

# Report

## Cabinet

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### Part 1

Date: 15 February 2023

**Subject** 2023/24 Capital Strategy and Treasury Management Strategy

**Purpose** The purpose of this report is to present to Cabinet the Capital and Treasury Management Strategies, following consideration by Governance & Audit Committee, before recommending these strategies to Council for approval. The report summarises the key aspects of both strategies, as well as highlighting the main implications and risks arising from them, which are brought to Cabinet's attention for review. The report also includes the proposed Capital Programme, which Cabinet are required to approve.

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**Ward** General

**Summary** As set out within the Corporate Plan, the Council has ambitious plans for the city, with the Capital Programme a key enabler in delivering this ambition. The current programme is due to end in March 2023, with a new five-year programme commencing in 2023/24. The new programme will predominantly comprise of annual recurring allocations and a number of ongoing schemes from the existing 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 Council's borrowing and investing activities, as part of the Treasury Management Strategy.

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

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

The main recommendations arising from the two strategies are outlined in this covering report.

**Proposal** That Cabinet recommend to Council for approval:

- The Capital Strategy (Appendix 2), including the proposed Capital Programme within it (shown separately in Appendix 1), and the borrowing requirements/limits needed to deliver the proposed programme.

- The Treasury Management Strategy and Treasury Management Indicators, the Investment Strategy and the Minimum Revenue Provision (MRP) policy for 2023/24. (Appendix 3)
- As part of the above:
  - To note the increasing debt, and corresponding revenue cost of this, in delivering the new Capital Programme, and the implications of this over both the short and medium-long term with regard to affordability, prudence and sustainability.
  - To note the Head of Finance comments that borrowing needs to be limited to that required to fund ongoing and previously approved schemes brought forward from the current Capital Programme only, and the recommended prudential indicators on borrowing limits to achieve this.
  - To note and comment on the proposal to prioritise annual sums funding over any new schemes, unless unavoidable.
  - To note the feedback provided by the Governance & Audit Committee on 26<sup>th</sup> January 2023 (paragraph 5).

**Action by** Head of Finance

**Timetable** Immediate

This report was prepared after consultation with:

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

**Signed**

# Background

## Governance and requirement of councils

1. In November 2022, the Cabinet approved the Council's new Corporate Plan, which set out how it would achieve the ambition of an *Ambitious, Fairer, Greener Newport for everyone*. This mission is underpinned by four wellbeing objectives and supported by a transformation plan. Achievement of the four wellbeing objectives will be pursued via a series of actions and individual service plans. In some instances, these actions will involve activity and projects of a capital nature.
2. Whilst Cabinet makes decisions regarding the capital projects to be included in the programme, it is full Council that approves the borrowing limits that the overall programme must remain within. Many projects are funded from capital grants, capital receipts and specific reserves, which do not impact on borrowing levels, but, where borrowing is required, it is important that those limits are not exceeded. This is an important area of overall financial management governance in that debt funded capital expenditure, and the external borrowing that results, lock in the Council into a long-term liability for the associated revenue costs. These costs, known as 'Capital Financing Costs' are comprised of the external loan interest costs and the provision for financing the debt funded capital expenditure, known as Minimum Revenue Provision (MRP).
3. The key governance documents that underpin this area of local authority finances are:

### Capital Strategy

This, at its core:

- i) Sets out the long-term context (10 years) in which capital decisions are made and includes the medium term Capital Programme;
- ii) Demonstrates that the local authority takes capital / investments decisions in line with service objectives, giving consideration to risk, reward and impact;
- iii) Shows how the Council takes account of stewardship of public funds, value for money and affordability, sustainability and prudence in its decisions and plans.

### Treasury Management Strategy

This, at its core:

- (i) Sets out the Council's longer term borrowing requirement and approach, which is driven mainly by the Capital Programme requirements and, in Newport specifically, the reducing 'internal borrowing' capacity;
- (ii) Outlines how the Council will manage and invest any surplus cash;
- (iii) Includes additional guidance, namely the Welsh Government Investment Guidance and the MRP Policy.

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

- **Affordable** – there must be sufficient resources to be able to meet the capital financing consequence of debt-funded capital expenditure within the overall revenue budget. There must

also be sufficient capital resources for any non-debt funded capital expenditure. In addition, total capital expenditure is to be within **sustainable** limits. Councils are required to consider their current and estimated future resources available, together with the totality of their capital expenditure and income forecasts in assessing affordability.

- **Prudent** – it is important that whilst capital expenditure and capital financing costs are affordable, they are also proportionate. I.e. it is important that an appropriate proportion of the revenue budget is allocated for the purpose of financing past capital expenditure and that this is **sustainable**. Consideration as to overall financial **sustainability** is a key aspect to this. The operational borrowing limit should provide for the most likely level of borrowing, not the worst case, with the authorised limit providing sufficient headroom to enable day to day cash management. There should be alignment with the treasury management policy statement and practices and investing activities should strike an appropriate balance between security, liquidity and yield, in that order.
  - **Sustainable** – sustainability is a key theme when considering both affordability and prudence and is something that should be assessed in terms of the long term financial picture.
4. The Capital Strategy and Treasury Management Strategy are inherently linked and the main recommendations and observations arising from these are summarised in the following sections. In light of the requirement for full Council to ultimately provide approval of these strategies, the Governance & Audit Committee were asked to review and provide comments on both strategies, and the limits and prudential indicators contained within them, as necessary, to enable Cabinet, and then Council, to appropriately consider and then approve each strategy as required.
  5. The report was considered by Governance & Audit Committee on 26<sup>th</sup> January 2023. There were no significant comments or observations raised and the committee endorsed the strategies for onward consideration by Cabinet and then Council. The Committee noted the anticipated increase in debt, noted the Head of Finance recommendations to Cabinet and noted the proposal to prioritise resources against the backdrop of a challenging financial context.
  6. Subsequent to Governance & Audit Committee considering the report, the draft capital programme has been updated to align with the in-year monitoring position as at December 2022, which is being reported to Cabinet in February 2023. The changes mainly relate to an increase in budgets being slipped from 2022/23 to the new programme. However, it is important to note that these changes have had no material impact of any of the prudential indicators, such as borrowing limits, included within both strategies.

### **Capital Strategy 2023/24 to 2033/34**

#### **Capital Programme to 2027/28**

7. The Council's current capital programme ends in March 2023, with a new five-year programme taking effect from 2023/24. Because of the extremely challenging financial context facing the Council, and all councils in Wales, the scope for additional borrowing over and above that approved in previous years is severely limited. Therefore, the new programme will comprise annual sums, for activity such as cyclical asset maintenance, and unfinished schemes carried forward from the previous programme. Because of the high level of slippage forecasted in 2022/23, it means that the new programme will still be significant in scale and, because of this, remain a challenge in terms of deliverability.
8. Although the new programme will contain no new schemes, and very little borrowing headroom for new schemes, there may be the scope to review this position, particularly beyond the first two years

of the programme. This is enabled by the move to a rolling approach to programme management, meaning each year the programme will be fully reviewed as another year is added to the back end of the five-year window. Therefore, should the financial outlook significantly improve, there may be scope to introduce new schemes or additional borrowing headroom. This may be critical, as there will inevitably be new demands upon capital resources emerging over the medium term and it will be important that the Council is able to respond to these demands.

9. In addition to new borrowing capacity, there may be one-off opportunities to bolster the capital headroom, via in-year revenue underspends. This would provide the scope to support new schemes and react to the risk of pressures being created by rising cost inflation on existing schemes. Even more critically, additional headroom would enable annual sums allocations to be augmented and deal with significant challenges in relation to maintenance backlogs and the increasing costs of renewal programmes, such as fleet. It is important to note that the current annual sums are based on historical allocations, with a minor uplift in light of the recent draft Local Government Settlement, where General Capital Financing (GCF) was increased. This is not currently sufficient for known pressures in relation, for example, to the fleet renewal programme. Work is currently ongoing to consider how best to prioritise the available resources towards the different areas that receive annual sums funding and ensure that the difficult costs to avoid, such as fleet renewal, are supported. However, ultimately, additional resource is required for annual sums and this is something that is being considered as part of the preparation of the 2023/24 budget and medium term financial plan.
10. The proposed programme is set out in the overview that follows. It shows a total programme of £157.5m, comprising annual sums of £31.9m and ongoing schemes totalling £125.6m. Borrowing headroom stands at only £1.057m (albeit £1m of this is ringfenced specifically in relation to the Council's Levelling Up bid) and is the residual value of the previously approved £4.5m, which is now almost entirely allocated for existing and past schemes. Significant schemes included within the proposed programme include the completion of the Council's Sustainable Communities for Learning Band B programme, the new leisure centre, the Transporter Bridge refurbishment and the Council's contribution towards the Cardiff Capital Region City Deal. The total value of the programme in 2023/24 stands at £83.3m, which is significantly more than has been spent in previous years and could be a challenge to deliver without any slippage occurring.

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

	NEW 5-YEAR CAPITAL PROGRAMME					Total new programme £m
	2023/24 Budget £m	2024/25 Indicative £m	2025/26 Indicative £m	2026/27 Indicative £m	2027/28 Indicative £m	
Annual Sums	7.9	5.8	5.8	5.8	5.8	31.9
Ongoing Schemes	75.9	38.1	8.8	2.6	0.0	125.6
Uncommitted borrowing*	1.1	0.0	0.0	0.0	0.0	1.1
<b>TOTAL EXPENDITURE</b>	<b>84.4</b>	<b>45.4</b>	<b>14.6</b>	<b>8.4</b>	<b>5.8</b>	<b>158.6</b>

11. The capital programme is financed through a variety of different funding streams, including external grants, capital receipts, Section 106 contributions, direct revenue funding, use of reserves and external borrowing (unfunded or debt-funded capital expenditure).
12. Capital Expenditure funded by debt increases the need to undertake external borrowing, unless it is possible to bridge this need via 'internal borrowing', which is the use of existing cash resources which are underpinned by the overall level of earmarked reserves. As the capacity to internally

borrow reduces, as reserves are utilised as intended, the need for external borrowing increases. This is particularly the case for this Council, which has had a high level of internal borrowing in the past, but is now seeing that capacity reducing over the medium-long term. Because of this, coupled with an increased level of unfunded capital expenditure, the Council is committed to be a net borrower for the long term. To ensure this borrowing is affordable and sustainable, Council is required to set an affordable borrowing limit.

### Affordable borrowing limit

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

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

	<b>2022/23 limit</b>	<b>2023/24 limit</b>	<b>2024/25 limit</b>	<b>2025/26 limit</b>
Authorised limit – borrowing	271	246	253	248
Authorised limit – PFI and leases	41	39	36	34
<b>Authorised limit – total external debt</b>	<b>312</b>	<b>285</b>	<b>289</b>	<b>282</b>
Operational boundary – borrowing	192	150	163	161
Operational boundary – PFI and leases	41	39	36	34
<b>Operational boundary – total external debt</b>	<b>233</b>	<b>189</b>	<b>199</b>	<b>195</b>

14. Over the medium term, it is anticipated that the level of borrowing required to facilitate the new capital programme will be substantial. As outlined in Table 2, it is projected that borrowing will reach £199m, compared with the £140m that is currently held. It should be noted, however, that this is a reduced figure from that forecasted in the previous Capital Strategy and compared with the previous year's limits, due to the slippage that has occurred in delivery the existing programme, short-term increase in the availability of internal borrowing and the removal of scope for additional borrowing over the medium term.
15. It can be seen that there is a significant difference between the Authorised Limit and the Operational Boundary. This is because of the level of internal borrowing available, underpinned by the level of cash backed reserves, which have increased significantly over recent years. The level of reserves will reduce over the medium-long term, in particular the PFI reserves, and, therefore, it will become necessary to undertake external borrowing in lieu of this reducing capacity. This will have a revenue impact because of the interest costs that will be incurred as a result of the external borrowing, compared to the lower cost of internal borrowing, which, in essence, is represented by interest income foregone.
16. It should be noted that the two limits described above only place a theoretical limit on borrowing that can be undertaken to fund new capital expenditure. This is particularly relevant where there is evidence of slippage occurring across the programme. As a consequence, in theory, additional borrowing could be undertaken over and above that budgeted in the existing Capital Programme, because the slippage means that the operational boundary, for example, would not be reached. This would present a risk that, ultimately, the cumulative level of borrowing could exceed that which is deemed affordable. Therefore, to ensure a measure of control on borrowing undertaken to fund new capital expenditure, a local indicator was introduced for 2022/23, which is directly linked to the level

of borrowing headroom within the Capital Programme. The limit amounts to only £1.057m in 2023/24, with only £57,000 not earmarked already, and will apply until the scope for affording new borrowing improves.

17. The commitment to increase external borrowing leads to increasing capital financing costs, comprising both Minimum Revenue Provision (MRP) and interest payable. Because the financial impact of the current borrowing commitments was funded up front in the 2021/22 revenue budget, the existing revenue budget is already sufficient (unless interest rates increase significantly beyond current levels) and is not set to change over the medium term. The current budgets are set out in Table 3, below. The table also shows the value of capital financing costs as a proportion of the total revenue budget. The percentages quoted are lower than in previous years and are also set to decrease over the medium term. This is largely because of the capital financing budgets remaining stable at a time when the overall revenue budget is increasing, due to funding increases to cover pressures in key services. There remains uncertainty regarding local authority settlements beyond 2024/25 and, therefore, affordability of new borrowing and corresponding capital financing increases could remain a challenge.

*Table 3: Capital Financing Budgets*

	<b>2023/24 budget</b>	<b>2024/25 budget</b>	<b>2025/26 budget</b>	<b>2026/27 budget</b>	<b>2027/28 budget</b>
Provision for repayment of debt (MRP)*	10.4	10.4	10.7	10.7	10.7
Net interest cost	6.9	6.9	7.0	7.0	7.0
<b>Total capital financing (exc PFI)</b>	<b>17.3</b>	<b>17.3</b>	<b>17.7</b>	<b>17.7</b>	<b>17.7</b>
PFI	5.7	5.5	5.5	5.7	5.7
<b>Total Financing costs* (£m)</b>	<b>23.0</b>	<b>22.8</b>	<b>23.2</b>	<b>23.4</b>	<b>23.4</b>
Proportion of net revenue stream	6.1%	5.9%	5.8%	5.9%	5.9%

\*includes charges direct to service areas

## Longer term outlook

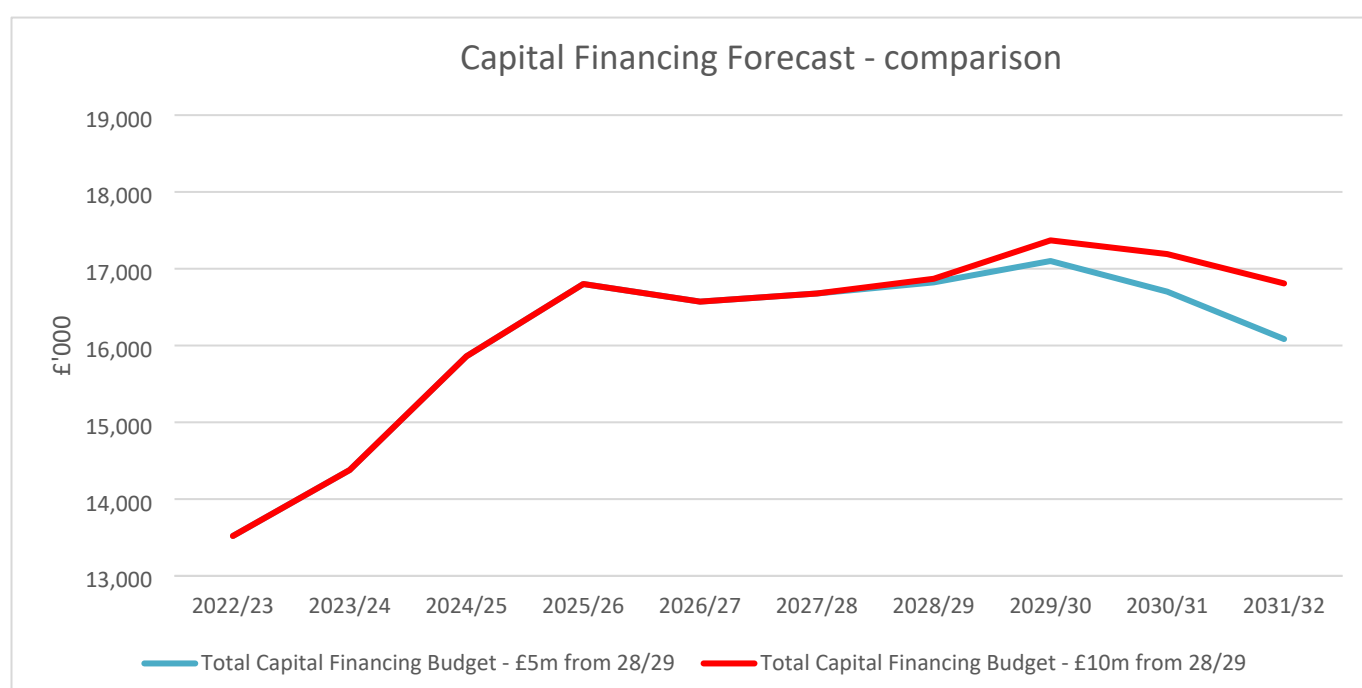
18. As well as considering the medium-term outlook, there is a need to look beyond this timeframe. This is particularly relevant when considering the move towards a rolling capital programme approach and future iterations of the capital programme. When reviewing the programme on a rolling basis, the overriding objective will be to ensure that capital expenditure plans are affordable, prudent and sustainable, requiring a limit to be placed upon debt funded capital expenditure over that period. When looking longer term, the following points will need to be considered:

- the high level of forecast borrowing and corresponding higher level of capital financing cost over the next few years
- the anticipated reduction in reserves and consequent capacity to be internally borrowed, requiring a continuing increase in external borrowing to replace it
- the need to refinance existing maturing borrowing, which could incur a higher interest cost than currently being incurred

- the Council's methodology for charging MRP, which realised a budget saving when changed in recent years, but which increases the charge each year from that point and will continue to do so going forward
- the challenging medium term outlook driven by high inflation, increasing demand for services and the potential for external funding reductions.

19. As a consequence of the points above, the new programme does not contain provision for any new borrowing. Beyond 2027/28, which is the final year of the new programme, an assumption of £5m per year of new borrowing has been modelled. However, this would be subject to affordability within the revenue budget and cannot be guaranteed. Should the medium term revenue outlook improve, however, there may be scope to afford new borrowing beyond that level. Therefore, a further scenario, whereby £10m additional borrowing per year is incurred, has been modelled. The impact of both scenarios is shown in the graphs within the main Capital Strategy document and the chart that follows. Both options would achieve the aim of stabilising the Capital Financing Requirement and, in the case of the first scenario (£5m borrowing per year), it would reduce the CFR overall.

*Chart 1: Capital Financing Cost Forecast, excluding PFI*



20. The above graph demonstrates the impact that the existing programme, with the significant borrowing requirement attached to it, has on the capital financing requirements, denoted by the sharp increase in costs over the short term. Beyond that, there is a levelling off before a more gradual increase over the middle years. There is then a drop-off in both scenarios, largely because of some current significant MRP commitments coming to an end. Whilst this could, theoretically, release budget to allow further borrowing to be undertaken, it wouldn't achieve the aim of stabilising the underlying need to borrow (CFR). It should be noted that any increase in capital financing costs beyond the current budget provision, may result in a pressure on future revenue budgets.

### **Accountability and Responsibility for delivery of the Capital Programme**

21. As outlined in the main strategy report, and capital monitoring reports during 2022/23, there has been a general issue in relation to slippage in recent years. A large part of this has been caused by the COVID-19 pandemic, which led to delays in scheme delivery, amongst other challenges.



However, there are also instances of other issues, such as overly optimistic profiling and a degree of placeholding each time a new programme is developed, which have had an impact. As a consequence of slippage, there is a risk that revenue budget is provided in advance of need and external borrowing is undertaken before required. Therefore, it is an issue that needs addressing, especially with revenue resources being under such pressure over the medium term.

22. To address this, and in line with the recent senior management restructure, governance arrangements for the capital programme are being strengthened. A capital board is being proposed as part of the introduction of the Transformation Programme. Cabinet will retain the same authority over setting the programme, approving additions to the programme and approving slippage from year to year, however this new board will have a clear remit in terms of overseeing the delivery of the programme. Existing boards and groups, such as the Capital Strategy & Asset Management Group which has oversight of the asset maintenance programme, will remain, however ultimate internal officer responsibility will rest with the new board. Heads of Service and project managers will report to this board and be held accountable for ensuring delivery of schemes on time and within budget. It is anticipated that this will reduce instances of slippage and reduce the risk of scarce resources being tied up unnecessarily.

### **Treasury Management Strategy**

23. The Council's detailed Treasury Management Strategy for 2023/24 and beyond are included as Appendix 3, as are the various treasury management indicators. Key points of interest are summarised below.

### **Borrowing Strategy**

24. As outlined in earlier sections of this report, the Council is committed to being a net borrower over the life of the proposed new Capital Programme. In particular, a significant increase in the need to borrow is being projected to 2025/26 financial year. However, the Council's preferred strategy is to maximise the level of internal borrowing, aided by the recent increase in earmarked reserve levels. Therefore, whilst the overall Capital Financing Requirement is set to increase, the need to undertake new borrowing will be deferred for as long as possible.
25. However, the capacity to internally borrow is planned to reduce over the medium to long term. In addition, some existing sizeable loans are due to mature over the next few years. These two factors, will mean that some new borrowing will be required, before considering any overall increase in the CFR. As well as this, in light of the Council's position as a committed long-term borrower, the decision could be taken to undertake borrowing in advance of need. This would only be done in consultation with the Council's treasury advisors and where it was felt to be appropriate, and affordable, in order to mitigate against future interest rate rises. This is especially relevant considering recent interest rate rises and the potential for further rate rises over the forthcoming 12 months.
26. When the need to undertake borrowing arises, the Council will need to give consideration as to the time period over which to borrow. The guiding principle will be to achieve a low, but certain cost of finance. This will generally mean long term borrowing, as this can provide certainty for periods of more than 50 years, if desired. Also, there is currently little difference between long and short term borrowing rates. However, with there being potential for long-term borrowing interest rates to reduce over the medium term, the Council could decide to undertake a degree of short term borrowing as a way of buying time before rates reduce. Also, this would achieve a more balanced borrowing portfolio, but also assist with mitigating the risk of locking into high long-term borrowing rates prior to rates dropping. Again, individual borrowing decisions would only be taken in consultation with the Council's treasury advisors, but also whilst considering the maturity profile of the current borrowing portfolio, as well as overall affordability.

## **Investment Strategy**

27. Both the CIPFA Code and the WG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. Currently, this is not easy to achieve, despite increasing interest rates, due to the high inflation rates. However, in any longer term investment the Council makes, it would still seek to maximise the level of return providing security and liquidity was deemed acceptable from a risk management perspective.
28. As originally outlined in the 2021/22 Capital Strategy, and reiterated in last year's strategy, the Council intends to diversify its investment portfolio, given the relatively low returns from short-term unsecured bank investments and the need to maximise income generation in support of a very challenging medium-term outlook. The recent upturn in interest rates, coupled with uncertainty regarding the IFRS9 statutory override, led to this ambition being put on hold. However, it is intended to explore this further during the last quarter of 2022/23 and into 2023/24. The outcome is likely to be the Council investing all, or part, of the £10m that is available for long-term investment in higher yielding asset classes, such as pooled property funds or covered bonds. This would represent a move away from investing in low yielding bank deposits or with other local authorities. The detail regarding the approved counterparty list and limits is shown in Appendix 3.

## **Head of Finance Summary**

29. The Council's Capital Strategy, and in particular the Capital Programme itself, are, from a financial perspective, decisions with long term implications and where decisions today 'lock-in' the impact on budgets once projects have progressed and borrowing taken out. As explained in the first part of this report, the core requirement for councils is to make decisions whilst taking into account affordability, prudence and sustainability:
30. In terms of the Council's proposed Capital Programme to 2027/28:

### **Affordability**

- There is a significant increase in the Council's projected level of external borrowing and the associated capital financing costs over the next three years, in particular. However, some of this borrowing requirement is simply delayed from previous years. Due to the better than anticipated settlement the Council received for 2021/22, it was possible to fully fund the revenue costs of the entire current Capital Programme, to its conclusion. The current capital programme is therefore affordable, in totality, as a result of this. This is an important position because the Council has an unbalanced medium term financial position currently, due to high inflation driving up costs and increased demand for services. There is also a risk that funding constraints could arise over the medium term. Having already fully funded the revenue impact of the existing programme means that there is one less pressure on an already challenging outlook.

### **Prudence**

- Prudent operational limits on the level of capital expenditure funded by borrowing have been recommended, which align with the proposed programme requirement and, therefore, the Council's priorities. These operational limits increase over the course of the programme and will result in the Council taking on significantly more debt. Therefore, the Capital Programme

needs to be strictly managed within those limits to ensure that the need to externally borrow does not increase and expose the Council to any further risk or interest costs.

## Sustainability

- As outlined above, the revenue costs arising from the existing Capital Programme have been fully funded within the overall revenue budget. In addition, WG have provided an indicative funding settlement for the next financial year, which provides some assurance regarding future funding levels. Providing that the Council is able to meet the challenge of balancing its budget over the medium term, then the costs of borrowing are sustainable.
- However, there is potentially a more significant challenge when considering the longer term sustainability of meeting the costs of debt funded capital expenditure, although this is dependent upon the funding context and the position in relation to inflation and demand for services. The Capital Strategy provides two scenarios, which exemplify the costs of limiting the annual level of debt funded capital expenditure to either £5m or £10m from 2028/29 onwards. Both of these scenarios would be successful in restricting the growth in the CFR longer term, with the £5m scenario actually reducing the CFR. However, due to the reducing capacity for internal borrowing and the MRP policy, the cost of capital financing does not reduce. Therefore, when developing future iterations of the Capital Programme, from a sustainability perspective, it will be important for the Council not to overcommit itself to additional borrowing, particularly with the uncertainty regarding future funding levels.

31. The proposed new Capital Programme is unlike many in the past insofar as it is restricted to ongoing schemes and annual sums. This is reflective of the current financial situation and the extremely challenging MTFP situation meaning that new borrowing is not currently affordable. Because of the high volume and cost of schemes being carried forward from the current programme to the new programme, this is not necessarily a problem because there will be enough of a challenge in delivering the new programme without any new schemes on top. However, it is recognised that there will be a need for new schemes over the course of the next five years, as well as a critical need to address asset maintenance and fleet renewal challenges through the annual sums. Therefore, with a rolling approach now in place, it will be important to continually review the programme and the scope for additional borrowing. As well as this, all opportunities to increase the capital headroom via one-off sums need to be taken when available and potentially prioritised over other emerging pressures. This will assist with mitigating the impact of the maintenance backlogs and potentially avoiding the high cost impact of asset failure. The absence of significant capital headroom will mean that other funding sources will need to be pursued for any new schemes, as well as maximising the ability to self-fund schemes. The new, strengthened, governance arrangements, will be a crucial part of managing the challenging situation over the medium term.

32. The Cabinet is required to consider the Capital and Treasury Management Strategies, including the prudential indicators and limits contained within, and recommended to full Council for approval.

## **Risks**

<b>Risk Title / Description</b>	<b>Risk Impact score of Risk if it occurs* (H/M/L)</b>	<b>Risk Probability of risk occurring (H/M/L)</b>	<b>Risk Mitigation Action(s)</b> What is the Council doing or what has it done to avoid the risk or reduce its effect?	<b>Risk Owner</b> Officer(s) responsible for dealing with the risk?
Increased need to borrow beyond currently	High*	Medium	Regular monitoring and reporting of available headroom should identify any issues at an early stage and keep Cabinet / Council	Members, Executive Board, Heads of Service

<b>Risk Title / Description</b>	<b>Risk Impact score of Risk if it occurs* (H/M/L)</b>	<b>Risk Probability of risk occurring (H/M/L)</b>	<b>Risk Mitigation Action(s)</b> What is the Council doing or what has it done to avoid the risk or reduce its effect?	<b>Risk Owner</b> Officer(s) responsible for dealing with the risk?
assumed levels.			updated. A mechanism exists for increasing borrowing limits and this should only be done where affordable, prudent and sustainable.	and Head of Finance.
Undertaking borrowing that is not ultimately required.	High	Low	Regular monitoring of schemes means that potential for slippage should be identified at an early stage. Continued reprofiling to be undertaken to guard against slippage not being identified. Regular contact with WG regarding potential grant funding, which could negate the need to undertake borrowing.	Executive Board, Heads of Service and Head of Finance.
Investment counterparty not repaying investments.	High*	Low	The Council only invests with institutions with very high credit scores. It employs advisors to monitor money market movements and 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.	Medium*	High	There is currently a climate whereby interest rates are changing on a regular basis. Interest rate forecasts are regularly received from external treasury advisors and the Council is prudent when forecasting future interest payable. In addition, the Treasury Strategy provides for a balance between short and long-term borrowing as a means of managing this particular risk.	Head of Finance, Treasury staff, based on advice from treasury advisors.

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

### **Links to Council Policies and Priorities**

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

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

### **Options Available and considered**

To endorse both the Capital Strategy and the Treasury Management Strategy for 2023/24 for approval by Council, and approve the capital programme.

### **Preferred Option and Why**

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

### **Comments of Chief Financial Officer**

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

The Capital Strategy highlights the anticipated increase in borrowing and the revenue costs resulting from the proposed Capital Programme, which is largely comprised of ongoing schemes from the current programme. Continuation of increasing borrowing at this level beyond the next few years is potentially unsustainable and, therefore, it is important that the Capital Financing Requirement is stabilised and, ideally, reduced. Whilst the current Capital Programme is affordable, as the necessary capital financing budgets were frontloaded as part of the 2021/22 revenue budget, it is important that expenditure is kept within the financing limits within the programme. If further borrowing is required, this will need to be approved by Council.

Over the longer-term, a position needs to ideally be reached whereby debt funded capital expenditure is no greater than annual MRP, allowing the CFR to stabilise or, ideally, reduce. Even by limiting borrowing, as exemplified in the Capital Strategy, the capital financing costs do not necessarily reduce and increase in some years, therefore showing the importance of agreeing a prudent limit for future iterations of the programme. This will be a key issue over the medium to long term, mainly due to the challenging financial outlook being faced by the Council. At a time when demand for revenue resources, due to rising costs and demand for services, it will be important that demand for capital financing is proportionate and, ideally, kept to a minimum.

The degree of slippage in future years will also be a significant factor. It will be important that the strengthened governance arrangements are effective and that resources are not unnecessarily tied up, when they could be used for other purposes. As well as this, it will be vital that opportunities to increase capital headroom are taken and that issues surrounding asset maintenance are prioritised. This will assist the Council with being able to react to emerging needs and mitigate the chance of asset failure.

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

## **Comments of Monitoring Officer**

There are no specific legal issues arising from the report. The Capital Strategy will provide a framework for future capital and investment decisions, having regard to principles of affordability, prudence, sustainability and risk/reward. The Treasury Management Strategy sets out the financial management principles that will underpin the Capital Strategy. As such, both strategies will form part of the Council's overall budget framework and are required to be formally approved and adopted by full Council. Governance & Audit Committee 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. The Committee did not raise any specific concerns for Cabinet to take into consideration.

## **Comments of Head of People, Policy & Transformation**

The Capital Strategy described within this report is considerate of, and meets the requirements of, the Wellbeing of Future Generations Act with a focus on long term planning and sustainability as part of the sustainable development principle. The Fairness and Equality Assessment completed and summarised below reinforces this element, along with the positive impact of protected characteristics.

The report supports the new Corporate Plan objectives which are ambitious and focused on working collaboratively with our staff, residents, and partners to improve service delivery across the city whilst supporting other related plans and strategies, in particular the Council's Strategic Equality Plan.

As the Council works towards its new Corporate Plan and Capital Strategy, it will be necessary to consider the workforce required to achieve the objectives as set out. Any staffing impact will be considered, and consultation will take place as and when necessary.

## **Scrutiny Committees**

N/A

## **Fairness and Equality Impact Assessment:**

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

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

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

programme that will, collectively, have had a positive impact upon groups with protected characteristics such as disability, language preference and socio-economic background.

## **Consultation**

N/A

## **Background Papers**

Report on Treasury Management for the period to 30 September 2022

Capital Monitoring and Additions Report – December 2022

Dated: 7<sup>th</sup> February 2023

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

	Budget 2023/24 (including slippage)	Indicative Budget 2024/25	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Total
<b><u>Annual Sums:</u></b>						
<u>People, Policy &amp; Transformation:</u>						
Asset Maintenance (including schools)	1,500	1,500	1,500	1,500	1,500	7,500
IT Replacement Schemes	224	150	150	150	150	824
<u>Prevention &amp; Inclusion:</u>						
Disabled Facilities Grants	1,669	1,000	1,000	1,000	1,000	5,669
Safety at Home	300	300	300	300	300	1,500
<u>Social Services:</u>						
Disabled Equipment (GWICES)	165	165	165	165	165	825
Telecare	30	30	30	30	30	150
<u>Infrastructure:</u>						
Fleet Replacement	2,648	2,123	2,123	2,123	2,123	11,140
Highways Asset Maintenance	1,372	1,371	500	500	500	4,244
<b>Annual Sums Total</b>	<b>7,908</b>	<b>6,639</b>	<b>5,768</b>	<b>5,768</b>	<b>5,768</b>	<b>31,851</b>
<b><u>Ongoing and Previously Approved Schemes:</u></b>						
<u>Education:</u>						
Sustainable Communities for Learning - Band B	31,353	16,858	400	46	30	48,687
Welsh Medium Primary School (Pillgwenlly / Nant Gwenlli)	1,277	2,625	1,159	0	0	5,061
Charles Williams Renovations	1,600	0	0	0	0	1,600
Pentrepoeth Primary School Accessibility Works	204	0	0	0	0	204
St Mary's Primary School	1,716	1,478	0	0	0	3,194
Education Maintenance Grant 2020/21	1,263	0	0	0	0	1,263
Education Maintenance Grant 2021/22	684	0	0	0	0	684
Education Maintenance Grant 2022/23	1,725	830	0	0	0	2,555



	Budget 2023/24 (including slippage)	Indicative Budget 2024/25	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Total
Education Accessibility Works - Phase 1 and 2	569	0	0	0	0	569
Free Schools Meals Capital Works	1,867	0	0	0	0	1,867
Community Focussed Schools	597	0	0	0	0	597
Supporting Learners with Additional Learning Needs	879	0	0	0	0	879
<b>Education Total</b>	<b>43,733</b>	<b>21,791</b>	<b>1,559</b>	<b>46</b>	<b>30</b>	<b>67,159</b>
<u>Environment &amp; Public Protection:</u>						
Refit	1,135	0	0	0	0	1,135
Parks Improvements	1,054	0	0	0	0	1,054
Cemeteries Improvements	802	0	0	0	0	802
<b>Environment &amp; Public Protection Total</b>	<b>2,991</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>2,991</b>
<u>Housing &amp; Communities:</u>						
Gypsy & Traveller Site Development	44	0	0	0	0	44
<b>Housing &amp; Communities Total</b>	<b>44</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>44</b>
<u>Infrastructure:</u>						
Hostile Vehicle Mitigation	572	572	0	0	0	1,144
Private Sector Bus Electrification	6,323	0	0	0	0	6,323
<b>Infrastructure Total</b>	<b>6,895</b>	<b>572</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>7,467</b>
<u>People, Policy &amp; Transformation:</u>						
IT Replacement Schemes (in addition to annual sum)	95	95	52	0	0	242
Information Station	23	0	0	0	0	23
<b>People, Policy &amp; Transformation Total</b>	<b>118</b>	<b>95</b>	<b>52</b>	<b>0</b>	<b>0</b>	<b>265</b>
<u>Regeneration &amp; Economic Development:</u>						

	Budget 2023/24 (including slippage)	Indicative Budget 2024/25	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Total
Cardiff Capital Region City Deal – NCC Contribution	2,375	4,167	1,145	0	0	7,686
Cardiff Capital Region City Deal – Cost of Carry Contribution	0	0	2,037	2,628	0	4,665
Market Arcade	617	0	0	0	0	617
Transforming Towns	536	332	0	0	0	868
Central Library	518	0	0	0	0	518
Transporter Bridge	11,150	807	0	0	0	11,957
Lighting Strategy	450	0	0	0	0	450
New Leisure Centre	2,270	10,948	4,086	0	0	17,304
Newport Centre Demolition	1,200	0	0	0	0	1,200
<b>Regeneration &amp; Economic Development Total</b>	<b>19,116</b>	<b>16,254</b>	<b>7,268</b>	<b>2,628</b>	<b>0</b>	<b>45,265</b>
<u>Social Services:</u>						
Rosedale Annexes	224	0	0	0	0	224
Cambridge House	1,630	0	0	0	0	1,630
Forest Lodge	596	0	0	0	0	596
<b>Social Services Total</b>	<b>2,450</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>2,450</b>
<b>Total Capital Programme</b>	<b>83,254</b>	<b>45,351</b>	<b>14,647</b>	<b>8,442</b>	<b>5,798</b>	<b>157,492</b>

	Budget 2023/24 (including slippage)	Indicative Budget 2024/25	Indicative Budget 2025/26	Indicative Budget 2026/27	Indicative Budget 2027/28	Total
<b><u>Financed by:</u></b>						
General Capital Grant	4,268	4,268	4,268	4,268	4,268	21,340
Supported Borrowing	4,155	4,155	1,201	20	10	9,541
Unsupported Borrowing	14,601	11,099	4,140	2,628	0	32,468
External Grants	38,283	20,581	3,538	26	20	62,447
S106	3,664	328	0	0	0	3,992

Other Contribution	436	0	0	0	0	436
Capital Receipts	3,629	950	0	0	0	4,579
Revenue Contribution	1,500	1,500	1,500	1,500	1,500	7,500
Reserves	12,719	2,470	0	0	0	15,189
<b>Total Capital Programme Financing</b>	<b>83,254</b>	<b>45,351</b>	<b>14,647</b>	<b>8,442</b>	<b>5,798</b>	<b>157,492</b>

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# NEWPORT CITY COUNCIL CAPITAL STRATEGY 2023/24 TO 2033/34

## **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 a summary of the implications for future financial sustainability.

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

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

The strategy highlights the key risks and recommendations:

- The Council's new rolling capital programme, a large proportion of which relates to ongoing and previously approved schemes being carried forward from the previous programme, requires a substantial amount of borrowing to 2024/25, in particular. Whilst this is affordable, due to the revenue budget requirement being forward funded in the 2021/22 budget, it would be unsustainable to continue increasing borrowing thereafter, especially given the current economic climate and pressures upon the Council's revenue budget.
- The Council's Medium Term Financial Plan includes no provision for any new borrowing over and above that already funded within the existing revenue budget. This is on the basis that new borrowing would not be affordable, prudent or sustainable. However, this position will be kept under review as certainty regarding the medium-term outlook increases.
- As per the agreed framework (detailed in the report), the new programme needs to be maintained within the agreed limits and not result in a medium-term increase in the Capital Financing Requirement. This is to be achieved by not incurring new expenditure to be funded via borrowing, other than that already approved. Any required increase in the level of capital expenditure to be specifically funded by borrowing would need approval by full Council.
- Due to the pressure for additional capital resources, primarily driven by the need to increase investment in annual sums for asset maintenance (buildings and highways) and fleet renewal, there is a requirement to supplement the capital headroom with one-off resources, and preferably recurring resources, wherever possible. To achieve this, it is proposed that any revenue underspends over the medium term are redirected towards the capital headroom and used to augment annual sums allocations. In addition, consideration is required as part of the revenue budget setting process to allocating additional base budget resources to supplement annual sums.
- As well as prioritising funding for annual, recurring, sums, there is a need to develop various strategic plans across the organisation which drive the need for capital expenditure. This will include clearer visibility and assessment of demand for maintenance of assets such as schools, highways and other operational assets, as well as focussing on asset rationalisation.

- The pressure upon the Capital Programme and the historic challenges in relation to programme delivery and slippage, coupled with a relatively new management structure, increases the need for clearer, more robust, governance structures around the programme. These are currently being developed but will likely result in a greater prominence for capital expenditure and funding, overseen by the Executive Board, coupled with a clear link to the Transformation Programme.
- The prudential indicators, including borrowing limits, are in line with the MTFP approved by Cabinet.

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

## **OVERVIEW OF THE STRATEGY**

### **1.1. INTRODUCTION**

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

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

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

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

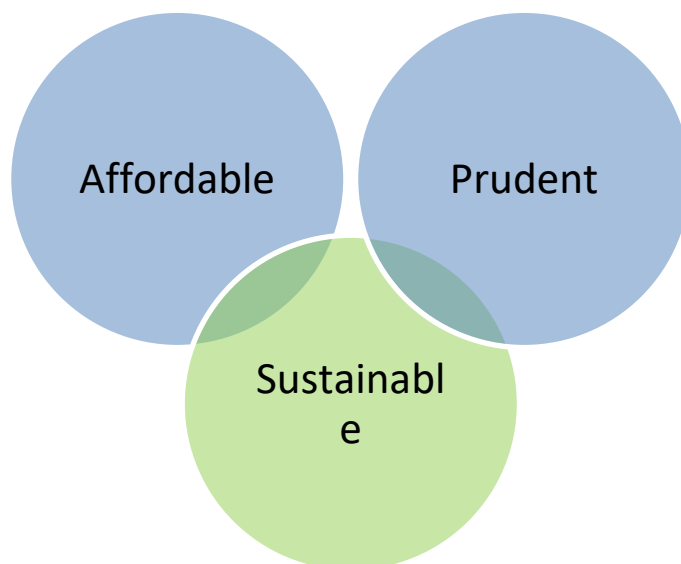
The report sets out:

- The key objectives outlined in the Prudential Code and the governance arrangements for the Capital Strategy and programme, including the move towards a rolling approach to programme development and management (Section 2)
- The new proposed capital programme to 2027/28, including schemes carried forward from the current programme, its financing, and the revenue implications arising from demands on capital expenditure (Section 3)
- The long-term (10 year) projection for the capital financing costs of the Council and where future demands arise from the various strategic plans across the Council for further capital resources. (Section 4)
- Links between the Capital Strategy and Treasury Management strategy, and treasury decision making. (Section 5)
- A look at the commercial activity of the Council and the strategy going forward. (Section 6)
- Overview of other long-term liabilities the Council has, which members need to be aware of when looking at the Capital Strategy. (Section 7)
- Summary of the skills and knowledge the Council holds in order for it to carry out its duties for capital and treasury matters. (Section 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 Council's capital expenditure is affordable and prudent. In terms of both affordability and prudence, it is important that sustainability is considered and can be demonstrated;



#### **AFFORDABLE**

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

#### **PRUDENT**

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

#### **SUSTAINABLE**



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

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

All local authorities are required to have regard to CIPFA's Prudential Code and Treasury Management Code. During the autumn of 2021, a number of changes were consulted on and subsequently introduced. Some of these changes, such as local authorities being precluded from borrowing for investment where the primary aim is to generate a commercial return, were reflected in the 2022/23 Capital Strategy. Other changes, which were outlined in the previous strategy document and include prudential indicators being reported more frequently, could be deferred until 2023/24 and will be reflected in this year's strategy and in-year reports.

## **2.2. GOVERNANCE FOR APPROVAL AND MONITORING OF CAPITAL EXPENDITURE**

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

- Council approves the overall revenue and capital budgets following recommendations from the Cabinet. As part of this, Council approves the external borrowing limits, which place a cap on the level of borrowing the Council can undertake during the year. These limits are based around the level of unfunded capital expenditure, including uncommitted expenditure, within the capital programme. The limits will not include expenditure on any schemes where borrowing is required, but which finance themselves through the savings generated. These limits are a key performance indicator for treasury management and ensure that capital expenditure is limited and borrowing remains affordable. Any changes required to the borrowing limits must be approved by full Council.
- Council approves the Treasury Management and Investment strategies, which are intrinsically linked to capital expenditure and the Capital Strategy. Further details of these are provided in sections 5.1 and 5.3.
- The detailed capital programme, contained within the overall budget, is approved by Cabinet following individual project appraisals by officers, which include the views of the Head of Finance.
- Items of capital nature are discussed at the Capital Strategy Asset Management Group (CSAMG), which is made up of senior officers from all service areas and the Council's property advisors, Newport Norse. Discussions centre on the asset management agenda and include asset disposals and prioritisation of capital expenditure requirements. Other boards with capital considerations, include the People Services Capital Board.
- Operational decisions on capital expenditure will be made by the Capital Board, following a review of the project appraisal and/or business case and advice from CSAMG, where relevant. The board will also monitor the position in relation to previously approved schemes and ensuring that they remain affordable within the overall approved programme envelope. Should action be required to respond to increasing costs, Heads of Service and project managers will be expected

to demonstrate that alternative options, such as rescoping and seeking alternative funding, have been considered.

- Cabinet approves any new capital expenditure to be added to the capital programme, including that funding from external resources, such as specific grant.
- Monitoring of Capital Expenditure is reported to Cabinet, including updates on capital receipts and the impact on the revenue budget of decisions made.

Affordability and sustainability are key considerations when approving capital expenditure, and therefore the agreed framework detailed in section 3.1 is used. Included within Appendix 2a is the process map used for the approval of capital expenditure.

Decisions on the approval of capital expenditure will be made in liaison with the Capital Accountancy Team and an understanding of the long-term revenue implications of the expenditure is assessed before it is added to the programme. Cabinet approves additions to and deletions from the Capital Programme when approving the regular monitoring reports. Approval of slippage from one financial year to the next is also a Cabinet responsibility and tends to take place towards the end of the financial year, as greater certainty around slippage levels become evident.

### **3. CAPITAL EXPENDITURE AND FINANCING**

#### **3.1. CURRENT CAPITAL PROGRAMME**

The current capital programme originally covered the five-year period between 2018/19 and 2022/23. However, as approved by Cabinet in January 2020, an additional two years were added to the programme to incorporate those schemes, such as the Sustainable Communities for Learning Band B Programme, where completion was projected to extend beyond the original five-year timeframe. As the original capital programme window is due to end in March 2023, a new five-year programme is required.

This programme will run from 2023/24 to 2027/28, although a rolling approach to capital programme development and management will be introduced as part of this. This means that, rather than having a new programme once every five years, there will be a continual evolution of the programme, with a new year added each time the strategy is refreshed and the most recent year withdrawn. Because of the rolling approach, it means that future years within the programme will be shown as indicative only, until the point at which the full funding is in place for the expenditure planned in that respective year (in the case of debt-funded expenditure, this would require the requisite capital financing budget to be in place). However, this approach will allow for longer term planning and more flexibility in how the programme is managed. In addition, it means that schemes will only be added when ready, which should reduce the instances of “placeholding” and reduce the level of slippage reported.

Given the financial constraints that the Council has faced in recent years, and continues to face, Cabinet and Council established a framework for managing the programme, aimed at maximising capital expenditure but keeping new borrowing at a level that could be afforded within a sustainable revenue budget and, in doing so, not adding unnecessary pressure to the medium term outlook. This framework is as follows:

- a. Funding from sources other than borrowing needs to be maximised, by securing grant funding whenever possible and maximising capital receipts;
- b. Any change and efficiency schemes requiring capital expenditure, and generating savings as a consequence, would be funded by offsetting the capital financing costs against the savings achieved;
- c. Schemes and projects which generate new sources of income would need to fund any capital expenditure associated with those schemes.

This framework ensures that the capital programme can be maximised but those schemes which cannot fund any resulting borrowing costs can be afforded and maximised within any headroom available. This available headroom is made up of residual borrowing headroom agreed within the previous programme and identified uncommitted capital reserves and capital receipts. The new programme does not currently include any allowance for new borrowing over and above that already approved for specific schemes. Therefore, the headroom going forward will largely comprise of capital reserves and receipts.

Because of this, the new programme, in the first few years at least, will be made up of recurring annual sums, ongoing schemes and those schemes approved and funded, but not yet started, as part of the previous programme. This will result in a relatively low level of capital headroom to be able to react to other emerging pressures. As a consequence, it will be necessary to top-up the capital headroom whenever possible, using one-off resources. These one-off resources will include repurposing of existing earmarked reserves, future capital receipts and any underspends against the overall revenue budget.

The proposed new capital programme is summarised in the table below. For 2023/24, the programme contains approved capital schemes of £83.3m, and the overall programme to 2027/28, including uncommitted borrowing, is £158.6m. This total figure includes £4.7m for the cost of carry of undertaking borrowing for Cardiff Capital Region City Deal schemes, prior to the funding from HM Treasury being received, and just £1.1m of uncommitted borrowing headroom (of which only £57,000 is not earmarked for specific schemes).

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

	NEW 5-YEAR CAPITAL PROGRAMME					Total new programme £m
	2023/24 Budget £m	2024/25 Indicative £m	2025/26 Indicative £m	2026/27 Indicative £m	2027/28 Indicative £m	
Annual Sums	7.9	5.8	5.8	5.8	5.8	31.9
Ongoing Schemes	75.9	38.1	8.8	2.6	0.0	125.6
Uncommitted borrowing*	1.1	0.0	0.0	0.0	0.0	1.1
<b>TOTAL EXPENDITURE</b>	<b>84.4</b>	<b>45.4</b>	<b>14.6</b>	<b>8.4</b>	<b>5.8</b>	<b>158.6</b>

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

The new capital programme, including previously approved schemes, is substantial and leads to a considerable increase in the Capital Financing Requirement (CFR) over the medium term. As a result, there is a consequential increase in capital financing costs. As part of the overall 2021/22 Council budget, a £2.1m investment in the capital financing budget was made in order to provide for the revenue costs arising from the full capital programme. By committing these resources in advance, it means that no additional investment is required over the medium term to meet these costs. Due to the level of

slippage experienced and projected beyond the current financial year, it means that there is likely to be an in-year underspend against this budget during 2023/24 and 2024/25. This may provide one-off opportunities to bolster the capital headroom, assuming there are no other emerging in-year pressures against the revenue budget, for which the underspends are needed for the Council to be able to balance its overall monitoring position.

In terms of funding, the WG General Fund Capital Grant in 2023/24 is set to return to levels in line with 2021/22, having reduced temporarily in 2022/23. The draft Local Government settlement for 2023/24 has confirmed an amount of £4.268m, which actually represents an increase on historic levels. This increase will go a small way to reducing the pressure upon annual sums expenditure.

The overall programme contains a number of key capital schemes, some of which will continue beyond the forthcoming 2023/24 financial year. These include:

- Sustainable Communities for Learning Band B Programme
- Transporter Bridge renovation
- Cardiff Capital Region City Deal (CCRCD)
- New Leisure Centre

There may be other requirements for capital funding for schemes that are not yet contained within the overall programme. Any new schemes that arise during the year will either need to be funded via specific funding sources (e.g. external grant) or will represent a call upon the residual headroom available. It is important that capital expenditure remains at an affordable level within the framework agreed and, therefore, prioritisation of capital expenditure is essential and needs to be affordable and sustainable in the long-term. Regular reviews of previously approved schemes, not yet started, will be undertaken to ensure that they remain affordable. This is especially relevant in the current climate of high construction inflation and where capital expenditure is to be funded via borrowing, as there is a risk that the existing revenue budget may be insufficient. It will be expected that all necessary steps will be taken to ensure that existing budgets can be kept within, including reducing scope, seeking alternative funding sources and mitigating within a wider programme. As a last resort, consideration as to whether a scheme can still proceed will be required.

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

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

Table 2: Capital financing in £ millions

	NEW 5-YEAR CAPITAL PROGRAMME					Total new programme
	2023/24 Budget £m	2024/25 Indicative £m	2025/26 Indicative £m	2026/27 Indicative £m	2027/28 Indicative £m	£m
<b>TOTAL EXPENDITURE</b>	<b>84.4</b>	<b>43.9</b>	<b>14.6</b>	<b>8.4</b>	<b>5.8</b>	<b>158.6</b>
<b>Financed by:</b>						
Committed Grants and contributions	46.7	25.2	7.8	4.3	4.3	88.2
Committed Reserves, capital receipts, revenue	17.9	4.9	1.5	1.5	1.5	27.3
Committed new borrowing	18.9	15.3	3.3	0.0	0.0	37.3
Committed new borrowing for City Deal Cost of Carry	0.0	0.0	2.0	2.6	0.0	4.7
<b>TOTAL COMMITTED (Appendix 1)</b>	<b>83.3</b>	<b>45.4</b>	<b>14.6</b>	<b>8.4</b>	<b>5.8</b>	<b>157.5</b>
Uncommitted borrowing*	1.1	0.0	0.0	0.0	0.0	1.1
<b>TOTAL UNCOMMITTED</b>	<b>1.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>1.1</b>
<b>TOTAL FINANCING</b>	<b>85.8</b>	<b>45.4</b>	<b>14.6</b>	<b>8.4</b>	<b>5.8</b>	<b>158.6</b>

As previously outlined, the better than expected Local Government settlement in 2021/22 enabled the Council to fully fund the revenue budget requirements arising from the commitment to undertake borrowing to fund the capital programme. For the new programme, the forecast level of borrowing is £43.1m, including borrowing headroom. The full impact of this is already funded within the revenue budget and, should there be any need to increase this total, it would need approval by Council.

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

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

	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget
MRP budget	10.4	10.4	10.7	10.7	10.7

The table above shows the budgeted amount of MRP that is included within the Council's overall revenue budget, including where service areas are making contributions towards the capital financing costs of invest to save schemes. Because the capital financing costs arising from the existing schemes were fully funded in the 2021/22 revenue budget, and there is no new borrowing planned, there is currently no requirement to increase the MRP budget over the medium term, other than a planned

increase in relation to the Leisure Centre scheme. Should there be any new commitment to borrow in future years, this will need to be reflected via an increase in the MRP budget.

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

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

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

	<b>2023/24 budget</b>	<b>2024/25 budget</b>	<b>2025/26 budget</b>
Financing costs* (£m)	23.0	22.8	23.2
Proportion of net revenue stream	6.1%	5.9%	5.8%

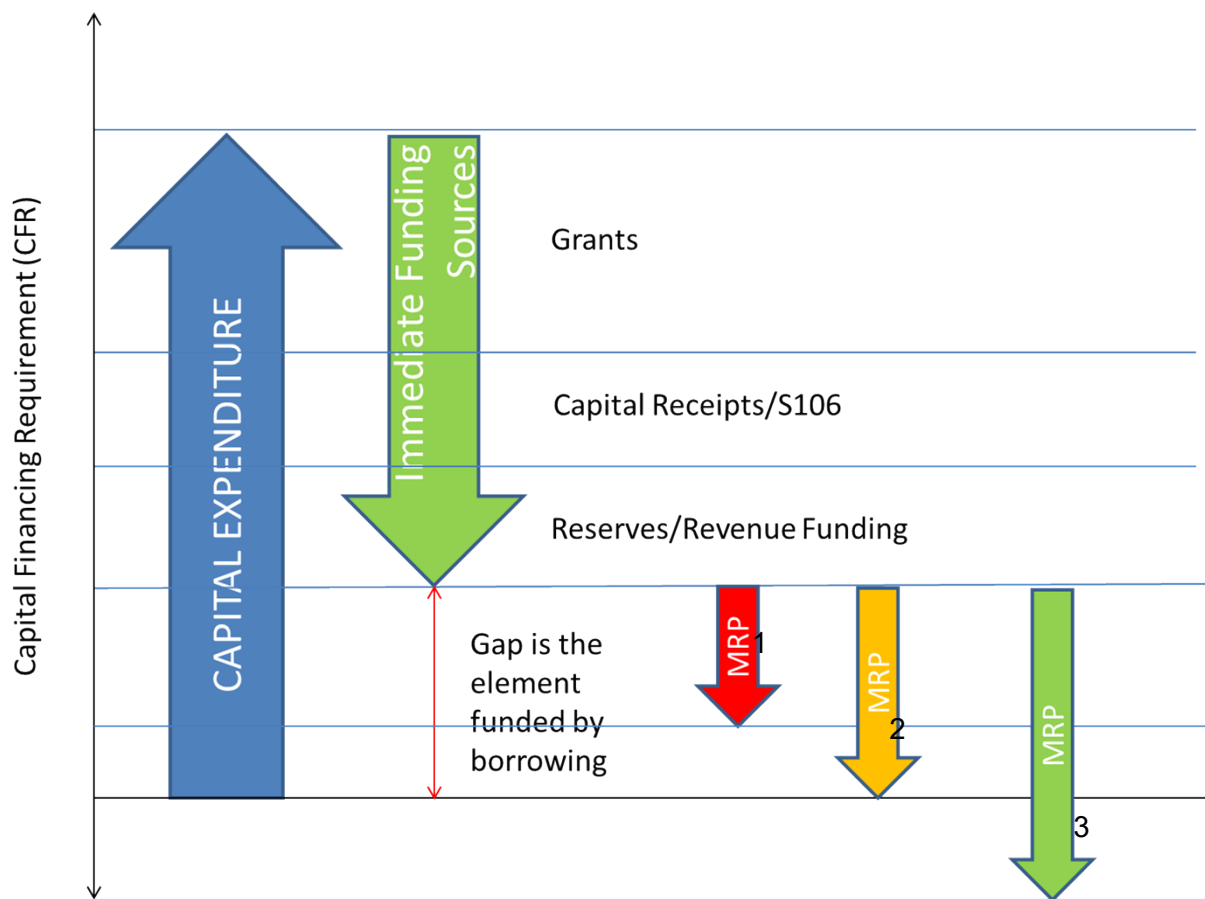
\*includes capital financing costs of PFIs

From the table above it is evident that the proportion of the budget set aside to finance capital expenditure is set to steadily decrease over the medium-term. This reduction is a reflection of the fact that the capital financing budget was frontloaded in 2021/22 and is not set to significantly change during that period. However, core revenue funding is set to increase, via a combination of increased core funding from Welsh Government and Council Tax increases. This increase in funding is having the effect of reducing the proportion of the core revenue stream utilised on capital financing costs.

- Information on the revenue implications of capital expenditure is also included in the 2023/24 revenue budget report.

### **Capital Financing Requirement (the underlying need to borrow)**

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



The diagram above shows the following:

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

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

The table below provides the medium-term outlook for the Council's CFR, inclusive of the impact of PFI arrangements. This is based on the proposed new programme and, therefore, does not reflect the potential for additional borrowing beyond that already approved. As can be seen, the CFR is expected to increase by £8.9m during 2023/24 to £282.6m, compared to the slight reductions that have occurred in the last three years. Therefore, this increase represents a stepped change in position, when compared with previous years, where the figure has generally stayed at around £273m.

This significant increase in capital expenditure, including that funded via other sources, will be a challenge to achieve, evidenced by the significant levels of slippage incurred during the 2021/22 and 2022/23 financial years. Therefore, it is important to recognise the likelihood that the actual CFR may turn out lower by the end of the 2023/24 financial year, in turn reducing the actual need to undertake external borrowing. This is a significant challenge for the Council, as it is important that ambitions for capital expenditure are not unrealistic, as this can result in unnecessarily committing resources towards the capital financing budget, which may result in other budget priorities not being able to be pursued.

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

	<b>31/03/22 Actual</b>	<b>31/03/23 Forecast</b>	<b>31/03/24 Budget</b>	<b>31/03/25 Indicative</b>	<b>31/03/26 Indicative</b>	<b>31/03/27 Indicative</b>	<b>31/03/28 Indicative</b>
<b>TOTAL CFR</b>	<b>273.5</b>	<b>273.7</b>	<b>282.6</b>	<b>286.5</b>	<b>280.2</b>	<b>270.9</b>	<b>259.3</b>

With the introduction of the accounting requirements of IFRS 16 Leases, the CFR and debt identified as relating to leases is likely to increase, due to the change in the way that finance leases for lessees are treated. CIPFA/LASAAC took the decision to initially defer the implementation of IFRS 16 Leases until the 2022/23 financial year in response to pressures on Council finance teams, as a result of the COVID-19 pandemic. However, there has been a subsequent further deferral, meaning that the introduction of the accounting standard is likely to be in 2024 at the earliest. Work is continuing to be undertaken to gather the relevant information and fully understand the impact upon the Council. The output of this work will be reflected in the 2024/25 Capital Strategy, at the earliest.

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

#### **4. LONG-TERM VIEW OF CAPITAL EXPENDITURE**

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

Due to the financial constraints that the Council continues to face, it is anticipated that revenue to fund capital financing will remain incredibly restricted over the long term. The capacity to use internal borrowing is also reducing, which means that the authority will face a challenge in relation to its medium to long term capital aspirations, particularly if there is a need or desire to incur a certain level of capital expenditure funded via borrowing. This comes at a time when the authority is facing challenges in relation to its existing asset base, in terms of maintenance backlogs, as well as demand pressures (e.g. increasing pupil numbers) adding to the need to invest in new and existing assets.



As already outlined, there will be no scope for new borrowing in the immediate future. Therefore, this presents an opportunity to stabilise, and possibly reduce, the increasing level of its CFR. This, in turn, will minimise the increase in associated capital financing costs and ensure that they remain affordable and sustainable. This is particularly relevant when considering the position outlined in the Medium Term Financial Plan and the competing financial pressures facing the Council.

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

To assist with exemplifying the potential impact over the medium to long term, two scenarios have been modelled. The first scenario assumes no additional (i.e. in addition to already approved schemes) unfunded capital expenditure during the new programme window and then £5m of unfunded capital expenditure from 2028/29 onwards. The second scenario is based on incurring £10m of unfunded capital expenditure from 2028/29 onwards. Charts 1a and 1b, below, demonstrate the impact that these scenarios could potentially have upon the overall level of the CFR and the actual requirement to undertake external borrowing.

*Chart 1a – Liability Benchmark v1 - £5m additional borrowing per year beyond 2027/28*

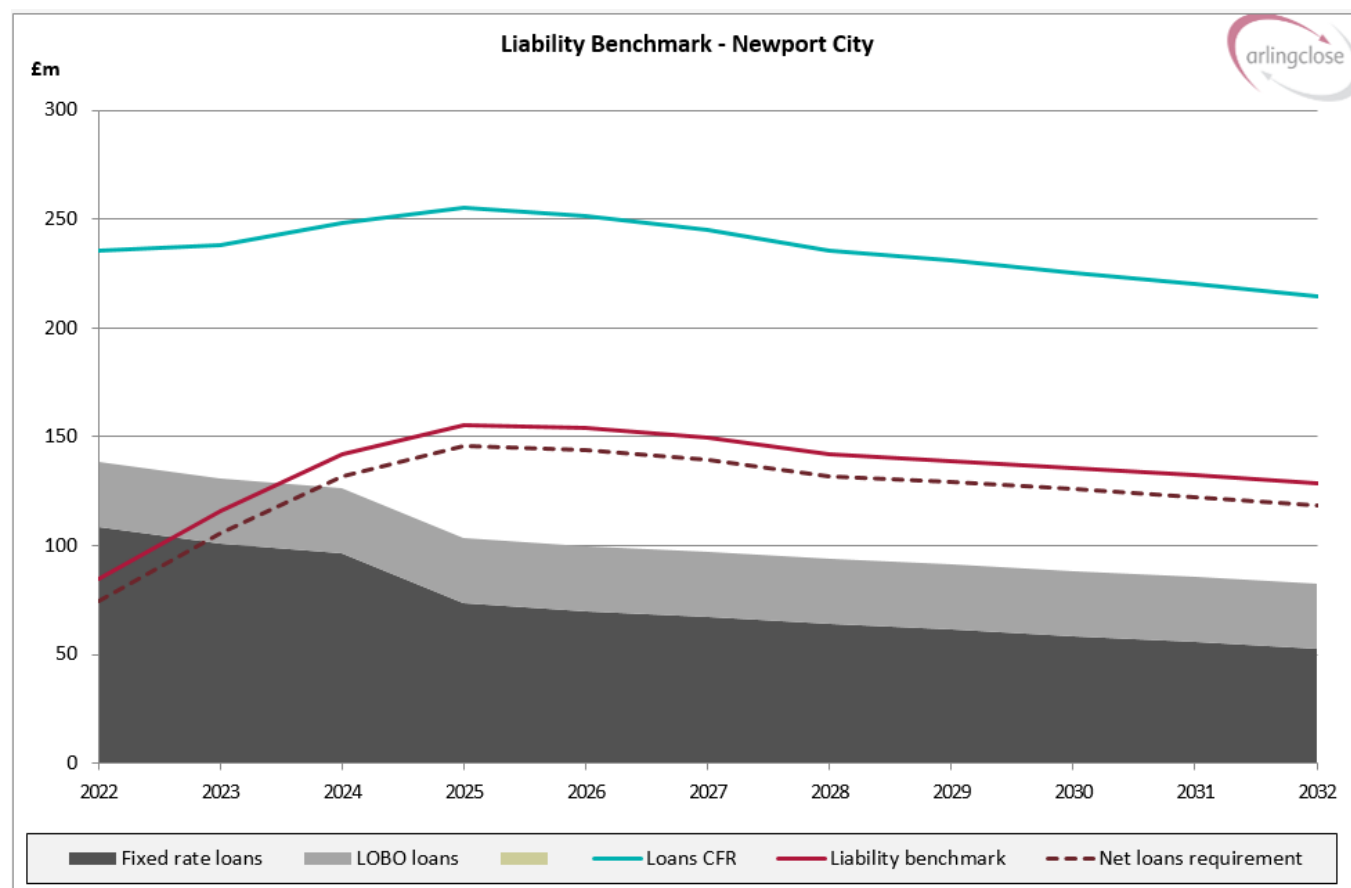
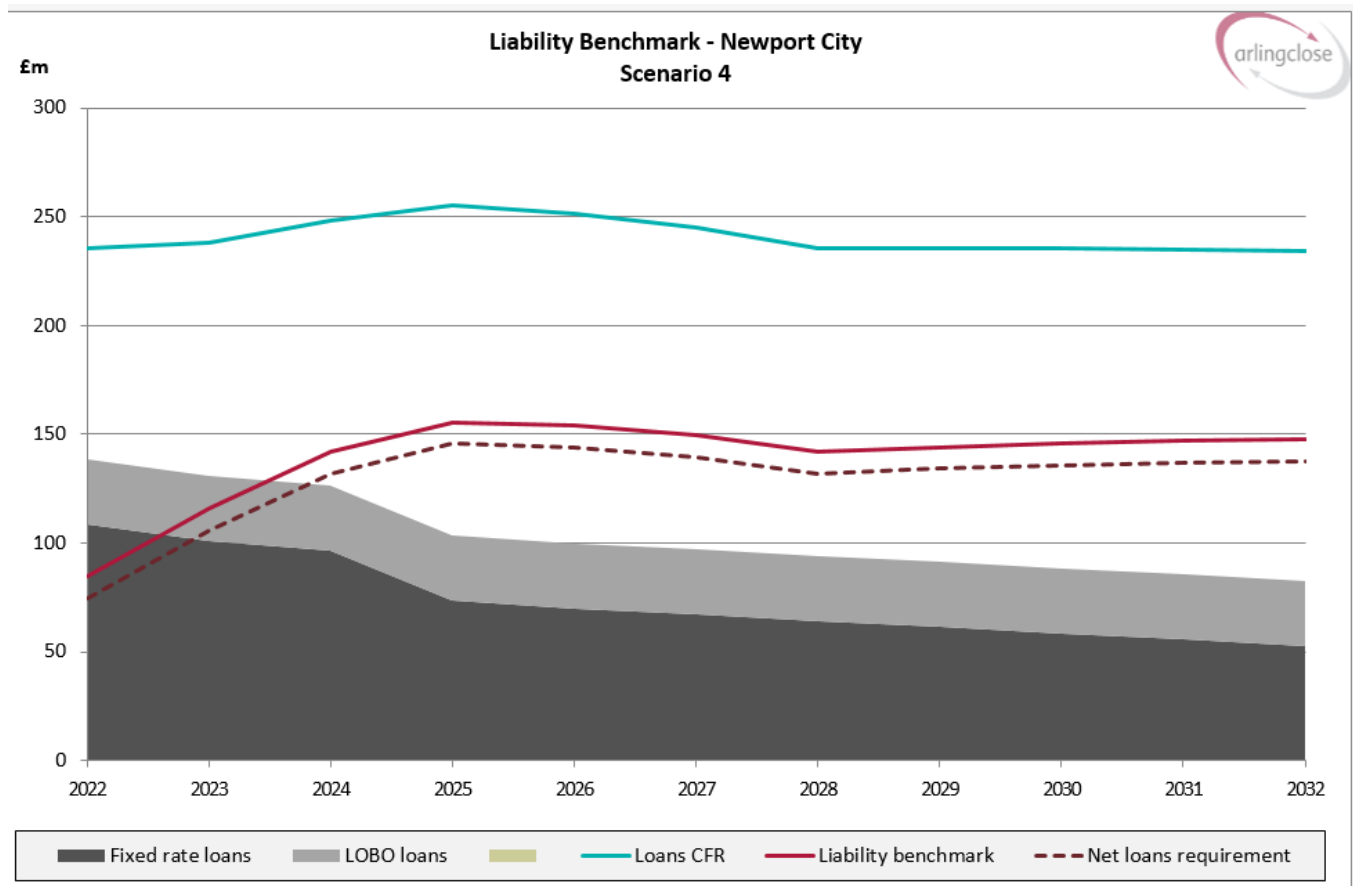


Chart 1b – Liability Benchmark v2 - £10m additional borrowing per year beyond 2027/28



Charts 1a and 1b, known as the Liability Benchmark, demonstrate the following, in terms of the impact of the current capital programme and the two modelled scenarios:

- The impact the current capital programme has in terms of the increasing CFR and consequent need for external borrowing, denoted by the steepness of the solid and dashed red curves over the first few years.
- A longer-term stabilisation (v1 and v2), and then reduction (v1), in the overall level of CFR, as shown by the trajectory of the solid blue lines.
- A longer-term stabilisation of the need to undertake actual external borrowing (v1 and v2), followed by a gradual reduction (v1), as shown by the trajectory of the dashed red lines.
- The impact of the reducing capacity for internal borrowing, demonstrated by the convergence of the two set of lines over the first few years and thereafter.
- The fact that a level of existing borrowing is scheduled for repayment (denoted by the shaded grey area) over the medium to long term, although the underlying need to borrow actually grows during that time, meaning that the repaid borrowing will need to be replenished.

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

Chart 2 – Capital Financing Cost Forecast

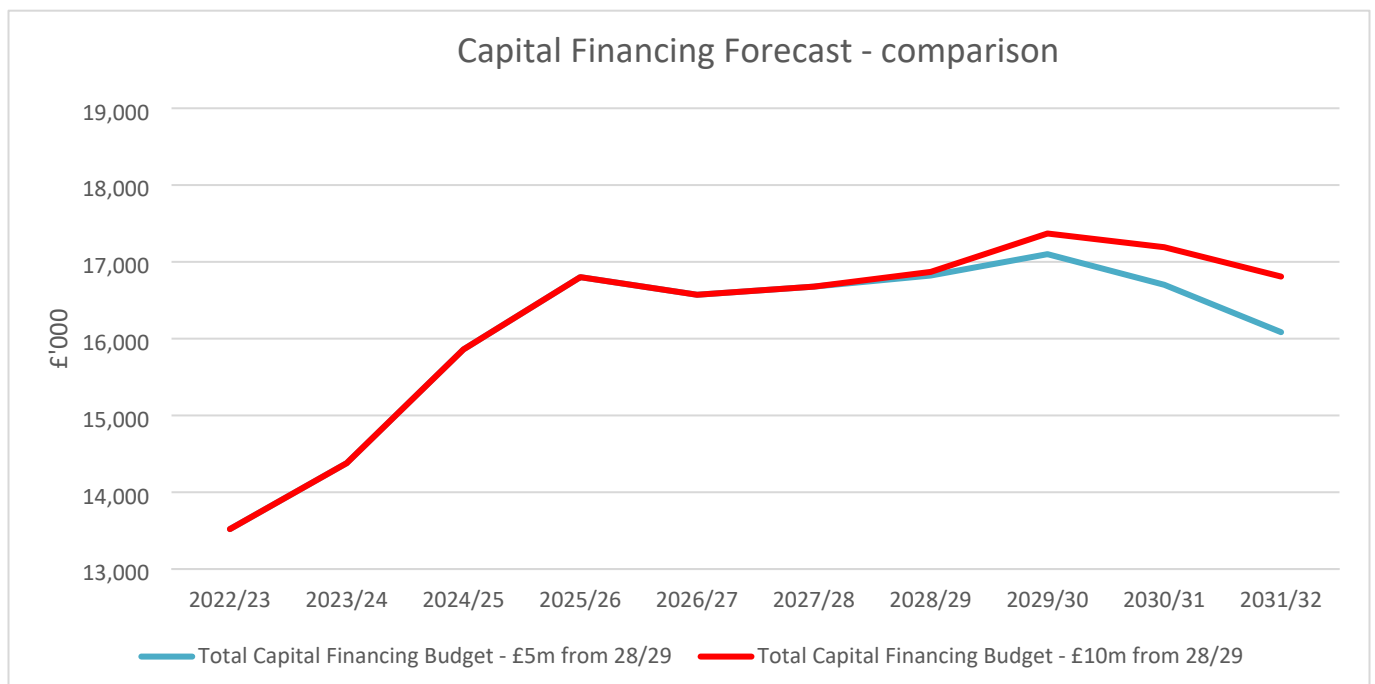


Chart 2 shows the increasing capital financing costs over the next 10 years with a limit of £5m or £10m of unfunded capital expenditure per annum after the current programme. This is initially driven by the capital programme that is proposed, resulting in a significant spike in capital financing costs to 2025/26. This is despite the modelled reductions in the CFR, as outlined in Charts 1a and 1b. Although the revenue costs arising from the current capital programme have been fully funded, this chart highlights the fact that there could be future capital financing budget pressure beyond the new programme window, especially if £10m of unfunded capital expenditure per year is pursued. Due to slippage experienced in delivering the current programme, it should be noted that the actual costs of capital financing are lagging behind the existing budget provision, resulting in an underspend against the revenue budget. This is set to continue in the short to medium term, although as the new programme nears completion, the full capital financing budget is likely to be required, depending upon interest rates on future borrowing.

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

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

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

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

## **Sustainability and Ongoing Capital Programme Development**

As already outlined, the long-term nature of the impacts arising from short to medium term capital expenditure and financing need to be understood in terms of its prudence, affordability and sustainability. The Head of Finance is satisfied that the current programme meets this key requirement, evidenced by the fact that the revenue implications are already fully funded. However, the key challenge facing the Council, in relation to capital, is the continuing pressure relating to the existing estate, in terms of maintenance backlogs and ensuring no asset failures occur. The current annual sums allocations are not as high as would be ideal, meaning that it can be challenging enough to maintain the status quo in terms of backlogs, before considering reducing them. In addition, there is the potential for demand for new schemes to emerge over the medium term, especially in relation to pupil number increases, for example.

On the basis that the current Medium Term Financial Plan is not balanced, there would appear to be little scope to increase capital resourcing by way of external borrowing, as the revenue budget would not be able to cater for the increased MRP and interest costs. The MTFP challenge is especially acute in 2023/24 and 2024/25. Whether or not the challenge will ease beyond those years will largely depend upon the rate of inflation being experienced and the position in relation to core funding via UK and Welsh governments. Therefore, it cannot be assumed that it will be possible to afford borrowing over the medium term. If the pressures upon the capital programme make this unavoidable, then members would need to prioritise those pressures over other competing pressures when setting a balanced budget for the year in question.

In light of this challenge, it is important that the authority understands the key drivers and risks associated with delivering an annually refreshed capital programme. These drivers are captured through various plans across the authority and are outlined in the diagram that follows. These plans will be subject to ongoing revision and it will be necessary for the authority to develop its understanding of the cost of key priorities arising from each plan, to inform what will potentially be a constrained programme in terms of the overall financial envelope.



There will be a range of priorities originating from these plans, particularly the Corporate Plan, which has been refreshed following the local elections in May 2022 and reflects some of the administration's manifesto commitments. As well as the priorities contained within the Corporate Plan, there is the aforementioned requirement to maintain the current asset base. This is something that has been severely impacted by constrained funding levels in previous years and has resulted in the maintenance backlog developing, which gives rise to the potential for major asset failures to occur where issues have developed over time. There is a particular risk surrounding highways and school buildings, although there are other asset bases that hold maintenance backlogs as well.

Therefore, whilst annual allocations are provided for asset maintenance, they are generally insufficient in value. The challenging revenue budget position does not provide an easy solution in increasing these allocations to a level that would, in the first instance, stop the backlogs from increasing. Because of this, it will be critical that opportunities to augment the annual sums, such as those outlined earlier in the strategy, are taken wherever possible. If it doesn't prove possible to increase the annual sums, they should, as a minimum, ensure the highest priority backlog issues are addressed, first and foremost. However, they would, in most cases, be insufficient to address any asset failures.

In addition to the annual sums, other approaches need to be pursued in order to reduce the maintenance backlog. This should include a review of the asset base more generally, and consideration to rationalising the number of assets. This rationalisation, which is a key tenet of the new Transformation Plan, could be achieved in a number of ways, such as closure or disposal of assets, asset transfers or schemes to refurbish/redevelop existing assets (e.g. neighbourhood hubs, Chartist Tower and the Newport Market development). Furthermore, it will be necessary to target external grant funding, such as Sustainable Communities for Learning funding, which will enable wholesale upgrade or replacement of existing assets, including those with significant maintenance backlogs.

Therefore, when developing the rolling capital programme, it will be necessary for decision-makers to ensure that the ongoing maintenance of existing assets is sufficiently addressed. However, there will be other priorities to be included within the programme at some point in the future, such as the need to address the climate emergency via a pursuit of carbon neutral assets, a response to the need for a new way of working, the next phase of WG's Sustainable Communities for Learning Programme and further regeneration schemes for the city. As already outlined, the pressure to support such initiatives will need to be carefully balanced against other competing priorities for revenue resources.

Although members will ultimately decide upon both the overall size of the new programme, and the schemes contained within it, it will be important that there is appropriate governance surrounding the development of the programme. This will be especially important given the constrained funding outlook and the need to be absolutely clear as to where the highest priorities lie. To achieve this, the Capital Board will need to act as an effective gateway and ensure that only those schemes with a clear plan for delivery and where the necessary due diligence has been undertaken are recommended for addition to the programme. The board should also ensure that there is enhanced oversight and management of the programme on an ongoing basis and reduce the likelihood of slippage or grant funding being foregone in future years. As an outcome, a more realistic, deliverable and achievable programme should result.

## **5. TREASURY MANAGEMENT**

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

### **5.1. TREASURY MANAGEMENT**

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

As a result of decisions taken in the past, the Council as at 31<sup>st</sup> December 2021, has £140.4m borrowing at a weighted average interest rate of 3.6% and £51.5m treasury investments at a weighted average rate of 3.0%.

As outlined earlier, CIPFA consulted on changes to the Treasury Management code during 2021 and issued a new version of the code subsequent to that. The changes required as a result of the update were outlined in last year's strategy and are reflected in this year's strategy, where relevant and appropriate.

### **5.2. BORROWING STRATEGY**

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

Whilst investment counterparty risk is minimised through this strategy, the risk of interest rate exposure is increased, as the current longer term borrowing rates may rise further in the future. However, long-term borrowing interest rates are broadly similar to short-term borrowing interest rates. Therefore, should there be a need to undertake borrowing at short notice, the current similarity in interest rates mitigates the risk to some extent and also ensures the Council is no worse off in the short term. The market position is being constantly monitored in order to manage this risk.

The Council's overall main objective when borrowing is to achieve a low but certain cost of finance, whilst retaining flexibility should plans change in the future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between short-term loans (which have traditionally been available at a lower cost) and long-term fixed rate loans where the future cost is known but higher. In the current economic context, short-term borrowing is not much cheaper than long-term borrowing (both available at between 4.0% and 5.0%), however this may revert to a more typical scenario in the medium term. The current availability of positive cashflow has meant that the Council has not been required to undertake any short-term borrowing recently, although this can change at relatively short notice.

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

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

	<b>31.3.2022 Actual</b>	<b>31.3.2023 Forecast</b>	<b>31.3.2024 Budget</b>	<b>31.3.2025 Budget</b>	<b>31.3.2026 Budget</b>
Debt (incl. PFI & leases and ST & LT borrowing)	193	174	186	197	192
Capital Financing Requirement	273	274	283	286	280

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

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

**Operational Boundary:** The Council is obliged to approve an operational borrowing limit. This boundary has been set in line with the expected borrowing required to finance the current Capital Programme until 2027/28, taking account of likely levels of internal borrowing. A small additional allowance has also been made for the timing of PFI debt repayments. If any increase to the operational boundary is required,

including to borrow for investment/income generation schemes or regeneration investment (loans) this will need to be brought to Council for approval.

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

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

	<b>2022/23 limit</b>	<b>2023/24 limit</b>	<b>2024/25 limit</b>	<b>2025/26 limit</b>
Authorised limit – borrowing	271	246	253	248
Authorised limit – PFI and leases	41	39	36	34
<b>Authorised limit – total external debt</b>	<b>312</b>	<b>285</b>	<b>289</b>	<b>282</b>
Operational boundary – borrowing	192	150	163	161
Operational boundary – PFI and leases	41	39	36	34
<b>Operational boundary – total external debt</b>	<b>233</b>	<b>189</b>	<b>199</b>	<b>195</b>

Whilst the above indicators place a theoretical limit upon the level of borrowing that a council can undertake, they do not, for example, make an allowance for any amount of slippage that may be incurred whilst delivering the Capital Programme. This is relevant in the case of the Council's Capital Programme where, in relation to 2023/24 in particular, there is a significant level of forecasted unfunded expenditure and a high probability of slippage occurring. Therefore, to ensure that the level of expenditure to be funded via borrowing is controlled, a local indicator exists which restricts any unfunded expenditure being added to the existing Capital Programme over and above the headroom that is already in place. This indicator is in line with Table 1 of this report and, for 2023/24 only, limits additional borrowing for new capital expenditure to £1.057m. Should borrowing above this limit be required, it will need to be approved by full Council.

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

	<b>2023/24 limit</b>	<b>2024/25 limit*</b>	<b>2025/26 limit*</b>
Borrowing headroom	1.1	0	0

*\* The limit is currently £0m, in line with the existing Capital Programme, but the £1.1m effectively applies across the three years shown.*

### **5.3. INVESTMENT STRATEGY**

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

Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held



for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy. In the case of certain funds, the Council may request its money back at short notice.

*Table 9: Treasury management investments in £millions*

	<b>31.3.2023 Forecast</b>	<b>31.3.2024 Budget</b>	<b>31.3.2025 Budget</b>	<b>31.3.2026 Budget</b>	<b>31.3.2027 Budget</b>	<b>31.3.2028 Budget</b>
Near-term investments	22.4	0	0	0	0	0
Longer-term investments	0	10	10	10	10	10
<b>TOTAL</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and relevant staff, who must act in line with the Treasury Management Strategy approved by Council. Half-year and end of year reports on treasury management activity are presented Council, although the frequency of these reports will change to quarterly from 2023/24, in line with the recent changes to the Treasury Management Code. The Governance & Audit Committee is responsible for scrutinising treasury management decisions.

### **Loans to other organisations**

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

The Council will also use other methods of assisting businesses to promote economic regeneration by providing grants or by allowing rent free periods where the Council is the owner of the freehold, such as the case with Chartist Tower.

Decisions on service investments are made by the relevant service manager in consultation with the Head of Finance and Monitoring Officer and must meet the criteria and limits laid down in the investment strategy.

## **6. COMMERCIALISATION**

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

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

As outlined in the 2022/23 strategy, the third element of this approach would entail, in essence, investment primarily for the purpose of yield. This type of activity is now precluded by the Public Works

Loans Board no longer lending to local authorities for this purpose and the updated Prudential Code preventing investment funded by borrowing solely for the purpose of yield. Combined with the financial constraints currently being faced, and new borrowing not currently being considered affordable, this area of the Commercialisation Strategy is no longer being pursued. The first two elements of the strategy are still areas that the Council will consider and potentially pursue, subject to affordability, risk acceptability and the ability to contribute towards the medium-term financial challenges.

## **7. OTHER LONG-TERM LIABILITIES**

In addition to debt of £140.4m outlined above, the Council has a number of other long-term liabilities, which represent potential future calls on Council resources, as follows:

### **Private Finance Initiative (PFI)**

The Council has two PFI arrangements. These are for the provision of the Southern Distributor Road (21 years remaining) and for Glan Usk Primary School (11 years remaining). As at 31<sup>st</sup> March 2022, the combined value of the liabilities was £40.7m. The Council holds specific earmarked reserves to cover the future costs of the PFIs.

### **Pension Liability**

The Council is committed to making future payments to cover its pension fund deficit (valued at £403.2m) as at 31<sup>st</sup> March 2022.

### **Provisions**

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

### **Contingent Liabilities**

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

## **8. KNOWLEDGE AND SKILLS**

### **In-house expertise**

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

## **External expertise**

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

## **Members**

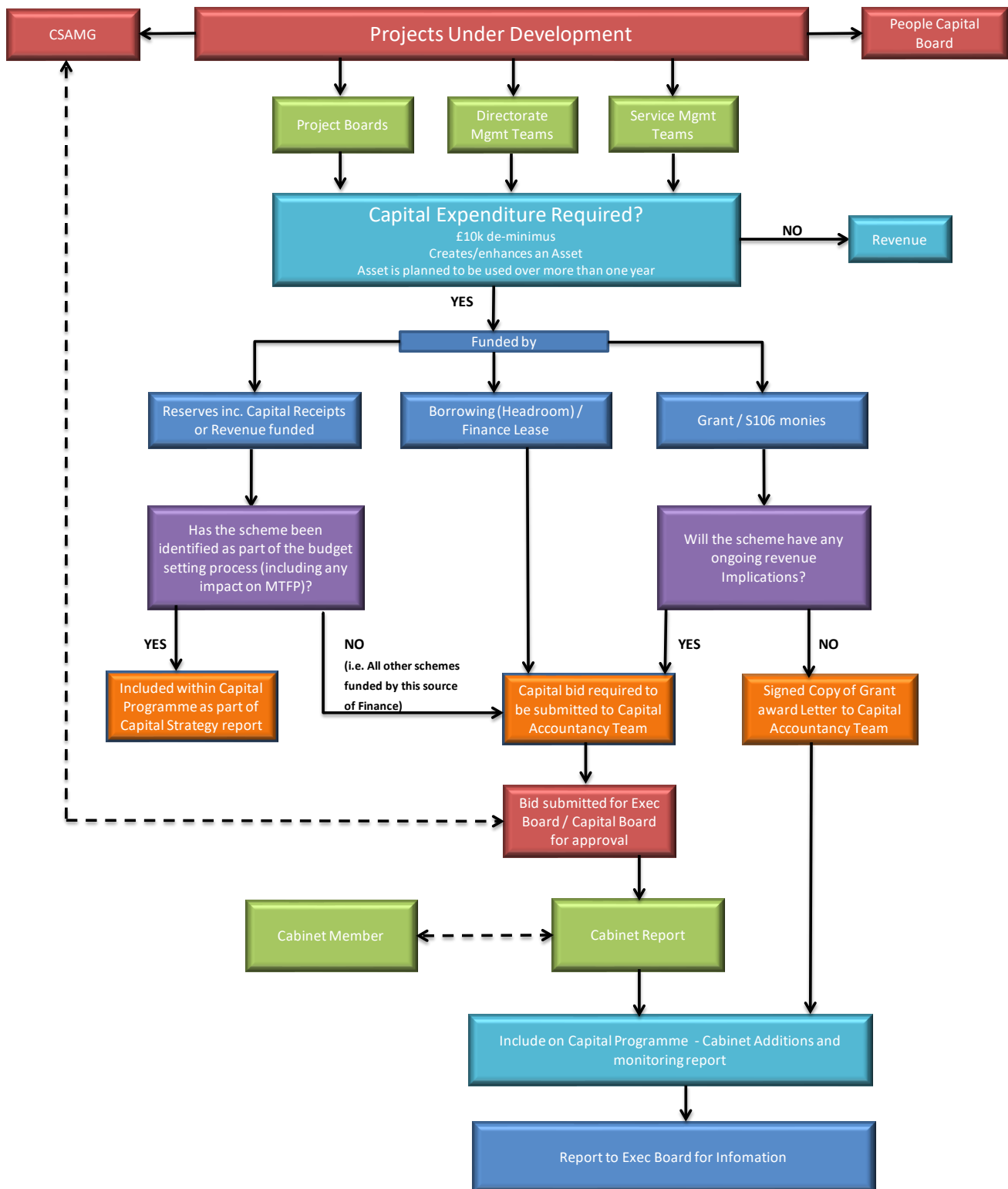
Training is offered to members to ensure they have up to date skills to make capital and treasury decisions. Training has been provided as recently as December 2022, with a number of new members attending for the first time. A register is also kept on member attendance. The Council also involves members at a very early stage of a project's life cycle.

## **9. SUMMARY**

- Capital expenditure plans for the Council need to be affordable, prudent and sustainable.
- The revenue budget includes the estimated revenue costs for the entire current capital programme, which includes a small level of headroom for additional capital projects to be added without impacting further on the MRP budget, as per the agreed framework.
- There are a number of demands on the capital programme and there is the need to link the capital strategy with a number of strategic plans across the organisation. This is to ensure that the pressures on the capital programme are known and the risks are assessed and prioritised within an affordable framework. This will include clear visibility and assessment of demand for schools, highways and other operational assets.
- Decisions on funding capital expenditure through borrowing locks the Council into committing revenue funding over a very long period (as long as 40 years +). With the capital financing budget increasing over the long-term, as shown in Chart 2, the Council will need to make some difficult decisions when developing the rolling Capital Programme, to ensure the capital plans remain affordable, prudent and sustainable.
- The Treasury Management Strategy, detailed in Appendix 3, highlights the Council's approach to managing its borrowing and investments. The proposed strategy for 2023/24 is in line with previous years and is based upon a low risk approach to both investments and borrowing. This means that investments held are generally low in value and the approach to borrowing is to look for security of costs, resulting in a generally high proportion of long-term borrowing compared to short term borrowing.

## APPENDIX 2a – Capital Additions Process Map

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



## Treasury Management Strategy Statement 2023/24

### 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 2021 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Authority to approve an investment strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

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

### External Context

#### **Economic background:**

The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour

market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

#### **Credit outlook:**

Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic. CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from negative to stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

#### **Interest rate forecast (December 2022):**

The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly 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 A.

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 4.65%.

#### **Local Context**

On 31<sup>st</sup> December 2022, the Authority held £140.4m of borrowing and £51.5m 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*

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Capital financing requirement	273.5	273.7	282.6	286.5	280.2
Less: Other debt liabilities *	(40.8)	(38.5)	(36.2)	(34.0)	(31.8)
<b>Loans CFR</b>	<b>232.7</b>	<b>235.1</b>	<b>246.5</b>	<b>252.5</b>	<b>248.4</b>
Less: External borrowing **	(141.1)	(135.6)	(130.3)	(107.0)	(103.1)
<b>Internal borrowing</b>	<b>91.6</b>	<b>99.5</b>	<b>116.1</b>	<b>145.5</b>	<b>145.3</b>
Less: Balance sheet resources	(151.0)	(122.1)	(106.4)	(99.7)	(97.7)
Preferred Investment position	10.0	10.0	10.0	10.0	10.0
<b>Treasury investments (or New borrowing)</b>	<b>49.4</b>	<b>12.6</b>	<b>(19.7)</b>	<b>(55.8)</b>	<b>(57.6)</b>

\* leases and PFI liabilities that form part of the Authority's total debt

\*\* shows only loans to which the Authority is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums 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 an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £57.6m over the forecast period. This is broken down into £38.0m refinancing of maturing existing borrowing and £19.6m additional external borrowing.

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 2023/24.

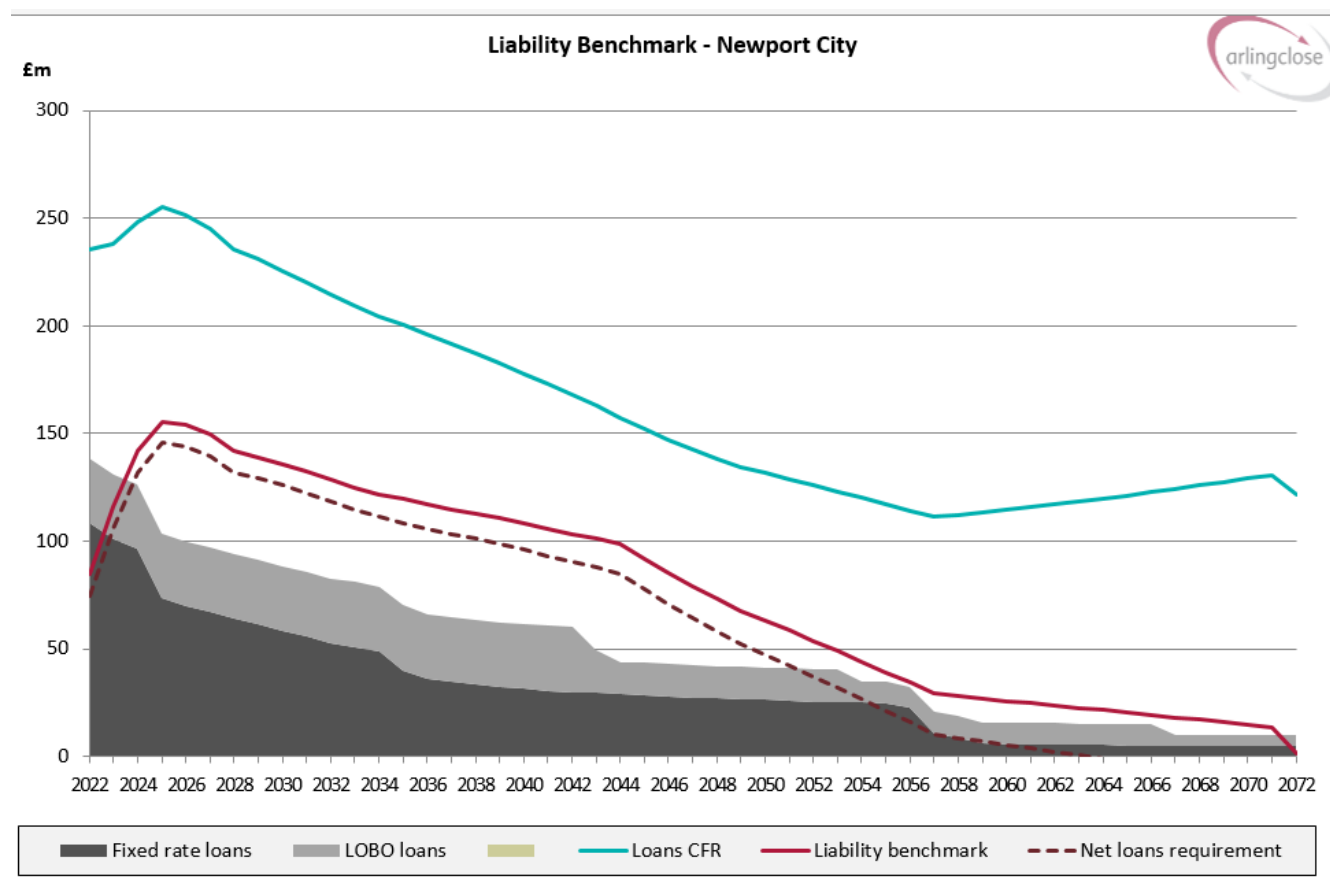
**Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level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

The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

*Table 2: Prudential Indicator: Liability benchmark*

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Loans CFR	232.7	235.1	246.5	252.5	248.4
Less: Balance sheet resources	(151.0)	(122.1)	(106.4)	(99.7)	(97.7)
<b>Net loans requirement</b>	<b>81.7</b>	<b>113.0</b>	<b>140.1</b>	<b>152.8</b>	<b>150.7</b>
Plus: Liquidity allowance	10.0	10.0	10.0	10.0	10.0
<b>Liability benchmark</b>	<b>91.7</b>	<b>123.0</b>	<b>150.1</b>	<b>162.8</b>	<b>160.7</b>

Following on from the medium-term forecasts in Table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £5m a year from 2028/29, minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.0% a year. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



The chart above shows actual borrowing maturing over time (grey area reducing), however the need to borrow (the blue CFR line) is increasing sharply over the short term due to the proposed capital programme. Over the long-term, to ensure a sustainable position, the CFR needs to stop increasing and ideally come down in order for the liability benchmark to stabilise. This, in turn, reduces the need to borrow and consequent pressure on the capital financing budget. Its important to note that, even with limited planned unfunded capital expenditure beyond the medium term, the liability benchmark doesn't reduce to current levels until circa 2044. Therefore, the chart is demonstrating the following important points/assumptions:

- To be sustainable, the CFR cannot continue increasing at the rate it is currently, and a prudent limit should be placed on the future capital programme to reduce the CFR over the long-term (set out further in the Capital Strategy)
- The ability to use further internal borrowing will diminish, with internal borrowing reducing over time as reserves are utilised.
- As existing borrowing matures (grey area reducing) there will be the need to refinance this debt over the long-term.
- The liability benchmark is increasing significantly in the short term, meaning that the Council will be required to undertake new borrowing over time, although the revenue impact of this is already funded, assuming interest rates don't increase significantly from the current position.
- 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 £140.4 million of loans, a decrease of £3.4 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 1 shows that the Authority expects to borrow up to £19.7m in 2023/24. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £246 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 pressures upon 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 2023/24 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 the 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 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 plc 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 2023/24, and with interest rates having risen recently, there is now a reasonable chance that lenders will exercise their options. If they do, the Authority will take the option to repay LOBO loans to reduce refinancing risk in later years, 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. Financial derivatives may be used to manage this interest rate risk (see section 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. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

### **Treasury Investment Strategy**

The Authority currently holds significant 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 £40 million and £99 million. It is anticipated that the level of investments held in 2023/24 will be lower, as cash balances are used in lieu of external borrowing, in line with the authority's internal borrowing strategy.

**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. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

**Strategy:** As demonstrated by the liability benchmark above, the Authority expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments. However, because of the requirement to remain Mifid II compliant, the authority will need to retain a £10m minimum investment balance. The intention is to explore longer term, higher yielding asset classes during 2023/24, such as strategic pooled funds and covered bonds, as well as continuing its use of Money Market Funds, where necessary and appropriate. This will also enable the authority to generate a higher rate of return and contribute towards the medium-term challenges facing the revenue budget.

The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Authority may opt to make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by adding diversification to the strategic pooled fund portfolio.

**ESG policy:** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will, wherever possible, prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are

signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

**Business models:** Under the 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 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 3 below, subject to the limits shown. It should be noted that the Council is only intending to invest for longer term periods up to the Mifid value of £10m. However, some counterparty limits exceed £10m and this is because of the need to manage short term investment requirements when surplus cash balances exist.

*Table 3: Treasury 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 *	25 years	£10m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£5m	£10m
Registered providers (unsecured) *	5 years	£5m	£25m
Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£10m	£25m
Real estate investment trusts	n/a	£10m	£25m
Other investments *	5 years	£5m	£5m

This table must be read in conjunction with the notes below

**\* Minimum credit rating:** Treasury investments 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 to, and 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 to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

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

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

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

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

**Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1 million per bank, wherever possible. 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 "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day 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, or with other local authorities. This will cause investment returns 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 £120.5 million on 31<sup>st</sup> March 2023 and £104.8 million on 31<sup>st</sup> March 2024. 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.

Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £1 million in operational bank accounts count against the relevant investment limits.

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

*Table 4: Additional investment limits*

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

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

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

### **Treasury Management Prudential Indicators**

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

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

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

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates. The impact of a 1% rise is predicated on known maturing borrowing during 2023/24, plus an allowance for borrowing in advance of need, should it be appropriate to do so as a means for mitigating the potential for rising interest rates. The impact of a 1% fall in rates is predicated on the Council's minimum £10m investment balance.

**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 limit	Lower limit
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.

**Long-term treasury management investments:** 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 prudential limits on the long-term treasury management investments will be:

Price risk indicator	2023/24	2024/25	2025/26	No fixed date
Limit on principal invested beyond year end	£10m	£10m	£10m	£10m

Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

### **Related Matters**

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

**Financial derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in section 24 of the *Local Government and Elections (Wales) Act 2021* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk

calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

**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 2023/24 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 2023/24 is £6.9 million, based on the known annual cost of existing borrowing plus assumed new borrowing at a rate of 4.65%. 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 CIPFA Code does 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 2022**

### **Underlying assumptions:**

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power - recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

### **Forecast:**

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.
- The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.



	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
<b>Official Bank Rate</b>													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
<b>3-month money market rate</b>													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.00	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.50	3.40	3.40	3.40
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
<b>5yr gilt yield</b>													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.43	3.60	3.80	3.80	3.80	3.70	3.60	3.50	3.40	3.30	3.30	3.30	3.30
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>10yr gilt yield</b>													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.47	3.50	3.60	3.60	3.60	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>20yr gilt yield</b>													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.86	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>50yr gilt yield</b>													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

**Appendix 3b - Existing Investment & Debt Portfolio Position**

	31/12/2022 Actual portfolio £m	31/12/2022 Average rate %
<b>External borrowing:</b>		
Public Works Loan Board	95.8	3.8
LOBO loans from banks	30.0	3.8
Other loans	14.6	1.3
<b>Total external borrowing</b>	<b>140.4</b>	<b>3.6</b>
<b>Other long-term liabilities:</b>		
Private Finance Initiative	40.7	
Leases	0.1	
<b>Total other long-term liabilities</b>	<b>40.8</b>	
<b>Total gross external debt</b>	<b>181.2</b>	
<b>Treasury investments:</b>		
The UK Government	11.5	3.1
Local authorities	30.3	3.3
Money market funds	10.0	2.9
<b>Total treasury investments</b>	<b>51.5</b>	<b>3.0</b>
<b>Net debt</b>	<b>129.7</b>	

### Appendix 3c - Additional requirements of Welsh Government Investment 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 has invested in, as part of the overall capital programme, a number of energy efficiency related schemes, including LED projects and Solar PV, as well as ultra-low emission vehicles. In addition, new schools are now being constructed on a net carbon zero basis.

**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 Council currently has loans totalling £10.6m as at 31<sup>st</sup> December 2022. These are all developer loans issued to local enterprises and are secured. The current value of loans issued represent approximately 7% of the useable reserve balance held as at 31<sup>st</sup> March 2022. The authority's aim when issuing loans is to ensure that they do not exceed 15% of total useable reserves as at the end of each financial year and, therefore, the current value of loans is within that self-assessed limit. The authority is also working to the loan limits set out below.

*Table C1: Loan limits*

Borrower	Cash limit
Local enterprises	£15m
Local charities	£5m
Wholly owned companies	£5m
Joint ventures	£5m
Treasury management investments meeting the definition of a loan	Unlimited

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
Shares in local organisations	£10m
Total non-specified investments	£15m

**Non-financial investments:** This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset's purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. On an assessment as at 31<sup>st</sup> March 2022, the Authority's investment property portfolio is anticipated to provide security for capital investment, since its fair value totals £12.530m and is likely to exceed the original purchase price (as in a number of cases, the purchases took place a significant amount of time ago). The authority will undertake further work to confirm, wherever possible, that the necessary security exists.

The Authority consider that the scale of its commercial investments including property are proportionate to the resources of the authority since such investments represent just 8% of its £151m useable reserves.

**Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. However, the Council is not actively pursuing a strategy of acquiring investment properties. Therefore, the current level of investment properties, which represents a relatively low proportion of useable reserves, is not likely to increase in the near future. As a result, it is not anticipated that these investments will need to be liquidated in the medium term.

Because the invested funds, if required, would potentially take time to be liquidated, the authority ensures that it holds adequate available cash balances to be able to, for example, repay capital borrowed. In addition, the authority plans to hold a minimum £10m in investments (to meet Mifid II requirements) which could, if needed, be liquidated at relatively short notice, although this would be avoided if possible to ensure that the professional client status could be retained.

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

**Borrowing in advance of need:** Welsh Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority, after having regard to the guidance, will only borrow in advance of need as part of a strategy for reducing risk of future interest rate rises and would not undertake such activity purely in order to profit from an investment.

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

**Commercial deals:** Any commercial deals that the Council would be involved in would involve statutory officers in those discussions and any final decisions. This ensures that the core principles of the prudential framework and the regulatory regime of the local authority is adhered to when making such decisions.

**Corporate governance:** The Council has a clear corporate governance framework set out within its constitution, scheme of delegations and Annual Governance Statement. This ensures that decisions regarding investment are taken at the appropriate level. For example, the overarching treasury strategy and framework is approved by full Council. Operational decisions, such as day to day cashflow management, including borrowing, are delegated to the Head of Finance.

### Appendix 3d - Minimum Revenue Provision Policy

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

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

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

- For supported capital expenditure incurred after 31<sup>st</sup> 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 31<sup>st</sup> March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in on an annuity basis with an annual interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational.
- For capital expenditure loans to third parties that are repaid over a short time period (less than 12 months) or frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement. The only other scenario whereby MRP would not be charged is where there is unencumbered first charge security, held against separate assets, upon which the loan is secured. For all other capital expenditure loans to third parties, MRP will be charged in accordance with the MRP policy for the assets funded by the loan.
- The MRP policy and charges in relation to the Cardiff Capital Region 'City Deal' will reflect those within the Joint Working Agreement.

Capital expenditure incurred during 2023/24 will not be subject to a MRP charge until 2024/25.

Based on the authority's latest estimate of its Capital Financing Requirement as at 31<sup>st</sup> March 2023, the estimated cost of MRP in 2023/24, including finance leases and PFI, is as follows:

	31.03.2023 Estimated CFR £m	2023/2024 Estimated MRP £m
Supported capital expenditure	161	5
Unsupported capital expenditure	74	4
Finance leases* and Private Finance Initiative	39	2
<b>Total General Fund</b>	<b>274</b>	<b>11</b>