CABINET
11 OCTOBER 2022

TREASURY MANAGEMENT ANNUAL REPORT AND OUTTURN PRUDENTIAL INDICATORS 2021/22

Responsible Cabinet Member -
Councillor Scott Durham, Resources Portfolio

Responsible Director -
Elizabeth Davison, Group Director of Operations

SUMMARY REPORT

Purpose of the Report

1. This report provides important information regarding the regulation and management of the Council's borrowing, investments and cash-flow. It is a requirement of the Council's reporting procedures and by regulations issued under the Local Government Act 2003 to produce an annual treasury management review that covers treasury activity for 2021/22. The report also seeks approval of the Prudential Indicators results for 2021/22 in accordance with the Prudential Code.

Summary

2. The financial year 2021/22 was another unprecedented year with regard to treasury management due to the ongoing pandemic, with the cost of borrowing remaining low throughout. However, as Members are aware due to low returns for cash investments new ways to improve investment returns are continually sought.

3. During 2021/22 the Council complied with its legislative and regulatory requirements. The borrowing need (**Table 1**) was only increased for capital purposes.

4. At 31 March 2022 the Council's external debt was £149.649m which is £11.882m less than the previous year, this reduction relates to not re-borrowing for matured debt due to an increase in the level of monies received by the Council. The average interest rate for borrowing reduced from 2.76% in 2020/21 to 2.47% in 2021/22. Investments totalled £63.399m at 31 March 2022 (£59.399m at 31 March 2021) earning interest of 0.21% on short term cash investments and 2.21% on Property Fund units net of costs.

5. Financing costs have been reduced during the year and a saving of £0.366m has been achieved from the original MTFP. The savings are a mixture of reduced interest on debt as well as increased investment income, especially from property funds.

Recommendation

6. It is recommended that:

   (a) The outturn 2021/22 Prudential Indicators within this report and those in **Appendix 1** be noted.

   (b) The Treasury Management Annual Report for 2021/22 be noted.

   (c) This report to be forwarded to Council, in order for the 2021/22 Prudential Indicators to be approved.

Reasons

7. The recommendations are supported by the following reasons:

   (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities.

   (b) To inform members of the Performance of the Treasury Management function.

   (c) To comply with the requirements of the Local Government Act 2003.

Elizabeth Davison
Group Director of Operations

Background Papers
(i) Accounting Records
(ii) Annual Investment Strategy 2021/22
(iii) Prudential Indicators and Treasury Management Strategy Report 2021/22

Peter Carrick: Extension 5401

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Well Being	There are no issues relating to health and wellbeing which this report needs to address
Carbon Impact and Climate Change	There are no issues relating to carbon impact
Diversity	There are no specific implications for diversity
Wards Affected	The proposals affect all wards
Groups Affected	The proposals do not affect any specific group
Budget and Policy Framework	The report does not change the Council's budget or Policy framework but needs to be considered by Council
Key Decision	This is not an Executive decision
Urgent Decision	This is not an Executive decision
Council Plan	The proposals in the report support delivery of the Council Plan through appropriate and effective deployment of the Councils Resources
Efficiency	The report outlines movements in the national economic outlook that have enabled officers to take advantage of different types of Investments and changing interest rates to benefit the Revenue MTFP.
Impact on Looked After Children and Care Leavers	This report has no impact on Looked After Children or Care Leavers

MAIN REPORT

Information and Analysis

8. This report summarises:

   (a) Capital expenditure and financing for 2021/22
   (b) The Council's overall borrowing need
   (c) Treasury position at 31 March 2022
   (d) Prudential indicators and compliance issues
   (e) The economic background for 2021/22
   (f) A summary of the Treasury Management Strategy agreed for 2021/22
   (g) Treasury Management activity during 2021/22
   (h) Performance and risk benchmarking

9. Throughout this report a number of technical terms are used, a glossary of terms can be found at the end of this report.

The Council's Capital Expenditure and Financing 2021/22

10. The Council undertakes capital expenditure on long term assets, which is financed either,

    (a) Immediately through capital receipts, capital grants, contributions and from revenue; or

    (b) If insufficient financing is available, by borrowing.

11. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flow, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost and then optimise performance.

12. Capital Expenditure forms one of the prudential indicators that are used to regulate treasury activity. Table 1 shows total capital expenditure and how this was financed, compared with what was expected to be spent and how this would have been financed. Actual expenditure was £6.290m less than planned, mostly down to reduced activity in the HRA and reduced lending to the joint ventures. However, the mix of funding differs from that which was expected as some schemes progressed quicker than others. This impacted slightly on the borrowing needed to fund expenditure which was £1.078m lower than initially anticipated.

Table 1 – Capital Expenditure and Financing

	2020/21	2021/22		
	Outturn £m	Revised Estimate £m	Outturn £m	Variance £m
General Fund Capital Expenditure	20.094	27.036	26.072	(0.964)
HRA Capital Expenditure	6.434	13.183	10.729	(2.454)
Loans to Joint Ventures etc	3.501	9.459	6.587	(2.872)
Total Capital Expenditure	**30.029**	**49.678**	**43.388**	**(6.290)**
Resourced by:				
Capital Receipts GF	2.538	0.586	0.586	0.000
Capital receipts Housing	0.684	0.303	0.986	0.683
JV Loans Repaid	6.200	7.727	7.927	0.200
Capital Grants	11.717	21.294	19.371	(1.923)
Capital Contributions	0.029	0.000	0.038	0.038
Revenue Contributions - GF	0.145	0.000	0.123	0.123
Revenue Contributions - HRA	5.750	12.835	8.502	(4.333)
Total Resources	**27.063**	**42.745**	**37.533**	**(5.212)**
Borrowing needed to finance expenditure	**2.966**	**6.933**	**5.855**	**(1.078)**

The Council's Overall Borrowing Need

13. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). The figure is a gauge for the Council's debt position. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents 2021/22 and prior years' net capital expenditure which has not yet been paid for by revenue or other resources.

14. Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the government, through Public Works Loan Board (PWLB), or the money markets) or utilising temporary cash resources within the Council.

15. The Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account borrowing need, (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

16. The total CFR can be reduced each year through a Voluntary Revenue Provision (VRP) or by the application of additional capital financing resources (such as unapplied capital receipts).

17. The Council's CFR for the year is shown in Table 2 and represents a key prudential indicator. The CFR outturn for 2021/22 is £224.285m which is £1.578m lower than approved due to the reduced borrowing need required to finance the additional capital expenditure in 2021/22.

18. No statutory MRP repayments were made on the General Fund debt in line with the report to Council on 23 February 2017, although a £0.500m VRP was made.

Table 2 - Capital Financing Requirement

	2020/21	**2021/22**		
	Outturn £m	**Approved Indicator £m**	**31 March Actual £m**	**Variance £m**
Opening Balance	219.488	220.685	220.685	0.000
Add Capital Expenditure financed by borrowing	9.166	14.660	13.782	(0.878)
Less repayment of JV loans	(6.200)	(7.727)	(7.927)	(0.200)
Less MRP/VRP GF	0.000	0.000	(0.500)	(0.500)
Less MRP/VRP Housing	(0.629)	(0.629)	(0.629)	0.000
Less MRP/VRP PFI	(1.140)	(1.126)	(1.126)	0.000
Closing balance	**220.685**	**225.863**	**224.285**	**(1.578)**

Treasury Position at 31 March 2022

19. Whilst the measure of the Council's underlying need to borrow is the CFR, the Group Director of Operations can manage the Council's actual borrowing position by:

    (a) Borrowing to the CFR level; or

    (b) Choosing to utilise some temporary cash flows instead of borrowing ("under borrowing"); or

    (c) Borrowing for future increases in CFR (borrowing in advance of need, the "over borrowed" amount can be invested).

20. The Council's treasury management debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting and through officer activity detailed in the Council's Treasury Management Practices.

21. The Council's total debt outstanding at 31 March 2022 was £149.649m. In addition to this, a liability of £9.232m relating to the PFI scheme and Finance Leases brings the total to £158.881m. The Council's revised CFR position was estimated to be £225.863m, however, the actual out turn position was £224.285m. When comparing this to our actual borrowing of £158.881m this meant that the Council was "under borrowed" by £65.404m. This "under borrowed" amount was financed by internal borrowing which means that the amount that could have been invested externally was reduced to cover this. The reduced under borrowed position still has the dual effect of reducing costs to the MTFP because borrowing costs are generally greater than investment returns and it reduces counterparty risk by reducing our exposure to banks and other financial institutions.

22. The treasury position at the 31 March 2022, including investments compared with the previous year is shown in table 3 below.

Table 3 – Summary of Borrowing and Investments

Treasury Position	**31 March 2021**		**31 March 2022**	
	Principal £m	**Average Rate %**	**Principal £m**	**Net Annualised Average Rate %**
General Debt - Fixed Rate Debt, Market and Public Works Loan Board (PWLB)	136.531	2.98%	124.649	2.66%
Property Fund Borrowing	25.000	1.42%	25.000	1.30%
Total Debt	**161.531**	**2.76%**	**149.649**	**2.47%**
Cashflow Investments up to 6 months	19.400	0.09%	33.400	0.21%
Capital Investments over 6 months	10.000	0.96%	0.000	0.00%
Property Fund Investment - net of costs	29.999	2.33%	29.999	2.21%
Total Investments	**59.399**		**63.399**	
Net borrowing position	**102.132**		**86.250**	

Prudential Indicators and Compliance Issues

23. Some prudential indicators provide an overview while others are specific limits on treasury activity. These indicators are shown below:

24. **Gross Borrowing and the CFR –** in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital

needs in 2021/22. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Table 4 – Gross Borrowing Compared with CFR

	31 March 2021 Actual £m	31 March 2022 Approved Indicator £m	31 March 2022 Actual £m
Gross Borrowing Position	**161.531**	**164.849**	**149.649**
PFI and Finance Lease Liability	**10.358**	**9.232**	**9.232**
Total	**171.889**	**174.081**	**158.881**
CFR	**220.685**	**225.863**	**224.285**
(Under)/over funding of CFR	**(48.796)**	**(51.782)**	**(65.404)**

25. **The Authorised Limit –** The Authorised Limit is the "Affordable Borrowing Limit" required by section 3 of the Local Government Act 2003. The Council does not have power to borrow above this level.

26. **The Operational Boundary –** The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are both acceptable, subject to the Authorised Limit not being breached.

27. **Actual financing costs as a proportion of net revenue expenditure -** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue expenditure. The actual for this indicator has risen from the previous year due to an increase in the Financing costs outturn.

Table 5 – Key Prudential Indicators

	Actual 2020/21 £m	Original Approved Limits 2021/22 £m	Revised Approved Limits 2021/22 £m	Actual Total Liabilities Borrowing + PFI/ leases 2021/22 Maximum £m
Approved Indicator – Authorised Limit	**231.719**	**240.979**	**237.156**	**158.881**
Approved Indicator – Operational Boundary	**171.889**	**186.550**	**174.081**	**158.881**
Financing costs as a percentage of net revenue expenditure	**2.39%**	**2.22%**	**2.22%**	**1.94%**

28. At 31 March 2022 the total liabilities were £158.881m which is below both the approved Authorised Limit and the approved Operational Boundary. The Operational Boundary is the point at which we expect borrowing to be, but it can be lower or higher. Borrowing cannot exceed the Authorised Limit.

29. A further four prudential indicators are detailed in Appendix 1.

Economic Background for 2021/22

30. A summary of the general economic conditions that have prevailed through 2021/22 provided by Link Asset Services, the Council's treasury management advisors is attached at **Appendix 2**. This update was provided in April 2022 to facilitate the outturn report for 2021/22. As members will be aware the economic position for the country has changed significantly, with the financial landscape moving rapidly with increased and further projected increases in interest rates. Further updates will be provided in the next treasury management update report.

Summary of the Treasury Management Strategy agreed for 2021/22

31. The revised Prudential Indicators anticipated that during 2021/22 the Council would need to borrow £6.933m to finance part of its capital programme, whereas the actual outturn figure was £5.855m.

32. The Annual Investment Strategy stated that the use of specified (usually less than 1 year) and non-specified (usually more than 1 year) investments would be carefully balanced to ensure that the Council has appropriate liquidity for its operational needs. In the normal course of the Council's business it is expected that both specified and non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

33. Longer term instruments (greater than one year from inception to repayment) will only be used where the Council's liquidity requirements are safeguarded. An estimate of long term investments (over 1 year) were included in the report on the Prudential Indicators update these were as follows £50m for 2021/22 and £50m for 2022/23. No other investments of over 1 year duration have been made during 2021/22.

Treasury Management Activity during 2021/22

Borrowing Strategy

34. During 2021/22, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the CFR), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

35. A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

36. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years (see table 6 below). However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Table 6 – net borrowing

	Market Loans (incl. other Local Authorities)			Total
	Amount £m	Length of Loan	Interest Rate %	£m
New Loans Taken				
	5.000	1 year	0.25%	
	3.000	1 year	0.10%	
				8.000
Loans Repaid				
	(4.750)	10 years	3.19%	
	(5.000)	2 years	0.87%	
	(2.000)	1 year	0.90%	
	(3.000)	1 year	0.90%	
	(5.000)	1 year	0.20%	
				(19.750)
Total New Borrowing				(11.750)

37. The additional funding was utilised to not replace maturing short term loans.

38. **Summary of Debt Transactions –**The consolidated rate of interest reduced from 2.76% to 2.47% due to the above transactions as some of the debt repaid was at a higher interest rate than the longer term debt still held.

Investment Position

39. **Investment Policy –** the Council's investment policy for 2021/22 is governed by the DLUHC Guidance which has been implemented in the annual investment strategy for 2021/22 approved by Special Council on 18 February 2021. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

40. The investment activity during the year conformed to the approved Strategy and the Council had no liquidity difficulties.

41. Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates and one feature of the year was the continued

growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid -19 pandemic were no longer necessitated.

42. The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February).

43. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

44. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

45. Investments held by the Council consist of temporary surplus balances, capital receipts and other funds. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. These include investments in Money Market Funds, the Government's Debt Management Office, other local authorities and bank short term notice accounts. Short term investments of up to a year earned interest of £52k on an average balance of £25.526m which equated to an annual average interest rate of 0.21%.

46. The Council also has longer term investments which consist of the property funds and the returns are shown below in **Table7**.

Table 7 – Longer Term 6 months to 5 years - Property Funds

	Original Budget 2021/22	Actual 2021/22
Daily average level of Investments	£29.999m	£29.999m
Interest earned (gross)	0.840m	0.988m
Average Rate of Return on Investment Interest earned (gross)	2.80%	3.29%
Average Rate of Return on Investment (net of costs)	1.53%	2.21%

Performance and Risk Benchmarking

47. A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance.

48. The following reports the current position against the benchmarks originally approved.

49. Security – The Council's maximum security risk benchmarks for the current portfolio of investments, when compared to historic default tables was set as follows:

    0.077% historic risk of default when compared to the whole portfolio

50. **Table 8** shows that there has been a fluctuation in the historic levels of default over the year although still well below the benchmark. This is mainly due to some longer term investments actually being made for shorter terms, i.e. up to six months rather than 1 year as these investments were better value than longer term investments and were also a better fit with how the council was expecting to utilise investments. It also shows more emphasis being placed on counterparties with a higher credit rating.

51. The investment portfolio was maintained within this overall benchmark during this year as shown in **Table 8**.

Table 8

Maximum	Benchmark 2021/22	Actual June 2021	Actual October 2021	Actual December 2022	Actual March 2022
Year 1	0.077%	0.012%	0.007%	0.004%	0.013%

52. The counterparties that we use are all high rated therefore our actual risk of default based on the ratings attached to counterparties is virtually nil.

53. Liquidity – In respect of this area the Council set liquidity facilities/benchmark to maintain

(a) Bank Overdraft £0.100M

(b) Liquid short term deposits of at least £3.000M available within a week's notice.

(c) Weighted Average Life benchmark is expected to be 146 days with a maximum of 1 year.

54. Liquidity arrangements have been adequate for the year to date as shown in **Table 9**.

Table 9

	Benchmark	Actual June 2021	Actual October 2021	Actual December 2022	Actual March 2022
Weighted Average life	146 days to 1 year	165 days	127 days	173 days	164 days

55. The figures are for the whole portfolio of cash flow investments deposited with Money Market funds on a call basis (i.e. can be drawn on without notice) as well as call accounts that include a certain amount of notice required to recall the funds.

56. Yield - In respect of this area performance indicators relating to interest rates for borrowing and investments were set with reference to comparative interest rates. For borrowing, the indicator is the average rate paid during the year compared with the previous year. Investment rates are compared with a representative set of comparative rates.

Risk

57. The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:-

(a) The Local Government Act 2003(the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity.

(b) The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2021/22).

(c) Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act.

(d) The SI requires the Council to undertake any borrowing activity with regard to the CIFPA Prudential Code for Capital Finance in Local Authorities.

(e) The SI also requires the Council to operate the overall treasury function with regard to the CIPFA code of Practice for Treasury Management in Public Services.

(f) Under the Act the Department of Levelling Up, Housing & Communities has issued Investment Guidance to structure and regulate the Council's investment activities.

(g) Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

58. The Council's Treasury Management function has complied with all of the relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low risk approach.

59. Officers of the Council are aware of the risks of passive management of the treasury portfolio and, with the support of Capita Asset Services, the Council's advisers, have proactively managed the debt and investments over the year.

Treasury Management Budget

60. There are three main elements within the Treasury Management Budget:

(a) Long Term capital investments including Property Funds which earns interest, this comprises of the Council's revenue and capital balances, unused capital receipts, reserves and provisions.

(b) Cash flow interest earned – the authority has consistently had positive cash flow. Unlike long term capital investments it does not represent any particular sum but it is the consequence of many different influences such as receipts of grants, the relationship between debtors and creditors, cashing of cheques and payments to suppliers.

(c) Debt servicing costs – This is the principal and interest costs on the Council's long term debt to finance the capital programme.

Table 10 - Changes to the Treasury Management Budget 2021/22

	£m	£m
Original Treasury Management Budget		**0.823**
Debt		
Reduced interest payable on debt	**(0.189)**	
Investments		
Increased investment income including property funds etc	**(0.144)**	
Other Costs		
Less reduced brokerage charges	**(0.033)**	**(0.366)**
Outturn Treasury Management Budget 2021/22		**0.457**

61. The savings relate to a reduction in the interest payable on debt due to the cost of short term borrowing and reduced debt levels as well as an increase in the interest received on investments due to the cashflow levels.

Conclusion

62. The Council's treasury management activity during 2021/22 has been carried out in accordance with Council Policy and within legal limits. Financing costs have been reduced during the year and a saving of £0.366m achieved from the original MTFP.

Outcome of Consultation

63. No formal consultation has been undertaken regarding this report.

Appendix 1

Additional Prudential Indicators not reported in the body of the report

		2020/21 Actual	2021/22 Approved Indicator	2021/22 Outturn
1	**limits on fixed interest rates**	**88%**	**100%**	**84%**
2	**limits on variable interest rates**	**12%**	**40%**	**16%**
3	**Maturity structure of fixed interest rate borrowing (upper Limit)**			
	Under 12 months	**12%**	**40%**	**16%**
	12 months to 2 years	**22%**	**50%**	**19%**
	2 years to 5 years	**25%**	**60%**	**19%**
	5 years to 10 years	**35%**	**90%**	**29%**
	10 years and above	**100%**	**100%**	**100%**
4	**Maximum Principal funds invested greater than 364 days**	**£50m**	**£50m**	**£50m**

Appendix 2

The Economy and Interest Rates

UK. Economy. Over the last two years, 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 until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, now that the CPI measure has already risen to 6.2% and is likely to exceed 8% in April.

Gilt yields fell towards the back end of 2021, but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April utilities prices as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1st April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

Average inflation targeting. This was the major change in 2020/21 adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August 2020 was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and *achieving the 2% target sustainably*". That mantra now seems very dated. Inflation is the "genie" that has escaped the bottle, and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

USA. The flurry of comments from Fed officials following the mid-March FOMC meeting – including from Chair Jerome Powell himself – hammering home the hawkish message from the mid-March meeting, has had markets pricing in a further 225bps of interest rate increases in 2022 on top of the initial move to an interest rate range of 0.25% - 0.5%.

In addition, the Fed is expected to start to run down its balance sheet. Powell noted that the rundown could come as soon as the next meeting in May.

The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (CPI is estimated at 7.8% across Q1), but the hit to real disposable incomes and the additional uncertainty points in the opposite direction.

More recently, the inversion of the 10y-2y Treasury yield spread at the end of March led to predictable speculation that the Fed's interest rate hikes would quickly push the US economy into recession. Q1 GDP growth is likely to be only between 1.0% and 1.5% annualised (down from 7% in Q4 2021). But, on a positive note, the economy created more than 550,000 jobs per month in Q1, a number unchanged from the post-pandemic 2021 average. Unemployment is only 3.8%.

EU. With euro-zone inflation having jumped to 7.5% in March it seems increasingly likely that the ECB will accelerate its plans to tighten monetary policy. It is likely to end net asset purchases in June – i.e., earlier than the Q3 date which the ECB targeted in March. And the market is now anticipating possibly three 25bp rate hikes later this year followed by more in 2023. Policymakers have also hinted strongly that they would re-start asset purchases if required. In a recent speech, Christine Lagarde said "we can design and deploy new instruments to secure monetary policy transmission as we move along the path of policy normalisation."

While inflation has hit the headlines recently, the risk of recession has also been rising. Among the bigger countries, Germany is most likely to experience a "technical" recession because its GDP contracted in Q4 2021, and its performance has been subdued in Q1 2022. However, overall, Q1 2022 growth for the Eurozone is expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Finishing on a bright note, unemployment fell to only 6.8% in February.

China. After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; however, 2021 has seen the economy negatively impacted by political policies that have focussed on constraining digital services, restricting individual freedoms, and re-establishing the power of the One-Party state. With the recent outbreak of Covid-19 in large cities, such as Shanghai, near-term economic performance is likely to be subdued. Official GDP numbers suggest growth of c4% y/y, but other data measures suggest this may be an overstatement.

Japan. The Japanese economic performance through 2021/22 is best described as tepid. With a succession of local lockdowns throughout the course of the year, GDP is expected to have risen only 0.5% y/y with Q4 seeing a minor contraction. The policy rate has remained at -0.1%, unemployment is currently only 2.7% and inflation is sub 1%, although cost pressures are mounting.

World growth. World growth is estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

Deglobalisation. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for 18% of total world GDP (the USA accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy. In addition, after the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, 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 (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

Central banks' monetary policy. During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.

Glossary of Terms

Capital Financing Requirement (CFR)	This is the Councils underlying need to borrow which can be traced back to the Councils Balance Sheet and the value of the Councils assets which have yet to be paid for.
Minimum Revenue Provision (MRP)	Monies set aside from the revenue budget to repay accumulated debt.
Call	Investments that can be returned without a period of notice
Counterparty	Institutions, Banks etc. that with make investments or take out loans with.
Specified Investments	Investments in Banks and Building Societies with a high credit rating for periods of less than 1 year
Non-Specified Investments	Investments in un-rated Building Societies and any investments in Banks and Building Societies for more than 1 year.
Operational Liquidity	Working Cash flow
Authorised Limit	Maximum amount of borrowing that could be taken in total.
Operational Boundary	The expected amount of borrowing assumed in total.
PWLB	Public Works Loan Board. The Governments lending body to Local Authorities
Discount	Amount payable by the PWLB when loans are repaid if the current loan rate is less than the rate borne by the original debt
Yield Curve	Is a graph that shows the relationship between the interest rate paid and length of time to repayment of a loan.
Gilts	Government Borrowing Bonds
SONIA	The Sterling Overnight Index Average – generally a replacement set of indices (for LIBID) for those benchmarking their investments.
Spreads	The difference between the highest rate of interest and the lowest rate of interest earned/charged on any one particular maturity period i.e. 1 year, 2 year 5 year etc.
LIBID	London Interbank Bid Rate. The average rate at which a bank is willing to borrow from another bank – No longer used
LIBOR	London Interbank Offer Rate. The average rate at which a bank is willing to lend to another bank. LIBOR is always higher than the corresponding bid rate and the difference between the two rates is known as the spread.