Report

Cabinet

Part 1

Date: 22 February 2021

Subject 2021/22 Capital Strategy and Treasury Management Strategy

Purpose The purpose of this report is to present to Cabinet the Capital and Treasury Management Strategies, noting the comments made by Audit Committee before recommending these strategies to Council for approval. Both strategies are appended to this report. The report summarises and highlights the key areas relating to the strategies, alongside those areas of key implications/risks coming out of them, which are bought to the Cabinet's attention for their review.

Author Head of Finance

Ward General

Summary The Council has ambitious plans for the city as set out in its Corporate Plan and the promises set out within it. A key enabler to deliver on this ambition is the capital programme. 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 Councils borrowing & 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 and demonstrates how/that the Local Authority takes capital and investment decisions in line with service objectives, gives consideration to both risk/reward and impact; as well as properly taking account of stewardship, 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 That Cabinet recommend to Council for approval:

- The Capital Strategy (Appendix 2), including the current capital programme within it (shown separately in Appendix 1) and the borrowing requirements/limits needed to deliver the current capital programme.
- The Treasury Management Strategy and Treasury Management Indicators, the Investment Strategy and the Minimum Revenue Provision (MRP) for 2021/22. (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 in terms of 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 do this

- Beyond the current capital programme period, there are potential financial challenges around on-going affordability and sustainability but these will need to be reviewed closer to the start of the new programme within the context of funding levels and the Councils budget position.

- Note comments made by Audit Committee on 28 January 2021 (paragraph 5 & 6).

Action by

Head of Finance

Timetable

Immediate

This report was prepared after consultation with:

- Leader of Council 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

CONTEXT

Governance and requirement of Councils

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

2. Whilst Cabinet make decisions relating to what capital projects and spend to make, it is the full Council that approves the 'borrowing limits' that these are kept 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, the programme is required to be set within those limits.

   This is an important area of overall financial management governance in that borrowing levels, once taken up, lock in the Council to a long term lability for revenue costs in relation to the provision of the repayment of those loans (MRP costs) and external loan interest costs – together known as 'capital financing costs',

3. The key governance documents that explain and control this area 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 both risk/reward and impact;

   iii) Shows how the Council takes account of stewardship, 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 Councils longer term borrowing requirement and plans, which is driven mainly by the capital programme requirements and in Newport specifically, its reducing 'internal borrowing' capacity

   (ii) Includes how it will manage and invest its surplus cash which also have various targets/limits as part of the suite of 'prudential indicators'

   (iii) Includes additional guidance - the Welsh Government Investment Guidance and the Minimum Revenue Provision Policy.

   Both these strategies are a requirement of CIPFA's Prudential Code which sets out the requirement for them and ensure, within the frameworks which these document set, that capital expenditure plans are:

- **Affordable -** capital spend and programmes are within sustainable limits. Councils are required to take into account current and forecast funding available to them and the totality of their capital plans and their costs in assessing affordability.

- **Prudent –** Councils need to set borrowing limits (called 'operational' and 'authorised limits' – part of the suite of Treasury 'prudential indicators') which reflect the Councils plan for affordable capital plans and their financing costs. On investing activities, Councils need to consider the balance between security, liquidity and yield which reflects their own risk appetite but which prioritises security and liquidity over yield.

- **Sustainable –** Council's capital plans and the revenue cost of financing the current and future forecast borrowing/debt taken out for that needs to be sustainable in terms of the Councils overall finances and its impact on that**.**

4. The Capital Strategy and Treasury Management Strategy are inherently linked and the main recommendations and observations coming from these are summarised in the following sections. Full Council are required to approve these strategies and the limits and the prudential indicators within.

5. The report was taken to Audit Committee on 28 January 2021 for observations and comment. The following comments were received from the Committee and where relevant the response is reflected in the report:

   - Noted the significant increase in the capital programme over the period from 2020/21 due to the completion of the current capital programme.
   - Chair noted that while the report highlighted that the debts were unsustainable going forward and were high, the strategy does not answer the question "how high is high?"
   - Chair commented that it was difficult to tease out what the recommendations of the Head of Service are, and that it seemed the level of borrowing is basically driven by the capital programme. Chair recommended if the recommendation was that debt levels were getting too high, then the operational boundary could be amended or clarified in the paper.
   - Chair also said the paper could give further clarity to councillors on the operational debt levels and whether the capital programme was too ambitious for the Councils funds.

6. In response to the above comments:

   - The current capital programme is restricted by what is deemed as affordable and sustainable. This is because the increased budget provision put into the capital financing budget has meant that the high levels of borrowing are currently affordable whilst the risks to sustainability are no different to those that exist today and the percentage of the Councils overall budget allocated to this is broadly the same at the end of the programme compared to current levels today. The operational boundary limit in paragraph 11 limits the amount debt funded expenditure the Council can undertake and reflects the current capital programme for which the revenue budget exists.
   - There are potentially future affordability and sustainability issues beyond the levels here in the current programme but these cannot be confirmed or assessed until we are nearer to the new programme period and more certainty is known on funding levels and the Council's general budget position at that time. In saying this, affordability and sustainability issues will need to be carefully considered and should impact and drive the size of the next capital programme.
   - The Head of Finance summary in this report provides clarity on the affordability of the current programme and the sustainability on future borrowing levels, summarised above.

Capital Strategy 2020/21 to 2029/30

Capital Programme to 2024/25

7. The Council's capital programme goes to 2024/25 (this is the original capital 5 year programme to 2022/23 which has been extended by 2 years for projects whose completion spans beyond the 5 years). It is a significant capital programme and Cabinet's intention to bring forward a new leisure scheme in the city centre (included in another report to this Cabinet meeting), regeneration schemes plus fund its share of the accelerated investments being made by the Cardiff City Region requires this to increase further and also therefore, the borrowing limits to facilitate these. A further £4.5m of further 'capacity' for borrowing to facilitate further schemes funded from borrowing between now and 2022/23 is also required for flexibility.

8. The capital programme includes £211.4m of already approved projects and alongside the investments above; the borrowing for cost of carry for Cardiff City Capital Region spend at £17.3m, £19.7m for the new leisure scheme and £4.5m for further uncommitted borrowing for future projects – brings a total investment of £252.9m for the programme ending 2024/25. The table below shows the prudential indicator for estimates on expenditure and financing, from which the borrowing limits will be set (Table 2).

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

	2018/19 Actual £m	**2019/20 Actual** £m	**2020/21 Forecast** £m	**2021/22 Budget** £m	**2022/23 Budget** £m	**2023/24 Budget** £m	**2024/25 Budget** £m	**Total 7-year programme £m**
TOTAL EXPENDITURE	29.5	31.4	32.7	62.7	71.6	17.9	5.6	**252.9**
Financed by:								
TOTAL COMMITTED (Appendix 1)	**29.5**	**31.4**	**32.7**	**60.7**	**50.9**	**17.9**	**5.6**	**228.7**
TOTAL UNCOMMITTED*			**1.5**	**2.0**	**20.7**			**24.2**
TOTAL FINANCING	**29.5**	**31.4**	**34.2**	**62.7**	**71.6**	**17.9**	**5.6**	**252.9**

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

10. Capital Expenditure funded by debt increases the need to undertake external borrowing. A further driver for the need to undertake external borrowing is the capacity to be 'internally borrowed' reducing as earmarked reserves are utilised, which in turn needs to be replaced with external borrowing. This is the case particularly for this Council which has a high level of 'internal borrowing'; which is now reducing over the medium-long term. The Council is committed and has a requirement 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.

11. **Affordable borrowing limit:** The Council is legally obliged to approve an affordable borrowing limit (also termed the 'authorised limit' for external debt) each year.

    The 'Operational borrowing limits' over the medium term, have been set in line with the expected borrowing required to finance the current capital programme to 2024/25. 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. The 'Authorised

borrowing limits', provide a buffer for the ability to manage day to day cash requirements (ii) undertake a level of borrowing early where appropriate / affordable.

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	254	281	283	284
Authorised limit – PFI and leases	42	41	39	36
Authorised limit – total external debt	**296**	**322**	**322**	**320**
Operational boundary – borrowing	187	226	231	234
Operational boundary – PFI and leases	42	41	39	36
Operational boundary – total external debt	**229**	**267**	**270**	**270**

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 substantial with external borrowing increasing from an estimated £164m at the end of this financial year to £234m in 2024/25, an increase of over £70m. To summarise the position at the end of the current capital programme:

- actual external borrowing is forecast to be c£234 (Operational boundary)
- the total committed requirement for external borrowing is forecast to be c£284m (Authorised limit)

The difference between both is the Council's 'internal borrowing' because of its cash backed reserves, which has been used in lieu of external borrowing. As reserves are spent over the medium term, in particular the PFI reserves, our reducing capacity for internal borrowing will need to be replaced with 'real', external borrowing. The Council will therefore, over the medium-long term, see this difference reduce and the external borrowing will increase to the committed requirement. This will have a revenue impact due to increasing interest costs of the 'real', external borrowing (2%-2.5% currently) compared to internal borrowing ('nil'/'minimal' cost currently).

13. The commitment to increase external borrowing leads to increasing capital financing costs as shown in table 3 below, and show a significant increase in capital financing costs from 2020/21. These costs are included in the Council's MTFP. Costs will continue to increase into the medium to long term. Compared to comparative authorities, the percentage of the capital financing costs as a proportion to the Councils total net revenue is high, particularly when compared to other Councils of similar demographics, showing the need to maintain a sustainable level of spending on capital expenditure funded by debt to manage these costs.

Table 3: Capital Financing Costs

	2020/21 budget	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
Provision for repayment of debt (MRP)*	8.5	9.4	9.4	9.6
Net interest cost	7.0	7.3	7.3	7.5
Total capital financing (exc PFI)	**15.5**	**16.7**	**16.7**	**17.1**
PFI	5.5	5.6	5.6	5.7
Total Financing costs* (£m)	**21.0**	**22.3**	**22.3**	**22.8**
Proportion of net revenue stream	7.0%	7.0%	6.9%	6.9%

*includes charges direct to service areas

14. The Council has received a positive draft settlement from Welsh Government, and therefore to ensure it is funded at the point of approval and to support the Medium Term Financial Plan reducing the overall budget gap, Cabinet has, in its draft budget, ring-fenced the budget required to fund the full capital programme until 2024/25 in Appendix 1 in 2021/22.

15. At the end of the current capital programme the revenue budget required to finance the level of borrowing is forecast to be £22.8m, representing about 6.9% of the Council's predicted net budget at that point. The percentage of the capital financing budget/costs as a proportion to the Councils total net revenue is high when compared with other comparable Welsh Councils, though the allocation of available resources to different services/costs is a decision for individual Council's. The revenue cost of servicing the Council's external debts is a long-term cost and is increasing, at a time of uncertainty regarding future funding, though as a percentage of the net budget, is staying reasonably static given the increase in the Council's net budget, especially in 2021/22. There is currently no medium term UK budget and there is uncertainty of how funding might be affected by any plans to deal with the UK debt.

Beyond the current capital programme (2023/24 onwards)

16. Any debt funded capital expenditure means that the Council is locked into the commitment to borrow for the long-term. The Council must approve a capital strategy which ensures that the capital expenditure plans of the authority are affordable, prudent and sustainable. To help achieve this, the Council will need to set a sustainable limit for debt funded capital expenditure over the long-term and will need review as we approach 2024/25.

    Beyond the current programme, the context for that is its starting point, which are:

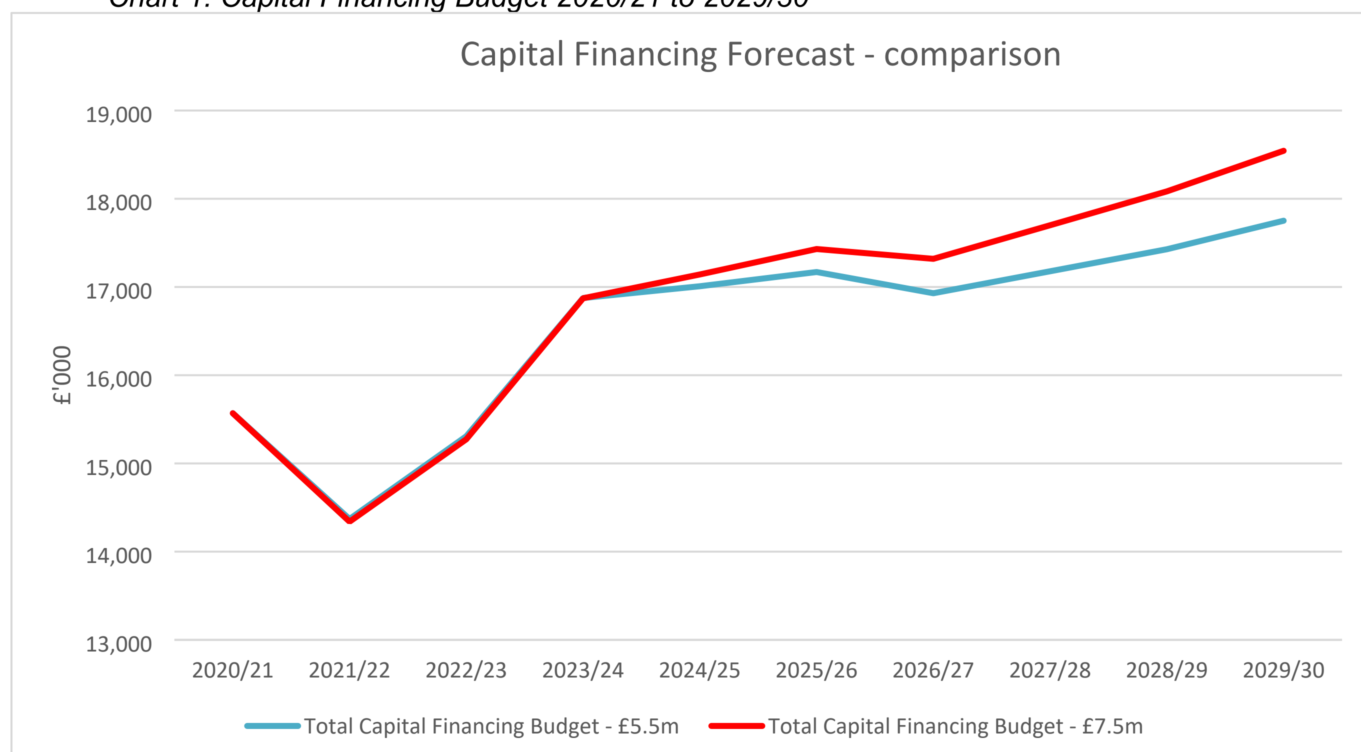
    - a higher level of forecast borrowing at the end of the current capital programme
    - a corresponding higher level of capital financing cost at the end of the current capital programme
    - continuation of the reduction in reserves and therefore capacity to be internally borrowed, requiring a continuing increase in external borrowing to replace it
    - the methodology for charging MRP at the Council, which realised a budget saving when changed 2-3 years ago but which increases the charge each year from that point and will continue to do so

    Ultimately, the issues above will also need to be seen in the context of (i) the Council's future funding; both external from WG core funding and local Council Tax which, for the former, will depend to some extent on the UK's response to the current debt and WG funding priority for the Local Government sector (ii) the Council's ability to produce robust/balanced budgets and (iii) progress on delivery (and spend) of the current capital programme.

    The current trajectory of debt funded capital spend and associated debt to finish the current capital programme will inevitably provide a challenging context.

17. 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.

Chart 1: Capital Financing Budget 2020/21 to 2029/30



18. The above shows the increasing capital financing costs over the next 10 years with a limit of both £5.5m and £7.5m of debt funded capital expenditure after the current programme. As is evident, based on the current programme the revenue capital financing costs of implementing a large capital programme is increasing year on year from 2021/22 to the end of the current programme in 2024/25 and alongside a revenue budget Medium Term Financial Projection showing a funding gap, provides the challenging context mentioned above.

19. Beyond the current programme:

- With limiting borrowing to £5.5m per annum, this reduces the Councils long-term committed need to borrow over the period, but actual borrowing reduces only very slightly. This is due to internal borrowing capacity reducing which in turn increases the need to borrow, dampening out most of the potential benefit of the reducing long-term committed need to borrow. This therefore reduces costs very slightly itself but is then offset by the increasing MRP charge methodology, increases the net capital financing costs

- With £7.5m borrowing per annum, the Council's actual borrowing does not reduce and stays broadly level, with no dampening of this from the reducing long-term committed need to borrow which is at a smaller level than above. The MRP charging methodology increases the capital financing costs as before

Whilst the costs of the current capital programme is now funded, these are the issues which will provide further medium-long term challenges to funding the Council's future capital programme thereafter and will, as said, need to be reviewed in light of forecast/known funding and the position on the Council's overall budget

Other Capital Strategy areas

20. The Capital Strategy includes a number of other areas to be considered by Council which are included in full in Appendix 2. One area that requires particular attention is the commercial activities section which has changed since last year.

21. Due to the economic impact of Covid-19 and the recent changes to the criteria in accessing the Public Works Loan Board for commercial investments, the Councils future commercial activities and in particular the £50m investment fund that was agreed as part of the capital strategy during 2019/20 has been paused. Council will be updated following a review on the future of these activities. The figures above in relation to capital expenditure and associated borrowing already incurred and included within the programme to 2024/25 do not include any borrowing forecast for the previously announced investment fund.

Treasury Management Strategy

22. Our detailed Treasury strategies for 2021/22 are included at Appendix 3. In addition, planned strategies to 2022/23 are also included, in line with the Council's remaining Medium Term Projections. Key points of interest are summarised below.

Borrowing Strategy

23. The capacity to be internally borrowed will reduce over the medium to long term. In 2021/22 the Council is expected to undertake external borrowing both for the refinancing of maturing loans and to fund increasing capital spend in the existing capital programme; it will remain as much 'internally borrowed' as is possible and increase actual external borrowing only when needed to manage its cash requirements. However, the Council may, where it feels necessary to mitigate the risk of interest rate rises, undertake borrowing early to secure interest rates within agreed revenue budgets. This will be done in line with advice from our Treasury Advisors.

24. The Council is committed and has a requirement to be a 'net borrower' over a long-term as shown in paragraph 11-12. The Councils medium term financial projections (MTFP) include the revenue costs required to finance the borrowing limits in relation to finance the capital programme as mentioned above. Where this borrowing is undertaken for the investment/income generation schemes or investment purposes the revenue costs would be offset by the income received from the investment.

25. It is recommended given the long-term need to remain a 'net borrower', that future external borrowing will be taken over long time period taking into account the maturity profile of existing debts, in conjunction with advice from the Council's treasury advisers.

Investment Strategy

26. Both the CIPFA Code and the WG Guidance require the Authority 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 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.

27. Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into higher yielding asset classes during 2021/22, this has been delayed from 2020/21 due to the current economic climate as a result of the pandemic. This is especially the case for the estimated £10 million that is available for longer-term investment. All of the Authority's surplus cash is currently invested in short-term unsecured bank deposits and local authorities. This diversification will represent a change in strategy over the coming year.

28. The approved counterparty list and limits are shown table 4 of Appendix 3.

29. Treasury indicators and limits are outlined in the strategy, these set out the investment limits across various bodies/organisations, the maturity structure of borrowing and the amount invested over one

year (long-term). The limit placed on investments over one year is £10m, in line with the approved counterparty limits.

30. The Council will also be required to borrow and invest in the short-term to manage the shorter term cash-flow requirements of the Council.

Head of Finance Summary

31. The Councils 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. Decisions taken today are also being made in a period of significant uncertainty on future funding, within a challenging time for public finances. As explained in the context section above, the core requirements for Councils are to makes decisions here taking into account:

    (i) affordability – what are the increasing costs of debt that may be required, can it be funded/afforded in the overall revenue budget taking account of other spending pressures and forecast future income, including the impact of this spend vs spend in other areas?
    (ii) sustainability – the impact of the debt and financing costs on the Councils budget long term and sustaining the impact of that
    (iii) prudence – appropriate limits and targets are set to manage and monitor affordable and sustainable borrowing and investments are made with a view to balance security, liquidity and yield

    In terms of the Councils current capital programme to 2024/25 and increases to it

    Affordability

    - There is a significant increase in the Council’s level of external borrowing and its associated capital financing costs over the next three years. Due to the better settlement the Council was awarded for 2021/22, Cabinet were able to set the revenue budget required in order to fund the current capital programme to its conclusion in their draft budget. The current capital programme is now affordable, in totality, as a result of this.

      This is an important position to be in for the following reasons, taken together:

    - The Council has an unbalanced MTFP over the next three years.
    - The revenue capital financing cost increase is very significant over a short period of time
    - Funding availability is uncertain, with a low funding base and uncertainty surrounding future funding from WG given the lack of a UK Comprehensive Spending Review and the increasing cost pressures on the budget from education/schools and social care

    Sustainability

    - The increased level of external borrowing and associated capital financing costs over the current capital programme period will produce some challenges and increased risks potentially in terms of sustainability and in agreeing to the borrowing limits, the Council needs to be aware of this. This is because of the increased budget requirement to fund the increasing debt, the relatively high amount of the Council’s revenue budget allocated to this already and over the medium-long term, costs will continue to increase as internal borrowing capacity reduces.

    In saying this, it is forecasted that the proportion of the overall net budget that is spent on this cost will broadly remain the same by 2024/25 compared to now and is therefore no more potentially challenging than the current position. This is also based on currently prudent MTFP assumptions on WG funding, certainly based on funding increases over the last few years.

Therefore the risk here is the potential prospect of reduced public sector funding or funding not keeping up with budget demands and the 'locked-in' capital financing costs which are high and rising and therefore the risk to other service budgets. Council needs to be aware of this position but again, is not new or different to the current position or level.

Prudence

- Prudent operational limits on the level of capital expenditure funded by borrowing have been recommended which matches the current programme requirement carefully, including allowances for new schemes and regeneration schemes such as the new leisure centre but no more and therefore the Council's priorities, and in turn the capital programme need to be managed within those limits set. This ensures the programme and external borrowing are closely aligned and Council has oversight and limits the current significant increase. This is in line with the requirements of the CIPFA Prudential Code.

32. The starting point for the next capital programme beyond the current one with current forecast indebtedness and associated capital financing costs increasing is challenging and introduces some challenges as a starting point. Thereafter, reducing capacity for internal borrowing and an increasing MRP charge provides further funding challenges over the medium-long term. Key issues will therefore be the forecast/actual known funding position for the Council and the position on the Council's budget and demands on that.

It should also be remembered that most of the Council's funding for its capital spend comes from capital grants (c.60-65% on the current programme) and this is very likely to continue, especially in relation to key WG policy areas such as school buildings, for example.

33. Council are required to approve the Capital and Treasury Strategies including the prudential indicators and limits within these strategies.

Risks

Risk	Impact of risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Capital Expenditure increases need to borrow	H	M	Regular monitoring and reporting of available headroom should identify any issues at an early stage and keep Cabinet / Council updated	Members, Head of Finance
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor money market movements and 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.	Members, Head of Finance, Treasury staff, based on advice from treasury advisors

Interest Rates moving adversely against expectations	Low	Low	Base and short-term Interest rates are expected to remain at current levels until. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

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 Assembly Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

To endorse both the Capital Strategy and the Treasury Management Strategy and the recommendations within to Council for approval, and approve the capital programme 2018/19-2024/25.

Preferred Option and Why

To approve the updated 2018/19-2024/25 capital programme. The Prudential Code 2017 places a requirement on Local Authorities to determine a long term Capital Strategy. The Prudential Code and statute also requires that, before the end of the financial year, reports on Treasury Management matters are presented to Cabinet/Council for approval. Therefore, Cabinet are required to endorse both the Capital Strategy and the Treasury Management Strategy to Council and approve the capital programme.

Comments of Chief Financial Officer

Both the Treasury Management and Capital Strategy 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 significant increase in borrowing and resultant revenue costs resulting from the current capital programme. Continuation of borrowing at this level into the next programme is unsustainable.

While the current capital programme is affordable and budgets have been identified in the 2021/22 budget for the delivery of the programme, 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 with the limited borrowing shown in the capital strategy the capital financing costs continue to increase, therefore showing the importance of agreeing a prudent limit for the future programme.

The treasury management strategy highlights that the borrowing strategy has changed on previous years due to the capacity for further internal borrowing being diminished. The Council now will need to undertake external borrowing, and will take a view 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 proposed 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 they will need to be formally approved and adopted by full Council. Audit Committee have been 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. Audit Committee were only concerned with the effectiveness of the strategies in terms of how capital and investment decisions are made, and the detail of individual capital and investments decisions within the capital programme are executive decisions for Cabinet.

Comments of Head of People and Business Change

There are no human resources implications arising from the report. An effective capital strategy will enable the Council to support long term planning in line with the sustainable development principle of the Well-being of Future Generations Act.

Comments of Cabinet Member

N/A

Local issues

N/A

Scrutiny Committees

N/A

Equalities Impact Assessment and the Equalities Act 2010

The Equality Act 2010 contains a Public Sector Equality Duty which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better informed decision-making and policy development and services that are more effective for users. In exercising its functions, the Council must have due regard to the need to: eliminate unlawful discrimination, harassment, victimisation and other conduct that is prohibited by the Act; advance equality of opportunity between persons who share a protected characteristic and those who do not; and foster good relations between persons who share a protected characteristic and those who do not. The Act is not overly prescriptive about the approach a public authority should take to ensure due regard, although it does set out that due regard to advancing equality involves: removing or minimising disadvantages suffered by people due to their protected characteristics; taking steps to meet the needs of people from protected groups where these differ from the need of other people; and encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.

Children and Families (Wales) Measure

N/A

Wellbeing of Future Generations (Wales) Act 2015

The Wellbeing of Future Generations (Wales) Act 2015 is taken into account when looking at the long-term impact of treasury management and capital decisions. The Council has a prudent Minimum Revenue Provision Policy and abides by the treasury management and prudential indicators detailed in the report.

An effective capital strategy will enable the Council to support long term planning in line with the sustainable development principle of the Act.

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 2020
Capital Monitoring and Additions Report

Dated: 22 February 2021

Appendix 1 – Detailed Budget Breakdown of the current 7 year Programme

	Outturn 18/19	Outturn 19/20	Budget 20/21	Budget 21/22	Budget 22/23	Budget 23/24	Budget 24/25	Total
21st Century Schools - Band A	8,046	1,220	74	-	-	-	-	9,340
21st Century Schools - Band B	675	1,712	3,345	23,418	35,944	10,137	140	75,371
Jubilee Park - Fixtures, Furniture & Equipment	13	-	-	-	-	-	-	13
Gaer Annexe Education Use	-	416	79	-	-	-	-	495
Blaen-y-Pant Bungalow (Educational Use)	52	-	8	-	-	-	-	60
St Mary's Toilet Refurbishment.	-	42	-	-	-	-	-	42
Somerton Primary - ICT Equipment	11	-	-	-	-	-	-	11
Feminine hygiene hardware & toilet facilties.	34	-	-	-	-	-	-	34
Lliswerry High (S106 Funds)	110	80	-	-	-	-	-	190
Maesglas Reducing classroom size	-	64	200	257	-	-	-	521
Lliswerry IT Replacements	53	-	-	-	-	-	-	53
Welsh Medium Primary School	-	150	373	1,978	1,000	2,300	-	5,801
Reducing Classroom size bids	-	61	527	-	-	-	-	588
Bassleg Demountables	-	116	90	-	-	-	-	206
ICT Equipment Lease (Clytha Primary)	-	20	-	-	-	-	-	20
ICT Equipment Lease (St Mary's)	-	11	-	-	-	-	-	11
St Patricks ICT	-	12	-	-	-	-	-	12
Bassaleg ICT	-	69	-	-	-	-	-	69
ICT Equip Lease Ysgol Gymraeg Ifor Hael	-	10	-	-	-	-	-	10
Ringland Perimeter Fence	-	-	85	-	-	-	-	85
Llanmartin Primary ICT	10	-	-	-	-	-	-	10
Malpas Park Primary	11	-	-	-	-	-	-	11
Education Maintenance Grant 2018/19	-	1,470	358	-	-	-	-	1,828
Education Maintenance Grant 2019/20	-	-	1,341	800	-	-	-	2,141
Education Asset Improvements - balance to be drawn down	1,055	200	27	-	-	-	-	1,282
Bassaleg Demountables - year 7	-	-	771	14	-	-	-	785
EdTech Grant	-	-	362	-	-	-	-	362
Education Accessibility Studies	-	-	268	-	-	-	-	268
Charles Williams Renovations	-	-	110	1,510	-	-	-	1,620
Lliswerry Safeguarding	-	-	57	-	-	-	-	57
Maindee Primary Toilets	-	-	172	-	-	-	-	172
Milton IT replacement	-	-	26	-	-	-	-	26

St Michael's lt replacement	-	-	16	-	-	-	-	16
Prior Year Scheme - Various	(38)	(39)	-	-	-	-	-	(77)
Education	**10,032**	**5,614**	**8,289**	**27,977**	**36,944**	**12,437**	**140**	**101,433**
Gypsy/Traveller Site Development	2,993	78	10	55	-	-	-	3,136
Indoor Newport Market	-	-	1,000	3,500	-	(4,500)	-	-
HLF Market Arcade Townscape Heritage Scheme	39	266	1,556	980	-	-	-	2,841
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	-	412	2,594	5,188	-	-	9,402
Cardiff City Region Deal - Cost of Carry	-	-	-	-	1,850	9,987	5,482	17,319
Mill Street Development Loan	-	2,341	1,659	-	-	-	-	4,000
Neighbourhood Hubs	915	1,344	-	-	-	-	-	2,259
Arva Investment Loan	385	333	32	-	-	-	-	750
Disabled Facilities	898	1,092	1,100	1,000	1,000	-	-	5,090
Safety at Home	364	375	270	300	300	-	-	1,609
ENABLE Adaptations Grant	197	197	197	-	-	-	-	591
Homelessness Prevention Grant	98	-	-	-	-	-	-	98
Asset Management Programme	1,066	1,245	1,519	2,619	1,500	-	-	7,949
Flying Start Schemes	-	-	-	-	-	-	-	-
FS Maintenance 1819 / 1920	31	38	-	-	-	-	-	69
FS Shaftsbury Community Centre	183	-	-	-	-	-	-	183
Childcare - Flying Start	-	546	428	1,095	-	-	-	2,069
All Wales Play Opportunities	-	-	183	-	-	-	-	183
Castle Kids Refurbishment Works	-	-	18	-	-	-	-	18
Central Library - Structural Works	72	17	200	374	-	-	-	663
Transporter Bridge	72	913	265	10,287	1,400	-	-	12,937
Chartist Tower	-	1,344	256	-	-	-	-	1,600
PAC System	-	57	-	-	-	-	-	57
OLEV Residential EV charging Equipment	-	-	-	-	-	-	-	-
Medieval Ship	-	-	-	12	-	-	-	12
Information Station	-	-	140	1,610	-	-	-	1,750
Renewable Energy Investment	-	2	5	1,722	-	-	-	1,729
FS City Wide Maintenance & Repair of Premises	-	-	43	90	-	-	-	133

Improvements to Flying Start Facilities	-	-	118	-	-	-	-	118
TRI Thematic Funding	-	-	1,078	-	-	-	-	1,078
Prior Year Scheme - Various	(7)	(18)	-	-	-	-	-	(25)
Regeneration, Investment and Housing	**9,787**	**10,914**	**10,518**	**26,238**	**11,238**	**5,487**	**5,482**	**79,664**
IT Replacement Schemes	94	9	-	665	150	-	-	918
Corporate EDMS Rollout	-	13	-	-	-	-	-	13
CRM	250	276	243	-	-	-	-	769
I Trent Development	-	91	144	-	-	-	-	235
Print 2010- Managed Printer Service	131	-	249	-	-	-	-	380
People and Business Change	**475**	**389**	**636**	**665**	**150**	**-**	**-**	**2,315**
Telecare Service Equipment	97	12	36	30	30	-	-	205
Equipment for Disabled Grant (GWICES)	165	165	165	165	165	-	-	825
Home Care System	32	-	-	-	-	-	-	32
Centrica Lodge	(6)	(3)	-	-	-	-	-	(9)
SMAPF	320	305	297	-	-	-	-	922
Adults and Community Services	**608**	**479**	**498**	**195**	**195**	**-**	**-**	**1,975**
Disbursed accommodation and Covid-19 equipment	-	-	337	-	-	-	-	337
3 New Homes	701	792	629	-	-	-	-	2,122
Oaklands Respite Home	505	102	-	-	-	-	-	607
Windmill Feasibility Study	41	110	90	1,300	-	-	-	1,541
Children's and Families Services	**1,247**	**1,004**	**1,056**	**1,300**	**-**	**-**	**-**	**4,607**
Fleet Replacement Programme	797	1,912	2,428	1,153	1,850	-	-	8,140
Bus station - Friars Walk Development	29	93	-	-	-	-	-	122
Flood Risk Regulation Grant	24	34	33	-	-	-	-	91
Cemetery Infrastructure Improvements	16	30	64	-	-	-	-	110
Peterstone Sewage Scheme	1	28	194	-	-	-	-	223
Road Safety Capital 2018/19	-	1,379	-	-	-	-	-	1,379
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	1,024	2,645	-	-	-	4,060
Decriminalised Parking	232	874	280	-	-	-	-	1,386
Update Facilities in Parks	18	47	-	-	-	-	-	65
Decommissioning 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	-	-	-	-	1,840
Street Lighting LEDs	564	2,202	132	-	-	-	-	2,898
Park Square Lights	-	-	65	-	-	-	-	65
Velodrome Lights	-	173	166	-	-	-	-	339
Local Transport Fund - Active Travel Northern 2018/19	290	196	114	-	-	-	-	600
Tredegar Park Car Park	-	-	12	-	-	-	-	12
Tredegar Park - Pedal Power	-	3	152	35	35	-	-	225
Lliswerry Road (81)	-	9	2	-	-	-	-	11
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	376	-	-	-	-	400
Core AFT Allocation	-	340	-	-	-	-	-	340
Inner City Links	-	684	206	-	-	-	-	890
LTNF - ECO Stars	42	41	-	-	-	-	-	83
Safe Routes - St David's RC Primary	84	145	60	-	-	-	-	289
Gwastad Mawr Flood Attenuation Improvement Works	2	-	53	-	-	-	-	55
18-19 Collection Collaborative Change Programme	1,175	-	-	-	-	-	-	1,175
LTF Monkey Island Bridge Lliswerry Pill	29	121	-	-	-	-	-	150
LTF Sustainable Transport	25	309	-	-	-	-	-	334
Riverside Park	20	-	-	-	-	-	-	20
Pye Corner Railway Station Development Works	21	-	-	-	-	-	-	21
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	-	-	234	-	-	-	-	234
Highways Annual Sums	455	322	501	500	500	-	-	2,278

Lliswerry Recreation Ground Changing Rooms	4	339	-	-	-	-	-	343
Safe Routes - St David's RC Primary Year 2	-	-	278	-	-	-	-	278
Sustainable Transport Improvements Year 2	-	-	291	-	-	-	-	291
Upgrading and Replacement of Bus Stops	-	-	100	-	-	-	-	100
Road Safety Capital A48 Llandevaud	-	-	74	-	-	-	-	74
Resilient Roads	-	-	65	-	-	-	-	65
Western Corridor-Inner City Links	-	-	607	-	-	-	-	607
Monkey Island Bridge Year 2	-	-	990	-	-	-	-	990
Core Allocation Year 2	-	-	99	-	-	-	-	99
Flood and Coastal Erosion Risk Management	-	-	105	-	-	-	-	105
Carnegie Court Emergency River Works	-	-	1,100	-	-	-	-	1,100
Parry Drive Play Area Improvements	-	-	23	-	-	-	-	23
Brecon Road Play Area Improvements	-	-	3	-	-	-	-	3
Sorrell Drive Repairs and Glasllwch Kickwall Installation	-	-	26	-	-	-	-	26
Marshfield Community Centre	-	-	16	-	-	-	-	16
Improvements to Throwing Facilities at Newport Athletics Stadium	-	-	154	-	-	-	-	154
Local sustainable transport measures in response to Covid	-	-	600	-	-	-	-	600
Ultra Low Emission Grants	-	-	205	-	-	-	-	205
Flood recovery works - Tredegar Park	-	-	-	-	-	-	-	-
Kingsway car park operation	-	-	25	-	-	-	-	25
Increased Recycling	-	-	25	-	-	-	-	25
Repair & Reuse Activities in Town Centres	-	-	400	-	-	-	-	400
Repair & Reuse Newport Makerspace	-	-	58	-	-	-	-	58
Prior Year Scheme - Various	(11)	-	-	-	-	-	-	(11)
City Services	**7,316**	**12,959**	**12,059**	**4,333**	**2,385**	**-**	**-**	**39,051**
Total	**29,466**	**31,359**	**33,054**	**60,705**	**50,914**	**17,924**	**5,622**	**229,045**
Financed By:								
General Capital Grant	4,754	3,858	4,107	4,000	4,000	-	49	20,768
Supported Borrowing	4,058	4,077	4,097	4,058	3,219	1,701	-	21,210
Unsupported Borrowing	2,126	5,790	4,872	16,151	15,647	7,086	5,482	57,154
Prudential Borrowing	84	123	-	-	-	-	-	207
External Grants	12,911	13,055	15,838	33,107	25,014	9,137	91	109,154

S106	868	523	509	2,170	2,446	-	-	6,516
Other Contribution	242	268	65	397	-	-	-	972
Capital Receipts	3,136	820	2,325	448	588	-	-	7,317
Revenue Contribution	75	68	79	374	-	-	-	596
Reserve	1,081	2,777	913	-	-	-	-	4,771
Finance Lease	131	-	249	-	-	-	-	380
Total	**29,466**	**31,359**	**33,054**	**60,705**	**50,914**	**17,924**	**5,622**	**229,045**

Appendix 2

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NEWPORT
CITY COUNCIL
CYNGOR DINAS
CASNEWYDD

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. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

Decisions made this year on capital and treasury management will have financial consequences for the Authority 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.

It highlights that in the current climate of financial constraints and a Medium Term Financial Projection (MTFP) budget gap, that expenditure on capital needs to remain within affordable limits. Demand for capital resources remain high and therefore inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners are required to meet this demand.

The strategy highlights the key risks and recommendations:

- Capital expenditure plans for the Council need to be affordable, prudent and sustainable.
- The Council's current capital programme has a substantial amount of borrowing to 2024/25, and while this is affordable due to the revenue pressures being forward funded in the 2021/22 budget, it would be unsustainable to continue borrowing thereafter, at the current level.
- 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 potential leisure scheme which have not yet been approved and a level of uncommitted borrowing headroom limited at £4.5m. This will exclude any borrowing for any schemes which are self-financing over the life of the project.
- If the level of capital expenditure funded by borrowing is required to be increased from that detailed in the current programme it would need to be approved by Full Council.
- As per the agreed framework (detailed in the report) the current programme needs to be maintained within the agreed limits, therefore not putting additional pressure on the capital financing budgets that have been funded in 2021/22 budget.
- Within the context of significant demands for capital resources and limited availability, there is the need to develop our use of the various strategic plans across the organisation which drive the need for capital and develop alternative strategies to meet demand so the Councils own capital programme is prioritised within an affordable framework. This will include clearer and corporate 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 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.
- The Head of Finance recommends Council agree a limit debt funded capital expenditure in the future programme. The impact of a limit of £5.5m and £7.5m per annum is included within this strategy.
- 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

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 members' understanding of these sometimes technical areas.

Decisions made this year on capital and treasury management will have financial consequences for the Authority 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 sets out:

- The prudential code the need for a capital strategy and the governance arrangements for the capital strategy and programme (Paragraph 2)
- The current approved capital programme to 2024/25 (4 years) and its financing, and the revenue implications arising from demands on capital expenditure (Paragraph 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 authority for further capital resources. (Paragraph 4)
- Links between the Capital Strategy to Treasury Management strategy and treasury decision making. (Paragraph 5)
- A look at the commercial activity of the Council and its strategy going forward (Paragraph 6)
- Overview of other long-term liabilities the Council has, which members need to be aware of when looking at the capital strategy. (Paragraph 7)
- Summary of the skills and knowledge the Council has to carry out its duties for capital and treasury matters. (Paragraph 8)

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 capital expenditure plans of local authorities are;

- **AFFORDABLE -** Total capital investment of the authority remains within sustainable limits. A local authority is required to consider the resources currently available to it and those estimated to be available in the future, together with the totality of its capital plans and income and expenditure forecasts in assessing affordability.

- **PRUDENT –** The full Council set an authorised limit and operational boundary for external debt, these need to be consistent with the authority's plans for affordable capital expenditure and financing, and with its treasury management policy statement and practices. Authorities should consider a balance between **security, liquidity and yield** which reflects their own risk appetite but which prioritises security and liquidity over yield.

- **SUSTAINABLE –** taking into account the arrangements for repayment of debt (including through Minimum Revenue Provision (MRP) and consideration of risk and the impact, and potential impact, on the authority's overall financial sustainability. This strategy will look at the sustainability over the period of 10 years.

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

2.2. GOVERNANCE FOR APPROVAL AND MONITORING OF CAPITAL EXPENDITURE

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

- Council approve the overall revenue and capital budgets following recommendations from the Cabinet. They also approve the borrowing limits of which the capital programme will need to remain within. This means that the borrowing limits will include and limited to the approved capital expenditure and the amount of uncommitted capital expenditure included within the current programme. The exception to this would be any schemes for which borrowing is required, but which finance themselves through the savings generated. These limits are a key performance indicator for treasury management. This ensures that capital expenditure is limited and borrowing remains within an affordable limit.
- This borrowing limit is based on what is included in the table 2 of the capital financing within this report. If the borrowing within the current capital programme requires to be increased this will need to be approved by Council.
- Council approve the Treasury Management and Investment strategies, which are intrinsically linked to capital expenditure and the capital strategy. Further details of these are provided in paragraphs 5.1 and 5.3.
- The detailed capital programme within the overall budget is approved by Cabinet following individual project appraisals by officers, containing 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 our property advisors, Newport Norse. Discussions include asset disposals, where capital expenditure is required and prioritisation of those areas and the overall asset management agenda.
- Decisions on Capital Expenditure will be made by the Senior Leadership Team (SLT) following review of the project appraisal.
- Cabinet approve capital expenditure to be added to the capital programme.
- Monitoring of Capital Expenditure is reported to Cabinet, and includes update on capital receipts and impact on the revenue budget of decisions made.

Affordability and sustainability is a key focus on the approval of expenditure, and therefore the agreed framework detailed in paragraph 3.1 is used. There is a process map for the approval of capital expenditure which is used, this is shown in Appendix 2a.

Decisions made on the approval of capital expenditure will be made with the liaison of the capital accountancy team and understanding of the long-term revenue implications of the expenditure is assessed before being added to the programme. Cabinet approve additions and deletions, as well as slippage, from the capital programme alongside the monitoring report.

3. CAPITAL EXPENDITURE AND FINANCING

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

3.1. CURRENT CAPITAL PROGRAMME

The current capital programme was recently extended to 7 years to reflect projects whose completion spanned beyond the original 5 year programme, taking the total programme from 2018/19 to 2024/25, this was approved at Cabinet in January 2020. Given the current financial constraints facing the authority, Cabinet and Council established a framework in order maximise capital expenditure but keep within a sustainable revenue budget to fund new borrowing, this was as follows:

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

b. Regeneration schemes would be funded from ring-fencing the capital works reserve only and Joint Venture funds. Other kinds of support through the making of loans etc. would then be considered to support schemes, where it was needed and appropriate.

c. Any change and efficiency schemes or schemes which save money requiring capital expenditure would be funded by netting off the capital funding costs from the savings achieved

d. 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 e.g. new schools programme, can be afforded and maximised within the headroom available. The limit is made up of identified uncommitted capital reserves and capital receipts, an estimated level of borrowing which is 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 2021/22, the Cabinet have approved capital schemes of £60.7m, and the overall programme to 2024/25 included uncommitted borrowing is £252.9m (this 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):

	7-YEAR CAPITAL PROGRAMME							
	2018/19 Actual £m	**2019/20 Actual £m**	**2020/21 Forecast £m**	**2021/22 Budget £m**	**2022/23 Budget £m**	**2023/24 Budget £m**	**2024/25 Budget £m**	**Total 7-year programme £m**
Approved Schemes	29.5	31.4	32.7	60.7	49.1	7.9	0.1	**211.4**
City Deal - cost of carry					1.8	10.0	5.5	**17.3**
Regeneration Schemes (not yet approved)					19.7			**19.7**

Uncommitted borrowing to invest in council assets / regeneration*			1.5	2	1			**4.5**
TOTAL EXPENDITURE	**29.5**	**31.4**	**34.2**	**62.7**	**71.6**	**17.9**	**5.6**	**252.9**

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

The current approved capital programme is substantial and leads to a considerable increase on the Capital Financing Requirement (CFR) over the medium term. Table 1 includes the current capital programme Cabinet approved in January for the November monitoring and additions report, any regeneration schemes not yet approved and a level of uncommitted borrowing for potential additional capital schemes. A limit of £4.5m has been placed on any additional borrowing to fund capital expenditure within the current programme after 2020/21 to 2022/23.

Over the current capital programme there is a significant increase in borrowing to fund the projects within. Capital financing costs are increasing substantially with a £2.1m investment in the capital financing budget in 2021/22. It is important to note that this budget will not be fully required in 2021/22 and is a forward commitment, therefore a large proportion will be available in 2021/22 to fund other priorities.

Paragraph 3.2 illustrates the revenue impact of the capital programme. The framework agrees that the over the term of the current **capital programme would set at a level that does not put additional revenue pressure on the Medium Term Financial Projections (MTFP).** This 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 pressures on revenue.

The general fund capital grant in 2021/22 remains the same as awarded in 2020/21 which has been reflected within the above headroom figures, the future years grant is unconfirmed therefore for prudence it is not assumed that there will be any increase in subsequent years.

The programme has been compiled with regard for the latest demands on the capital programme which include:

- 21st Century Schools Programme – completion of Band A in 2018/19 and Band B from then on.
- Fleet Replacement Programme
- A number of HLF grant funded schemes including Transporter Bridge and Newport Market Arcade
- Cardiff Capital Region City Deal (CCRCD)
- Regeneration schemes which have not yet been formally approved.

There are a number of demands on the authority which will require significant capital expenditure which are not yet included on the programme, these will utilise the headroom available. It is important that capital expenditure is maintained at an affordable level within the framework agreed. Therefore, **prioritisation of capital expenditure is essential** and needs to be affordable and sustainable in the long-term to remain within the headroom available.

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 2 is as follows:

Table 2: Capital financing in £ millions - Current 7-year programme

	7-YEAR CAPITAL PROGRAMME							
	2018/19 Actual £m	**2019/20 Actual £m**	**2020/21 Forecast £m**	**2021/22 Budget £m**	**2022/23 Budget £m**	**2023/24 Budget £m**	**2024/25 Budget £m**	**Total 7-year programme £m**
TOTAL EXPENDITURE	29.5	31.4	34.2	62.7	71.6	17.9	5.6	**252.9**
Financed by:								
Committed Grants and contributions	19.2	17.7	20.1	39.7	31.5	10.8	0.1	**139.1**
Committed Reserves, capital receipts, revenue	4.3	3.7	3.1	1.3	1.1	0.5		**14.0**
Committed new borrowing	6.0	10	9.5	19.7	16.5	(3.4)		**57.3**
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**	**32.7**	**60.7**	**50.9**	**17.9**	**5.6**	**228.7**
Potential Borrowing required for Regeneration Schemes					15.2			**15.2**
Capital Reserves for Regeneration Schemes					4.5			**4.5**
Uncommitted borrowing			1.5	2.0	1.0			**4.5**
TOTAL UNCOMMITTED*			**1.5**	**2.0**	**20.7**			**24.2**
TOTAL FINANCING	**29.5**	**31.4**	**33.1**	**62.7**	**71.6**	**18.4**	**5.6**	**252.9**

Due to the better settlement the Council will receive in 2021/22, Cabinet have front loaded the required medium term budget into 2021/22. This means that the current capital programme, any regeneration schemes not yet approved and a level of uncommitted borrowing limited to £4.5m has been funded within the MTFP. Any underspends available within the short term will be able to be used for voluntary revenue payments (VRP) or moved to reserves.

The forecast borrowing for 2020/21 to 2024/25 is £78.6m, if this is to be increased it would need approval by Council.

There is a substantial increase in the Capital Financing Requirement (CFR) as a result of the current programme, which is not sustainable if the level of borrowing continues into the next programme. The level of capital expenditure funded by borrowing must slow down after the current programme, therefore, for the next capital programme, a borrowing limit for capital expenditure funded by borrowing will need to be agreed.

Ultimately, the issues above will also need to be seen in the context of (i) the Council's future funding; both external from WG core funding and local Council Tax which, for the former, will depend to some extent on the UK's response to the current debt and WG funding priority for the Local Government sector (ii) the Council's ability to produce robust/balanced budgets and (iii) progress on delivery (and spend) of the current capital programme.

This strategy has modelled two scenarios, which limits the level of borrowing to either £5.5m or £7.5m per annum and shows the impact of this additional borrowing on the CFR. This is further discussed in the long-term view of capital expenditure section below.

When capital expenditure is financed by debt/borrowing, you are essentially locking the Council into a long-term revenue commitment. The Council is required to repay debt from our revenue budget over time; this is done through the Minimum Revenue Provision (MRP). Planned MRP payments (excluding PFI and leases) are as follows:

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

	2018/19 actual	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
MRP budget	7.8	7.9	8.5	9.4	9.4	9.6	9.8

The table above shows the budgeted amount of MRP that is included within the MTFP, the amount is increasing on annual basis, and this will continue to do so over the longer term due to the MRP charge increasing. This shows an increasing pressure over the MTFP while there is still a funding gap, which emphasises the importance of maintaining capital expenditure within the headroom available in order not to put even more additional pressure on the revenue budget.

- The Council's full minimum revenue provision statement 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, offset by any investment income receivable - 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 Councils Prudential Indicators.

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

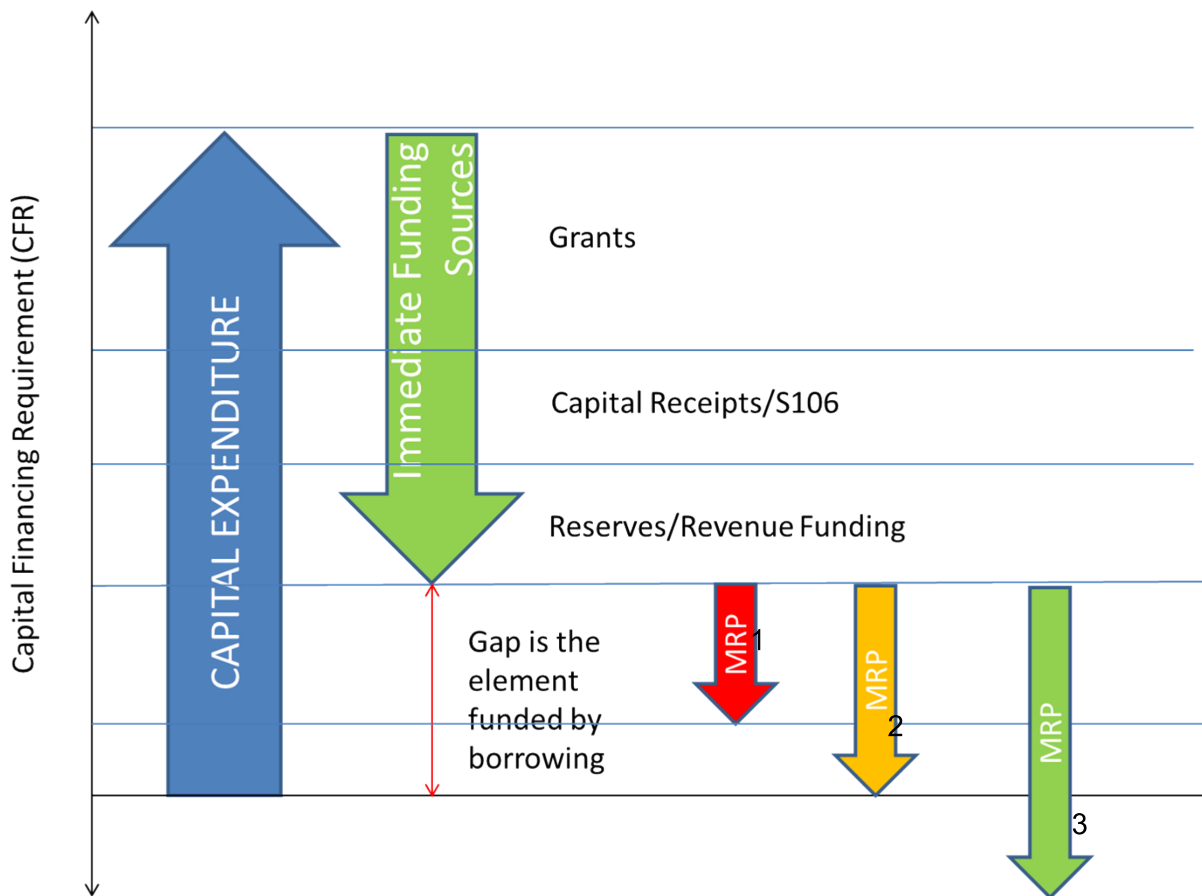
	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Financing costs* (£m)	21.0	22.3	22.3	22.8
Proportion of net revenue stream	7.0%	7.0%	6.9%	6.9%

*includes capital financing costs of PFIs

Capital costs continue to rise beyond the current programme even when limiting borrowing to £5.5m. This is because our ability to fund capital expenditure through internal borrowing is no longer applicable due to reserves being utilised, therefore this will need to be externally borrowed. External (or actual) borrowing will have interest rates payable on them which leads to increase in financing costs.
From the table above it is evident that the proportion of the budget set aside to finance capital expenditure is due to increase over the life of the current programme, again reiterating the pressure that capital expenditure, funded from debt, puts on the revenue budget.

- Further details on the revenue implications of capital expenditure are included in the 2021/22 revenue budget report.

Capital Financing Requirement (Our 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:

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

This is an important concept, as it shows how decisions on the level of capital expenditure and the level of MRP budget has on our long-term borrowing and the capital financing implications of this.

The CFR is expected to increase by £1.5m during 2021/22. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

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

	31.3.2019 actual	**31.3.2020 forecast**	**31.3.2021 budget**	**31.3.2022 budget**	**31.3.2023 budget**
TOTAL CFR	**278.8**	**280.2**	**281.7**	**295.4**	**319.8**

With the pending introduction 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 taken the decision to defer the implementation of IFRS 16 Leases until the 2022/23 in response to pressures on council finance teams as a result of the COVID-19 pandemic.

The greater the CFR the larger the impact will be on the revenue budget, therefore in the long-term there will be a need to keep capital expenditure funded by borrowing at a level below the MRP budget in order to maintain the revenue budget at a sustainable level.

- For full details of the Council's capital programme are included in the Capital Additions and Monitoring Report to Cabinet February 2021.

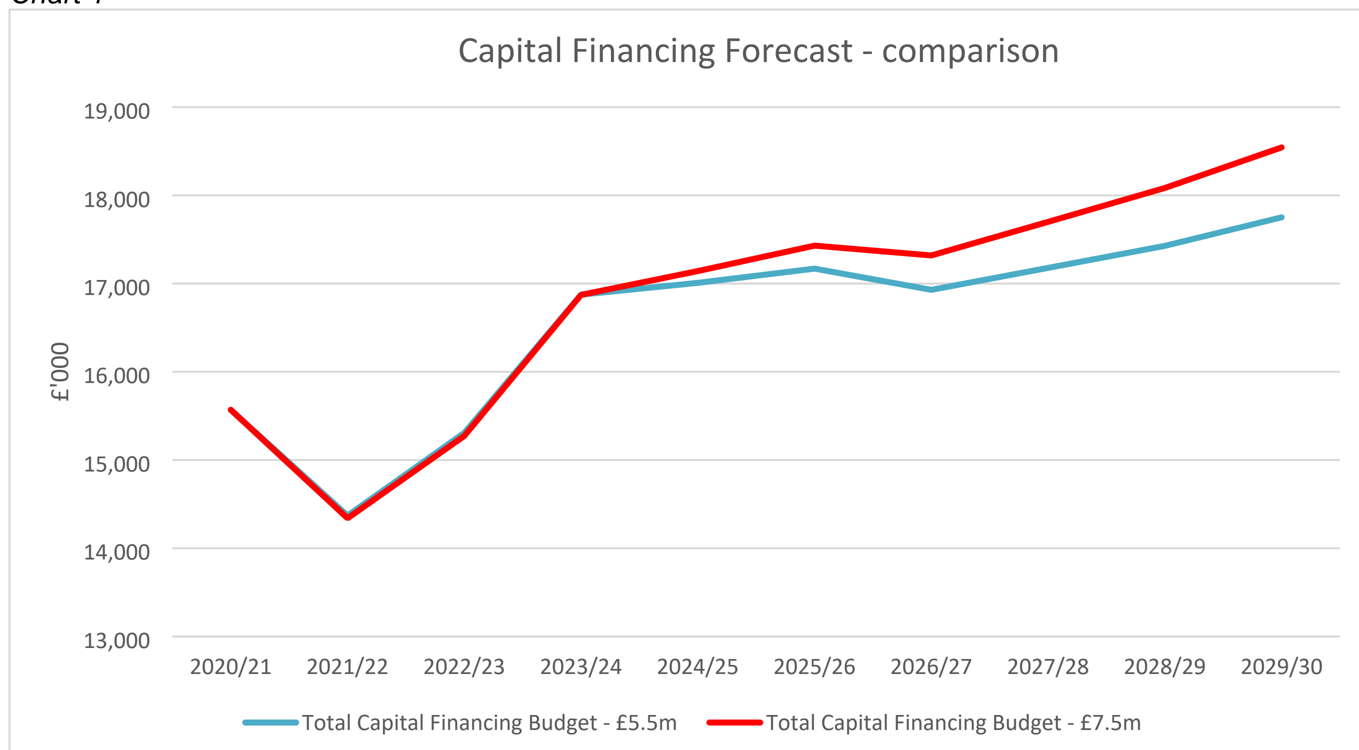
4. LONG-TERM VIEW OF CAPITAL EXPENDITURE

Expenditure on capital assets/projects are often for assets which have a long-term life i.e. buildings may have an asset life of 40 years+. The financing of these assets could also be over a long-term period. Therefore, as well as the Capital Programme highlighted in paragraph 3.1, 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 fund capital expenditure from borrowing, the Council is locked into the revenue implications for that borrowing for a long-period.

Due to the financial constraints that the Council is currently facing, assumptions on future available finances are likely to remain tight and therefore over the long-term it is anticipated that revenue to fund capital financing will remain restricted. The capacity to use internal borrowing is also reducing which means that the authority will face a challenge in developing its next capital programme.

Chart 1 below shows the increasing capital financing costs over the next 10 years with a limit of £5.5m and £7.5m of capital expenditure after the current programme. As is evident, based on the current programme the revenue cost of implementing a challenging capital programme is increasing year on year from 2021/22, with only a very limited amount of uncommitted borrowing available. Alongside a revenue budget Medium Term Financial Projection showing a funding gap this provides a significant challenge within current context of funding constraints on Local Government.

Chart 1



The table illustrates the significant increase in financing costs as a result of the current capital programme, which, although it is funded due to the better than expected settlement, it shows that even by limiting the capital expenditure in the future to either £5.5m or £7.5m revenue costs will be substantial and will continue to rise.

With limiting borrowing to £5.5m per annum, this reduces the Councils long-term committed need to borrow over the period, but actual borrowing reduces only very slightly. This is due to internal borrowing capacity reducing which in turn increases the need to borrow, dampening out most of the potential benefit of the reducing long-term committed need to borrow. This therefore reduces costs very slightly itself but is then offset by the increasing MRP charge methodology, increases the net capital financing costs

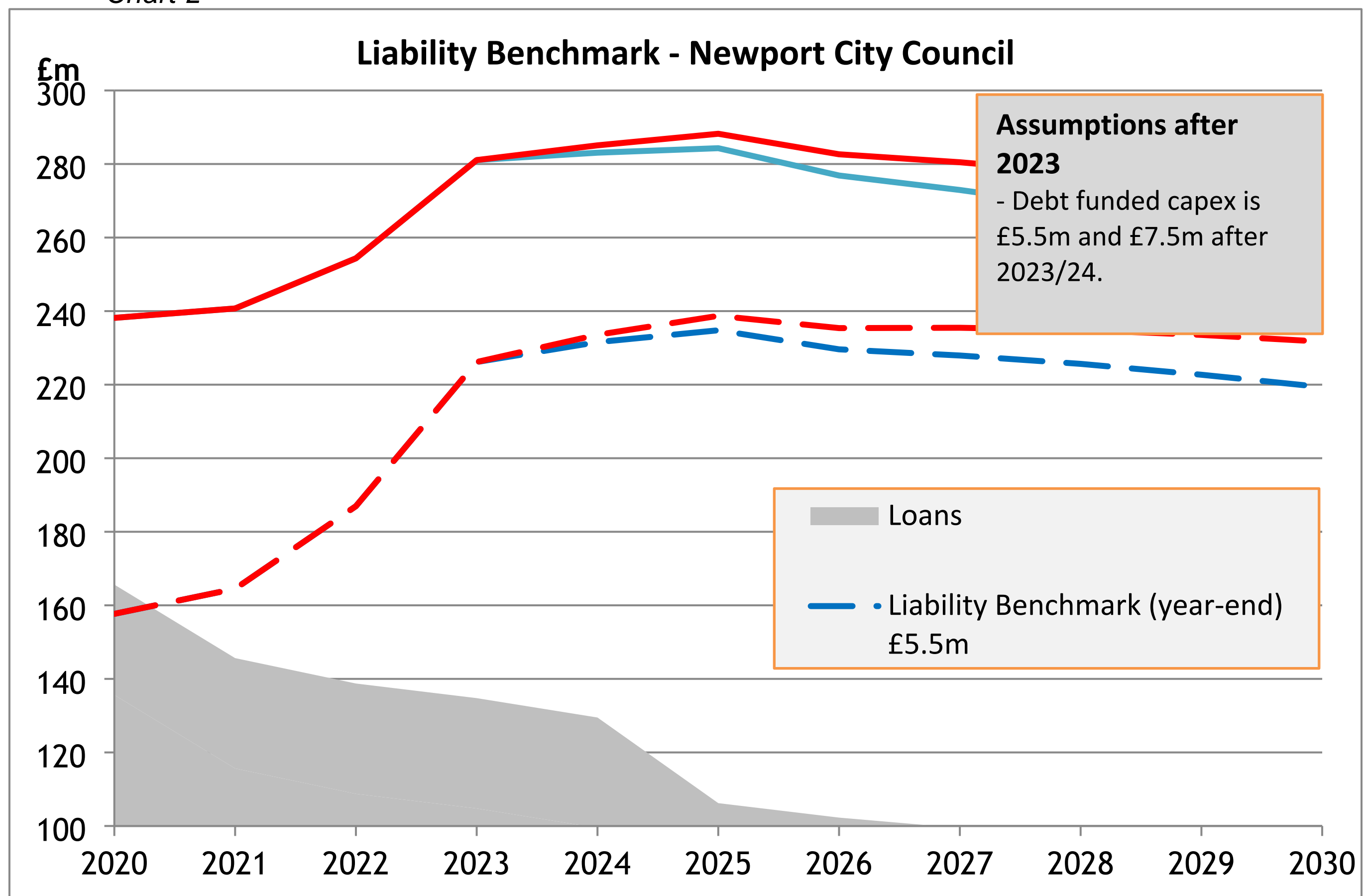
With £7.5m borrowing per annum, the Council's actual borrowing does not reduce and stays broadly level, with no dampening of this from the reducing committed need to borrow. The MRP charging methodology increases the capital financing costs as before.

The above will obviously be affected by a number of factors including amount of capital funding from Welsh Government, achievement of capital receipts and use and level of earmarked reserves.

- Earlier in paragraph 3.1 it highlighted the future demands on capital expenditure; the CFR is integral to understanding the affordability and sustainability of the capital programme. If the CFR is increasing over the long-term this puts pressure on the revenue budget to both repay that debt and also on the interest rates to fund the borrowing.

The chart below shows our overall need to borrow (Capital Financing Requirement) and need for external borrowing if the liability benchmark is set at £5.5m and £7.5m.

Chart 2



- The chart above illustrates the following:
  - In the current programme there is a significant increase in the need for external borrowing with the steepness of the curve over the next 4 years.

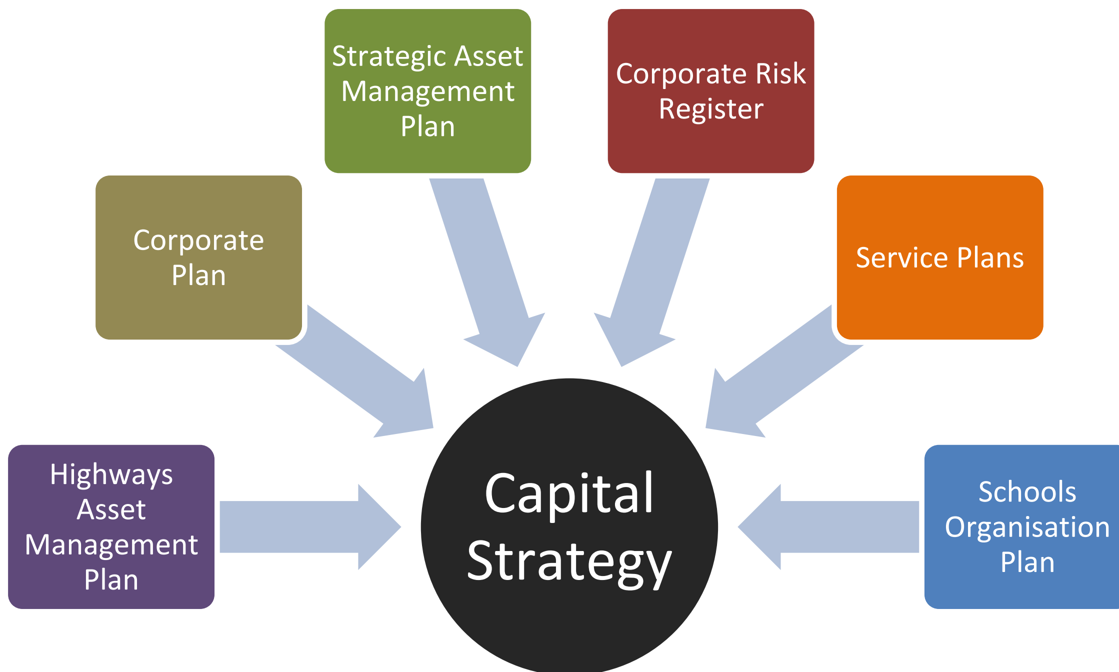
- This is unsustainable if it continues at the same level as the current programme, so there must be a limit placed for future which is wither £5.5m or £7.5m per annum.
- To remain affordable, capital expenditure funded by borrowing should be no higher than the MRP budget and ideally should be lower to limit the level of external borrowing that is required over time.
- As earmarked reserves are utilised the amount we are internally borrowed (using our own cash to fund capital expenditure) reduces. We have reached the capacity of internal borrowing, and any further capital expenditure which is not financed at source (i.e. grants, capital receipts, reserves) will require external borrowing.
- As current external borrowing matures, we will need to re-finance this debt rather than re-pay debt. This is due to the inherent need to borrow over the long-term.
- The above puts additional pressure on the capital financing budgets through additional interest costs.
- Therefore, it is vital that the CFR is at a level which is affordable and sustainable.
- A limit needs to be agreed to limit future borrowing to ensure that the liability benchmark is kept within a sustainable level
- A limit of £5.5m will reduce the level of borrowing after the current programme and £7.5m will keep the level of debt borrowing level, however in both scenarios as shown in Chart 1 previously the level of capital financing continues to increase over the long-term.
- Recent decisions to change the MRP methodology for charging to annuity method for unsupported borrowing and to a 40-year asset life for supported borrowing put future pressures on the revenue budget without any additional capital expenditure (While over the long-term borrowing is still repaid, the charge today is less and increases over future years). Therefore, we know that any additional expenditure funded by borrowing will put additional pressure on the revenue budgets in the future.
- Overall this shows a significant challenge for the next capital programme, onwards, and will mean prioritising all forms of capital expenditure in order to keep additional borrowing to a minimum is essential.
- Whilst the costs of the current capital programme is now funded, these are the issues which will provide further medium-long term challenges to funding the Council's future capital programme thereafter and will need to be reviewed in light of forecast/known funding and the position on the Council's overall budget.

➢ Capital Financing costs are discussed further in the Treasury Management section in paragraph 5.

Sustainability

Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Head of Finance is satisfied that the capital programme is prudent, affordable and sustainable, although there is currently a funding gap in the Medium Term Financial Projections, the increasing capital financing costs and challenges are included within these and plans for closing this gap will need to be put in place by the authority and this is understood by Senior Managers and Members. The next capital programme will be challenging due to the increasing capital financing costs and demands. Therefore, there is the need for prioritisation for the next capital and this will prove a challenge for the Council.

In light of the above, the authority needs to understand the demands and risks associated with the deliverability of meeting these demands. The key drivers of the Council's capital plans are captured through various plans across the authority, these include:



The Authority will need to develop its understanding of the costs arising from each of the above strategic documents, and use these to prioritise restricted funding over the current and future programmes. Capital investment in service assets is highly constrained by the funding available and therefore has not been funded at a level required to keep these assets in a steady state condition or to address backlog maintenance needs.

This is especially so in relation to highway assets and school buildings. The annual sum required to not only maintain assets at their current standard but to bring the assets to a standard level is significantly above the level that is available.

The plans highlighted above show the significant challenge facing the Authority in coming years and detail backlog maintenance challenges that face the Authority.

Annual sums included in the capital programme for highways maintenance, relevant specific capital grants and the 21st Century Schools programme will assist in addressing the highest priority backlog issues, focussing on worst condition first and risk. However, estate rationalisation programmes, closure/disposal of assets, asset transfers and other capital projects to refurbish or replace operational properties (i.e. neighbourhood hubs, work on the library, Newport market development) will also be utilised to offset the backlog funding required. This will not address the total backlog, but is a way of targeting the main issues in an affordable manner.

Backlog maintenance has been estimated at the following values:

- Schools estate - £55m
- Other Council operational estate - £30m

5. TREASURY MANAGEMENT

The Treasury Management Strategy is taken alongside the Capital Strategy within the same report for approval at Council. The figures within link directly with the borrowings resulting from this Capital Strategy.

The Council will need to approve both the prudential indicators detailed below and limits of borrowing that this strategy recommends.

5.1. TREASURY MANAGEMENT

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council limits the need to take out actual borrowing by using positive cash-flow, largely from reserves, to fund capital expenditure funded by borrowing, known as internal borrowing.

Due to decisions taken in the past, the Council currently has £149m borrowing at a weighted average interest rate of 3.7% and £29m treasury investments at a weighted average rate of 0.17%.

5.2. BORROWING STRATEGY

Whilst the Council has significant long term borrowing requirements, the Council's current strategy of funding capital expenditure is through reducing investments ('internal borrowing') rather than undertaking new borrowing i.e. we defer taking out new long term borrowing and fund capital expenditure from day to day positive cash-flows for as long as we can.

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 the main reason for our current 'internally borrowed' strategy.

Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.

The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.1%) and long-term fixed rate loans where the future cost is known but higher (currently around 1.5 to 2.5%). Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities, leases are shown below, compared with the capital financing requirement (see above). You will note the estimate projected debt is the same as the operational boundary as a limit for borrowing to carry out the programme as highlighted within this Capital Strategy.

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

	31.3.2020 actual	**31.3.2021 forecast**	**31.3.2022 budget**	**31.3.2023 budget**	**31.3.2024 budget**
Debt (incl. PFI & leases)	208	229	229	267	270
Capital Financing Requirement	280	287	296	322	322

With the pending introduction of IFRS 16 Leases, the CFR and debt identified as relating to leases is likely to increase during 2021/22 due to the change in the way that finance leases for lessees are treated. There is currently an ongoing project assessing these leases across the Council and an update will be given alongside the in-year 2021-22 treasury monitoring report to Council.

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. **Affordable borrowing limit:** The Council is legally obliged to approve an affordable borrowing limit (also termed the 'authorised limit' for external debt) each year.

The 'Operational borrowing limits' over the medium term, have been set in line with the expected borrowing required to finance the current capital programme to 2024/25. 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. The 'Authorised borrowing limits', provide a buffer for the ability to manage day to day cash requirements (ii) undertake a level of borrowing early where appropriate / 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	254	281	283	284
Authorised limit – PFI and leases	42	41	39	36
Authorised limit – total external debt	**296**	**322**	**322**	**320**
Operational boundary – borrowing	187	226	231	234
Operational boundary – PFI and leases	42	41	39	36
Operational boundary – total external debt	**229**	**267**	**270**	**270**

- Further details on borrowing are in the treasury management strategy

5.3. INVESTMENT STRATEGY

Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.
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 and the Council may request its money back at short notice.

Table 8: Treasury management investments in £millions

	31.3.2020 actual	**31.3.2021 forecast**	**31.3.2022 budget**	**31.3.2023 budget**	**31.3.2024 budget**
Near-term investments	12.5	10	0	0	0
Longer-term investments	0	0	10	10	10
TOTAL	**12.5**	**10**	**10**	**10**	**10**

- Further details on treasury investments are in pages 6 to 10 of the treasury management strategy

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and 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. The 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 freehold, such as the case at 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.

COMMERCIAL ACTIVITIES

5.4. COMMERCIALISATION

Due to the ongoing pressures and risks and challenges as a result of the Covid-19 pandemic, the commercialisation strategy has been paused for the short-term.

6. OTHER LONG-TERM LIABILITIES

In addition to debt of £149m detailed above, the Council has a number of other long-term liabilities (potential call on future Council resources) as follows:

Private Finance Initiative (PFI)

The Council has two PFI arrangements for the provision of the Southern Distributor Road (23 years remaining) and for Glan Usk Primary School (14 years remaining). As at 31 March 2020 the value of the liability was £42.3m. The Council holds an earmarked reserve which covers the future costs of the PFI.

Pension Liability

The Council is committed to making future payments to cover its pension fund deficit (valued at £348.2m).

Provisions and Guarantees

The Council has set aside provisions and reserves for risks in relation to outstanding insurance claims and guaranteed subsidies in relation to Friars Walk. The Council has also entered into a number of financial guarantees where the Council has entered into agreements to act as a guarantor in particular safeguarding of former employee pension rights when their employment is transferred to third party organisations.

7. KNOWLEDGE AND SKILLS

IN-HOUSE EXPERTISE

The overall Capital Programme 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 qualified and part-qualified accountants who follow Continuous Professional Development Plan (CPD) / attend courses on an ongoing basis to keep abreast of new developments and skills. There is a small Treasury Management team who manage the day-to-day cash-flow activities and banking arrangements of the authority, these again attend the necessary courses and training and have a vast amount of experience.

EXTERNAL EXPERTISE

All the Council's commercial projects have project teams from all the professional disciplines from across the Council and when required external professional advice is taken from the property advisors, Newport Norse, or other professional advice if required.

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 projects life cycle.

8. SUMMARY

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

- The MTFP includes the current revenue costs for the capital programme, which includes level of headroom for additional capital projects to be added without impacting further on the revenue budget.

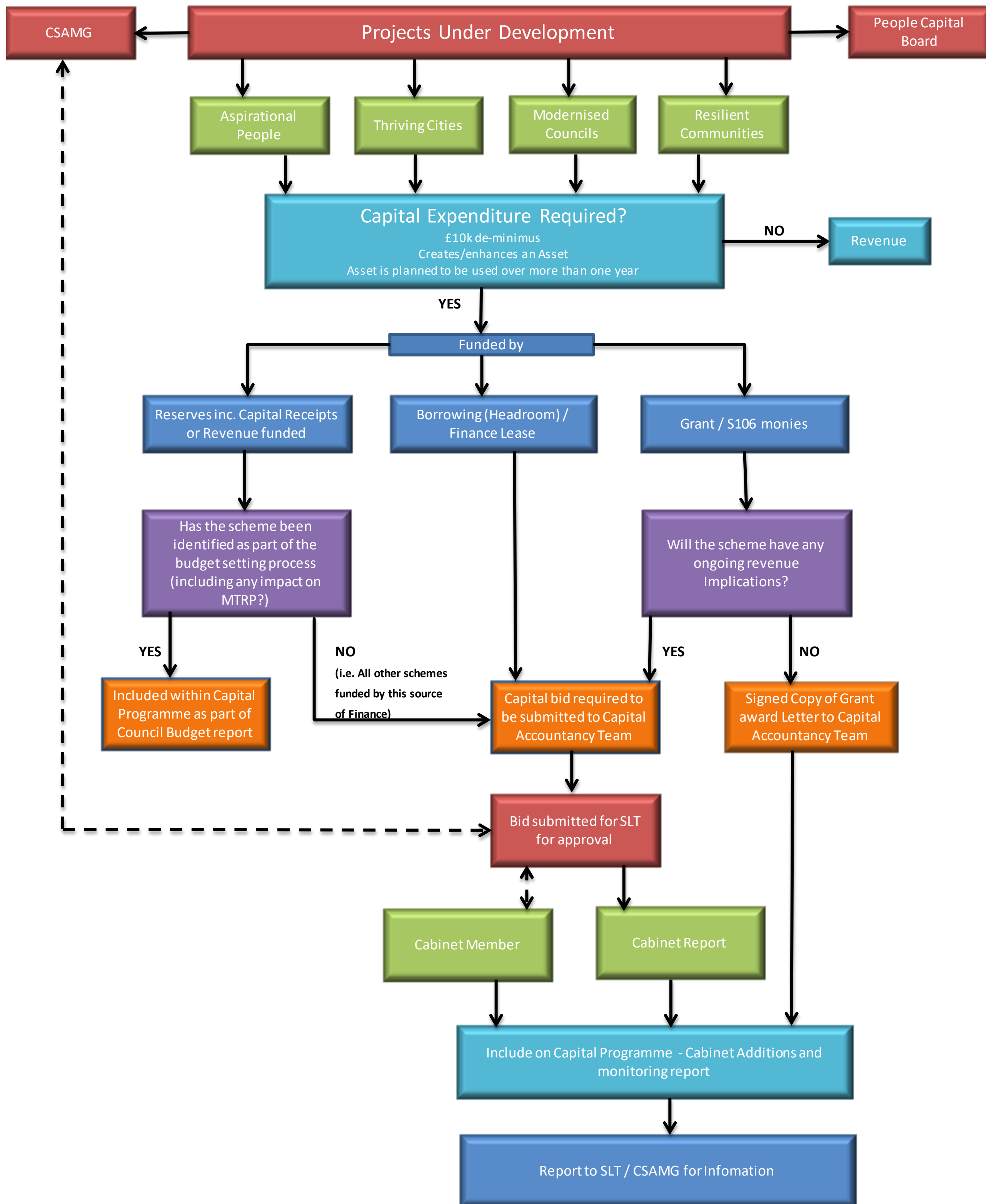
- As per the agreed framework the current programme needs to be maintained within the affordability headroom, therefore not putting additional pressure on the MRP budget.

- There are a number of demands on the capital programme, there is the need to link the capital strategy with a number of strategic plans across the organisation to ensure 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.

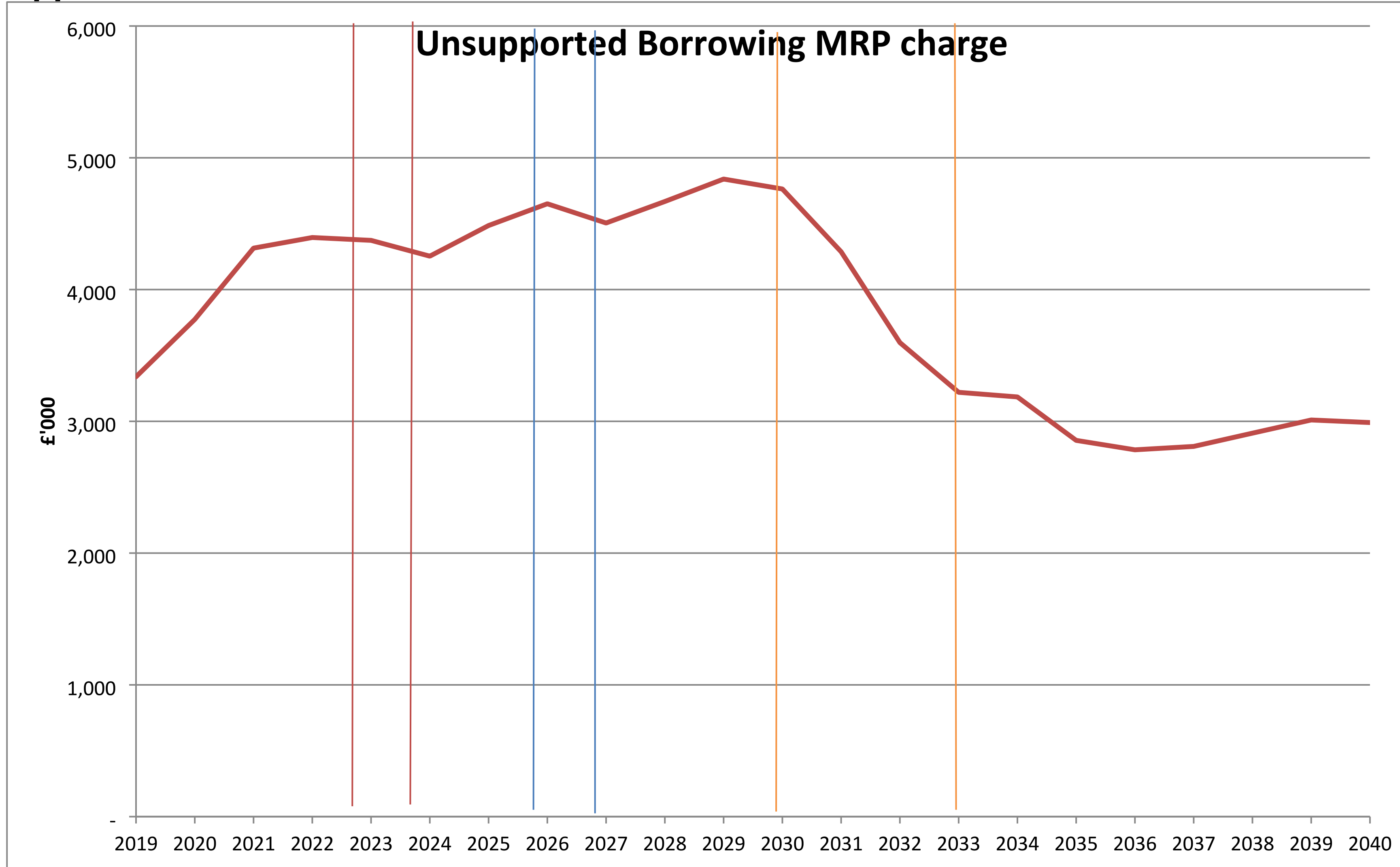
- Decisions on funding capital expenditure through borrowing locks the Council into committing revenue funding over a very long period (as long as 40 years +). With the MRP budget increasing over the long-term as shown in chart 1, the Council will need to make some difficult decisions going into the next programme to ensure the capital plans remain affordable and sustainable.

APPENDIX 2a – Capital Additions Process Map

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



Appendix 2b



Appendix 3

Treasury Management Strategy Statement 2021/22

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 impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the Authority's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

Credit outlook: After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.
Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but 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%.

Local Context
On 31st December 2020, the Authority held £149.2m of borrowing and £28.8m 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

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
General Fund CFR	280.2	281.7	294.8	319.2	318.9
Less: Other debt liabilities *	(42.3)	(41.3)	(40.7)	(38.4)	(36.1)
Loans CFR	**237.9**	**240.4**	**254.1**	**280.8**	**282.8**
Less: External borrowing **	(165.6)	(145.6)	(138.7)	(134.8)	(129.5)
Less: Usable reserves	(87.1)	(82.8)	(74.0)	(61.5)	(58.1)
Less: Working capital	(3.4)	(3.4)	(3.4)	(3.4)	(3.4)
Preferred Investment position		10.0	10.0	10.0	10.0
Treasury Investments or (New borrowing)	**18.2**	**(18.6)**	**(48.0)**	**(91.1)**	**(101.8)**

* 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.

With the pending introduction of IFRS 16 Leases, the CFR is likely to increase during 2021/22 due to the change in the way that finance leases for lessees are treated. There is currently an ongoing project assessing these leases across the Council and an update will be given alongside the in-year 2021-22 treasury monitoring report to Council.

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 capital programme, but minimal investments and will therefore be required to borrow up to £101.8m over the forecast period, this is broken down into £36.1m refinancing of maturing existing borrowing and £65.7m additional (£165.6m to £231.3m) 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

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
Loans CFR (as per table 1)	**237.9**	**240.4**	**254.1**	**280.8**	**282.8**
- Cumulative Internal Borrowing	90.5	86.2	77.4	64.9	61.5
- Investments	(18.2)	(10.0)	(10.0)	(10.0)	(10.0)
- Cumulative External Borrowing	165.6	164.2	186.7	225.9	231.3
Increase in External Borrowing		**(1.4)**	**22.5**	**39.2**	**5.4**
Represented by:					
Change in loan CFR (Cap Exp funded by debt less MRP)		2.5	13.7	26.7	2.0
Reduction in reserves		4.3	8.8	12.5	3.4
Reduction in investments		(8.2)	0	0	0
Increase in External Borrowing		**(1.4)**	**22.5**	**39.2**	**5.4**

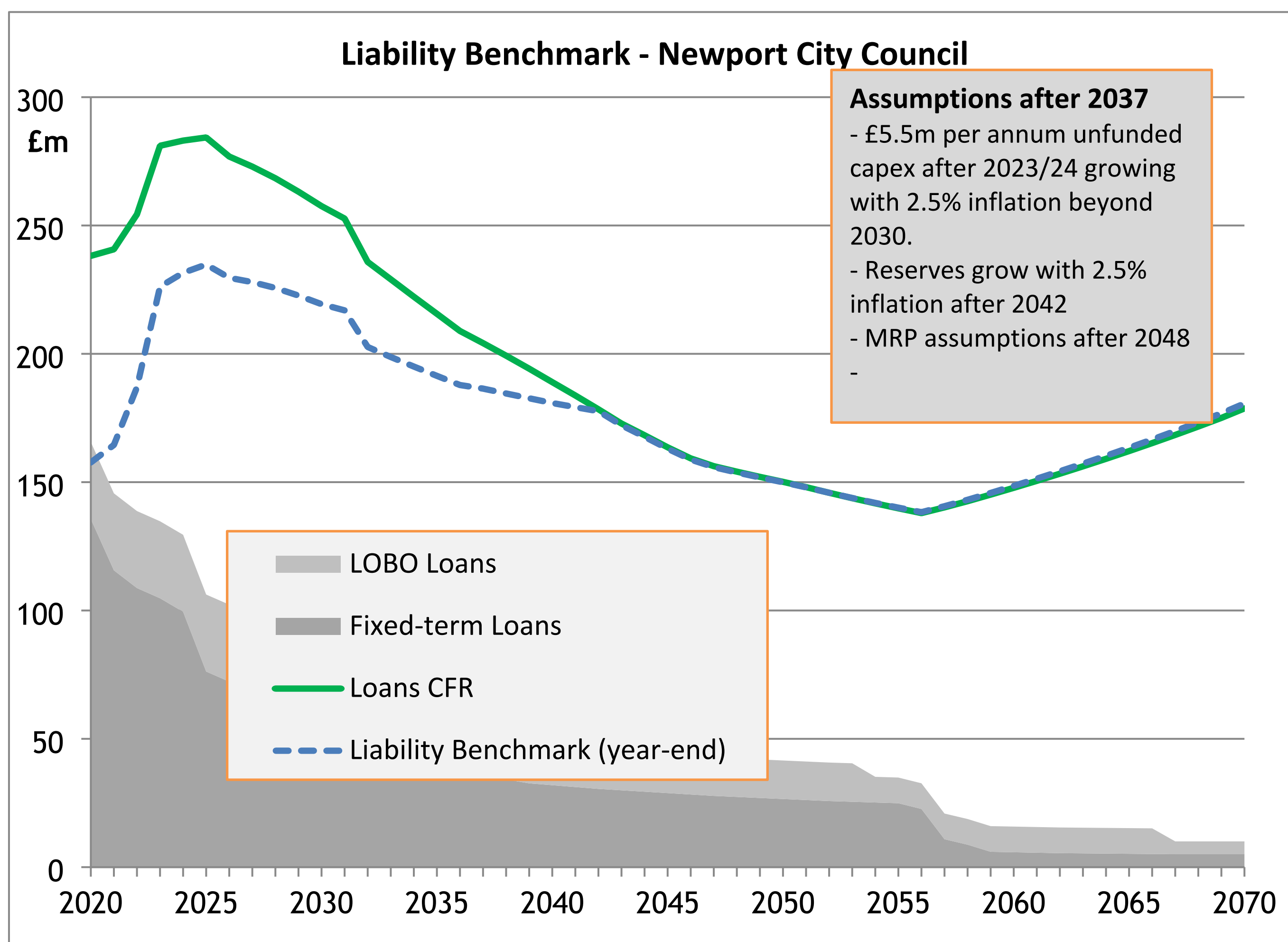
CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2021/22.

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, 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

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
Loans CFR	237.9	240.4	254.1	280.8	282.8
Less: Usable reserves	(87.1)	(82.8)	(74.0)	(61.5)	(58.1)
Less: Working capital	(3.4)	(3.4)	(3.4)	(3.4)	(3.4)
Plus: Minimum investments	18.2	10.0	10.0	10.0	10.0
Liability Benchmark	**165.6**	**164.2**	**186.7**	**225.9**	**231.3**

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 scenarios for the period of the next 10 years are included in the capital strategy):



The chart above shows actual borrowing maturing over time (grey area reducing), however our need to borrow (the green 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 2047. Therefore, the chart is showing the following important points/assumptions:

- To be sustainable the capital financing requirement 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 has diminished, 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 £149.2 million of loans, a decrease of £17.1 million on the previous year, as part of its strategy for funding previous years' capital programmes, there was also a significant amount of temporary borrowing at year end to cash-flow business grants in the early period of the Covid-19 pandemic. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £164.2 million in 2021/22. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £254 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 2021/22 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. £25m of these LOBOs have options during 2021/22, 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.

<u>Treasury Investment Strategy</u>

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 £12.5 million and £65.2 million, levels of c. £10 to £20 million are 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 2021/22. This is especially the case for the estimated £10 million that is available for longer-term investment. All of the Authority's surplus cash is currently invested in short-term unsecured bank deposits and local authorities. This diversification will represent a change in the coming year while it has been put on hold due to the Covid-19 pandemic.

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	£10 m	£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. Investments in REIT shares cannot be withdrawn but can be sold on to the stock market to another investor.

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

Operational bank accounts: The Authority may incur operational exposures, for example though 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 £75 million on 31st March 2020. 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, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 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.

Treasury Management 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

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 2021/22 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 2021/22 is £7.8 million, based on an average debt portfolio of £2.7 million at an average interest rate of 3.7%. 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 long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance 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 2020

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.

- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.

- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.

- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.

- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.

- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.

- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out, especially with likely emergency action in response to a no-deal Brexit.

- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.

- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

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

	31/12/2020 Actual Portfolio £m	31/12/2020 Average Rate %
External borrowing:		
Public Works Loan Board	104.3	3.8
Local authorities	0.0	-
LOBO loans from banks	30.0	4.4
Other loans	14.9	1.3
Total external borrowing	**149.2**	**3.7**
Other long-term liabilities:		
Private Finance Initiative	43.0	
Finance Leases	0.1	
Total other long-term liabilities	**43.1**	
Total gross external debt	**192.3**	
Treasury investments:		
Banks (unsecured)	3.8	0.02
Local authorities	25.0	0.19
Total treasury investments	**28.8**	**0.17**
Net debt	**163.5**	

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 our capital programme a number of energy efficiency related schemes, including LED projects and Solar PV.

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 and where possible ensure there is appropriate security i.e. charges on assets. In some cases where security is not available in order to be prudent the Council may fund the loan at the point of drawdown through an appropriate charge i.e. Minimum Revenue Provision charge or through a reserve.

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 profit, primarily investment property. The Council holds investment properties to the fair value of £7.8m on, these

give an annual rental income of £1.2m. These are historic investment properties, namely Kingsway shopping centre and Chartist Tower and the Council has not recently undertaken purchase of non-financial investments.

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 meeting with them.

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 2010.

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

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 or more 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 instead.

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 2020/21 will not be subject to a MRP charge until 2021/22.
Based on the Authority's latest estimate of its Capital Financing Requirement on 31st March 2021, the budget for MRP has been set as follows:

	31.03.2021 Estimated CFR £m	**2021/2022 Estimated MRP £m**
Supported capital expenditure	161	4
Unsupported capital expenditure	76	4
Finance leases* and Private Finance Initiative	42	1
Total General Fund	**279**	**9**

*With the pending introduction of IFRS 16 Leases, the CFR and debt identified as relating to leases is likely to increase during 2020/21 due to the change in the way that finance leases for lessees are treated. There is currently an ongoing project assessing these leases across the Council and an update will be given alongside the in-year 2020-21 treasury monitoring report to Council.