

Report to Cabinet

Subject: Prudential Code Indicator Monitoring 2021/22 and Quarterly Treasury Activity Report for Quarter ended 31 December 2021

Date: 27 January 2022

Author: Head of Finance and ICT

Wards Affected

All

Purpose

To inform Members of the performance monitoring of the 2021/22 Prudential Code Indicators, and to advise Members of the quarterly Treasury activity as required by the Treasury Management Strategy.

Key Decision

This is **not** a key decision.

Recommendation

That:

1. Members note the report, together with the Treasury Activity Report 2021/22 for Quarter 3 at Appendix 1, and the Prudential and Treasury Indicator Monitoring 2021/22 for Quarter 3, at Appendix 2.

1 Background

- 1.1 The Council is required by regulations issued under the Local Government Act 2003 to report on its Prudential Code indicators and treasury activity. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 For 2021/22 the minimum reporting requirements are that the Full Council should receive the following reports:

- An annual Treasury Strategy in advance of the year (the TMSS, considered by Cabinet on 11 February 2021 and subsequently approved by Full Council on 4 March 2021);
- A mid-year treasury update report;
- An annual review following the end of the year describing the activity compared to the Strategy.

In accordance with best practice, quarterly monitoring reports for treasury activity are provided to Members, and this exceeds the minimum requirements.

1.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report provides details of the position at 31 December 2021 and highlights compliance with the Council's policies.

2 Proposal

2.1 Economic update - UK

General:

At its November meeting, the Monetary Policy Committee's (MPC) concluded that it needed assurance that the labour market would get over the end of the furlough scheme on 30 September without unemployment increasing sharply, and their decision was therefore not to raise Bank Rate. However, at its meeting on 16 December MPC members voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% in the face of building inflationary pressures, as well as unanimously deciding to leave unchanged its programme of Quantitative Easing (QE) purchases, due to finish in December 2021.

GDP growth in October was a disappointing 0.1% suggesting that economic growth had already slowed significantly before the Omicron variant was discovered in late November. Early evidence suggests growth in November will be better, however at such low rates of growth the Government's "Plan B" restrictions could cause the economy to contract in December.

Labour market statistics for the three months to October were released on 14 December. The fallout after the end of the furlough scheme on 30 September, by which time affected approximately one million people, was smaller and shorter than the Bank of England had feared. Unemployment did not increase hugely in October, indeed, vacancies rose to a record 1.2m in the three months to November - showing that there were acute shortages of labour.

The CPI inflation figure for November was released on 15 December, rising further from 4.2% to 5.1%, reconfirming that inflationary pressures had been building sharply. However, Omicron also caused a sharp fall in world oil and other commodity prices, and gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies. Other elements of inflation are also deemed transitory, eg. the price of goods being forced up by supply shortages, and shortages of shipping containers due to ports being clogged have caused huge increases in shipping costs. These issues reduced during the second half of 2021 and are likely to clear during 2022, when prices are expected to fall back to more normal levels. Gas prices and electricity prices should also reduce once winter has passed and demand falls away.

The Government has offered some further fiscal support to the economy, targeted mainly at the hospitality sector. Due to the huge cost of such support to date, this is likely to remain limited, and targeted on narrow sectors. It may therefore effectively be left to the MPC and its monetary policy to support economic growth - at just the time when the threat posed by rising inflation is near to peaking. Indications are that the MPC is now concerned that inflationary pressures are building and need concerted action to counter them, indicating that there will be more Bank Rate increases to come, with financial markets predicting 1% by the end of 2022. The 8-1 vote to raise the rate in December shows that there is firm agreement that inflation now poses a threat, especially after the CPI figure hit a 10-year high. The MPC commented that “there has been significant upside news” and that “there were some signs of greater persistence in domestic costs and price pressures”. However, it also commented that “the Omicron variant is likely to weigh on near-term activity”. There was no reference in December to an expectation for inflation to be below the 2% target in two years’ time, whereas at the November meeting the MPC made reference to the suggestion that the markets had gone too far in expecting interest rates to rise to over 1% by the end of the year. All these comments indicate that there has been a material reappraisal by the MPC of inflationary pressures since its last meeting, and the Bank also increased its forecast for inflation to peak at 6% in April, rather than at 5%.

The Bank retained its guidance that only a “modest tightening” in policy will be required, suggesting that it is not thinking that it will need to increase interest rates too much further. A typical policy tightening cycle usually involves rates rising by 0.25% four times in a year. “Modest” suggests something slower than that, possibly raising interest rates two or three times in 2022 to 0.75% or 1.00%. A considerable part of the current inflationary pressure is transitory and should subside naturally - and since economic growth is likely to be weak over the next few months, this would appear to indicate that the monetary tightening cycle is likely to be comparatively short.

Covid-19:

The UK's successful Covid-19 vaccination programme boosted confidence that life in the UK could largely return to normal during the second half of 2021. The emergence of the Omicron variant in November threatened the Christmas holidays but the Government decided against more severe restrictions in the hope that whilst this strain was highly contagious it might be milder, and would not therefore overwhelm hospitals. The key question remains whether further virus mutations might 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.

2.2 Economic update – Rest of the World

US – A huge package of financial stimulus has already been pushed through by the Democratic party, and approval for a further major package is being sought although this is currently mired in political haggling. Financial markets were alarmed that such stimulus came at a time when a fast vaccination programme had enabled a rapid opening up of the economy in 2021, the economy was growing strongly, and there was little spare capacity in the economy. This has led to excess demand and strong inflationary pressure, leading the Federal Reserve (Fed) to start tapering its QE purchases. Three rate rises are also expected during 2022, followed by a further three in 2023 and two in 2024 – taking rates back above 2%.

EU – The European Central Bank (ECB) announced on 16 December 2021 that it would begin reducing its QE purchases by a half from October 2022. Although headline inflation reached 4.9% in November, over half of this was due to energy – but oil and gas prices are expected to fall sharply after the winter. As overall inflation falls in 2022 it is likely that the ECB will leave its central rate below zero over the next two years. The major difficulty in recent years has been that inflation has remained stubbornly below the target rate of 2% despite major programmes of monetary easing.

World growth - World growth was in recession in 2020 but recovered during early 2021, until losing 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 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.

2.3 Interest rate forecast

The Council's Treasury management advisers, Link Asset Services (LAS) provided its latest forecast of interest rates on 20 December 2021 and these

together with the previous rates provided on 29 September are shown in the tables below. PWLB rates in the table are based on the Certainty Rate which include a 0.2% reduction on the standard rates. A comparison of these forecasts shows that PWLB rates have fallen, and an acceleration in the rate of increase in Bank Rate as inflation is now posing a greater risk.

Link Group Interest Rate View 20.12.21														
	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	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

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				

The Covid-19 pandemic has done huge economic damage to the UK, and to economies around the world. After the Bank of England's emergency action in March 2020 to cut Bank Rate, first to 0.25% and then to 0.10%, it remained unchanged until the 16 December 2021 meeting, when it was raised back to 0.25%, the Bank of England becoming the first major western bank to raise rates.

The next increase in Bank Rate may come in February 2022, depending on the severity of the Omicron impact. If further lockdowns are imposed this could create a barrier to the MPC raising rates. With inflation expected to peak between 5% and 6% in April, the MPC may instead wish to take action in May, when the Quarterly Monetary Policy Report is released. However, rises in gas and electricity prices in October 2021, as well as those due in April 2022, other price increases caused by supply shortages, and increases in taxation, will all deflate consumer spending power without the MPC taking any action on Bank Rate to cool inflationary pressures. Consumers are however holding around £160bn of excess savings not used during the pandemic, and concerns remain about the timing of such potentially massive spending.

The December 2021 MPC meeting was more concerned with combatting inflation over the medium term than supporting economic growth in the short term. Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022. However, the MPC will be seeking to normalise Bank Rate over the next three years so that its main monetary policy tool is available to use in time for the next downturn. Link forecast that Bank Rate will rise by 0.25% in Q1 of each year from 2023 to recognise this upward trend in Bank Rate, but it acknowledge that the actual timing of such rises is difficult to predict.

Covid mutations remain a major potential downside threat in the forecasts. With the high level of uncertainty on multiple fronts, it is likely that Link's forecasts will need to be revised again in the near future in line with the prevailing economic news.

2.4 Investment strategy

The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by Council on 4 March 2021, and sets out the Council's investment priorities as:

- Security of capital;
- Liquidity;
- Yield.

Whilst the Council will always seek to obtain the optimum return (yield) on its investments, this will at all times be commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate either to keep investments short term to cover cash flow needs, or to extend the period up to 12 months with highly rated financial institutions, selected by the use of the LAS creditworthiness methodology (see below) which includes consideration of sovereign ratings.

Investment counterparty limits for 2021/22 are generally **£3m** per individual counterparty, however a higher limit of **£4m** per Money Market Fund is considered prudent since such funds are already by definition highly diversified investment vehicles. There is no limit on Investment with the Debt Management Office (DMO) since this represents lending to central government. The Chief Financial Officer has delegated authority to vary these limits as appropriate, and then to report any change to Cabinet as part of the next quarterly report.

Members are advised that no new variations have been made during Q3 of 2021/22, having been previously advised of an extension to £4m with Santander and a limitation to £3m with the CCLA PSDF, both for operational reasons. These variations remain in place.

Limits with investment counterparties have not exceeded the prevailing levels approved by the CFO during the period 1 April to 31 December 2021.

Credit ratings advice is taken from LAS and the Chief Financial Officer has adopted the LAS credit rating methodology for the selection of investment counterparties. This employs a sophisticated modelling approach utilising credit ratings from all three of the main rating agencies to give a suggested maximum duration for investments. Accordingly it does not place undue reliance on any one agency's ratings.

The methodology subsequently applies an "overlay" to take account of positive and negative credit watches and/or credit outlook information, which may increase or decrease the suggested duration of investments. It then applies a second overlay based on the credit default swap spreads for institutions, the monitoring of which has been shown to give an early warning of likely changes in credit ratings. It also incorporates sovereign ratings to ensure selection of counterparties from only the most creditworthy countries. The current Treasury Strategy permits the use of any UK counterparties subject to their individual credit ratings under the LAS methodology. It also permits the use of counterparties from other countries with a minimum sovereign rating of AA. For information, the UK currently has a rating of AA minus.

The LAS modelling approach combines all the various factors in a weighted scoring system and results in a series of colour coded bands which indicate the creditworthiness of counterparties. The colour bandings are as follows:

- Yellow 5 years (UK Government debt or its equivalent)
- Dark pink 5 years for Ultra Short Dated Bond Funds (credit score 1.25)
- Light pink 5 years for Ultra Short Dated Bond Funds (credit score 1.50)
- Purple 2 years
- Blue 1 year (nationalised or semi nationalised UK banks only)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Significant downgrades by the Ratings agencies have not materialised since the beginning of the Covid-19 crisis in March 2020. Where changes were made these were generally limited to "outlooks", however as economies have begun to reopen, there have been some instances of previous reductions to ratings being reversed.

Credit ratings are monitored weekly and the Council is also alerted to interim changes by its use of the LAS creditworthiness service, however ratings under the methodology, including sovereign ratings, will not necessarily be the sole determinant of the quality of an institution. Other information sources used will include the financial press, share price and other such information pertaining to

the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The ultimate decision on what is prudent and manageable for the Council will be taken by the Chief Financial Officer under the approved scheme of delegation.

2.5 Treasury Activity during Quarter 3 of 2021/22

The Treasury Activity Report for the quarter ended 31 December 2021 is attached at Appendix 1, in accordance with the Treasury Management Strategy.

Members will note that investment interest of £51,173 was generated from MMF activity, term deposits with banks and building societies, and the property fund, during the period from 1 April to 31 December 2021. This represents an overall equated rate for the Council of 0.25% and outperforms the benchmark 7 day LIBID rate, which averaged negative 0.07% for the same period. In cash terms this represents additional income to the General Fund of around £65,500 (since at a negative rate there would have been a cost to the Council to place funds) and was achieved by positive investment management, and in particular a favourable return on the property fund (see below). Performance in respect of the longer 3 month LIBID rate, which averaged negative 0.02%, still represents additional income of £55,300.

During the period from 1 April to 31 December 2021, significant use was made of the Council's three Money Market Funds (MMFs). These are AAA rated investment vehicles which allow the pooling of many billions of pounds into highly diversified funds, thus reducing risk. The current rates of return on these funds are between 0.05% and 0.16%, which whilst exceptionally low, remain generally higher than overnight treasury deposit rates, and the rate obtainable from the Debt Management Office (DMO), which is frequently negative for short term deposits.

The Council made an investment of £1m in the CCLA Local Authority Property Fund (LAPF) on 1 December 2017. The LAPF is a local government investment scheme approved by the Treasury under the Trustee Investments Act 1961 (section 11). Dividends are treated as revenue income and have in previous years averaged around 4%. The fund performed better than expected during 2020/21 despite challenging economic conditions and a temporary suspension, and the equated dividend for the year remained at 4%. The dividends for Q1 and Q2 of 2021/22 equated to 3.63% and 3.41% respectively, so whilst falling slightly it remains the most significant factor in the overall investment return achieved to date. The dividend for Q3 has not yet been confirmed but is anticipated to be around 3.6%.

The LAPF investment allows the Council to introduce a property element into its investment portfolio without the risks associated with the direct purchase of assets. It should be noted however that the capital value is **not** guaranteed and can fall as well as rise, as was the case in 2020/21 when the certificated value of the investment fell from £936k to £930k. At 31 December 2021 the value was £1.045m, ie. above the initial investment for the first time. This serves to demonstrate that the investment must be seen as a long-term commitment.

Interest rates in the market remain very low, and this is likely to continue in view of the pandemic, as well as the ongoing uncertainty surrounding the full impact of Brexit and the ending of the transition period. As investments mature every effort is made to replace them at favourable rates, however security and liquidity will always be the overriding factors in the Council's treasury management. LAS currently forecast that whilst the next rise in Bank Rate may be as early as February 2022, it is more likely that it will be later than this, however there is much uncertainty and interest rates are expected to rise only gradually, and not significantly.

It is currently anticipated that the outturn for investment interest will be £67,500, an increase of £7,500 on the current approved estimate for 2021/22 of £60,000. The impact of this is included in the Q3 revenue budget monitoring report elsewhere on this agenda. The increase is due largely to the better than anticipated performance of the property fund.

2.6 New borrowing

At 31 December 2021 new borrowing of £1m for 50 years from the PWLB at 1.81% had been undertaken, and it is estimated that another £1m may be arranged before 31 March should conditions be favourable. It is currently anticipated that the outturn for PWLB interest payable will be £358,500, a reduction of £3,900 on the current approved estimated for 2021/22 of £362,400. The impact of this is included in the Q3 revenue monitoring report elsewhere on this agenda. The reduction is due to the revised projections for the amount and timing of new borrowing.

Advice will be taken from LAS with regard to the amount and timing of any additional borrowing, and should conditions become advantageous, some borrowing in advance of need will also be considered by the Chief Financial Officer. The Council's Capital Financing Requirement (CFR) represents its underlying need to borrow to finance capital investment. Due to favourable interest rates, borrowing in advance of need is sometimes desirable, with the result that the CFR can differ to the planned borrowing in the year. Investment guidance issued in February 2018 reaffirmed that Councils may not borrow in advance of need purely to profit from the investment of the extra sums borrowed, rather than prudent early borrowing for a demonstrable service objective, which is permitted.

PWLB reduced its interest rates by 1% across the board from 26 November 2020. However, investment rates remain exceptionally low, and serious consideration must be given to the cost of carrying any additional borrowing during the period prior to it being required for the financing of capital expenditure since this places a further burden on the General Fund.

2.7 Debt rescheduling

When the current day PWLB rate for the same term is higher than that being paid on an existing loan there is the potential for a discount to be receivable if the loan is repaid prematurely.

However, debt rescheduling opportunities are limited in the current economic climate, and due to the structure of PWLB interest rates. Advice in this regard will continue to be taken from LAS. No debt rescheduling has been undertaken during the period from 1 April to 31 December 2021.

2.8 Compliance with Prudential and treasury indicators

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Prudential and Treasury Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS) approved by Full Council on 4 March 2021.

During the financial year to date the Council has at all times operated within the treasury limits and Prudential Indicators set out in the Council's TMSS, and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators as at 31 December 2021 are shown at Appendix 2.

A) Prudential Indicators:

These indicators are based on estimates of expected outcomes, and are key indicators of "affordability". They are monitored on a quarterly basis, and Appendix 2 compares the approved indicators with the projected outturn for 2021/22, and shows variances on the indicators, as described below:

a. Capital Expenditure

The latest projected outturn shows that total capital expenditure is expected to be £9,543,200. This differs to the approved indicator of £10,868,300 due to the inclusion of approved carry-forward requests from 2020/21 and variations on the current year's capital programme.

b. Capital Financing Requirement (CFR)

The CFR represents the historic outstanding capital expenditure which has not yet been paid for from capital or revenue resources, and is essentially a measure

of the Council's underlying borrowing need. The CFR does not increase indefinitely since the minimum revenue provision (MRP) is a statutory annual revenue charge for the economic consumption of capital assets.

At 31 December 2021 the projected closing CFR for 2021/22 is £13,415,400. This differs to the approved indicator of £15,290,400, due to savings and deferrals on the 2020/21 capital programme, as well as to variations to the current year's capital programme.

c. Gearing ratio

The concept of "gearing" compares the total underlying borrowing need (the CFR) to the Council's total fixed assets and the gearing ratio can provide an early indication where debt levels are rising relative to long term assets held.

The projected gearing ratio at 31 March 2022 is 33%, which is in line with the approved indicator and is broadly comparable with the average gearing ratio for councils of a similar size.

d. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of borrowing net of investment income against the net revenue stream. Financing costs represent the element of the Council's budget to which it is committed even before providing any services.

The projected outturn of 18.45% differs to the approved indicator of 17.70% due to additional direct revenue financing, offset by a reduction in MRP arising from savings and deferrals on the capital programme in 2020/21.

e. Maximum gross debt

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for 2021/22 and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The Council's gross debt at 31 December 2021 was £10.812m, which was within the approved indicator.

f. Ratio of internal borrowing to CFR

The Council is currently maintaining an "internal borrowing" position, ie. the underlying borrowing need (CFR) has not yet been fully funded with loan debt as cash supporting the Council's reserves and balances is being used as a temporary measure.

The projected outturn for internal borrowing is 12%, which is lower than the

approved indicator of 16% due to variations to the capital programme - which in turn reduce the projected outturn for CFR and hence the difference between CFR and projected external borrowing.

B) Treasury Management Indicators:

These indicators are based on limits, beyond which activities should not pass without management action. They include two key indicators of affordability and four key indicators of prudence.

Affordability:

a. Operational boundary for external debt

This is the limit which external debt is not “normally” expected to exceed. In most cases, this would be a similar figure to the CFR, but it may be lower or higher depending on the levels of actual debt, and must allow for unusual cashflow movements.

b. Authorised limit for external debt

This limit represents a control on the “maximum” level of borrowing. It is the statutory limit determined under s3 (1) of the Local Government Act 2003 and represents the limit beyond which external debt is prohibited. The Authorised Limit must be set, and revised if necessary, by Full Council. It reflects a level of external debt which, while not desirable, could be afforded in the short term, but is not sustainable in the longer term. The Government retains an option to control either the total of all councils’ plans, or those of a specific council, although this power has not yet been exercised.

Prudence:

c. Upper limits for the maturity structure of borrowing

These are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing.

d. Maximum new principal sums to be invested during 2021/22 for periods in excess of one year (365 days)

All such investments are classified as “non-specified”. This indicator is subject to the overall limit for non-specified investments set out in the TMSS, and to the overall limit per counterparty.

e. Interest rate exposure

The latest Treasury Management Code requires a statement in the TMSS explaining how interest rate exposure is managed and monitored by the Council, and this is repeated below:

The Council has a general preference for fixed rate borrowing in order to minimise uncertainty and ensure stability in the charge to revenue, however it is acknowledged that in certain circumstances, some variable rate borrowing may be prudent, for example if interest rates are expected to fall. The Council's investments are generally for cashflow purposes and accordingly a mix of fixed and variable rates will be used to maximise flexibility and liquidity. Interest rate exposure will be managed and monitored on a daily basis by the Chief Financial Officer.

Local indicators for the proportions of fixed and variable rate loans, have been retained by the Council for information purposes.

Appendix 2 shows the actual position as at 31 December 2021, and demonstrates that all activities are contained within the currently approved limits.

2.9 Other Issues

a. Prudential Code

Following a consultation that ended on 16 November CIPFA has issued a new edition of the Prudential Code. CIPFA make it clear that the new Code applies with immediate effect, but authorities may defer introducing revised reporting requirements until the 2023/24 financial year. These include changes in capital strategy, prudential indicators and investment reporting. The Council's treasury advisors, Link Asset Services, advise that the TMSS for 2022/23, which is already in preparation, should still be based on the existing template, and that consideration of any necessary changes be given early in the new financial year. Link will work towards providing templates that ensure full compliance with the new Code by the 31 March 2023 deadline, ie. in time for the preparation of the TMSS for 2023/24. The ongoing principle that a authority must not borrow to invest primarily for financial return applies with immediate effect.

Some key features are:

- Authorities must demonstrate that capital and investment plans are affordable and proportionate; all borrowing and other long-term liabilities must be within prudent and sustainable levels; risks associated with investment must be proportionate to financial capacity, and treasury management decisions must be in accordance with good professional practice;

- There is further strengthening on the matters to be taken into account when setting and revising prudential indicators, particularly decision making on capital investment, determining a capital strategy, prudence and affordability;
- Definitions of investment are given, with separate categories for treasury investment, service investment and commercial investment;
- CIPFA leaves decisions to maintain long-term treasury investments for each s151 Officer to justify (the assumption being that these are not borrowed for) and any longer term treasury investment is to be linked to the business model (eg. a link to cash flow management or treasury risk management);
- CIPFA makes a clear statement that it is not prudent to make any investment or spending decision that will increase capital financing requirement, and so lead to new borrowing, unless directly and primarily related to the functions of the authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.

b. Treasury Management Code

Following a consultation that ended on 16 November CIPFA has issued a new edition of the Treasury Management Code. Unlike the Prudential Code there is no reference to an effective date, as the TM Code has no statutory underpinning.

The Code includes some updates to Treasury Management Practices, notably TMP10 (knowledge and skills) is strengthened - although Link suggest that some further clarification may be needed on this. The Code also makes clear that TM reporting should set out service and commercial investment risk, especially where this is supported by borrowing.

The new Code also introduces a “liability benchmark”, but CIPFA have advised that it is not prescriptive - and if an authority can justify that it is prudent to maintain a position above or below benchmark that is up to them. Link will advise in due course on the implications of this issue for the Council.

c. MRP Consultation

The Department for Levelling Up, Housing and Communities (DLUHC) published a consultation on changes to the Minimum Revenue Provision (MRP) on 30 November 2021. The consultation closes on 8 February 2022 and any implications for the Council will be reported to Members in due course.

d. Environmental, Social and Governance (ESG) considerations

The ESG agenda is becoming a major focus for local authorities, but while around two thirds of councils have declared a “climate emergency”, this has not yet led to the inclusion of anything more formal within treasury-related

investment strategies, ie the TMSS. The recently issued revision to the CIPFA Treasury Management Code makes reference to ESG, and Link will advise on this in due course.

Link's view is that the most important issue is ensuring that there is a clear understanding of what "environmental, social and governance (ESG)" investment considerations actually **mean**. It is about understanding the ESG "risks" that an entity like the Council is exposed to, and evaluating how well it manages those risks, as all entities will be subject to them to some extent. ESG is **not** the same as Socially Responsible Investing, (typically where "negative screens" are applied to investment counterparties), and equally, it is **not** the same as Sustainable Investing, (investing in products or companies based on expected sustainable and beneficial societal impact, alongside a financial return).

There is huge potential for misunderstanding, and this could have material unintended consequences, ie. limiting the Council's potential counterparty options and thus decreasing diversification. This could then lead to the Council widening its credit criteria to take on more names, or those with a stronger ESG performance, which could then increase credit risk - which would place the cornerstone of prudent investing at risk.

Many local authorities can, or already do, take ESG considerations into account via the use of ratings from credit rating agencies. All the agencies now stress how they incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings. The Council uses the Link creditworthiness service which is a sophisticated model including data from all three major agencies, and therefore does take ESG considerations into account to some extent.

ESG risks are about potential impact on an entity's enterprise value - the "G" (Governance) is the most important factor when considering treasury investments, the majority of which will be shorter-term in nature. This is because poor governance can have a more immediate impact on the financial circumstances of an entity, and the potential for a default event that would impact the amount the local authority receive back from its investments. Those financial institutions that are viewed as having poor or weak corporate governance are generally less well rated in the first instance, or have a higher propensity for being subject to negative rating action. So this element of ESG is of high importance to an investor that is following investment guidance with the security, liquidity and yield (SLY) principle at its core. Environmental & Social factors are also important, but more for the long-term impact, unless an authority is specifically going down the "impact" or "sustainable" type investment route - and there are not many options for that in respect of short-term investments.

Link continues to look at ways in which these factors can be incorporated into its creditworthiness assessment service. However, the lack of consistency, as well as coverage, in addition to uncertainty as to what is required from the Treasury Management Code perspective, means that they continue to review the options and will update clients as progress is made. Link's advice is therefore that it is not practicable to include ESG into its template for 2022/23 at the current time.

No other significant treasury management issues have arisen since approval of the TMSS on 4 March 2021 that should be brought to the attention of Members.

3 Alternative Options

An alternative option is to fail to present a quarterly Prudential Code Indicator Monitoring and Treasury Activity Report, however this would contravene the requirement of the Council's Treasury Management Strategy Statement (TMSS).

4 Financial Implications

No specific financial implications are attributable to this report.

5 Legal Implications

There are no legal implications arising from this report.

6 Equalities Implications

There are no equalities implications arising from this report.

7 Carbon Reduction/Environmental Sustainability Implications

There are no carbon reduction/environmental sustainability implications arising from this report.

8 Appendices

1. Treasury Activity Report 2021/22 for Quarter 3 (31 December 2021).
2. Prudential and Treasury Indicator Monitoring 2021/22 for Quarter 3.

9 Background Papers

None identified.

10 Reasons for Recommendation

To comply with the requirements of the Council's Treasury Management Strategy Statement.

Statutory Officer approval:

Approved by: Chief Financial Officer

Date: 19.01.22

Approved by: Monitoring Officer

Date: 19.01.22