AUDIT COMMITTEE 29 OCTOBER 2021

TREASURY MANAGEMENT MID-YEAR MONITORING REPORT 2021/22

1. RECOMMENDATIONS

Members are recommended to:

1.1. consider the performance of the treasury function detailed in this report.

2. PURPOSE

2.1. New Forest District Council has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2017. The CIPFA Code requires the Council to approve a treasury management strategy before the start of the year and a semi-annual and annual treasury outturn report. The purpose of this report is therefore to meet this obligation by providing an update on the performance of the treasury management function at the mid-year point.

3. SUMMARY

3.1. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and provides an update on the performance of the treasury management function at the mid-year point.

3.2. The Council's treasury management strategy was most recently updated and approved at a meeting of the Council in February 2021. The Council has borrowed and invested 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 risk are therefore central to the Council's treasury management strategy.

3.3. Treasury management in the context of this report is defined as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.4. This mid-year report sets out the performance of the treasury management function for the period April – September 2021, to include the effects of the decisions taken and the transactions executed within this period.

3.5. Hampshire County Council's Investments & Borrowing Team has been contracted to manage the Council's treasury management balances since March 2014 but overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

3.6. All treasury activity has complied with the Council's revised Treasury Management Strategy and Investment Strategy for 2021/22, and all relevant statute, guidance and accounting standards. In addition, support in undertaking treasury management activities has been provided by the Council's treasury advisers, Arlingclose.

3.7. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The latest iteration of the Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council in February 2021.

4. EXTERNAL CONTEXT

4.1. The following sections outline the key economic themes against which investment and borrowing decisions have been made so far in 2021/22.

Economic commentary

4.2. The coronavirus pandemic continued to dominate the news during the period, with economic resurgence following the rapid vaccination programme.

4.3. The Bank of England (BoE) has held Bank Rate at 0.1% since March 2020 and has maintained its Quantitative Easing programme at £895bn since November 2020. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% from 2.9%, in part reflecting tighter supply conditions. CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation.

4.4. The BoE's Monetary Policy Committee (MPC) does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating the economy's spare capacity and achieving the 2% inflation target sustainably.

Financial markets

4.5. Ongoing monetary and fiscal stimulus together with improving economic growth prospects and successful vaccine rollout programmes continued to boost equity markets over the period. In the UK, the FTSE 250 index continued making gains over pre-pandemic levels and the more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

4.6. Inflation worries continued during the period but declines in bond yields between April and June suggest bond markets may be expecting any general price increases to be less severe, or more transitory, than was previously thought. However, an increase in gas prices in the UK and European Union, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, lead to higher prices. UK government bonds remained positive over the period.

Credit review

4.7. Credit default swap spreads were flat over the period and are broadly in line with their pre-pandemic levels. Credit default swaps are used as an indicator of credit risk, where higher premiums indicate higher perceived risks.

4.8. Over the period credit ratings agencies, Fitch and Moody's, upwardly revised to stable the outlook on a number of UK banks and building societies on Arlingclose's counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

4.9. The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

4.10. On 24 September 2021 Arlingclose published its review of its credit advice on unsecured deposits, judging that the UK has seen six months of positive GDP growth, and while forward-looking indicators suggest that economic growth has entered a slower phase as the UK heads into autumn, and the risks around both the continuing pandemic and a period of economic adjustment post government support remain, the likelihood of further significant economic fallout from the pandemic impacting on the financial viability of certain banks has diminished. As a result Arlingclose has updated its treasury management advice, allowing maximum durations of 100 days for unsecured investments with some UK banks on their list of recommended counterparties.

5. LOCAL CONTEXT

5.1. At 31 March 2021 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £141.9m, while usable reserves and working capital which are the underlying resources available for investment were £49.9m (principal invested plus gains on investments with a variable net asset value). These factors are summarised in Table 1.

Table 1: Capital Financing Summary

	31/03/21 Balance £m
General Fund CFR	9.6
Housing Revenue Account CFR	6.0
HRA Settlement	126.3
Total CFR	141.9
Financed By:	
External Borrowing	126.9
Internal Borrowing	15.0
Total Borrowing	141.9

5.2. The Council's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, to reduce risk and keep interest costs low. The treasury management position at 30 September 2021 and the change during the year is shown in Table 2.

Table 2: Treasury Management Summary

	31/03/21 Balance £m	Movement £m	30/09/21 Balance £m	30/09/21 Rate %
Long-term borrowing	(122.6)	0.1	(122.5)	3.3
Short-term borrowing	(4.3)	0.0	(4.3)	2.4
Total borrowing	(126.9)	0.1	(126.8)	3.3
Long-term investments	16.5	7.6	24.1	2.8
Short-term investments	25.1	9.3	34.4	0.1
Cash and cash equivalents	8.3	10.9	19.2	0.0
Total investments	49.9	27.8	77.7	0.9
Net borrowing	(77.0)	27.9	(49.1)	

Note: the figures in Table 2 at 31 March 2021 are from the balance sheet in the Council's statement of accounts adjusted to exclude operational cash.

5.3. The reduction in net borrowing of £27.9m shown in Table 2 reflects an increase in investment balances of £27.8m as well as a repayment at maturity of borrowing of £0.1m in line with the Council's policy on internal borrowing. Further details are provided in the Borrowing Activity and Treasury Investments Activity sections of this report.

6. BORROWING UPDATE

6.1. Local authorities can borrow from the Public Works Loan Board (PWLB) provided they have not purchased an investment asset primarily for yield since 26 November 2020 and can confirm they are not planning to do so in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 / Section 95 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

6.2. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

6.3. Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

6.4. The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB if required. The Council may have a need for borrowing based on the current investment plans supporting the New Forest economy and employment, and in it's aspiration to increase housing numbers.

6.5. CIPFA has recently released a further consultation on its Prudential Code (more information provided at section 11 of this report) ahead of the new Code being released in December 2021. The consultation documents include the guidance that authorities 'must not borrow to invest for the primary purpose of financial return', and the sector was concerned that the documentation also seemed to read that those authorities who were invested in pooled funds would not be able to access borrowing from the PWLB. However CIPFA have subsequently published early guidance on not borrowing to invest which covers existing commercial investments:

6.6. "The Code's statement that authorities 'must not borrow to invest for the primary purpose of financial return' is not intended to require the forced sale of existing commercial investments, whether commercial properties or financial investments. Selling these investments and using the proceeds to net down debt does, however, reduce treasury risks on both sides of the balance sheet and is therefore an option which should be kept under review, especially if new long term borrowing is being considered."

6.7. Responses to this consultation are expected by 16 November 2021 before the final Code is released in December 2021, and the Council as well as its adviser, Arlingclose, intends to respond to this consultation.

Revised PWLB Guidance

6.8. HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26th November 2020 is allowable even for an 'investment asset primarily for yield'.

- Capital plans should be submitted by local authorities via a DELTA return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.

- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.

- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.

- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

Changes to PWLB Terms and Conditions from 8 September 2021

6.9. The settlement time for a PWLB loan has been extended from two workings days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.

7. BORROWING ACTIVITY

7.1. At 30 September 2021 the Council held £126.8m of loans, a decrease of £0.1m since 31 March 2021 which was a repayment of borrowing in line with maturity. The vast majority of the outstanding loans are in relation to the resettlement of the HRA in 2012/13. The borrowing position as at 30 September 2021 and movement since 31 March 2021 change are summarised in Table 3.

Table 3: Borrowing Position

	31/03/21 Balance £m	Movement £m	30/09/21 Balance £m	30/09/21 Rate %	30/09/21 WAM* years
Public Works Loan Board	(126.9)	0.1	(126.8)	3.3	15.4
Total borrowing	(126.9)	0.1	(126.8)	3.3	15.4

* Weighted average maturity

7.2. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

7.3. Short-term interest rates have remained much lower than long-term rates and the Council has therefore considered it to be more cost effective in the near term to use internal resources than to use additional borrowing. In line with this strategy no new borrowing was undertaken during the period and £0.1m of PWLB loans was allowed to mature without refinancing.

7.4. This borrowing strategy has been monitored by Arlingclose and has enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

8. **TREASURY INVESTMENT ACTIVITY**

8.1. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six month period from 1 April to 30 September 2021, the Council's investment balance ranged between £50.4m and £97.0m due to timing differences between income and expenditure.

8.2. Table 4 shows investment activity for the Council as at 30 September 2021 in comparison to the reported activity as at 31 March 2021. The increase in total investments since 31 March 2021 reflects the fact that the balance at 31 March is typically the lowest of the year.

Table 4: Treasury investment position

Investments	31/03/2021 Balance £m	Net movement £m	30/09/2021 Balance £m	30/09/21 Income return %	30/09/21 WAM* years
Short term Investments					
Banks and Building Societies:					
- Unsecured	9.1	4.7	13.8	0.05	0.0
- Secured	-	17.8	17.8	0.10	0.7
Money Market Funds	5.2	10.1	15.3	0.01	0.0
Government:					
- Local Authorities	17.0	(12.5)	4.5	0.09	0.7
- Supranational banks	-	3.0	3.0	0.08	0.5
Cash Plus Funds	2.0	0.0	2.0	0.75	0.0
	33.3	**23.1**	**56.4**	**0.34**	**0.4**
Long term investments					
Banks and Building Societies:					
- Secured	3.0	0.0	3.0	0.45	1.4
Government:					
- Supranational banks	-	3.9	3.9	0.14	1.2
	3.0	**3.9**	**6.9**	**0.20**	**1.3**
High yield investments					
Pooled Property Funds**	7.6	0.0	7.6	4.05	N/A
Pooled Equity Funds**	3.0	0.0	3.0	5.83	N/A
Pooled Multi-Asset Funds**	3.0	0.0	3.0	4.61	N/A
	13.6	**0.0**	**13.6**	**4.58**	**N/A**
TOTAL INVESTMENTS	**49.9**	**27.0**	**76.9**	**0.89**	**0.4**

* Weighted average maturity, excluding pooled funds

** The rates provided for pooled fund investments are reflective of annualised income returns over the year to 30 September 2021 based on the market value 12 months earlier.

Note: the figures in Table 4 at 31 March 2021 are from the balance sheet in the Council's statement of accounts but adjusted to exclude operational cash, market value adjustments and accrued interest. The 30 September 2021 position differs from that shown in Table 2 as Table 4 removes the effect of market value and other accounting adjustments to show the principal balance.

8.3. Investment balances have increased since 31 March 2021 in line with previous years due to 31 March typically holding the lowest balances, and the mid year position reflects the higher balances typically seen at this time of year, due to the difference in timing between income and expenditure

8.4. The CIPFA Code and Government guidance both require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is therefore to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults against the risk of receiving unsuitably low investment income. The Council's Treasury Management Strategy Statement (TMSS) sets out how it will manage and mitigate these risks.

8.5. The security of investments has been maintained by following the Council's counterparty policy and investment limits within the TMSS, taking advice from Arlingclose on changes in counterparty credit worthiness, and making use of secured investment products that provide collateral. The Council invests in liquid investments to ensure money is available when required to meet its financial obligations, spreading these investments across a number of counterparties to mitigate operational risk.

8.6. In delivering investment returns, the Council has operated against a backdrop in which the UK Bank Rate was cut to 0.10% in March 2020 in response to the coronavirus pandemic. UK Bank Rate has remained at this rate throughout the year, having an impact on rates across the market. Returns have been at or around +0.01% for liquid investment options such as Money Market Funds (MMFs), bank call accounts and the UK Government's Debt Management Account Deposit Facility (DMADF) and have not been significantly higher for other short-term options like fixed duration loans to other local authorities and bank notice accounts. Investment income has therefore largely come from investments arranged at fixed rates of interest prior to the pandemic and through the Council's investments in pooled funds.

8.7. The Council benchmarks the performance of its internally managed investments against that of other Arlingclose clients. Internally managed investments include all investments except externally managed pooled funds but do include MMFs. The performance of these investments against relevant measures of security, liquidity and yield are shown in Table 5, providing data as at 30 June 2021 and at 31 March 2021 for comparison. The Council's data as at 30 September 2021 is available and is shown in Table 5, however unfortunately the comparative benchmarking data was not available at the publishing date.

Table 5: Investment benchmarking (excluding pooled funds)

	Credit rating	Bail-in exposure	Weighted average maturity (days)	Rate of return
31.03.2021	AA-	42%	106	0.22%
30.06.2021	AA-	67%	101	0.06%
Similar LAs	A+	68%	41	0.12%
All LAs	A+	67%	12	0.11%
30.09.2021	AA	47%	160	0.16%

8.8. Table 5 shows the average credit rating of the portfolio increased over the first half of the financial year, and bail-in exposure rose and then fell again (as a function of the total balances for investment), settling at a low level, both measures reflecting a greater investment balance in secured investments, which are not subject to bail-in risk as they provide collateral. The weighted average maturity of investments increased over the period as longer term high quality investments in supranational banks were made. The average rate of return (0.16%) was lower than at 31 March 2020, which is reflective of returns at or close to 0% for many investments across the market. The Council compared favourably with the other local authorities included in the benchmarking exercise at 30 June 2021 across most metrics. Although it is difficult to know the exact reason why the rate of return was lower than the average of the other local authorities as at 30 June 2021, it is most likely due to the large liquid investment balance that was held at that point, which continues to be invested in short and long term appropriate options as they become available.

Externally managed pooled funds

8.9. In order to minimise the risk of receiving unsuitably low investment income, the Council has continued to invest a proportion of steady core balances in externally managed pooled funds as part of its higher yielding strategy.

8.10. The CIPFA Code requires the Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the Council's investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long-term security of the Council's investments.

8.11. The Council's investments in pooled funds fell considerably in value when the coronavirus pandemic hit world markets but have since recovered well. This recovery means these investments are now worth marginally more in aggregate than the initial sums invested, as shown in Table 6, demonstrating the importance of taking a longer term approach and being able to ride out periods of market volatility, ensuring the Council is not a forced seller at the bottom of the market.

Table 6: Higher yielding investments – market value performance

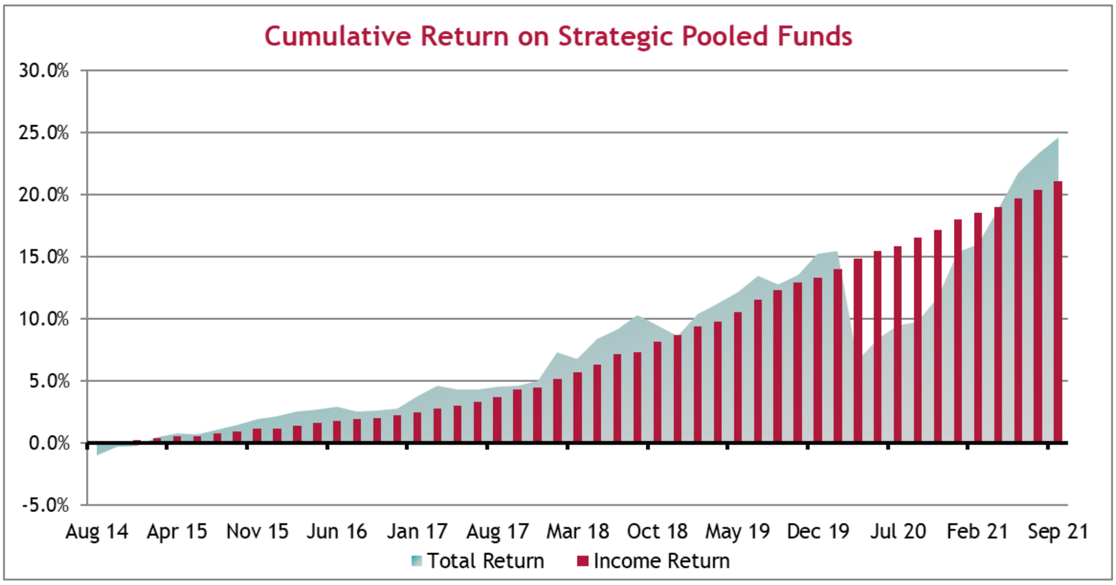
	Amount invested	Market value at 30/09/21	Gain / (fall) in capital value	
			Since purchase	One year
	£m	£m	£m	£m
Pooled property funds	7.60	7.88	0.28	0.65
Pooled equity funds	3.00	3.24	0.24	0.73
Pooled multi-asset funds	3.00	2.91	(0.09)	0.09
Total	13.60	14.03	0.43	1.47

8.12. The Council's investments in pooled funds target long-term price stability and regular revenue income and bring significant benefits to the revenue budget. As shown in Table 7 the annualised income returns have averaged 4.21% pa (per annum) since purchase, contributing to a total return of 24.60% over their life.

Table 7: Higher yielding investments – income and total returns since purchase

	Annualised income return	Total return
	%	%
Pooled property funds	4.07	26.39
Pooled equity funds	4.71	31.01
Pooled multi-asset funds	4.08	13.69
Total	4.21	24.60

8.13. The Council's pooled fund investments continue to deliver income returns far in excess of what could be generated from cash investments. The cumulative total return from the Council's investments in pooled equity, property and multi-asset funds since purchase is shown in the following graph. This highlights that the Council has benefited from strong and steady income returns over time and the way that capital values have recovered since March 2020.



8.14. The IFRS 9 accounting standard that was introduced in 2018/19 means that annual movements in the capital values of investments need to be reflected in the revenue account on an annual basis, although a five year statutory override was put in place for local authorities that exempts them from complying with this requirement.

8.15. Pooled fund investments have no defined maturity date but are available for withdrawal after a notice period and their performance and continued suitability in meeting the Council's investment objectives is monitored regularly and discussed with Arlingclose.

9. NON-TREASURY INVESTMENTS

9.1. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in the Ministry for Housing, Communities and Local Government's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

9.2. This could include service investments for operational and/or regeneration reasons as well as commercial investments which are made mainly for financial reasons.

9.3. The Council's existing non-treasury investments are listed in Table 8.

Table 8 – Non-treasury investments

	30/09/21 Asset value £m	30/09/21 Annual rate of return
Hythe Marina	2.54	4.57%
Saxon Inn Calmore	0.18	6.89%
Meeting House Lane	0.14	-

New Milton Health Centre	2.54	5.40%
Ampress Car Park	2.12	4.85%
Employment Land at Crow Lane	2.01	-
The Parade Salisbury Road Totton	1.43	7.66%
1-3 Queensway New Milton	0.88	8.21%
Unit 1 Nova Business Park	0.54	6.51%
Total investment properties	**12.38**	**4.73%**
Lymington Town Hall	3.45	2.88%
Hardley Industrial Estate	3.86	6.27%
Total income earning properties	**7.31**	**4.67%**
Grand total	**19.69**	**4.71%**

9.4. Council has agreed to the allocation of £8.445m in funding from internally held cash in the first instance to develop the land at Crow Lane, Ringwood into single-storey industrial units and two-storey office units as well as associated external works and parking areas.

9.5. The development looks to contribute to the Council's visions as stated in its adopted 2020 Corporate Plan *"to secure a vibrant and prosperous New Forest"* by seeking to *"maintain a vibrant local economy that brings opportunities to the area"*. It is estimated that this development could sustain around 150-200 new jobs once fully let as well as supporting several more during the twelve-month construction period.

9.6. In addition to providing employment for local people, it is predicted that this development will achieve an investment yield of just over 5%.

9.7. After a period of additional survey work and detailed design it is expected that the contractor shall mobilise to site by the end 2021, and making an allowance for unforeseen delays, it is anticipated that construction of the development shall by complete before the end of 2022, with some units completed ahead of the ultimate completion date.

10. COMPLIANCE REPORT

10.1. The Council confirms compliance of all treasury management activities undertaken during the period covered by this report with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

10.2. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 9.

Table 9: Debt limits

	2021/22 Maximum £m	30/09/21 Actual £m	2021/22 Operational Boundary £m	2021/22 Authorised Limit £m	Complied
Total debt	130.8	130.8	188.9	206.3	✓

10.3. The total actual debt as measured by the debt limits was £130.8m on 30 September 2021 which represents the use of £4m of the Council's overdraft facility in addition to the £126.8m PWLB debt. On 30 September 2021 £4m principal was due to be returned to the Council on maturity of a secured bond, however in error it was not released due to counterparty error and so the Council was forced to use its overdraft facility with Lloyds, who decided to waive the interest charge in this instance. This issue is currently being looked into by the custodian to understand why this event occurred.

10.4. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

11. TREASURY MANAGEMENT INDICATORS

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

Interest rate exposures

11.2. The following indicator shows the sensitivity of the Council's current investments and borrowing to a change in interest rates.

Table 10 – Interest Rate Risk Indicator

	30/09/21 Actual	Impact of +/- 1% interest rate change
Sums subject to variable interest rates		
Investment	£62.4m	+/- £0.6m
Borrowing	£0m	N/A

11.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity structure of borrowing

11.4. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the Treasury Management Strategy Statement.

Table 11: Refinancing rate risk indicator

	30/09/21 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	3%	25%	0%	✓
12 months and within 24 months	3%	25%	0%	✓
24 months and within 5 years	10%	25%	0%	✓

5 years and within 10 years	16%	25%	0%	✓
10 years and above	68%	100%	0%	✓

Principal sums invested for periods longer than a year

11.5. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end were:

Table 12: Price risk indicator

	2021/22	2022/23	2023/24
Actual principal invested beyond a year	£23.5m	£13.6m	£13.6m
Limit on principal invested beyond a year	£40m	£30m	£25m
Complied	✓	✓	✓

11.6. The table includes investments in strategic pooled funds of £13.6m as although these can usually be redeemed at short notice, the Council intends to hold these investments for at least the medium-term.

12. OTHER

Revisions to CIPFA Codes

12.1. In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

12.2. In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.

- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.

- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.

- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).

- Prudential Indicators

    - New indicator for net income from commercial and service investments to the budgeted net revenue stream.

    - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.

    - Excluding investment income from the definition of financing costs.

- Incorporating ESG issues as a consideration within TMP 1 Risk Management.

- Additional focus on the knowledge and skills of officers and elected members involved in decision making

MHCLG Improvements to the Capital Finance Framework

12.3. Ministry of Housing, Communities & Local Government (MHCLG – now known as Department for Levelling Up, Housing and Communities) published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that "while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk".

12.4. The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

12.5. A further consultation on these matters is expected soon.

Arlingclose's outlook for the remainder of 2021/22

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

12.6. Arlingclose expects Bank Rate to rise in Quarter 2 2022. We believe this is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure.

12.7. Investors have priced in multiple rises in Bank Rate to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.

12.8. The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

12.9. While Quarter 2 UK GDP expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Quarter 3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.

12.10. Inflation rose to 3.2% in August 2021. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

12.11. The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increased in wages is possible given the pressures on businesses.

12.12. Government bond yields increased sharply following the September Federal Open Market Committee (FOMC) and MPC minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.

12.13. The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

13. CRIME AND DISORDER AND ENVIRONMENTAL IMPLICATIONS

13.1. None arising directly from this report.

Further information	Background papers
Please contact: Gemma Farley Principal Accountant Investments & Borrowing Hampshire County Council gemma.farley@hants.gov.uk Alan Bethune Executive Head of Financial (S151) and Corporate Services New Forest District Council alan.bethune@nfdc.gov.uk	The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance Local Government Act 2003 SI 2003/3146 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 Treasury Management Mid-Year Monitoring Report 2020/21 Audit Committee – 23 October 2020 Treasury Management Strategy Report 2021/22 Audit Committee – 29 January 2021 Council – 25 February 2021 Treasury Management Annual Outturn Report 2020/21 Audit Committee – 2 July 2021