based on the actual CFR as at 31 March 2021 (£886m) increased by in-year capital expenditure financed by borrowing (£56m) and reduced by the minimum revenue provision (MRP) for repayment of debt and the repayment of the debt facilities within other long term liabilities (£13m).

Limits to Borrowing Activity

51. The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2021/22 Original Estimate £m	2021/22 Latest Estimate £m
Gross borrowing	561	451
Plus other long term liabilities*	132	132
Gross borrowing & long term Liabilities	**693**	**583**
CFR* (year-end position)	983	929

** Includes on balance sheet PFI schemes and finance leases etc.*

52. The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

53. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003.

Authorised limit for external debt	**2021/22 Approved Indicator £m**
Total Borrowing	**1,000**

Proposal

54. That the Mid-Year Treasury Management report for 2021/22 is noted.

Other Options Considered

55. None

Risk Assessment

56. Borrowing and lending activity is reported to the Mayor.
The principal risks associated with treasury management are:

Risk	**Mitigation**
Loss of investments as a result of failure of counterparties	Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties
Increase in the net financing costs of the authority due to borrowing at high rates of interest / lending at low rates of interest	Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs)

Public Sector Equality Duties

57. a) Before making a decision, section 149 Equality Act 2010 requires that each decision-maker considers the need to promote equality for persons with the following “protected characteristics”: age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex, sexual orientation. Each decision-maker must, therefore, have due regard to the need to:

i) Eliminate discrimination, harassment, victimisation and any other conduct prohibited under the Equality Act 2010.

ii) Advance equality of opportunity between persons who share a relevant protected characteristic and those who do not share it. This involves having due regard, in particular, to the need to --

- remove or minimise disadvantage suffered by persons who share a relevant protected characteristic;
- take steps to meet the needs of persons who share a relevant protected characteristic that are different from the needs of people who do not share it (in relation to disabled people, this includes, in particular, steps to take account of disabled persons' disabilities);

- encourage persons who share a protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.

iii) Foster good relations between persons who share a relevant protected characteristic and those who do not share it. This involves having due regard, in particular, to the need to –

- tackle prejudice; and
- promote understanding.

b) There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Legal and Resource Implications

Legal

The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

(Legal advice provided by Tim O'Gara - Service Director - Legal and Democratic Services)

Financial

(a) Revenue

The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan. Any additional operating costs will have to be contained within the revenue budget of the relevant department.

(Financial advice provided by Jon Clayton - Capital and Investments Manager)

(b) Capital

Not applicable

Land

Not applicable

Personnel

Not applicable

Appendices:

None

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

Background Papers:

None