Report

Council

Part 1

Date: 1 March 2022

Subject **2022/23 Capital Strategy and Treasury Management Strategy**

Purpose The purpose of this report is to present to Council the 2022/23 Capital and Treasury Management Strategies for approval. Both strategies are appended to this report, with the report itself summarising the key aspects of both strategies, as well as highlighting the main implications and risks arising from them. Also appended to the report is the Capital Programme, which Cabinet approved at its meeting on 18th February 2022.

Author Assistant Head of Finance / Head of Finance

Ward General

Summary As set out within the Corporate Plan, the Council has ambitious plans for the city, with the Capital Programme a key enabler in delivering this ambition. The current programme is entering its last year, with a number of key programmes and projects having been completed to date and a number of others nearing completion.

This report includes both the Capital and Treasury Management Strategies which, at their core, (i) confirm the Capital Programme, as part of the Capital Strategy and (ii) the various borrowing limits and other indicators which govern the management of the Council's borrowing and investing activities, as part of the Treasury Management Strategy.

The Capital Strategy also sets out the long-term context (10 years) in which capital decisions are made. It demonstrates that the Council's approach to taking capital and investment decisions is in line with service objectives, whilst giving consideration to risk, reward and impact. It also demonstrates that these decisions are taken whilst having proper regard to stewardship of public funds, value for money, prudence, sustainability and affordability.

The capital plans of the authority are inherently linked with the treasury management activities it undertakes and, therefore, the Treasury Management Strategy is included alongside the Capital Strategy.

The main recommendations arising from the two strategies are summarised in this report below and are also appended.

Proposal Council is asked:

- To approve the Capital Strategy (Appendix 2), which incorporates the current approved capital programme, and the borrowing requirements/limits needed to deliver the current capital programme.
- To approve the Treasury Management Strategy and Treasury Management Indicators, the Investment Strategy and the Minimum Revenue Provision (MRP) for 2022/23. (Appendix 3)

- As part of the above:

    - To note the increased debt and corresponding revenue cost of this, in delivering the current Capital Programme, and the implications of this over both the short and medium-long term with regard to affordability, prudence and sustainability.

    - To note the Head of Finance recommendation to Council that borrowing needs to be limited to that included in the current Capital Programme, and the recommended prudential indicators on borrowing limits to achieve this.

    - To note the requirement to limit and manage debt funded expenditure beyond the existing programme period, for sustainability purposes, with particular regard to the development of the new Capital Programme.

    - To note the changes to the Prudential Code and Treasury Management Code, and the impact of those changes on the Council's approach to capital investment and treasury management.

    - Note comments made by Audit Committee on 27th January 2022 (paragraph 6).

Action by Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Leader of the Council and Cabinet Member for Economic Growth and Investment
- Chief Executive
- Strategic Directors
- All Heads of Service
- Newport Norse
- The Council's Treasury Advisors
- Accountancy staff

Signed

Background

Governance and requirement of councils

1. The Council's Corporate Plan sets out how the Council will take forward its mission of 'Improving Peoples' Lives' and includes a set of key promises. Delivery of these will, in some instances, involve capital funded projects.

2. Whilst Cabinet makes decisions regarding the capital projects to be included in the programme, it is full Council that approves the borrowing limits that the overall programme must remain within. Many projects are funded from capital grants, capital receipts and specific reserves, which do not impact on borrowing levels, but, where borrowing is required, it is important that those limits are not exceeded.

3. This is an important area of overall financial management governance in that debt funded capital expenditure, and the external borrowing that results, lock in the Council into a long-term liability for the associated revenue costs. These costs, known as 'Capital Financing Costs' are comprised of the external loan interest costs and the provision for financing the debt funded capital expenditure, known as Minimum Revenue Provision (MRP).

4. The key governance documents that underpin this area of local authority finances are:

   <u>Capital Strategy</u>

   This, at its core:

   i) Sets out the long-term context (10 years) in which capital decisions are made and includes the medium term Capital Programme;

   ii) Demonstrates that the local authority takes capital / investments decisions in line with service objectives, giving consideration to risk, reward and impact;

   iii) Shows how the Council takes account of stewardship of public funds, value for money and affordability, sustainability and prudence in its decisions and plans.

   <u>Treasury Management Strategy</u>

   This, at its core:

   (i) Sets out the Council's longer term borrowing requirement and approach, which is driven mainly by the Capital Programme requirements and, in Newport specifically, the reducing 'internal borrowing' capacity;

   (ii) Outlines how the Council will manage and invest its surplus cash;

   (iii) Includes additional guidance, namely the Welsh Government Investment Guidance and the MRP Policy.

   Both these strategies are a requirement of CIPFA's Prudential Code (which has recently been updated), which ensures, within the frameworks which these documents set, and a suite of prudential indicators, that capital expenditure plans are:

   - **Affordable –** total capital expenditure is to be within **sustainable** limits. Councils are required to consider their current and estimated future resources available, together with the totality of their capital expenditure and income forecasts in assessing affordability.

- **Prudent –** councils must ensure that its capital and investment plans are prudent and **sustainable**. Consideration as to overall financial **sustainability** is a key aspect to this. The operational borrowing limit should provide for the most likely level of borrowing, not the worse case, with the authorised limit providing sufficient headroom to enable day to day cash management. There should be alignment with the treasury management policy statement and practices and investing activities should strike an appropriate balance between security, liquidity and yield, in that order.

- **Sustainable –** sustainability is a key theme when considering both affordability and prudence and is something that should be assessed in terms of the long term financial picture.

5. The Capital Strategy and Treasury Management Strategy are inherently linked and the main recommendations and observations arising from these are summarised in the following sections. In light of the requirement for full Council to ultimately provide approval of these strategies, the Governance & Audit Committee was asked to review and provide comments on both strategies, and the limits and prudential indicators contained within them, as necessary, to enable Cabinet, and then Council, to appropriately consider and then approve each strategy as required.

6. The report was considered by Governance & Audit Committee on 27th January 2022. The comments and observations are outlined below and, where relevant, the response has been reflected in the report.

    - The committee noted the existing challenges regarding delivery of the Capital Programme, partly caused by capacity issues, resulting in large amounts of slippage in the programme. The Chair suggested that capacity challenges should be highlighted in the outturn report, where levels of slippage would be reported.
    - The Chair observed that the approach towards determining borrowing limits tended to be reactive, rather than proactive, with the value of the Capital Programme itself being the driver of the borrowing limits. This is as opposed to determining the overall level of affordability in terms of borrowing, which then dictates the maximum value of the Capital Programme.
    - The Chair noted the paragraph which outlined the suggested new prudential indicator relating to the borrowing headroom. It was felt as though further clarity was required in terms of the purpose of this indicator.

7. In response to the above comments:

    - The current Capital Programme is determined by an overall level of affordability and sustainability, as reflected by the inclusion of a level of borrowing headroom. This means that whilst there is scope for the value of schemes to be increased or new schemes to be added to the programme, there is an overall limit placed upon the amount of borrowing that can be undertaken in support of the current programme.
    - It is recognised that in developing the new programme, there will be a need to provide clarity regarding the overall level of unfunded capital expenditure that is deemed affordable. This has been provisionally modelled, as shown by the two scenarios outlined in the Long Term section of the Capital Strategy, however this will need to be developed further, and set out clearly, in next year's strategies and reports.
    - In addition, the existing capacity challenges will be a consideration as part of developing the new programme, ensuring that schemes are only included where there is clear capacity for delivery. As well as this, strengthened governance structures will be introduced as part of this.
    - The paragraph relating to the new prudential indicator has been rewritten to provide clarity.
    - Also, the liability benchmark modelling scenarios have been updated since the committee meeting.

<u>Capital Strategy 2022/23 to 2032/33</u>

Capital Programme to 2024/25

8. The Council's capital programme is scheduled to run until to 2024/25, which reflects the original capital 5-year programme to 2022/23, plus two additional years to incorporate only those projects whose completion spans beyond the current programme. It is a significant capital programme and includes the provision of the new leisure facility, the 21st Century Schools Band B Programme, and the Council's share of the accelerated investments being made by the Cardiff Capital Region City Deal. In addition, the programme includes an amount of uncommitted borrowing headroom, which now stands at £2.391m, compared to the original £4.5m that was allowed for. The total value of the programme, which is summarised in the table below, stands at £288.4m. This total includes a significant level of projected expenditure in the 2022/23 financial year, where in excess of £100m is forecast to be spent, which, given the level of spending in previous years, would seem overly optimistic and could result in a similar level of slippage to that experienced in recent years.

Table 1: Prudential Indicator: Estimates of Capital Expenditure and Capital Financing in £ millions

	ORIGINAL 5-YEAR CAPITAL PROGRAMME					**ADDITIONAL 2 YRS**		**Total current pro-gramme £m**
	2018/19 Actual £m	**2019/20 Actual £m**	**2020/21 Actual £m**	**2021/22 Forecast £m**	**2022/23 Budget £m**	**2023/24 Budget £m**	**2024/25 Budget £m**	
Approved Schemes	29.5	31.4	26.2	57.6	99.2	24.7	0.1	**268.7**
City Deal - cost of carry					1.8	10.0	5.5	**17.3**
Uncommitted borrowing*					2.4			**2.4**
TOTAL EXPENDITURE	**29.5**	**31.4**	**26.2**	**57.6**	**103.4**	**34.7**	**5.6**	**288.4**

9. The capital programme is financed through a variety of different funding streams, including external grants, use of reserves and external borrowing.

10. Capital Expenditure funded by debt increases the need to undertake external borrowing, unless it is possible to bridge this need via 'internal borrowing', which is the use of existing cash resources which are underpinned by the overall level of earmarked reserves. As the capacity to internally borrow reduces, as reserves are utilised, the need for external borrowing increases. This is particularly the case for this Council, which has had a high level of internal borrowing, which is now reducing over the medium-long term. Because of this, coupled with an increased level of unfunded capital expenditure, the Council is committed to be a net borrower for the long term. To ensure this borrowing is affordable and sustainable, Council is required to set an affordable borrowing limit.

Affordable borrowing limit

11. The Council is legally required to approve an affordable borrowing limit (also termed the 'Authorised Limit' for external debt) each year. The Authorised Limit is the absolute maximum amount of borrowing that can be undertaken, in order to manage the overall, day to day, cash requirements of the Council. It also allows for a level of borrowing in advance of need to be undertaken, where appropriate and affordable. In addition, the Council needs to set an 'Operational Boundary', which is the expected level of borrowing required to finance the current Capital Programme. Any increase required to the Operational Boundary needs to be approved by full Council.

Table 2: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2021/22 limit	2022/23 limit	2023/24 limit	2024/25 limit
Authorised limit – borrowing	255	271	278	274
Authorised limit – PFI and leases	42	41	39	36
Authorised limit – total external debt	**297**	**312**	**317**	**310**
Operational boundary – borrowing	187	192	203	201
Operational boundary – PFI and leases	42	41	39	36
Operational boundary – total external debt	**229**	**233**	**242**	**237**

12. For the remaining three years of the current capital programme until 2024/25, the level of borrowing to facilitate the current capital programme is anticipated to be substantial with external borrowing increasing from an estimated £149m at the end of this financial year to £201m in 2024/25. It should be noted, however, that this is a reduced figure from that forecasted in the previous Capital Strategy, due to the short-term increase in the availability of internal borrowing.

13. It can be seen that there is a significant difference between the Authorised Limit and the Operational Boundary. This is because of the level of internal borrowing available, underpinned by the level of cash backed reserves, which increased significantly during the 2020/21 financial year. The level of reserves will reduce over the medium-long term, in particular the PFI reserves, and, therefore, it will become necessary to undertake external borrowing in lieu of this reducing capacity. This will have a revenue impact because of the interest costs that will be incurred as a result of the external borrowing, compared to the minimal cost of internal borrowing, which, in essence, is represented by interest income foregone.

14. It should be noted that the two limits described above only place a theoretical limit on borrowing that can be undertaken to fund new capital expenditure. This is particularly relevant where there is evidence of slippage occurring across the programme. As a consequence, in theory, additional borrowing could be undertaken over and above that budgeted in the existing Capital Programme, because the slippage means that the operational boundary, for example, would not be reached. This would present a risk that, ultimately, the cumulative level of borrowing could exceed that which is deemed affordable. Therefore, to ensure a measure of control on borrowing undertaken to fund new capital expenditure, a local indicator has been included, which is directly linked to the level of borrowing headroom within the Capital Programme. The limit amounts to £2.4m in 2022/23 and will only apply for the remainder of this programme, with a new limit to be decided for the new programme.

15. The commitment to increase external borrowing leads to increasing capital financing costs which are reflected in the Council's Medium Term Financial Plan and outlined in Table 3 below. Costs will continue to increase into the medium to long term as the need to borrow increases. Compared to similar authorities, especially when comparing with councils with similar demographics, the percentage of the capital financing costs as a proportion of the Council's total net revenue is high. This highlights the need to maintain a sustainable level of spending on capital expenditure funded by debt to ensure that these costs remain affordable. It should be noted that the reason for the decreasing percentages shown below is because of the positive revenue settlement the Council is set to receive for 2022/23 and indicatively beyond that year. There remains, however, uncertainty beyond 2024/25 in terms of revenue funding. Therefore, the need to manage the overall levels of capital expenditure funded via borrowing will remain, to ensure that there is no significant adverse impact on the medium to long term revenue budget position.

Table 3: Capital Financing Budgets

	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
Provision for repayment of debt (MRP)*	10.3	10.3	10.7	10.9
Net interest cost	6.9	6.9	7.0	7.0
Total capital financing (exc PFI)	**17.2**	**17.2**	**17.7**	**17.9**
PFI	5.6	5.6	5.7	5.5
Total Financing costs* (£m)	**22.8**	**22.8**	**23.4**	**23.4**
Proportion of net revenue stream	7.2%	6.6%	6.6%	6.4%

*includes charges direct to service areas

Beyond the current capital programme (2023/24 onwards)

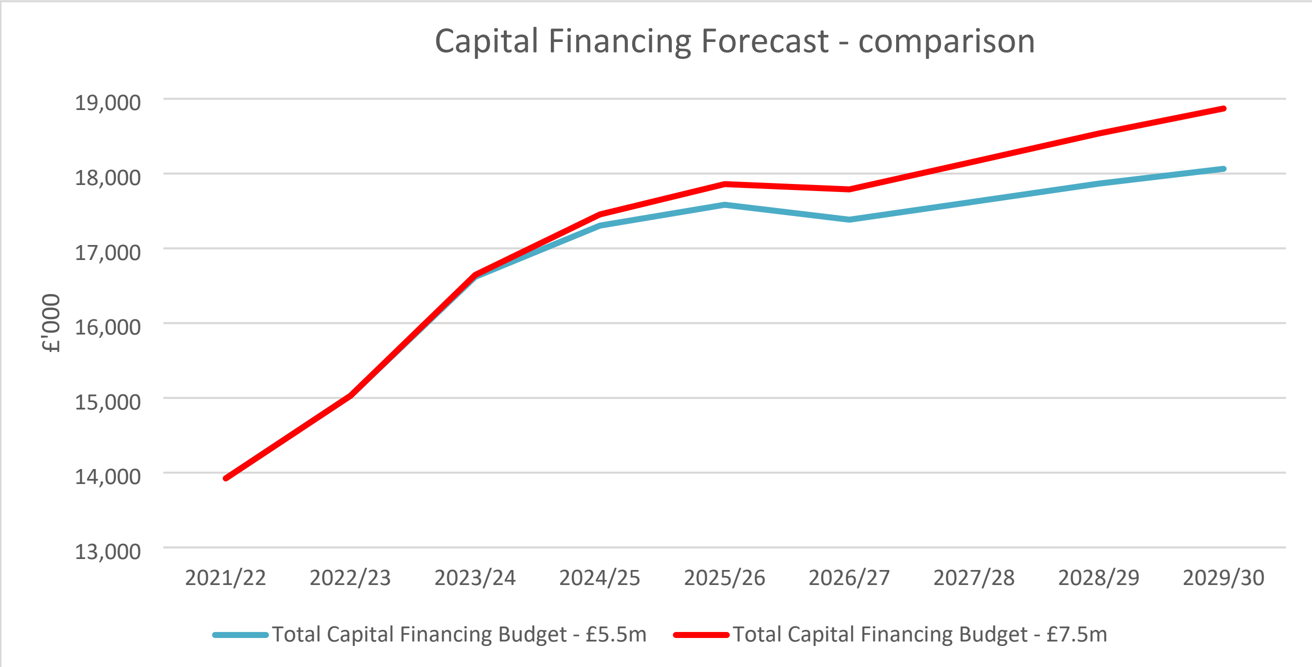
16. As well as considering the medium-term outlook, which coincides with the completion of the existing Capital Programme, and the additional two years added for specific projects, there is a need to look beyond this timeframe. This is particularly relevant when considering the need to develop the next programme, covering the period 2023/24 to 2027/28. When developing the new programme, the overriding objective will be to ensure that capital expenditure plans are affordable, prudent and sustainable, requiring a limit to be placed upon debt funded capital expenditure over that period. When looking beyond the current programme, the following points will need to be considered:

    - the high level of forecast borrowing and corresponding higher level of capital financing cost at the end of the current Capital Programme
    - the anticipated reduction in reserves and consequent capacity to be internally borrowed, requiring a continuing increase in external borrowing to replace it
    - the Council's methodology for charging MRP, which realised a budget saving when changed 3-4 years ago but which increases the charge each year from that point and will continue to do so going forward

17. As a consequence of the points above, the development of the new programme will be set against an increasing need to borrow, before considering any new schemes that will add to that need to borrow, as well as the need to complete the existing programme. In addition, the wider funding context will also be a major factor in determining an appropriate borrowing limit. For example, whilst WG have provided an indicative settlement figure for the next three years, there is uncertainty beyond that period, particularly with the impact of recovering from the pandemic to contend with. This will influence the UK Government's provision of funding to WG which, in turn, will impact on the funding levels provided to local authorities. As well as this, the Council's Council Tax levels and the ability to set balanced budgets will play a significant role in determining sustainable borrowing limits.

18. To exemplify potential approaches to setting a sustainable borrowing limit, and the consequent impact upon capital financing budgets, Chart 1, below, shows two modelled scenarios from 2023/24, - (i) £5.5m debt funded expenditure per annum and (ii) £7.5m debt funded expenditure per annum. Both scenarios are based on debt funded capital expenditure in addition to schemes already approved.

    Chart 1: Capital Financing Cost Forecast, excluding PFI



19. The above graph demonstrates the impact that the existing programme, with the significant borrowing requirement attached to it, has on the capital financing requirements, denoted by the sharp increase in costs over the short term. Beyond that, there is a slight levelling off before a more gradual increase in capital financing costs over the longer term. This increase is despite the fact that both modelled scenarios actually succeed in restricting the growth in the underlying need to borrow. However, as mentioned previously, the Council's chosen MRP methodology and the reduction in capacity for internal borrowing are responsible for driving up the cost of capital financing in those later years.

20. Whilst the costs of the current Capital Programme are already provided for within the revenue budget, the increasing capital financing costs from 2026/27, in particular, would place additional pressure upon the revenue budget. This would mean that the desire, or need, to undertake debt funded capital investment would have to be prioritised as part of the budget setting process and considered alongside other priorities for revenue funding.

Other Capital Strategy areas

21. The Capital Strategy includes a number of other areas to be considered, which are included in full in Appendix 2. The one area that has significantly changed, in light of the updated Prudential Code, is the Council's approach to commercialisation. As part of the 2019/20 Capital Strategy, the creation of a £50m investment fund was agreed. Examples of how this fund would be used included commercial property investment and investing in new services, such as energy provision. The intention would be to generate income to support the overall revenue budget. However, following the Public Works Loans Board's decision to stop lending to local authorities in situations where investment solely for the purpose of yield was intended, the new Code has implemented similar restrictions, with immediate effect. Therefore, it would no longer be appropriate for the Council to pursue its Commercialisation Strategy, as currently designed, and invest in the activities outlined above. It should be noted that the current programme does not reflect any such commercial activity, with the £50m having not been accessed, and there is no immediate impact upon the Council. On that basis, the element of the strategy has been withdrawn and will no longer feature going forward.

Treasury Management Strategy

22. The Council's detailed Treasury Management strategies for 2022/23 and beyond are included as Appendix 3, as are the various treasury management indicators. Key points of interest are summarised below.

Borrowing Strategy

23. As outlined in earlier sections of this report, the Council is committed to being a net borrower over the life of the existing Capital Programme and beyond. In particular, a significant increase in the need to borrow is being projected for the 2022/23 financial year. However, the Council's preferred strategy is to maximise the level of internal borrowing, aided by the recent increase in earmarked reserve levels. Therefore, whilst the overall Capital Financing Requirement is set to increase, the need to undertake new borrowing will be deferred for as long as possible.

24. However, the capacity to internally borrow is expected to reduce over the medium to long term. In addition, some existing loans are due to mature over the next few years. These two factors, will mean that some new borrowing will be required, before considering any overall increase in the CFR. As well as this, in light of the Council's position as a committed long term borrower, the decision could be taken to undertake borrowing in advance of need. This would only be done in consultation with the Council's treasury advisors and where it was felt to be appropriate, and affordable, in order to mitigate against future interest rate rises.

25. When the need to undertake borrowing arises, the Council will need to give consideration as to the time period over which to borrow. The guiding principle will be to achieve a low, but certain cost of finance. This will generally mean long term borrowing, as this can provide certainty for periods for more than 50 years, if desired. However, with long term borrowing interest rates currently much higher than short term borrowing interest rates, the Council could decide to undertake a degree of short term borrowing. This would achieve a more balanced borrowing portfolio, but also assist with mitigating the risk of locking into higher long-term borrowing rates. Again, individual borrowing decisions would only be taken in consultation with the Council's treasury advisors, but also whilst considering the maturity profile of the current borrowing portfolio, as well as overall affordability.

Investment Strategy

26. Both the CIPFA Code and the WG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

27. As outlined in the 2021/22 Capital Strategy, the Council intends to diversify its investment portfolio, given the increasing risk and very low returns from short-term unsecured bank investments. The uncertainty regarding the current economic climate has led to this change being put on hold, however it is intended to explore this further during 2022/23. The outcome is likely to be the Council investing all, or part, of the £10m that is available for long-term investment in higher yielding asset classes, such as pooled property funds. This would represent a move away from investing in low yielding bank deposits or with other local authorities. The detail regarding the approved counterparty list and limits is shown in Table 4 of Appendix 3.

Head of Finance Summary

28. The Council's Capital Strategy, and in particular the Capital Programme itself, are, from a financial perspective, decisions with long term implications and where decisions today 'lock-in' the impact on budgets once projects have progressed and borrowing taken out. As explained in the first part of this report, the core requirement for councils is to make decisions whilst taking into account:

    (i) affordability – what are the increasing costs of debt that may be required and whether they can be funded from within the overall revenue budget, taking account of other spending pressures, forecast future income and the impact of this expenditure compared with expenditure in other areas.
    (ii) prudence – appropriate limits and targets are set to manage and monitor affordable and sustainable borrowing and investments are made with a view to balancing security, liquidity and yield.
    (iii) sustainability – the impact of the debt and financing costs on the Council's budget long term and being able to withstand the impact of that on a recurring basis.

29. In terms of the Council's current Capital Programme to 2024/25:

    Affordability

    - There is a significant increase in the Council's projected level of external borrowing and the associated capital financing costs over the next three years. Due to the better than anticipated settlement the Council received for 2021/22, it was possible to fully fund the revenue costs of the entire current Capital Programme, to its conclusion. The current capital programme is therefore affordable, in totality, as a result of this. This is an important position to be in for the following reasons:

        - Whilst the Council currently has a broadly balanced MTFP over the next three years, following the positive draft settlement for 2022/23, there is a risk that unforeseen spending pressures will emerge or known pressures will increase in value, thus resulting in an unbalanced budget position emerging.
        - The revenue capital financing cost increase is very significant over a short period of time (as demonstrated in Chart 1).
        - Funding availability is uncertain, particularly beyond the medium term, and there remain significant cost pressures on the budget in relation to areas such as social care.

    Prudence

    - Prudent operational limits on the level of capital expenditure funded by borrowing have been recommended, which align with the current programme requirement and, therefore, the Council's priorities. These operational limits increase significantly over the course of the programme and will result in the Council taking on significantly more debt. Therefore, the Capital Programme needs to be strictly managed within those limits to ensure that the need to externally borrow does not increase and expose the Council to any further risk or interest costs.

    Sustainability

    - As outlined above, the revenue costs arising from the existing Capital Programme have been fully funded within the overall revenue budget. In addition, WG have provided indicative funding settlements for the next three financial years, which provides some assurance regarding future funding levels. Providing that the Council is able to balance its budget over the medium term, then the costs of borrowing are sustainable.

- However, there is a more significant challenge when considering the longer term sustainability of meeting the costs of debt funded capital expenditure. The Capital Strategy provides two scenarios, which exemplify the costs of limiting the annual level of debt funded capital expenditure to either £5.5m or £7.5m. Both of these scenarios would be successful in restricting the growth in the CFR longer term, however, due to the reducing capacity for internal borrowing and the MRP policy, the cost of capital financing still increases. Therefore, when developing the next Capital Programme, from a sustainability perspective, it will be important for the Council not to overcommit itself to additional borrowing, particularly with the uncertainty regarding future funding levels.

30. The development of the next Capital Programme will be challenging, as it will incorporate the tail end of the existing programme, there may be an amount of slippage to contend with and there will be a need to limit the overall increase in the need to externally borrow. It will be important that the Council has a clear framework for building up the next programme, ensuring that it is affordable, prudent and sustainable. A clear and accountable governance structure to oversee the development of the programme will be critical, as there will most likely be competing demands for new capital investment, coupled with a need to ensure sufficient funding for addressing the asset maintenance backlog. It will be vital that schemes are only added to the programme when there is confidence regarding cost estimates, ability to deliver them on time and clarity regarding funding source (i.e. a large proportion of the Council's capital expenditure tends to be funded via grant). This will go some way towards minimising the level of slippage and the risk of committing to borrow when not absolutely necessary.

31. Council are required to approve the Capital and Treasury Management Strategies, including the prudential indicators and limits contained within.

Risks

Risk Title / Description	**Risk Impact score of Risk if it occurs* (H/M/L)**	**Risk Probability of risk occurring (H/M/L)**	**Risk Mitigation Action(s)** What is the Council doing or what has it done to avoid the risk or reduce its effect?	**Risk Owner** Officer(s) responsible for dealing with the risk?
Increased need to borrow beyond currently assumed levels.	High*	Medium	Regular monitoring and reporting of available headroom should identify any issues at an early stage and keep Cabinet / Council updated. Potential for slippage in overall programme to negate need for additional borrowing.	Members, Senior Leadership Team, Heads of Service and Head of Finance.
Undertaking borrowing that is not ultimately required.	High	Low	Regular monitoring of schemes means that potential for slippage should be identified at an early level. Regular contact with WG regarding potential grant funding, which could negate the need to undertake borrowing.	Senior Leadership Team, Heads of Service and Head of Finance.
Investment counterparty not repaying investments.	High*	Low	The Council only invests with institutions with very high credit scores. It employs advisors to monitor money market movements and	Members, Head of Finance, Treasury staff, based

Risk Title / Description	Risk Impact score of Risk if it occurs* (H/M/L)	Risk Probability of risk occurring (H/M/L)	**Risk Mitigation Action(s)** What is the Council doing or what has it done to avoid the risk or reduce its effect?	**Risk Owner** Officer(s) responsible for dealing with the risk?
			changes to credit scores and acts immediately should things change adversely. The lower levels of funds/duration available for relatively higher risk investment as measured by 'credit ratings' will also alleviate the risk.	on advice from treasury advisors.
Interest Rates moving adversely against expectations.	Medium*	Medium	There is the potential that interest rates could increase as the economic recovery from the COVID-19 pandemic continues. The Treasury Strategy provides for a balance between short and long term borrowing as a means of managing this particular risk.	Head of Finance, Treasury staff, based on advice from treasury advisors.

** Impact is ultimately determined by the values involved, with the impact reducing as the values decrease.*

Links to Council Policies and Priorities

The Capital Strategy sets out the Capital Programme over a long term context and demonstrates that the Capital Programme supports a number of the Council's aims and objectives.

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

To approve both the Capital Strategy and the Treasury Management Strategy for 2022/23, including the prudential indicators contained with both documents.

Preferred Option and Why

The Prudential Code places a requirement upon local authorities to determine a long term Capital Strategy. The Prudential Code and statute also require that, before the end of the financial year, reports on Treasury Management matters are presented to Council for approval. Therefore, Council are required to approve both the Capital Strategy and the Treasury Management Strategy.

Comments of Chief Financial Officer

This report, and the Capital and Treasury Management Strategies appended, both highlight the revenue implications from capital expenditure, and for the need for the capital plans of the authority to be affordable, prudent and sustainable.

The Capital Strategy highlights the anticipated significant increase in borrowing and the revenue costs resulting from the current Capital Programme. Continuation of increasing borrowing at this level into the next programme is potentially unsustainable. Whilst the current Capital Programme is affordable, and the necessary capital financing budgets were frontloaded as part of the 2021/22 revenue budget, it is important that expenditure is kept within the financing limits within the programme. If further borrowing is required, this will need to be approved by Council.

Over the longer-term, beyond the current Capital Programme, a slow-down of debt funded capital expenditure would be required and, even by limiting borrowing as exemplified in the Capital Strategy, the capital financing costs continue to increase, therefore showing the importance of agreeing a prudent limit for the future programme.

This will be a key aspect of the development of the new programme, which will commence during this financial year, as will the need to address the significant level of slippage being reported against the current programme. This issue with slippage is evidenced in the forecasted level of expenditure in the 2022/23 financial year, which exceeds £100m. This is a level of expenditure far in excess of anything spent in previous financial years and suggests that achieving this level of spend, with the current level of project management capacity, will be a significant challenge.

Should similar levels of slippage continue to be reported, beyond 2022/23, this has the potential to significantly impact upon the capacity to deliver new schemes during the first two years of the new programme. Therefore, the Council will need to be very clear in its priorities for the new programme and balancing them against available funding sources, scope for new borrowing and project management capacity to deliver those schemes.

The Treasury Management Strategy highlights that whilst the capacity for internal borrowing did not decrease as much as was anticipated in the previous strategy, longer term that capacity is forecasted to diminish. Therefore, the need for the Council to undertake external borrowing remains and a view will need to be taken on whether this can be done early to mitigate the risks of interest rate rises and remain within current set budgets.

Comments of Monitoring Officer

There are no specific legal issues arising from the report. The Capital Strategy will provide a framework for future capital and investment decisions, having regard to principles of affordability, prudence, sustainability and risk/reward. The Treasury Management Strategy sets out the financial management principles that will underpin the Capital Strategy. As such, both strategies will form part of the Council's overall budget framework and are required to be formally approved and adopted by full Council. Governance & Audit Committee were asked to comment on the draft Capital Strategy and Treasury Management Strategy as part of its responsibility for reviewing and monitoring the effectiveness of the Council's system of internal controls and the proper administration of its financial affairs and their comments have been included in the report. Governance & Audit Committee were only concerned with the effectiveness of the strategies in terms of how capital and investment decisions are made, rather than the detail, as individual capital and investments decisions within the Capital Programme are matters for Cabinet.

Comments of Head of People and Business Change

There are no human resources implications arising from the report. As identified in the Fairness and Equality Impact Assessment that has been undertaken, an effective Capital Strategy will enable the Council to support long term planning in line with the sustainable development principle of the Wellbeing of Future Generations Act.

Scrutiny Committees
N/A

Fairness and Equality Impact Assessment:

- **Wellbeing of Future Generation (Wales) Act**
- **Equality Act 2010**
- **Socio-economic Duty**
- **Welsh Language (Wales) Measure 2011**

The Council has a number of legislative responsibilities to assess the impact of any strategic decision, proposal or policy on people that may experience disadvantage or inequality. In relation to this strategy document, a Fairness and Equality Impact Assessment has been undertaken. The FEIA has been undertaken in light of this strategy being an overarching financial strategy, rather than a policy decision relating to one specific initiative or service. Therefore, there are elements to the assessment that don't lend themselves to this particular strategy. It should also be noted that there is a clear link between this strategy and the Council's revenue budget setting process, with the ultimate impact of capital expenditure being felt within the revenue budget. Therefore, any consultation required will have been undertaken as part of the revenue budget setting process. Also, specific schemes within the Capital Programme will have been subject to an FEIA, where relevant.

The main conclusions to be drawn from the FEIA undertaken is that there is a clear link between the long term nature of the Capital Strategy and the sustainable development principle of the Wellbeing of Future Generations Act. This is evidenced through the focus on ensuring affordability, prudence and, most relevantly, sustainability. Therefore, there is potentially a positive impact from the perspective of the younger age groups. In the case of the other protected characteristics, it is not felt that there is a specific impact, however this may not necessarily be the case for the individual schemes within the programme, which should have been subject to separate FEIAs. However, there are a variety of schemes within the programme that will, collectively, have had a positive impact upon groups with protected characteristics such as disability, language preference and socio-economic background.

Crime and Disorder Act 1998
Section 17(1) of the Crime and Disorder Act 1998 imposes a duty on the local authority to exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area.

Consultation
N/A

Background Papers
Report on Treasury Management for the period to 30 September 2021
Capital Monitoring and Additions Report – January 2022

Dated:

Appendix 1 – Detailed breakdown of the current Capital Programme (£000)

	Outturn 2018/19	Outturn 2019/20	Outturn 2020/21	Forecast 2021/22	Budget 2022/23	Budget 2023/24	Budget 2024/25	Total
<u>Education:</u>								
21st Century Schools - Band A	8,046	1,220	30	-	-	-	-	9,296
21st Century Schools - Band B	675	1,711	3,421	10,275	45,702	13,424	165	75,373
Welsh Medium Primary School	-	150	44	1,228	2,078	2,300	-	5,800
Jubilee Park - Fixtures, Furniture & Equipment	13	-	-	-	-	-	-	13
Blaen-y-Pant Bungalow (Educational Use)	52	-	14	-	-	-	-	66
St Mary's Toilet Refurbishment.	-	42	-	-	-	-	-	42
Somerton Primary - ICT Equipment	11	-	-	-	-	-	-	11
Feminine hygiene hardware & toilet facilties.	34	-	-	-	-	-	-	34
Gaer Annexe Education Use	-	416	95	-	-	-	-	511
Lliswerry High (S106 Funds)	110	80	1	7	-	-	-	198
Lliswerry IT Replacements	53	-	-	-	-	-	-	53
Maesglas Reducing classroom size	-	64	109	398	-	-	-	571
Llanmartin Primary ICT	10	-	-	-	-	-	-	10
Malpas Park Primary	11	-	-	-	-	-	-	11
Reducing Classroom size bids	-	61	647	(0)	-	-	-	708
Bassleg Demountables	-	116	102	-	-	-	-	218
ICT Equipment Lease (Clytha Primary)	-	20	-	-	-	-	-	20
ICT Equipment Lease (St Mary's)	-	11	-	-	-	-	-	11
Bassaleg ICT	-	69	-	-	-	-	-	69
Ringland Perimeter Fence	-	-	85	-	-	-	-	85
St Patricks ICT	-	12	-	-	-	-	-	12
Bassaleg Demountables - year 7	-	-	765	14	-	-	-	779
EdTech Grant	-	-	202	160	-	-	-	362
Charles Williams Renovations	-	-	104	56	1,460	-	-	1,620
Lliswerry Safeguarding	-	-	51	-	-	-	-	51
Maindee Toilets	-	-	177	-	-	-	-	177
ICT Equip Lease Ysgol Gymraeg Ifor Hael	-	10	-	-	-	-	-	10
Pentrepoeth - site accessibility	-	-	-	144	550	-	-	694
St Andrews	-	-	-	635	365			1,000
St Mary's Urgent Capital repairs grant	-	-	-	-	2,640			2,640

	Outturn 2018/19	Outturn 2019/20	Outturn 2020/21	Forecast 2021/22	Budget 2022/23	Budget 2023/24	Budget 2024/25	Total
Education Maintenance Grant 2018/19	-	1,470	574	49	-	-	-	2,093
Education Maintenance Grant 2019/20	-	-	732	947	76	-	-	1,755
Education Maintenance Grant 2020/21	-	-	-	351	2,185	-	-	2,537
Education Maintenance Grant 2021/22				817	1,861			2,678
Education Accessibility Studies	-	-	2	97	198	-	-	298
Education Asset Improvements - balance to be drawn down	1,055	200	1	-	-	-	-	1,256
Education Accessibility Studies - Phase 2	-	-	-	-	632	-	-	632
Milton IT replacement	-	-	25	-	-	-	-	25
St Michaels IT	-	-	16	-	-	-	-	16
Prior Year Scheme - Various	(38)	(39)	(3)	-	-	-	-	(80)
Education Total	**10,032**	**5,614**	**7,194**	**15,180**	**57,748**	**15,725**	**166**	**111,657**
Regeneration, Investment & Housing:								
Asset Management Programme	1,066	1,245	1,801	1,973	1,864	-	-	7,949
Gypsy/Traveller Site Development	2,993	78	10	55	-	-	-	3,136
Indoor Newport Market	-	-	1,086	4,414	-	-	-	5,500
HLF Market Arcade Townscape Heritage Scheme	39	266	1,043	1,429	-	-	-	2,777
Indoor Market Facilities Improvements	(2)	-	-	-	-	-	-	(2)
Civic Centre / Info Station Service Relocations	116	121	-	29	-	-	-	266
Info Station NSA enabling	536	-	-	-	-	-	-	536
123-129 Commercial Street (Pobl Regen)	623	623	-	-	-	-	-	1,246
Cardiff City Region Deal	1,208	-	196	-	7,998	-	-	9,402
Cardiff City Region Deal - Cost of Carry					1,850	9,987	5,482	17,319
Mill Street Development Loan	-	2,341	1,184	475	-	-	-	4,000
Neighbourhood Hubs	915	1,344	-	-	-	-	-	2,259
Arva Investment Loan	385	333	-	32	-	-	-	750
Disabled Facilities	898	1,092	784	1,046	1,122	-	-	4,942
Disabled Facilities ICF Funding	-	-	-	76				76
Safety at Home	364	375	243	398	378	-	-	1,758
ENABLE Adaptations Grant	197	197	197	197	-	-	-	788
Homelessness Prevention Grant	98	-	-	-	-	-	-	98

	Outturn 2018/19	Outturn 2019/20	Outturn 2020/21	Forecast 2021/22	Budget 2022/23	Budget 2023/24	Budget 2024/25	Total
FS Maintenance 1819 / 1920	31	38	-	-	-	-	-	69
FS Shaftsbury Community Centre	183	-	-	-	-	-	-	183
Childcare - Flying Start	-	546	256	1,101	195	-	-	2,098
FS City Wide Maintenance & Repair of Premises	-	-	59	74	-	-	-	133
Castle Kids Refurbishment Works	-	-	17	-	-	-	-	17
Improvements to Flying Start Facilities	-	-	116	-	-	-	-	116
Flying Start Capital Grant	-	-	-	300	-	-	-	300
FS Settings City Wide Equipment Replacement				110				110
FS East Hub ROSPA Inspection				25				25
FS Hubs City Wide Redecoration & Repair				90				90
Childcare Offer IT				60				60
Childcare Offer Capital COVID				100				100
All Wales Play Opportunities	-	-	144	266	-	-	-	410
Central Library - Structural Works	72	17	30	18	526	-	-	663
Transporter Bridge	72	913	80	400	7,000	3,716	-	12,180
Chartist Tower	-	1,344	(1)	256	-	-	-	1,599
POBL Empty Properties Phase One				15				15
PAC System	-	57	-	-	-	-	-	57
Medieval Ship	-	-	-	8	4	-	-	12
Information Station	-	-	141	385	1,224	-	-	1,750
Renewable Energy Investment	-	2	-	150	1,577	-	-	1,729
TRI Thematic Funding	-	-	49	758	272	-	-	1,078
Refit	-	-	-	90	1,310	600	-	2,000
Placemaking capital projects	-	-	-	-	1,650	-	-	1,650
Clarence House	-	-	-	750	-	-	-	750
Prior Year Scheme - Various	(7)	(18)	(9)	-	-	-	-	(34)
Regeneration, Investment and Housing Total	**9,787**	**10,914**	**7,424**	**15,080**	**26,969**	**14,302**	**5,482**	**89,960**
<u>People & Business Change:</u>								
IT Replacement Schemes	94	9	-	500	315	-	-	918
Corporate EDMS Rollout	-	13	-	-	-	-	-	13
CRM	250	276	246	200	-	-	-	971
I Trent Development	-	91	164	-	-	-	-	255

	Outturn 2018/19	Outturn 2019/20	Outturn 2020/21	Forecast 2021/22	Budget 2022/23	Budget 2023/24	Budget 2024/25	Total
Print 2010- Managed Printer Service	131	-	50	199	-	-	-	380
People and Business Change Total	**475**	**389**	**460**	**899**	**315**	**-**	**-**	**2,537**
Adult & Community Services:								
Telecare Service Equipment	97	12	35	30	30	-	-	204
Equipment for Disabled Grant (GWICES)	165	165	165	165	165	-	-	825
Home Care System	32	-	-	-	-	-	-	32
Centrica Lodge	(6)	(3)	-	-	-	-	-	(9)
SMAPF	320	305	296	512	-	-	-	1,433
Adult Call up System	-	-	76	-	-	-	-	76
Adults and Community Services Total	**608**	**479**	**572**	**707**	**195**	**-**	**-**	**2,561**
Children's & Families Services:								
3 New Homes	701	792	588	-	-	-	-	2,081
Oaklands Respite Home	505	102	-	-	-	-	-	607
Windmill Feasibility Study	41	110	25	1,355	10	-	-	1,541
Rose Cottage Sewerage Tank	-	-	0	23	-	-	-	23
Rosedale Annexes				500	-	-	-	500
Disbursed accommodation and Covid-19 equipment	-	-	331	346	-	-	-	677
Children's and Families Services Total	**1,247**	**1,004**	**945**	**2,224**	**10**	**-**	**-**	**5,430**
City Services:								
Fleet Replacement Programme	797	1,912	2,039	2,200	1,249	-	-	8,197
Bus station - Friars Walk Development	29	93	-	-	-	-	-	122
Flood Risk Regulation Grant	24	34	27	-	-	-	-	85
Cemetery Infrastructure Improvements	16	30	30	46	-	-	-	122
Peterstone Sewage Scheme	1	28	(13)	444	152	-	-	612
Road Safety Capital 2018/19	-	1,379	-	-	-	-	-	1,379

	Outturn 2018/19	Outturn 2019/20	Outturn 2020/21	Forecast 2021/22	Budget 2022/23	Budget 2023/24	Budget 2024/25	Total
Composting	567	-	-	-	-	-	-	567
Docksway Cell 4 Development	1,555	1,046	-	-	-	-	-	2,601
CCTV	-	37	8	-	-	-	-	45
Smaller Bins - MTRP BC	70	1,177	-	-	-	-	-	1,247
Newport Station Footbridge - LTF	77	314	655	8,878	-	-	-	9,924
Decriminalised Parking	232	874	21	-	-	-	-	1,127
Update Facilities in Parks	18	47	-	-	-	-	-	65
Decommisioning of Cemetery Office & Toilets	11	-	-	-	-	-	-	11
Building Improvements to Lodges	14	94	-	-	-	-	-	108
Small Scale Works Grant	34	-	-	-	-	-	-	34
Road Refurbishment Grant Scheme	931	198	711	716	-	-	-	2,556
Street Lighting LEDs	564	2,202	152	-	-	-	-	2,918
Park Square Lights	-	-	71	-	-	-	-	71
Velodrome Lights	-	173	128	36	-	-	-	337
Local Transport Fund - Active Travel Northern 2018/19	290	196	102	-	-	-	-	588
Tredegar Park Car Park	-	-	12	-	-	-	-	12
Tredegar Park – Cycle improvements	-	3	62	55	35	-	-	155
Lliswerry Road (81)	-	9	-	-	-	-	-	9
28-30 Stow Hill (11/0269)	-	7	-	-	-	-	-	7
Forbisher Road (15/0720)	-	9	-	-	-	-	-	9
Festive lighting	-	109	-	-	-	-	-	109
Local Transport Fund - Active Travel Design 2018/19	240	-	-	-	-	-	-	240
Bus Stop Enhancements	-	24	375	-	-	-	-	399
Core AFT Allocation	-	340	-	-	-	-	-	340
Inner City Links	-	684	249	-	-	-	-	933
LTNF - ECO Stars	42	41	-	-	-	-	-	83
Safe Routes - St Davids RC Primary	84	145	37	20	-	-	-	286
Gwastad Mawr Flood Attenuation Improvement Works	2	-	25	31	-	-	-	58
18-19 Collection Collaborative Change Programme	1,175	-	-	-	-	-	-	1,175
LTF Monkey Island Bridge Lliswerry Pill	29	121	587	225	-	-	-	962
LTF Sustainable Transport	25	309	-	-	-	-	-	334
Riverside Park	20	-	-	-	-	-	-	20
Pye Corner Railway Station Development Works	21	-	-	-	-	-	-	21

	Outturn 2018/19	Outturn 2019/20	Outturn 2020/21	Forecast 2021/22	Budget 2022/23	Budget 2023/24	Budget 2024/25	Total
Nappy Grant	-	202	-	-	-	-	-	202
Improving Flats Recycling Towards 70%	-	344	-	-	-	-	-	344
Increased Recycling at Docks Way	-	86	-	-	-	-	-	86
Plastic Waste Prevention Project	-	30	-	-	-	-	-	30
Green Infrastructure	-	-	35	169	-	-	-	204
Highways Annual Sums	455	322	125	705	463	-	-	2,070
Lliswerry Recreation Ground Changing Rooms	4	339	-	-	-	-	-	343
Safe Routes - St Davids RC Primary Year 2	-	-	21	-	-	-	-	21
Sustainable Transport Improvements Year 2	-	-	208	86	-	-	-	294
Upgrading and Replacement of Bus Stops	-	-	128	-	-	-	-	128
Road Safety Capital A48 Llandevaud	-	-	74	-	-	-	-	74
Resilient Roads	-	-	65	-	-	-	-	65
Carnegie Court Emergency River Works	-	-	1,096	-	167	-	-	1,263
Western Corridor-Inner City Links	-	-	536	1,144	-	-	-	1,680
Core Allocation Yr 2	-	-	69	21	-	-	-	90
Parry Drive Play Area Improvements	-	-	19	-	-	-	-	19
Brecon Road Play Area Improvements	-	-	3	-	-	-	-	3
Improvements to Throwing Facilities at Newport Athletics Stadium	-	-	156	-	-	-	-	156
Sorrell Drive Repairs	-	-	26	-	-	-	-	26
Improvements to Marshfield Village Sports Pitches	-	-	14	13	-	-	-	27
Local sustainable transport measures in response to Covid	-	-	499	14	-	-	-	514
Ultra Low Emission Grants	-	-	205	615	-	-	-	820
Kingsway car park operation	-	-	343	-	-	-	-	343
Increased Recycling - Bag Sorting at Household Waste Recycling Centre	-	-	-	25	-	-	-	25
Creation of a Reuse+Repair Hub	-	-	456	57	-	-	-	513
Repair & Reuse Newport Makerspace	-	-	69	-	-	-	-	69
Green Recovery (Ash Die Back)	-	-	190	-	-	-	-	190
Leisure centre New build	-	-	-	1,468	13,580	4,673	-	19,721
Bus Stop Enhancements - Yr 2	-	-	-	760	-	-	-	760
A467 Improvements Resilent roads	-	-	-	600	-	-	-	600
EV Development and Infrastructure	-	-	-	690	-	-	-	690
Bettws and Maplas Canal Link	-	-	-	1,207	-	-	-	1,207

	Outturn 2018/19	Outturn 2019/20	Outturn 2020/21	Forecast 2021/22	Budget 2022/23	Budget 2023/24	Budget 2024/25	Total
Core Allocation Yr 3	-	-	-	751	-	-	-	751
Upgrade of Facilities NISV	-	-	-	234	-	-	-	234
Eastern Links	-	-	-	61	-	-	-	61
Road Safety Traffic Enforcement Cameras	-	-	-	140	-	-	-	140
Newport Fflesci Demand Responsive Bus Pilot Scheme	-	-	-	968	-	-	-	968
SRIC & Road Safety Grant	-	-	-	203	-	-	-	203
Somerton Park	-	-	-	8	-	-	-	8
Underwood Play Area	-	-	-	12	-	-	-	12
Local Places for Nature Grant	-	-	-	109	-	-	-	109
Allotment Grant	-	-	-	35	-	-	-	35
Depot Infrastructure Charging	-	-	-	300	-	-	-	300
Pentonville Development (Sorrell Hill, Barack Hill and Allt-yr-yn)	-	-	-	24	26	-	-	50
Nature Networks - Monkey Island	-	-	-	67	21	-	-	88
Nature Networks - Shaftsbury Allotments	-	-	-	27	27	-	-	53
Nature Networks - Old Tredegar Golf Course	-	-	-	6	67	-	-	73
Jubilee Gardens grant				8				8
Active Travel grant - City centre				211				211
Active Travel grant - Community Cycle Hub				52				52
Prior Year Scheme - Various	(11)	-	-	-	-	-	-	(11)
City Services Total	**7,316**	**12,958**	**9,614**	**23,439**	**15,786**	**4,673**	**-**	**73,787**
Total Capital Programme	**29,466**	**31,358**	**26,210**	**57,530**	**101,022**	**34,699**	**5,647**	**285,932**

	Outturn 18/19	Outturn 19/20	Outturn 20/21	Forecast 21/22	Budget 22/23	Budget 23/24	Budget 24/25	Total
<u>Financed By:</u>								
General Capital Grant	4,754	3,858	4,107	4,083	4,060	1,173	37	22,072
Supported Borrowing	4,058	4,077	4,097		4,000	-	-	

				4,072				20,304
Unsupported Borrowing	2,126	5,787	1,771	8,913	32,475	17,038	5,519	73,629
Prudential Borrowing	84	123	-	-	-	-	-	207
External Grants	12,911	13,053	15,174	34,986	49,255	15,061	91	140,531
S106	868	523	410	1,293	3,051	1,412	-	7,557
Other Conts	242	268	75	46	639	15	-	1,285
Capital Receipts	3,136	820	25	1,584	2,754	-	-	8,319
Revenue Conts	75	68	38	522	755	-	-	1,458
Reserve	1,081	2,777	464	1,832	4,034	-	-	10,189
Finance Lease	131	-	50	199	-	-	-	380
Total Capital Programme Financing	**29,466**	**31,358**	**26,210**	**57,530**	**101,022**	**34,699**	**5,647**	**285,932**

Appendix 2

NEWPORT CITY COUNCIL CAPITAL STRATEGY 2022/23 TO 2032/33

NEWPORT CITY COUNCIL
CITY COUNCIL
CYNGOR DINAS
CASNEWYDD

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EXECUTIVE SUMMARY

This Capital Strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services, along with an overview of how associated risk is managed and the implications for future financial sustainability.

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

The report highlights that expenditure on capital needs to remain within affordable, prudent and sustainable limits. Demand for capital resources remains high and therefore, inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners are required to address this.

The strategy highlights the key risks and recommendations:

- The Council's current capital programme has a substantial amount of borrowing to 2024/25, and whilst this is affordable, due to the revenue budget requirement being forward funded in the 2021/22 budget, it would be unsustainable to continue increasing borrowing thereafter, at the current rate.

- The Council's Medium Term Financial Plan includes the revenue costs for the financing of the current capital programme to 2024/25, which includes a level of uncommitted borrowing headroom limited at £4.5m but excludes any borrowing for schemes which are self-financing.

- As per the agreed framework (detailed in the report), the current programme needs to be maintained within the agreed limits and not result in an increase in the Capital Financing Requirement or the level of new capital expenditure to be funded via borrowing, therefore not putting additional pressure on the capital financing budgets contained within the overall revenue budget. Any required increase in the level of capital expenditure to be specifically funded by borrowing would need approval by full Council.

- Within the context of significant demands for capital resources and limited availability, there is the need to develop the various strategic plans across the organisation which are driving the need for capital expenditure. This will include clearer visibility and assessment of demand for maintenance of assets such as schools, highways and other operational assets.

- Decisions on funding capital expenditure through borrowing locks the Council into committing revenue funding over a very long period (as long as 40 years+). With the MRP budget increasing over the long-term, the Council will need to make some difficult decisions going into the next programme to ensure the capital plans remain affordable and sustainable. A clear governance structure around the development of the new programme will also be required.

- The Head of Finance recommends Council agree a limit to debt funded capital expenditure in the future programme. The impact of a limit of £5.5m and £7.5m per annum is exemplified within this strategy, with the actual limit to be determined as part of developing the new programme.

- The prudential indicators, including borrowing limits, are in line with the MTFP approved by Cabinet.

The strategy will be reviewed and updated on an annual basis alongside the Treasury Management Strategy.

OVERVIEW OF THE STRATEGY

1.1. INTRODUCTION

Capital expenditure can be defined as expenditure on assets, such as property or vehicles, that will be used for more than one year. In local government, this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to acquire assets. It is the Council's policy not to treat any expenditure under £10,000 as capital, and therefore anything under this value will be charged as revenue in the year of expenditure.

The Prudential Code for Capital Finance in Local Authorities (2017) placed a requirement on local authorities to determine a Capital Strategy in order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives, and properly takes account of stewardship, value for money, prudence, sustainability and affordability.

This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services, along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance readers' understanding of these, sometimes, technical areas.

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

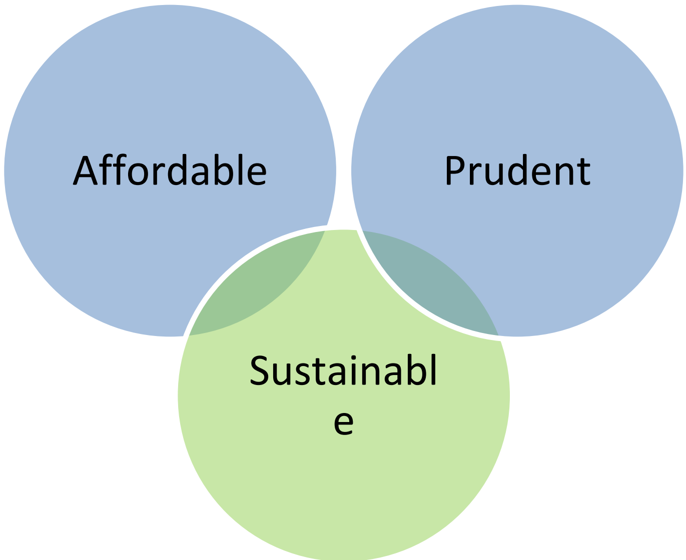
The report sets out:

- The key objectives outlined in the Prudential Code and the governance arrangements for the Capital Strategy and programme (Section 2)
- The current approved capital programme to 2022/23 (+ 2 additional years for schemes that extend beyond the final year of the existing programme) and its financing, and the revenue implications arising from demands on capital expenditure (Section 3)
- The long-term (10 year) projection for the capital financing costs of the Council and where future demands arise from the various strategic plans across the Council for further capital resources. (Section 4)
- Links between the Capital Strategy and Treasury Management strategy, and treasury decision making. (Section 5)
- A look at the commercial activity of the Council and the strategy going forward. (Section 5)
- Overview of other long-term liabilities the Council has, which members need to be aware of when looking at the Capital Strategy. (Section 6)
- Summary of the skills and knowledge the Council holds in order for it to carry out its duties for capital and treasury matters. (Section 7)

2. PRUDENTIAL CODE & GOVERNANCE

2.1. PRUDENTIAL CODE – KEY OBJECTIVES

The objective of the Prudential Code is to ensure, within a clear framework, that the Council's capital expenditure are affordable and prudent. In terms of both affordability and prudence, it is important that sustainability is considered and can be demonstrated;



AFFORDABLE

It is important that the Council's capital investment remains within **sustainable** limits. The Code requires authorities to consider the resources currently available to them and those estimated to be available in the future, together with the totality of the capital plans and income and expenditure forecasts. As well as capital expenditure plans, authorities should consider the cost of past borrowing, maintenance requirements, planned asset disposals and the MRP policy, which all impact upon affordability.

PRUDENT

The Council must ensure that its capital and investment plans are prudent and **sustainable**. As required by the Code, consideration should be given to the arrangements for the repayment of debt and the risk and impact on overall financial **sustainability**. The operational boundary for external debt should align with capital expenditure plans and provide for the most likely, not worse case, scenario. The authorised limit should provide sufficient borrowing headroom to enable day to day cash management. It is important that there is alignment with the treasury management policy statement and practices, and that risk management and analysis is taken into account. Borrowing in advance of need should only be undertaken where appropriate and affordable, and treasury management activities should find a balance between security, liquidity and yield reflecting the Council's risk appetite, but not prioritising yield over security and liquidity.

SUSTAINABLE

As highlighted above, the Council has to ensure sustainability when considering both affordability and prudence. In line with the long-term impact of decisions made in relation to capital investment plans, sustainability is considered over a minimum 10-year period.

In addition, the Council ensures that treasury management decisions are taken in accordance with good professional practice and with the full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.

CIPFA consulted upon various amendments to the Prudential Code and Treasury Management Code during the autumn of 2021. Following the consultation, the proposed amendments were agreed and will form part of an update to both codes. In the case of the Prudential Code, these include the following (with the changes to the Treasury Management Code being outlined later in this report):

- Local authorities being precluded from borrowing for investment where the primary aim is to generate a commercial return.
- Sale of commercial investments as an alternative to new borrowing for service purposes.
- Risk associated with commercial investment to be proportionate to the financial capacity to bear losses.
- Investments to be split into treasury, service and commercial categories.
- Prudential indicators to be monitored and reported at least quarterly.
- Introduction of a new prudential indicator regarding the income from commercial and service investments to net revenue stream.
- Removal of investment income from the financing costs indicator.

Of the changes outlined above, the first change, which is the most significant of the changes, is not anticipated to present any issues. This is because the Council does not have any such investments and is not planning any such investments. However, as outlined in the Commercialisation section of this report, the Council's Commercial Strategy contains provision to engage in such activity. Therefore, it will be necessary for this element of the Commercial Strategy to be withdrawn. In the case of the changes to prudential indicators and subsequent reporting of those indicators, the Council will ensure compliance as part of its budgeting and reporting processes. It should be noted that, whilst the new Code takes immediate effect, CIPFA have stated that authorities can defer the implementation until 2023/24, with the exception of the change relating to investment primarily for yield, which takes effect immediately.

2.2. GOVERNANCE FOR APPROVAL AND MONITORING OF CAPITAL EXPENDITURE

Member responsibility for assets rests with the Cabinet Member for Economic Growth and Investment, currently the Leader of the Council. The main governance and approval process for capital expenditure is summarised as follows:

- Council approves the overall revenue and capital budgets following recommendations from the Cabinet. They also approve the external borrowing limits, which place a cap on the level of borrowing the Council can undertake during the year. These limits are driven by the level of unfunded capital expenditure, including uncommitted expenditure, within the capital programme. The limits will not include expenditure on any schemes where borrowing is required, but which finance themselves through the savings generated. These limits are a key performance indicator for treasury management and ensure that capital expenditure is limited and borrowing remains affordable. Any changes required to the borrowing limits must be approved by full Council.
- Council approves the Treasury Management and Investment strategies, which are intrinsically linked to capital expenditure and the Capital Strategy. Further details of these are provided in sections 5.1 and 5.3.
- The detailed capital programme, contained within the overall budget, is approved by Cabinet following individual project appraisals by officers, which include the views of the Head of Finance.
- Items of capital nature are discussed at the Capital Strategy Asset Management Group (CSAMG), which is made up of senior officers from all service areas and the Council's property advisors, Newport Norse. Discussions centre on the asset management agenda and include asset disposals and prioritisation of capital expenditure requirements. Other boards with capital considerations, such as the People Services Capital Board, will feed into CSAMG.
- Operational decisions on capital expenditure will be made by the Executive Board, following a review of the project appraisal and advice from CSAMG.
- Cabinet approves any new capital expenditure to be added to the capital programme.
- Monitoring of Capital Expenditure is reported to Cabinet, including updates on capital receipts and the impact on the revenue budget of decisions made.

Affordability and sustainability are key considerations when approving capital expenditure, and therefore the agreed framework detailed in section 3.1 is used. Included within Appendix 2a is the process map used for the approval of capital expenditure.
Decisions on the approval of capital expenditure will be made in liaison with the Capital Accountancy Team and an understanding of the long-term revenue implications of the expenditure is assessed before it is added to the programme. Cabinet approves additions to and deletions from the Capital Programme, as well as slippage, when approving the regular monitoring reports.

3. CAPITAL EXPENDITURE AND FINANCING

3.1. CURRENT CAPITAL PROGRAMME

The current capital programme originally covered the five-year period between 2018/19 and 2022/23. However, as approved by Cabinet in January 2020, an additional two years were added to the programme to incorporate those schemes, such as the 21st Century Schools Band B Programme, where completion was projected to extend beyond the original five-year timeframe. Given the current financial constraints facing the Council, Cabinet and Council established a framework for managing the existing programme, aimed at maximising capital expenditure but keeping new borrowing at a level that could be afforded within a sustainable revenue budget. This framework is as follows:

a. Funding from sources other than borrowing needs to be maximised, by securing grant funding whenever possible and maximising capital receipts;

b. Any change and efficiency schemes requiring capital expenditure, and generating savings as a consequence, would be funded by offsetting the capital financing costs against the savings achieved;

c. Schemes and projects which generate new sources of income would need to fund any capital expenditure associated with those schemes.

This framework ensures that the capital programme can be maximised but those schemes which cannot fund any resulting borrowing costs can be afforded and maximised within the headroom available. This available headroom is made up of identified uncommitted capital reserves and capital receipts, an estimated level of borrowing which can be afforded from within the Minimum Revenue Provision (MRP) budget and a prudent estimate of future capital receipts.

The latest capital programme is summarised in the table below. For 2022/23, the programme contains approved capital schemes of £103.4m, and the overall programme to 2024/25, including uncommitted borrowing, is £288.4m. This total figure includes £17.3m for the cost of carry of undertaking borrowing for Cardiff Capital Region City Deal schemes, prior to the funding from HM Treasury being received, and £2.4m of uncommitted borrowing headroom.

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	ORIGINAL 5-YEAR CAPITAL PROGRAMME					**ADDITIONAL 2 YRS**		**Total current pro-gramme £m**
	2018/19 Actual £m	**2019/20 Actual £m**	**2020/21 Actual £m**	**2021/22 Forecast £m**	**2022/23 Budget £m**	**2023/24 Budget £m**	**2024/25 Budget £m**	
Approved Schemes	29.5	31.4	26.2	57.6	99.2	24.7	0.1	**268.7**

City Deal - cost of carry					1.8	10.0	5.5	**17.3**
Uncommitted borrowing*					2.4			**2.4**
TOTAL EXPENDITURE	**29.5**	**31.4**	**26.2**	**57.6**	**103.4**	**34.7**	**5.6**	**288.4**

** Uncommitted borrowing headroom to be invested in Council assets or regeneration.*

The current approved capital programme is substantial and leads to a considerable increase in the Capital Financing Requirement (CFR) over the medium term. Table 1 provides an overview of the total programme, comprising existing schemes, the Cardiff Capital Region City Deal cost of carry and the residual level of uncommitted borrowing for potential additional capital schemes. It should be noted that a limit of £4.5m was placed on any additional borrowing, referred to as capital headroom, to fund new capital expenditure for the period between 2020/21 and 2022/23. As outlined in the table above, a total of £2.109m has been committed against that original amount of borrowing headroom to date, with a balance of £2.391m remaining available for the remainder of the existing programme.

Over the course of the current capital programme, there is a significant increase in borrowing to fund the projects contained within it and a consequential increase in capital financing costs. As part of the overall 2021/22 Council budget, a £2.1m investment in the capital financing budget was made in order to provide for the revenue costs arising from the full capital programme. By committing these resources in advance, it means that no additional investment is required in the revenue budget for 2022/23. Due to the level of slippage projected into 2023/24, it means that there is likely to be an in-year underspend against this budget during 2022/23, which could be utilised on a one-off basis for other priorities.

Section 3.2 illustrates the revenue impact of the capital programme. The framework outlines that, over the current term, the **capital programme would be set at a level that minimises revenue pressure on the Medium Term Financial Plan (MTFP).** Therefore, it is vitally important to maintain capital expenditure at a level that is affordable over the medium term. The limit of uncommitted borrowing that is available allows for additional capital expenditure without increasing the pressure on the revenue budget.

The WG General Fund Capital Grant in 2022/23 has reduced significantly when compared to 2021/22. The award in 2022/23 is £2.827m, compared with £4.083m in 2021/22. Beyond 2022/23, the indicative settlement figures suggest that the grant will return to previous levels. Therefore, the position for 2022/23 would appear to be a one-off and, as a consequence, an amount of £4m has been assumed for 2023/24 and beyond. This grant funding is used to cover annual sums. To maintain the same level of annual expenditure, it has been assumed that earmarked reserves will be used to bridge the gap and this is reflected in the figures contained within this report.

The overall programme, which is now entering its final year, contains a number of key capital schemes, some of which will continue beyond the 2022/23 financial year. These include:

- 21st Century Schools Programme
- The HLF grant funded Transport Bridge scheme
- Cardiff Capital Region City Deal (CCRCD)
- New Leisure Centre

There may be other requirements for capital funding for schemes that are not yet contained within the overall programme. Any new schemes that arise during the year will either need to be funded via specific sources or will represent a call upon the residual headroom available. It is important that capital expenditure remains at an affordable level within the framework agreed and, therefore, prioritisation of capital expenditure is essential and needs to be affordable and sustainable in the long-term.

3.2. MEDIUM-TERM REVENUE IMPLICATIONS OF CAPITAL (CAPITAL FINANCING)

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). All debt has to be repaid and this includes both the actual debt principal plus interest costs on the debt. The planned financing of the expenditure shown in Table 1 is as follows:

Table 2: Capital financing in £ millions

	7-YEAR CAPITAL PROGRAMME					**ADDITIONAL 2 YRS**		**Total current programme £m**
	2018/19 Actual	**2019/20 Actual**	**2020/21 Actual**	**2021/22 Forecast**	**2022/23 Budget**	**2023/24 Budget**	**2024/25 Budget**	
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	
TOTAL EXPENDITURE	29.5	31.4	26.2	57.6	103.4	34.7	5.6	**288.4**
Financed by:								
Committed Grants and contributions	19.2	17.7	19.8	40.7	55.7	17.7	0.1	**170.9**
Committed Reserves, capital receipts, revenue	4.3	3.7	0.5	4.4	9.3	0.5		**22.7**
Committed new borrowing	6.0	10	5.9	12.5	34.2	6.5		**75.1**
Committed new borrowing for City Deal Cost of Carry					1.8	10.0	5.5	**17.3**
TOTAL COMMITTED (Appendix 1)	**29.5**	**31.4**	**26.2**	**57.6**	**101.0**	**34.7**	**5.6**	**286.0**
Uncommitted borrowing					2.4			**2.4**
TOTAL UNCOMMITTED					**2.4**			**2.4**

TOTAL FINANCING	**29.5**	**31.4**	**26.2**	**57.6**	**103.4**	**34.7**	**5.6**	**288.4**

Due to the better WG settlement the Council received in 2021/22, Cabinet front loaded the required medium term capital financing requirement into 2021/22, to then be carried forward into future years. This means that the current capital programme and a level of borrowing headroom, limited to £4.5m, was funded within the MTFP. Any underspends available within the short term, as evidenced as part of the revenue budget monitoring position in 2021/22, will be able to be used for voluntary revenue payments (VRP), one-off expenditure or moved to reserves.

The forecast borrowing for 2021/22 to 2024/25 is £60.4m. Should there be any need to increase this total, it would need approval by Council.

When capital expenditure is initially financed by debt/borrowing, the Council is essentially locked into a long-term revenue commitment to finance that expenditure over time. This financing is done via a mechanism known as the Minimum Revenue Provision (MRP). Budgeted MRP payments over the medium term (excluding PFI and leases) are as follows:

Table 3: Replacement of debt finance (MRP) in £ millions

	2018/19 actual	**2019/20 actual**	**2020/21 actual**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
MRP budget	7.8	7.9	8.7	10.3	10.3	10.7	10.9

The table above shows the budgeted amount of MRP that is included within the MTFP, that the amount significantly increased in 2021/22 and will gradually increase over the longer term. This increasing pressure on the MTFP should be seen in the context of continuing funding constraints, which emphasises the importance of maintaining capital expenditure within the headroom available in order to minimise the additional pressure on the revenue budget.

- The Council's full Minimum Revenue Provision statement and policy is available within the Treasury Strategy, which will be approved alongside this Capital Strategy.

Although capital expenditure is not charged directly to the revenue budget, as discussed above, interest payable on loans and MRP are charged to revenue - the net annual charge is known as 'financing costs'. The table below shows the financing costs as a percentage of the Council's net budget, which is one of the required prudential indicators.

Table 4: Prudential Indicator: Proportion of financing costs to net revenue stream

	2021/22 budget	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
Financing costs* (£m)	22.8	22.8	23.4	23.4
Proportion of net revenue stream	7.2%	6.6%	6.6%	6.4%

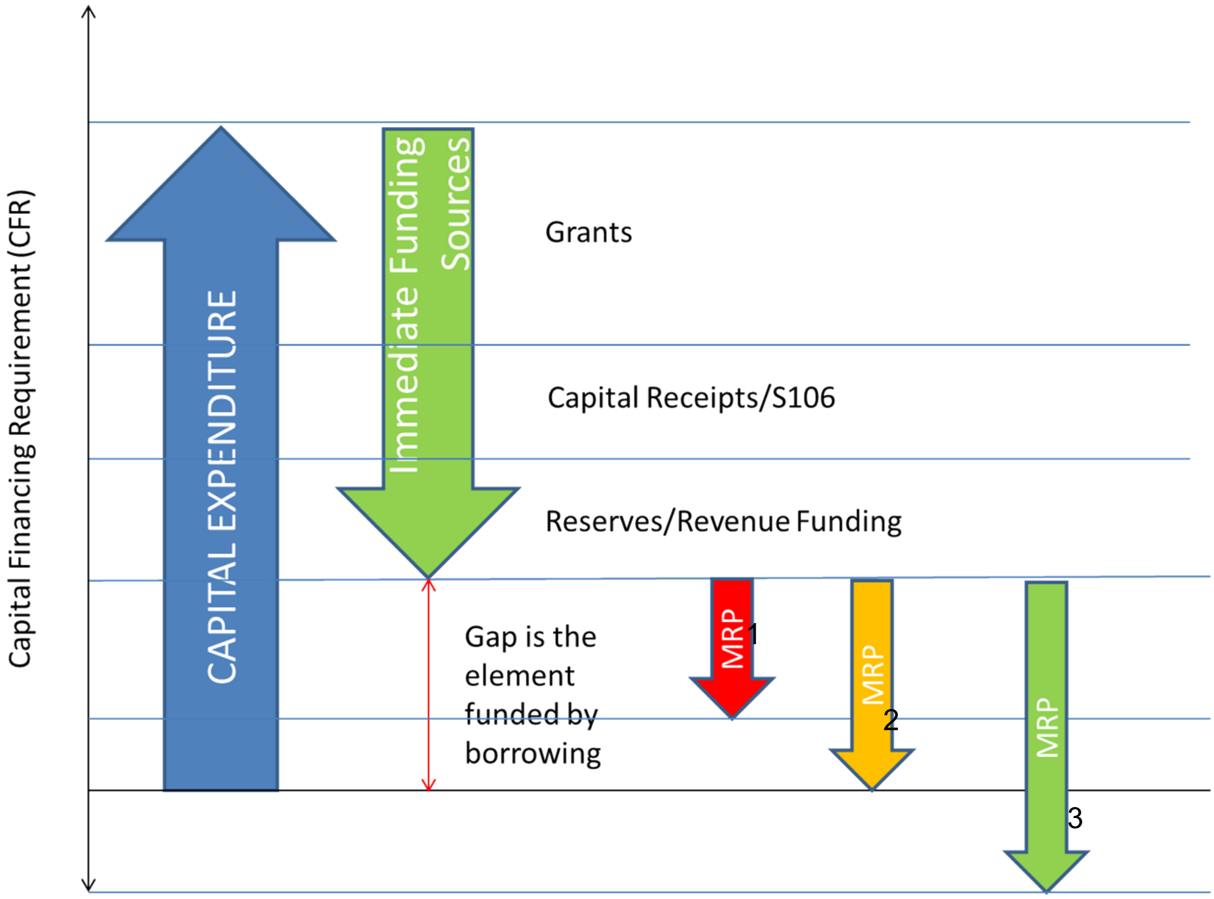
*includes capital financing costs of PFIs

From the table above it is evident that the proportion of the budget set aside to finance capital expenditure is set to decrease over the medium-term, with a more significant decrease in 2022/23, before easing off over the remainder of the period. This reduction is a reflection of the fact that the capital financing budget was frontloaded in 2021/22, coupled with the significant increase in core funding in 2022/23. The levels shown throughout the medium term are still significant and highlight the pressure that capital expenditure initially funded from debt can place upon the revenue budget.

- Information on the revenue implications of capital expenditure is also included in the 2022/23 revenue budget report.

Capital Financing Requirement (the underlying need to borrow)

The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The diagram below shows the impact of capital expenditure, financing and the MRP on the CFR:



The diagram above shows the following:

- CFR **increases** when capital expenditure is incurred.
- CFR **decreases** when capital expenditure is immediately financed - i.e., through grants, capital receipts, revenue funding, reserves, S106 income.
- If the MRP charge is **less than** the capital expenditure funded by borrowing in any given year (Red [1]) the net CFR increases
- If the MRP charge is **equal to** the capital expenditure funded by borrowing in any given year (Amber [2]) the net CFR stays the same
- If the MRP charge is **more than** the capital expenditure funded by borrowing in any given year (Green [3]) the net CFR decreases

This is an important concept, as it demonstrates how decisions on the level of capital expenditure and MRP budget impact upon the Council's long-term borrowing requirements and consequent capital financing implications. However, it is important to note that the CFR is only an indicator as to the need to undertake borrowing, with the actual need to borrow ultimately being driven by the overall short and long term cashflow requirements of the organisation.

The table below provides the medium-term outlook for the Council's CFR, inclusive of the impact of PFI arrangements. This is based on the existing programme only and does not reflect the potential for additional borrowing beyond 2022/23. As can be seen, the CFR is expected to increase by £28.2m during 2022/23, which is a significant increase on the estimated CFR as at 31st March 2022. This increase represents a stepped change in position, when compared with previous years, where the figure has generally stayed at around £280m.

This significant increase in capital expenditure, including that funded via other sources, will be a challenge to achieve, evidenced by the significant levels of slippage incurred during the 2021/22 financial year. Therefore, it is important to recognise the likelihood that the actual CFR may turn out lower by the end of the 2022/23 financial year, in turn reducing the actual need to undertake external borrowing. This is a significant challenge for the Council, as it is important that ambitions for capital expenditure are not unrealistic, as this can result in unnecessarily increasing the capital financing budget, which may result in other budget priorities not being able to be pursued.

Table 5: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31/03/19 actual	**31/03/20 actual**	**31/03/21 actual**	**31/03/22 forecast**	**31/03/23 estimate**	**31/03/24 estimate**	**31/03/25 estimate**
TOTAL CFR	**278.8**	**280.2**	**276.3**	**280.9**	**309.1**	**314.4**	**307.9**

With the upcoming introduction of the accounting requirements of IFRS 16 Leases, the CFR and debt identified as relating to leases is likely to increase, due to the change in the way that finance leases for lessees are treated. CIPFA/LASAAC took the decision to defer the implementation of IFRS 16 Leases until the 2022/23 financial year in response to pressures on Council finance teams, as a result of the COVID-19 pandemic. Work is ongoing to gather the relevant information and fully understand the impact upon the Council. The output of this work will be finalised during this calendar year and will form part of the 2023/24 Capital Strategy.

The greater the CFR, the larger the impact will be on the revenue budget, with that impact being exacerbated by an ongoing reduction in the availability of internal borrowing (defined as using available cash, underpinned by the overall level of earmarked reserves, in lieu of external borrowing). Therefore, in the long-term, there will be a need to keep annual capital expenditure funded by borrowing at a level below the annual MRP budget in order to maintain the capital financing revenue budget at a broadly sustainable level.

4. LONG-TERM VIEW OF CAPITAL EXPENDITURE

Expenditure on capital assets/projects are often for assets which have a long-term life i.e. buildings may have an asset life in excess of 40 years. The financing of these assets could also be over a long-term period. Therefore, it is important to take a long-term view of capital expenditure plans and the impact that may have on the affordability and sustainability of capital expenditure. Once a decision has been made to initially fund capital expenditure from borrowing, the Council is locked into the revenue implications arising from that decision (i.e. the annual cost of MRP) for a long-term period.

Due to the financial constraints that the Council continues to face, it is anticipated that revenue to fund capital financing will remain restricted over the long term. The capacity to use internal borrowing is also reducing, which means that the authority will face a challenge in developing its next capital programme, due to take effect from 2023/24, particularly if there is a need or desire to incur a certain level of capital expenditure funded via borrowing. Therefore, it is important that the Council stabilises the increasing level of its CFR, and actual need to externally borrow, to minimise the increase in associated capital financing costs and ensure that they remain affordable and sustainable. This is particularly relevant when considering the position outlined in the Medium Term Financial Plan and the competing financial pressures facing the Council.

Ideally, capital expenditure funded by borrowing should be less than the annual MRP budget, as this will reduce the overall level of the CFR on a year-to-year basis. However, it is recognised that this may be difficult to achieve and that a degree of capital expenditure funded by borrowing will be required as part of the next capital programme and thereafter.

To assist with exemplifying the potential impact over the medium to long term, two scenarios have been modelled. The first scenario assumes additional (i.e. in addition to already approved schemes) unfunded capital expenditure of £5.5m per annum, beyond the current capital programme window, with the second scenario assuming £7.5m per annum. Chart 1, below, demonstrates the impact that these scenarios could potentially have upon the overall level of the CFR and the actual requirement to undertake external borrowing.

Chart 1 – Liability Benchmark

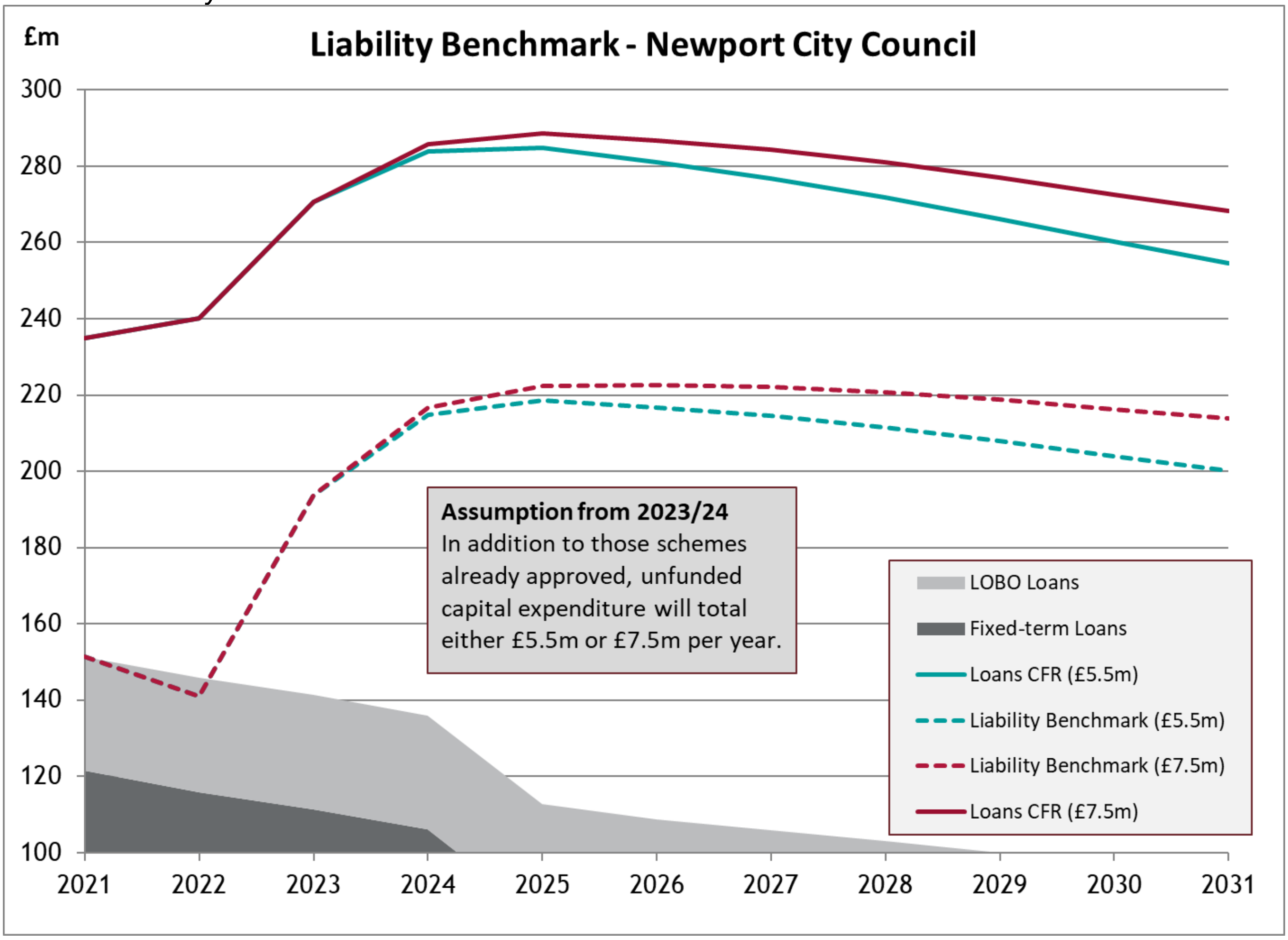


Chart 1, known as the Liability Benchmark, demonstrates the following, in terms of the impact of the current capital programme and the two modelled scenarios:

- The impact the current capital programme has in terms of the increasing CFR and consequent need for external borrowing, denoted by the steepness of the solid and dashed red curves over the first few years.
- A longer-term stabilisation, and then reduction, in the overall level of CFR, as shown by the trajectory of the solid red and blue lines.
- A longer-term stabilisation of the need to undertake actual external borrowing, followed by a gradual reduction, as shown by the trajectory of the dashed red and blue lines.
- The impact of the reducing capacity for internal borrowing, demonstrated by the convergence of the two set of lines over the first few years and thereafter.
- The fact that a level of existing borrowing is scheduled for repayment (denoted by the shaded grey area) over the medium to long term, although the underlying need to borrow actually grows during that time, meaning that the repaid borrowing will need to be replenished.

The two modelled scenarios demonstrate that it would be possible to stabilise, and slightly reduce, both the CFR and actual need to borrow over the medium to long term. This is critical if the increase in consequent capital financing costs is to be minimised and remain at a level which is prudent, affordable and sustainable over the medium term. However, as the following paragraphs and Chart 2 demonstrate, there are other factors which also impact upon the overall level of capital financing costs incurred.

Chart 2 – Capital Financing Cost Forecast

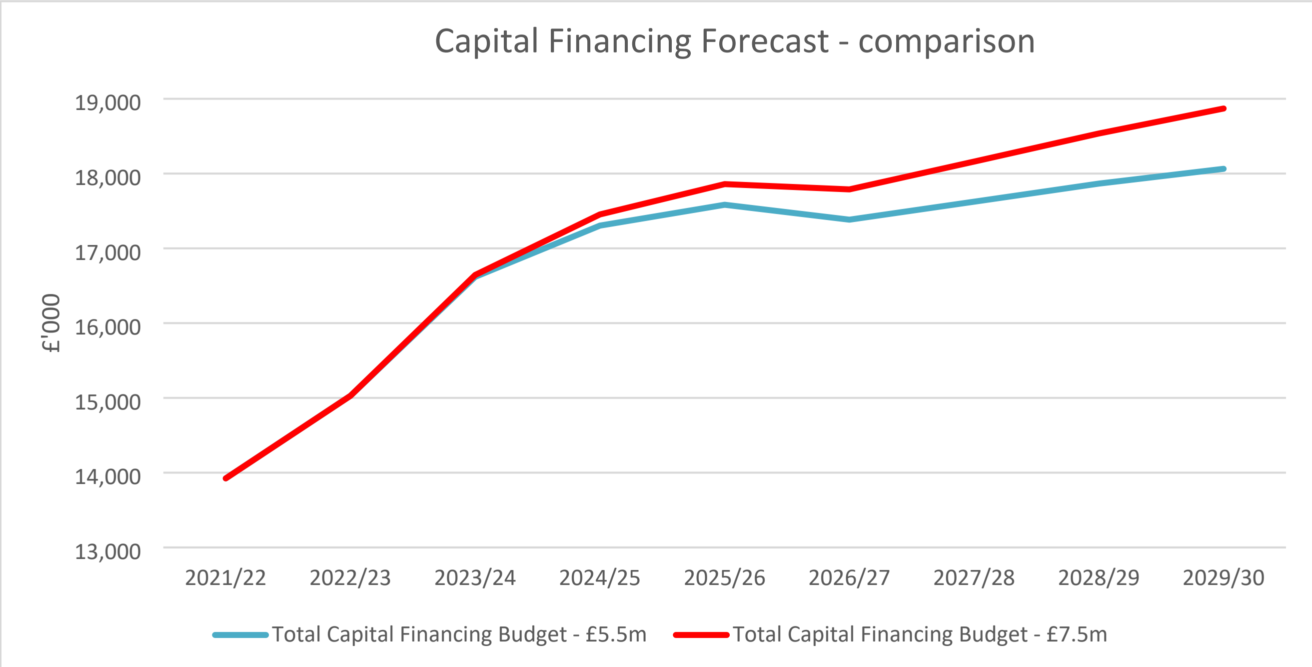


Chart 2 shows the increasing capital financing costs over the next 10 years with a limit of £5.5m or £7.5m of unfunded capital expenditure per annum after the current programme. This is initially driven by the ambitious capital programme that is currently in place, resulting in a significant spike in capital financing costs to 2023/24, but continues beyond that year. This is despite the modelled reductions in the CFR, as outlined in Chart 1. Although the revenue costs arising from the current capital programme have been fully funded, this chart highlights the fact that there will be a continued capital financing budget pressure during the new programme window as well. Due to slippage experienced in delivering the new programme, it should be noted that the actual costs of capital financing are lagging behind the existing budget provision, resulting in an underspend against the revenue budget.

The reason for the continued increase in capital financing costs, despite the levelling off of borrowing requirements, is primarily because of the change in MRP methodology, but also, in the earlier years, due to the reduced capacity for internal borrowing. What this means, in effect, is that additional external borrowing will need to be undertaken to replace the internal borrowing, just to maintain the status quo. The impact of this is that additional interest costs will be incurred and these will be borne by the capital financing budget. In the case of MRP, the change to the annuity methodology for unsupported borrowing means that MRP charges are lower in earlier years and increase as assets move through their useful life. Therefore, there will be an annual increase in MRP charges, and consequent impact upon the revenue budget, even if no additional unfunded capital expenditure is undertaken.

It should be noted that the scenarios above are for modelling purposes only, with assumptions included on the deliverability of the programme. In saying that, it is a good representation of the financial impact on Council finances given the two levels of capital spend funded from borrowing.

The actual position will of course be impacted by a number of factors that will ultimately determine the level of borrowing and associated capital financing costs. These factors include:

- (i) availability of capital grant funding from Welsh Government and other bodies, (i.e. will there be the capacity or need to include those levels of capital expenditure funded by borrowing?)
- (ii) the delivery of capital receipts (i.e. as above)
- (iii) the utilisation and overall level of earmarked reserves (i.e. as above)
- (iv) the general level of slippage within the capital programme (i.e. will the Council spend at the rates modelled even if included in budgets and programmes)

Sustainability and New Capital Programme Development

As already outlined, the long-term nature of the impacts arising from short to medium term capital expenditure and financing need to be understood in terms of its prudence, affordability and sustainability. The Head of Finance is satisfied that the current programme meets this key requirement, evidenced by the fact that the revenue implications are already fully funded. However, the key challenge facing the Council, in relation to capital, is the impending development of the new programme, which will run from 2023/24 to 2027/28. This challenge should be seen in the context of a Medium Term Financial Plan which, although broadly balanced at present, could worsen should new service pressures emerge. Therefore, any increase in capital financing costs would only add to that challenge. Therefore, should the new programme result in a further need to increase capital financing budgets, it will be necessary for those pressures to be prioritised by members and senior management against other competing pressures in order to ensure a balanced revenue budget.
In light of this challenge, it is important that the authority understands the key drivers and risks associated with delivering the new programme. These drivers are captured through various plans across the authority and are outlined in the diagram that follows. These plans will be subject to ongoing revision and it will be necessary for the authority to develop its understanding of the cost of key priorities arising from each plan, to inform what will potentially be a constrained programme in terms of the overall financial envelope.

There will be a range of priorities originating from these plans, particularly the Corporate Plan, which will be refreshed following the local elections taking place in May 2022 and will likely reflect a number of the new administration's manifesto commitments. As well as the priorities contained within the Corporate Plan, there will a requirement to maintain the current asset base. This is something that has been severely impacted by constrained funding levels in previous years and has resulted in a maintenance backlog developing, which gives rise to the potential for major asset failures to occur where issues have developed over time. There is a particular risk surrounding highways and school buildings, although there are other asset bases that hold maintenance backlogs as well.
Therefore, whilst annual allocations are provided for asset maintenance, in building the new programme, it will be necessary to review the level of those allocations, as well as the approach to their use. The growing backlog would suggest that the annual sums are not sufficient, although there is also a need to ensure that the best value for money and outcomes are being achieved with their use. The annual sums should, however, ensure that the highest priority backlog issues are addressed, first and foremost.
In addition to the annual sums, other approaches need to be pursued in order to reduce the maintenance backlog. This should include a review of the asset base more generally, and consideration to rationalising the number of assets. This rationalisation could be achieved in a number of ways, such as closure or disposal of assets, asset transfers or schemes to refurbish/redevelop existing assets (e.g. neighbourhood hubs, Chartist Tower and the Newport Market development). Furthermore, it will be

necessary to target external grant funding, such as 21st Century Schools funding, which will enable wholesale upgrade or replacement of existing assets, including those with significant maintenance backlogs.
Therefore, when developing the new programme, it will be necessary for decision-makers to ensure that the ongoing maintenance of existing assets is sufficiently addressed. However, there will be other priorities to be included within the programme, such as the need to address the climate emergency via a pursuit of carbon neutral assets, a response to the need for a new way of working, the next phase of WG's 21st Century Schools Programme and further regeneration schemes for the city. In addition, there will be an inevitable degree of slippage from the existing programme, which will effectively represent a first call on available resources. Should the level of slippage be significant, it may be appropriate to defer any new priorities until the middle and later years of the programme, to provide the bandwidth for existing schemes to be completed.
Although members will ultimately decide upon both the overall size of the new programme, and the schemes contained within it, it will be important that there is appropriate governance surrounding the development of the programme. This governance will be required to ensure that schemes are only added to the programme where sufficient planning, financial and non-financial, has been undertaken and that there is a clear corporate need or priority for including schemes within the programme. This may take the form of an internal Capital Board, led by the Senior Leadership Team, who will act as a gateway for schemes and ensure that members can take confidence in the recommendations being made to them. It should also ensure that there is enhanced oversight and management of the programme on an ongoing basis and reduce the likelihood of slippage or grant funding being foregone in future years. As an outcome, a more realistic, deliverable and achievable programme should result.

5. TREASURY MANAGEMENT

The Treasury Management Strategy (detailed in Appendix 3) and Capital Strategy are inextricably linked, with both strategies being considered for approval by Council as part of the same meeting. The figures within the Treasury Management Strategy align with the level of borrowing resulting from this Capital Strategy. The Council will need to approve both the prudential indicators detailed below and the borrowing limits recommended.

5.1. TREASURY MANAGEMENT

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, whilst managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council limits the need to take out actual borrowing by using positive cashflow, largely underpinned by earmarked reserve balances, to fund capital expenditure funded by borrowing, known as internal borrowing.
As a result of decisions taken in the past, the Council as at 31st December 2021, has £144m borrowing at a weighted average interest rate of 3.6% and £40m treasury investments at a weighted average rate of 0.19%.
As outlined earlier, CIPFA have recently consulted on changes to the Treasury Management Code and have recently confirmed the changes that will be implemented. CIPFA have not been prescriptive regarding an implementation date and, therefore, based on the advice of our treasury advisers, the changes will be reflected in the 2023/24 strategy document.
The main changes include the requirement to incorporate the liability benchmark as part of the Treasury Management Strategy, which the Council already does. Other changes will see a need for the introduction of investment management practices (IMPs) and detail around the Council's policy and practices relating to environmental, social and governance (ESG) investment considerations. There are now clearer definitions regarding categorisations of investments, which require local authorities to distinguish between treasury, service and commercial investments, with a number of additional requirements relating to the latter two categories. The final major change relates to knowledge and skills and the need for councils to disclose information regarding areas such as competencies, knowledge and skills schedules, monitoring and review.

5.2. BORROWING STRATEGY

Whilst the current outlook is for the Council to have significant long-term borrowing requirements, the current strategy is to fund capital expenditure through reducing investments rather than undertaking new borrowing. To clarify, this means deferring new long-term borrowing and funding capital expenditure from day-to-day positive cashflows for as long as possible. By using this strategy, the Council can also minimise cash holding at a time when counterparty risk remains high. The interest rates achievable on the Council's investments are also significantly lower than the current rates payable on long-term borrowing and this remains a primary reason for the current 'internally borrowed' strategy.

Whilst investment counterparty risk is minimised through this strategy, the risk of interest rate exposure is increased, as the current low longer term borrowing rates may rise in the future. However, long-term borrowing interest rates are currently significantly higher than short-term borrowing interest rates. Therefore, should there be a need to undertake borrowing at short notice, the current differential in interest rates mitigates the risk to some extent and also ensures cost avoidance in the short term. The market position is being constantly monitored in order to manage this risk.

The Council's overall main objective when borrowing is to achieve a low but certain cost of finance, whilst retaining flexibility should plans change in the future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between lower cost short-term loans (currently available at around 0.1% to 0.3%) and long-term fixed rate loans where the future cost is known but higher (currently around 1.5% to 2.0%). The current availability of positive cashflow has meant that the Council has not been required to undertake much in the way of short-term borrowing recently, although this can change at relatively short notice.

Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities and leases) are shown below, compared with the CFR (which has been detailed in earlier sections). It should be noted that the estimated projected debt is broadly in line with the Operational Boundary, which acts as a borrowing limit for delivering the Capital Programme, as highlighted in the paragraphs that follow.

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2021 actual	**31.3.2022 forecast**	**31.3.2023 budget**	**31.3.2024 budget**	**31.3.2025 budget**
Debt (incl. PFI & leases)	178	190	231	240	235
Capital Financing Requirement	276	281	309	314	308

As outlined earlier, the forthcoming introduction of IFRS 16 Leases will likely result in the CFR and debt identified as relating to leases increasing in future years. Work continues to assess the relevant leases that exist across the Council and their potential impact upon both the CFR and overall debt levels.

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from Table 6, the Council expects to comply with this in the medium term.

Operational Boundary: The Council is obliged to approve an operational borrowing limit. This boundary has been set in line with the expected borrowing required to finance the current Capital Programme until 2024/25, taking account of likely levels of internal borrowing. A small additional allowance has also been made for the timing of PFI debt repayments. If any increase to the operational boundary is required, including to borrow for investment/income generation schemes or regeneration investment (loans) this will need to be brought to Council for approval.

Authorised Limit: The Council is legally obliged to approve an affordable borrowing limit for external debt each year. This is the absolute limit for external borrowing and is set in line with the CFR, again with a small allowance made for the timing of PFI debt repayments. The authorised limit is greater than the Operational Boundary and provides a buffer for managing day to day cash requirements and undertaking borrowing in advance of need, where appropriate and affordable.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2021/22 limit	**2022/23 limit**	**2023/24 limit**	**2024/25 limit**
Authorised limit – borrowing	255	271	278	274
Authorised limit – PFI and leases	42	41	39	36
Authorised limit – total external debt	**297**	**312**	**317**	**310**
Operational boundary – borrowing	187	192	203	201

Operational boundary – PFI and leases	42	41	39	36
Operational boundary – total external debt	**229**	**233**	**242**	**237**

Whilst the above indicators place a theoretical limit upon the level of borrowing that a council can undertake, they do not, for example, make an allowance for any amount of slippage that may be incurred whilst delivering the Capital Programme. This is relevant in the case of the Council's Capital Programme where, in relation to 2022/23 in particular, there is a significant level of forecasted unfunded expenditure and a high probability of slippage occurring. Therefore, to ensure that the level of expenditure to be funded via borrowing is controlled, a local indicator has been introduced which restricts any unfunded expenditure being added to the existing Capital Programme over and above the headroom that is already in place. This indicator is in line with Table 1 of this report and, for 2022/23 only, limits additional borrowing for new capital expenditure to £2.4m. Should borrowing above this limit be required, it will need to be approved by full Council. A new indicator will be developed as part of producing the new Capital Programme over the next 12 months.

Table 8: Local Prudential Indicator: New capital expenditure to be funded via borrowing (£m)

	2022/23 limit	**2023/24 limit***	**2024/25 limit***
Borrowing headroom	2.4	0	0

** The limit is currently £0m, in line with the existing Capital Programme, but the £2.4m effectively applies across the three years shown, and these years will form part of the new programme, at which point a new indicator will be introduced.*

5.3. INVESTMENT STRATEGY

Treasury investments arise from receiving, and then holding, cash before there is a need to pay it out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management. The Council's strategies in this area of Treasury Management are (i) to be a short term and relatively low value investor and (ii) investment priorities should follow the priorities of security, liquidity and yield, in that order.

Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy. In the case of certain funds, the Council may request its money back at short notice.

Table 9: Treasury management investments in £millions

	31.3.2021 actual	**31.3.2022 forecast**	**31.3.2023 budget**	**31.3.2024 budget**	**31.3.2025 budget**
Near-term investments	24.8	0	0	0	0
Longer-term investments	0	10	10	10	10
TOTAL	**24.8**	**10**	**10**	**10**	**10**

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and relevant staff, who must act in line with the Treasury Management Strategy approved by Council. Half-year and end of year reports on treasury management activity are presented Council, although the frequency of these reports will change to quarterly from 2022/23, in line with the recent changes to the Treasury Management Code. The Governance & Audit Committee is responsible for scrutinising treasury management decisions.

Loans to other organisations

The Council can and does make investments to assist local public services, including making loans to businesses to promote economic growth. The Council will assess these opportunities and will only plan that such investments at least break even after all costs. Loans to such organisations will be approved following a due diligence process and formal governance arrangements.

The Council will also use other methods of assisting businesses to promote economic regeneration by providing grants or by allowing rent free periods where the Council is the owner of the freehold, such as the case with Chartist Tower.
Decisions on service investments are made by the relevant service manager in consultation with the Head of Finance and Monitoring Officer and must meet the criteria and limits laid down in the investment strategy.

6. COMMERCIALISATION

The 2019/20 Capital Strategy contained details of the Council's Commercialisation Strategy, which was agreed by Council during 2019. A feature of this commercial approach was to explore three areas of activity, all aimed at increasing income generation and contributing towards addressing the medium-term budget gap faced by the Council. The three areas of activity were:

1) Current services that could be provided on a more commercial basis - e.g. trade waste
2) New services that could be provided - e.g. energy services
3) Property investment – commercial and residential

To enable the third area of activity to be pursued, it was agreed that a £50m investment fund would be created, via an increase in the borrowing limit of an equivalent amount. This would enable the Council, via an investment board, to react to opportunities to acquire property, both within and outside of the authority boundary. Whilst acquisitions within Newport would be prioritised, with a particular focus on social value, a key aim was to generate an income stream that could support the delivery of core services. In effect, this would represent investment primarily for the purpose of yield.

As outlined in last year's report, the Commercialisation Strategy has been paused. This decision was taken in light of the ongoing pressures, risks and challenges resulting from the COVID-19 pandemic. The concerns regarding the longer-term impact of the pandemic on the commercial property market remain, however, in addition, there have been two key changes which mean that this particular element of the commercial approach can no longer be pursued. The first of these changes is that the Public Works Loans Board will no longer lend to local authorities for activity such as this. Secondly, CIPFA have recently introduced changes to the Prudential Code, with one of those changes seeking to prevent investment funded by borrowing solely for the purpose of yield. Therefore, it would no longer be appropriate for the Council to pursue a strategy of investing in property acquisitions solely for the purpose of financial return and, therefore, this element of the strategy should be ceased going forward.

7. OTHER LONG-TERM LIABILITIES

In addition to debt of £144m outlined above, the Council has a number of other long-term liabilities, which represent potential future calls on Council resources, as follows:

Private Finance Initiative (PFI)

The Council has two PFI arrangements. These are for the provision of the Southern Distributor Road (22 years remaining) and for Glan Usk Primary School (12 years remaining). As at 31st March 2021, the combined value of the liabilities was £41.3m. The Council holds specific earmarked reserves to cover the future costs of the PFIs.

Pension Liability

The Council is committed to making future payments to cover its pension fund deficit (valued at £475.1m) as at 31st March 2021.

Provisions

The Council has set aside long-term provisions for risks in relation to landfill capping and aftercare, and guaranteed subsidies in relation to Friars Walk.

Contingent Liabilities

The Council also has a number of contingent liabilities, which may or may not ultimately materialise as a call on Council resources. These liabilities are detailed in the annual Statement of Accounts and include potential insurance claims and risks attached to loans extended to external developers. As well as this, the Council has also entered into a number of financial guarantees to act as a guarantor, in particular for the safeguarding of former employee pension rights when their employment is transferred to third party organisations.

8. KNOWLEDGE AND SKILLS

In-house expertise

The overall Capital Programme, Capital Strategy and Treasury Management Strategy are overviewed by the Head of Finance and Assistant Head of Finance, who are both professionally qualified accountants with extensive Local Government finance experience between them. There is a Capital Accounting team consisting of experienced qualified and part-qualified accountants who maintain Continuous Professional Development (CPD) and attend courses on an ongoing basis to keep abreast of new developments and obtain relevant skills. In addition, there is a Treasury Management team who manage the day-to-day cash-flow activities and banking arrangements of the authority. Members of this team, again, attend the necessary courses and training and have an extensive amount of experience.

External expertise

All of the Council's main capital projects are overseen by project teams comprising the relevant professional disciplines from across the Council. When required, external professional advice is taken, primarily from the Council's property advisors, Newport Norse. The Council also engages with external treasury advisers for advice in relation to treasury management matters.

Members

Training is offered to members to ensure they have up to date skills to make capital and treasury decisions. A register is also kept on member attendance. The Council also involves members at a very early stage of a project's life cycle.

9. SUMMARY

- Capital expenditure plans for the Council need to be affordable, prudent and sustainable.

- The MTFP includes the estimated revenue costs for the entire current capital programme, which includes a level of headroom for additional capital projects to be added without impacting further on the MRP budget, as per the agreed framework.

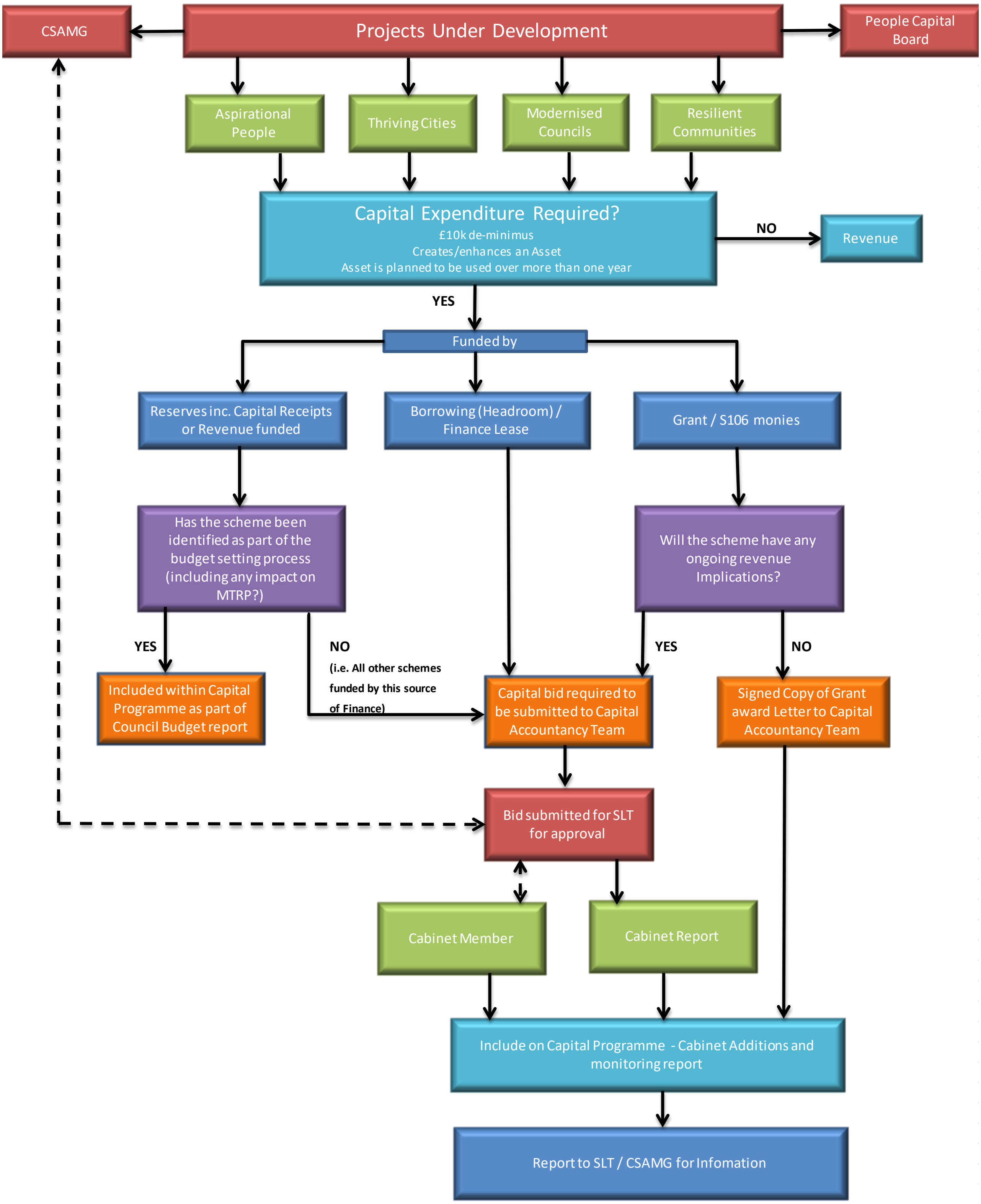
- There are a number of demands on the capital programme and there is the need to link the capital strategy with a number of strategic plans across the organisation. This is to ensure that the pressures on the capital programme are known and the risks are assessed and prioritised within an affordable framework. This will include clear visibility and assessment of demand for schools, highways and other operational assets.

- Decisions on funding capital expenditure through borrowing locks the Council into committing revenue funding over a very long period (as long as 40 years +). With the capital financing budget increasing over the long-term, as shown in Chart 2, the Council will need to make some difficult decisions when developing the next Capital Programme, which is now imminent, to ensure the capital plans remain affordable, prudent and sustainable.

- The Treasury Management Strategy, detailed in Appendix 3, highlights the Council's approach to managing its borrowing and investments. The proposed strategy for 2022/23 is in line with previous years and is based upon a low risk approach to both investments and borrowing. This means that investments held are generally low in value and the approach to borrowing is to look for security of costs, resulting in a generally high proportion of long term borrowing compared to short term borrowing.

APPENDIX 2a – Capital Additions Process Map

NO CABINET MEMBER/CABINET REPORT SHOULD BE SUBMITTED UNTIL THIS PROCESS IS COMPLETE



Appendix 3

Treasury Management Strategy Statement 2022/23

Introduction

Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Authority to approve an investment strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

Revised strategy: In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

External Context

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

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6%

from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% y/y in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Credit outlook: Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 3a.

For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 3%, and that new long-term loans will be borrowed at an average rate of 2.5%.

Local Context
On 31st December 2021, the Authority held £143.8m of borrowing and £40m of treasury investments. This is set out in further detail at ***Appendix 3b***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.21 Actual £m	**31.3.22 Estimate £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**
General Fund CFR	276.3	280.9	309.1	314.4	307.9
Less: Other debt liabilities *	(41.3)	(40.7)	(38.4)	(36.1)	(33.9)
Loans CFR	**235.0**	**240.2**	**270.7**	**278.3**	**274.0**
Less: External borrowing **	(151.4)	(145.7)	(141.4)	(136.0)	(112.7)
Less: Usable reserves	(108.3)	(99.2)	(86.7)	(83.3)	(81.3)
Less: Working capital	(1.6)	(1.6)	(1.6)	(1.6)	(1.6)
Preferred Investment position		10.0	10.0	10.0	10.0
Treasury Investments or (New borrowing)	**26.3**	**(3.7)**	**(51.0)**	**(67.4)**	**(88.4)**

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

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority has a significantly increasing CFR due to the current capital programme, but minimal investments and will therefore be required to borrow up to £88.4m over the forecast period. This is broken down into £38.7m refinancing of maturing existing borrowing and £49.7m additional (£151.4m to £201.1m) external borrowing, while internal borrowing and investments are forecast to reduce by £29.0m and £8.2m respectively as shown in table 2 below.

Table 2: Year on year change in internal and external borrowing

	31.3.21 Actual £m	**31.3.22 Estimate £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**
Loans CFR (as per table 1)	**235.0**	**240.2**	**270.7**	**278.3**	**274.0**
- Cumulative Internal Borrowing	109.9	100.8	88.3	84.9	82.9
- Investments	(26.3)	(10.0)	(10.0)	(10.0)	(10.0)
- Cumulative External Borrowing	151.4	149.4	192.4	203.4	201.1
Increase in External Borrowing		**(2.0)**	**43.0**	**11.0**	**(2.3)**
Represented by:					
Change in loan CFR (Cap Exp funded by debt less MRP)		5.2	30.5	7.6	(4.3)
Reduction in reserves					

		9.1	12.5	3.4	2.0
Reduction in investments		(16.3)	0	0	0
Increase in External Borrowing		**(2.0)**	**43**	**11.0**	**(2.3)**

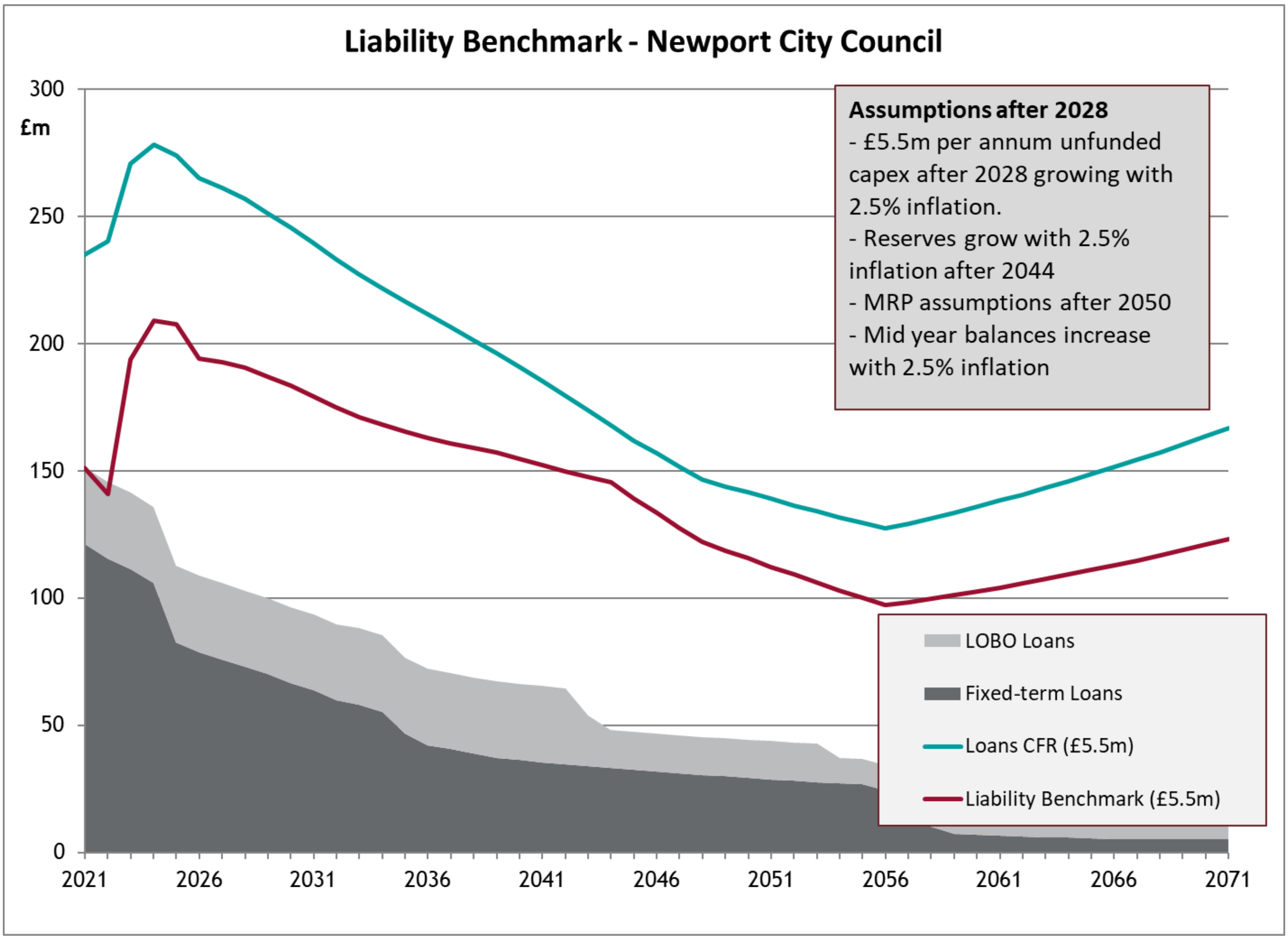
CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2021/22.

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, which are based on the existing Capital Programme, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 3: Liability benchmark

	31.3.21 Actual £m	**31.3.22 Estimate £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**
Loans CFR	235.0	240.2	270.7	278.3	274.0
Less: Usable reserves	(108.3)	(107.7)	(85.3)	(77.5)	(74.7)
Less: Working capital	(1.6)	(1.6)	(1.6)	(1.6)	(1.6)
Plus: Minimum investments	26.3	14.8	10.0	10.0	10.0
Liability Benchmark	**151.4**	**140.9**	**193.8**	**209.2**	**207.7**

From the table above and chart below it is evident to see the steep increase in the liability benchmark, flagging the need to slow down borrowing beyond the current programme. The long-term liability benchmark beyond the current programme shows a model based on a prudent level of capital expenditure to reduce the long-term liability benchmark. This is shown in the chart below (detail of alternative modelled scenarios for the period of the next 10 years are included in Section 4 of the Capital Strategy):



The chart above shows actual borrowing maturing over time (grey area reducing), however the need to borrow (the blue CFR line) is increasing significantly over the short term due to the extensive capital programme. Over the long-term, to ensure a sustainable position, the CFR needs to come down in order for the liability benchmark to stabilise and reduce to current levels (note, even with a steep reduction in CFR the liability benchmark doesn't reduce to current levels until circa 2047. Therefore, the chart is demonstrating the following important points/assumptions:

- To be sustainable, the CFR cannot continue increasing at the rate it is currently, and a prudent limit should be placed on the future capital programme to reduce the CFR over the long-term (set out further in the Capital Strategy)
- The ability to use further internal borrowing will diminish, with internal borrowing reducing over time as reserves are utilised.
- As existing borrowing matures (grey area reducing) there will be the need to refinance this debt over the long-term.
- The liability benchmark is increasing significantly in the short term, meaning that the Council will be required to undertake new borrowing over time, therefore putting pressure on the revenue budget through increased interest payments.
- The only way to reduce this need to borrow is to reduce the level of capital expenditure funded by borrowing.

Borrowing Strategy

The authority currently holds £143.8 million of loans, a decrease of £5.4 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 1 shows that the authority expects to borrow up to £192.4 million in 2022/23. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £271 million.

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

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the authority borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The authority has previously raised the majority of its long-term borrowing from PWLB but will consider long-term loans from other sources including, banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the authority intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow further short-term loans to cover unplanned cash flow shortages.

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Greater Gwent Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- Sale and leaseback

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

LOBOs: The authority holds £30m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOs have options during 2022/23, and although the authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £30m.

Short-term and variable rate loans: These loans leave the authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Treasury Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the authority's treasury investment balance has ranged between £17.9 million and £62.2 million, with levels of c. £10 million to £20 million expected in the forthcoming year.

Loans to organisations providing local public services i.e. regeneration and purchases of investment property are not normally considered to be treasury investments, and these are therefore covered separately in Appendix C.

Objectives: Both the CIPFA Code and the WG Guidance require the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the authority aims to diversify into more secure and/or higher yielding asset classes during 2022/23. This is especially the case for the estimated £10 million that is available for longer-term investment. The majority of the authority's surplus cash is currently invested in short-term unsecured bank deposits and local authorities, although an amount is also now invested in money market funds. This diversification will represent a continuation of the strategy that commenced during 2021/22.

Business models: Under the new IFRS 9 standard, the accounting for certain investments depends on the authority's "business model" for managing them. The authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 4 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 4: Approved investment counterparties and limits

Sector	**Time limit**	**Counterparty limit**	**Sector limit**
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£20m	Unlimited
Secured investments *	20 years	£10m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£5m	£10m
Registered providers (unsecured) *	5 years	£5m	£25m
Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£10m	£25m
Real estate investment trusts	n/a	£10m	£25m
Other investments *	5 years	£5m	£5m

Credit rating	**Banks unsecured**	**Banks secured**	**Government**	**Corporates**	**Registered Providers**
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£5m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	Not Applicable	£5m 5 years
Pooled funds and real estate investment trusts		£10m per fund or trust			

This table must be read in conjunction with the notes below

***Minimum Credit rating:** Treasury investment limits in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £20m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Secured investments: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and building societies (unsecured): Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Registered providers (unsecured): Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

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

Operational bank accounts: The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1 million per bank (in exceptional circumstances i.e. late receipt of significant sums this may be higher for a short-period of time). The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

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

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

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

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

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

Investment limits: The Authority's revenue reserves available to cover investment losses are forecast to be £107.7 million on 31st March 2022. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

Limits will also be placed on fund managers, investments in brokers' nominee accounts and foreign countries and as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Additional Investment limits

	Cash limit
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£10m per country

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

The Authority will spread its liquid cash over at least two providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Prudential Indicators

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

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

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of 1% rise in interest rates	£200,000
Upper limit on one-year revenue impact of 1% fall in interest rates	£100,000

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

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

Refinancing rate risk indicator	**Upper**	**Lower**
Under 12 months	60%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and within 20 years	30%	0%
20 years and within 30 years	20%	0%

30 years and within 40 years	20%	0%
40 years and within 50 years	20%	0%
50 years and above	20%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£10m	£10m	£10m

Related Matters

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

Financial Derivatives: In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Markets in Financial Instruments Directive: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Head of Finance believes this to be the most appropriate status.

Government Guidance: Further matters required by the WG Guidance are included in Appendix 3c

Financial Implications

The budget for investment income in 2022/23 is £0.3 million, based on an average investment portfolio of £10 million at an interest rate of 3%. The budget for debt interest paid in 2022/23 is £6.9 million, based on a debt portfolio with a weighted average interest rate of 3.6%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at	Debt interest costs will rise;	Higher investment balance

long-term fixed interest rates	this is unlikely to be offset by higher investment income	leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix 3a – Arlingclose Economic & Interest Rate Forecast – December 2021

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.
- Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.
- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.
- These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.
- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.
- Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.
- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Forecast:

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

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

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

Appendix 3b – Existing Investment & Debt Portfolio Position

	31/12/2021 Actual Portfolio £m	31/12/2021 Average Rate %
External borrowing:		
Public Works Loan Board	98.7	3.7
Local authorities	0.0	
LOBO loans from banks	30.0	3.7
Other loans	15.1	1.3
Total external borrowing	**143.8**	**3.6**
Other long-term liabilities:		
Private Finance Initiative	41.3	
Finance Leases	0.1	
Total other long-term liabilities	**41.4**	
Total gross external debt	**185.2**	
Treasury investments:		
Banks (unsecured)	10.0	0.13
Local authorities	20.0	0.23
Money Market Funds	10.0	0.15
Total treasury investments	**40.0**	**0.19**
Net debt	**145.2**	

Appendix 3c – Additional requirements of Welsh Government Guidance

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities that are not integral to this authority's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

Contribution: The Authority's investments contribute to its service delivery objectives and/or to promote wellbeing as follows:

- treasury management investments support effective treasury management activities,
- loans to local organisations provide financial support to those organisations to enable them to deliver local public services that would otherwise be provided directly by the authority, and
- investment property provides a net financial surplus that is reinvested into local public services.

Climate change: The Authority's investment decisions consider long-term climate risks to support a low carbon economy to the extent that the Council have invested in, as part of the overall capital programme, a number of energy efficiency related schemes, including LED projects and Solar PV, as well as ultra-low emission vehicles.

Specified investments: The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Loans: The WG Guidance defines a loan as a written or oral agreement where the authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local authority.

The Authority will provide loans where there has been appropriate due diligence undertaken and where possible ensure there is appropriate security i.e. charges on assets. In addition, the authority will fund the loan at the point of drawdown through an appropriate charge i.e. Minimum Revenue Provision charge or funded directly via earmarked reserves.

The Authority uses an allowed 'expected credit loss' model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Authority has appropriate credit control arrangements to recover overdue repayments in place.

Non-specified investments: Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. Limits on non-specified investments are shown in table C2; the Authority confirms that its current non-specified investments remain within these limits.

Table C2: Non-specified investment limits

	Cash limit

Units in pooled funds without credit ratings or rated below [A-]	£10m
Shares in real estate investment trusts	£10m
Total non-specified investments	£10m

Non-financial investments: This category covers non-financial assets held primarily or partially to generate a return, primarily investment property. The Council holds investment properties to the fair value of £9.9m, not including the Council's share of investment properties held by the Cardiff Capital Region City Deal. During 2020/21, there was a net revenue cost of holding these properties of £66,000.

Investment advisers: The Authority has appointed Arlingclose Limited as treasury management advisers and Newport Norse as property investment advisers. The quality of these services is controlled by regular review of the services provided by both advisers and regular strategy meetings with them.

Capacity and skills: The authority ensures that members and statutory officers involved in investment decisions have the appropriate skills, capacity and information to take informed decisions, assess individual investments in the context of strategic objectives and risk profile, and how the quantum of decisions impact upon the overall risk exposure of the authority. Steps taken include relevant training for elected members and a minimum level of qualification for statutory officers, as well as ensuring continuing professional development, via attendance at relevant training courses.

Appendix 3d – Minimum Revenue Provision Policy

Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Welsh Government's *Guidance on Minimum Revenue Provision* (the WG Guidance) most recently issued in 2018.

The broad aim of the WG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Welsh Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

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

For supported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments. This is currently deemed to be an average of 40 years.

For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in on an annuity basis with an annual interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational.

For capital expenditure loans to third parties that are repaid over a short time period (less than 12 months) or frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement. The only other scenario whereby MRP would not be charged is where there is unencumbered first charge security, held against separate assets, upon which the loan is secured. For all other capital expenditure loans to third parties, MRP will be charged in accordance with the MRP policy for the assets funded by the loan.

The MRP policy and charges in relation to the Cardiff City Capital Region 'City Deal' will reflect those within the Joint Working Agreement.

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

Based on the authority's latest estimate of its Capital Financing Requirement as at 31st March 2022, the budget for MRP has been set as follows:

	31.03.2022 Estimated CFR £m	**2022/2023 Estimated MRP £m**
Supported capital expenditure	161	4
Unsupported capital expenditure	77	4
Finance leases* and Private Finance Initiative	41	2
Total General Fund	**279**	**10**

* Where former operating leases will be brought onto the balance sheet on 1st April 2022, due to the adoption of the *IFRS 16 Leases* accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.