Agenda Item

FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

CABINET

13 January 2022

Report of the Director of Finance & ICT

Treasury Management Mid-Year Report 2021-22
(Corporate Services and Budget)

1. Divisions Affected

1.1 County-wide.

2. Key Decision

2.1 This is not a Key Decision.

3. Purpose

3.1 To provide Cabinet with details of Treasury Management activities during the first half of 2021-22 (to 30 September 2021) and to indicate the Council's compliance with the prudential indicators set by Council at its meeting of 3 February 2021, in accordance with the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice and Cross-Sectorial Guidance Notes 2017 (the CIPFA Code).

4. Information and Analysis

(i) Introduction

4.1 The Council's Treasury Management Strategy for 2021-22 was approved at a Council meeting on 3 February 2021, as part of the Capital Programme Approvals, Treasury Management and Capital Strategy Report. The Council 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 risk remains central to the Council's Treasury Management Strategy.

4.2 Treasury risk management at the Council is conducted within the framework of the CIPFA Code, which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

(ii) External Context

Economic background

4.3 The economic recovery from the Covid-19 pandemic continued to dominate the first half of 2021-22. By the end of the period over 48 million people in the UK had received their first dose of a Covid-19 vaccine and almost 45 million their second dose.

4.4 The Bank of England held its Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since its November 2020 meeting.

4.5 Government initiatives continued to support the economy, but the furlough scheme ended on 30 September 2021.

4.6 Labour market data showed that in the three months to September 2021 the unemployment rate fell to 4.3%. Growth in average regular pay was 4.9% over the period July to September 2021. The robust growth figures are partially due to measurement against a low base, following on from a decline in average pay in Spring 2020 associated with the furlough scheme.

4.7 Annual UK Consumer Price Inflation (CPI) fell slightly, to 3.1%, in September 2021 but after the end of the period, in October 2021, it reached 4.2%, largely due to surging demand and supply chain problems.

4.8 The easing of pandemic restrictions continued to boost activity, helping to push Gross Domestic Product (GDP) up by 1.3% in the quarter to 30 September 2021.

4.9 The US Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period.

4.10 The European Central Bank maintained its base rate at 0%, its deposit rate at -0.5% and asset purchase scheme at €1.85 trillion.

Financial markets

4.11 Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with more volatility towards the end. The US Dow Jones index hit another record high whilst the more internationally focused UK FTSE 100 index experienced more modest gains over the period and remains below its pre-crisis peak. The 5-year UK benchmark gilt yield began the financial year at 0.36%, before climbing to 0.64% on 30 September 2021. Over the same period the 10-year gilt yield rose from 0.80% to 1.03%. The 20-year yield rose from 1.31% to 1.37%.

4.12 The important UK interest benchmark, the Sterling Overnight Index Average (SONIA) averaged 0.05% over the period.

Credit background

4.13 Credit default swap spreads were flat over most of period and are broadly in line with their pre-pandemic levels.

4.14 Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on the counterparty list of the Council's Treasury Management Advisor, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

4.15 The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant that some institutions have been able to reduce provisions for loans which are not expected to be recovered. Whilst there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is now in a generally better position than it was earlier in 2021 and in 2020. However, sentiment could quickly change should further Covid-19 variants of concern emerge. The institutions and durations on the counterparty list of the Council's Treasury Management Advisor remain under constant review.

(iii) Local Context

4.16 On 31 March 2021, the Council had net investments of £18.291m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.03.21 Actual £m
General Fund CFR	525.679
Less: Other debt liabilities*	-64.392
Borrowing CFR	**461.287**
Less: Usable reserves	-420.353
Less: Working capital	-59.225
Net investments	**-18.291**
Borrowing CFR is comprised:	
External borrowing	333.774
Internal borrowing	127.513
	461.287

** finance leases, PFI liabilities and transferred debt that form part of the Council's total debt*

4.17 Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing.

4.18 The Council's strategy was to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position on 30 September 2021 and the in-year change is shown in Table 2 below.

Table 2: Treasury Management Summary*

	31.03.21 Balance £m	2021-22 Movement £m	30.09.21 Balance £m	30.09.21 Rate %
Long-term borrowing	272.899	0.000	272.899	4.50
Short-term borrowing	88.000	46.500	134.500	0.17
Total borrowing	**360.899**	**46.500**	**407.399**	**3.07**
Long-term strategic pooled funds	66.953	2.287	69.240	3.69
Long-term investments**	44.500	0.000	44.500	0.90
Short-term investments	170.000	81.345	251.345	0.39
Cash and cash equivalents	57.522	-26.905	30.617	0.00
Total investments	**338.975**	**56.727**	**395.702**	**1.03**
Net borrowing	**21.924**	**-10.227**	**11.697**	

**Nominal values unless stated*
***Excludes Non-Treasury Service Loans*

Borrowing Activity

4.19 At 30 September 2021, the Council held £407.399m of loans, an increase of £46.500m to 31 March 2021, as part of its strategy for funding previous and current years' capital programmes. The mid-year borrowing position at 30 September 2021 and the in-year change is summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.21 Balance £m	2021-22 Movement £m	30.09.21 Balance £m	30.09.21 Interest Rate %	30.09.21 WAM* Years
Public Works Loan Board	257.899	0.000	257.899	4.50	17
Banks (LOBO)	5.000	0.000	5.000	4.50	18
Banks (fixed-term)	10.000	0.000	10.000	4.69	23
Local authorities (short-term)	88.000	46.500	134.500	0.17	0
Total borrowing	**360.899**	**46.500**	**407.399**	**3.07**	**17**

**WAM - Weighted Average Maturity*

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

4.21 In furtherance of these objectives, no new long-term borrowing was undertaken in the first half of 2021-22. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

4.22 With short-term interest rates remaining much lower than long-term rates and with a surplus of liquidity continuing to feature in the local authority to local authority market, the Council considers it to be more cost effective in the near term to use internal resources and borrowed rolling temporary/short-term loans instead. Additional short-term borrowing has been used in the six months to 30 September 2021 to finance a lump sum payment to the Derbyshire Pension Fund for the Council's employer contributions, in full, on 30 April 2021, for the period 1 April 2021 to 31 March 2022. A similar prepayment in 2020-21 resulted in the Council making a saving of £0.632m. The Council also holds additional funding received by the D2N2 Local Enterprise Partnership (LEP), for which the Council is the accountable body. The net movement in temporary / short-term loans is shown in Table 3 above.

4.23 The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained during the period.

4.24 The Council continues to hold a £5.000m LOBO (Lender's Option Borrower's Option) loan, where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the period.

Borrowing Update

4.25 Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer.

4.26 Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to use PWLB borrowing, except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

4.27 In August 2021 the Government provided additional detail and clarification in respect of PWLB borrowing, predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26 November 2020 is allowable, even for an 'investment asset primarily for yield'.
- Capital plans should be submitted by local authorities. These open for the new financial year on 1 March and remain open all year. Returns must be updated if there is a change of more than 10%.
- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

4.28 The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB's loans.

4.29 In September 2021, the settlement time for a PWLB loan has been extended from two workings days to five working days. In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of the Bank of England Base Rate or 0.1%.

4.30 The Municipal Bonds Agency (MBA) is working to deliver a new short-term loan solution, available in the first instance to principal local authorities in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25m. Importantly, local authorities will borrow in their own name and will not cross guarantee any other authorities.

4.31 If the Council intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

4.32 £4bn has been earmarked for of lending to local authorities by the UK Infrastructure Bank which is wholly owned and backed by the Government. The availability of this lending to local authorities, for which there will be a bidding process, is yet to commence. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

Other Debt Activity

4.33 Private Finance Initiative (PFI) contracts, finance leases and transferred debt liabilities, total debt other than borrowing, stood at £64.392m on 30 September 2021.

Treasury Investment Activity

4.34 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the first half of 2021-22, the Council's investment balance ranged between £351.111m and £462.841m because of timing differences between income and expenditure. The period end investment position and the in-year change are shown in Table 4 below.

Table 4: Treasury Investment Position

	31.03.21 Balance £m	2021-22 Movement £m	30.09.21 Balance £m	30.09.21 Income Return %	30.09.21 Weighted Average Maturity days
Banks and building societies (unsecured)	52.522	38.095	90.617	0.24	3
Supranational bonds (secured)	0	34.844	34.844	0.09	76
Government (including local authorities)	214.500	-23.500	191.000	0.58	218
Registered Providers	5.000	5.000	10.000	1.58	348
Pooled Funds – Strategic Bond Funds	5.135	0.043	5.178	1.86	N/A
Pooled Funds – Equity Income Funds	13.464	0.679	14.143	4.12	N/A
Pooled Funds – Property Funds	23.441	1.635	25.076	4.04	N/A
Pooled Funds – Multi Asset Income Funds	24.914	-0.072	24.842	3.46	N/A
Total investments	**338.976**	**56.724**	**395.700**	**1.03**	**161**

**Weighted average maturity will apply to the first four categories above.*
Strategic *Pooled Funds have no maturity date but are realised when all units are sold.*

4.35 The Pooled Fund's investments are expected to be held over the medium term (for five years), however all funds can be realised within one week, except for the Property Fund (90 days). They have no set maturity date.

4.36 Both the CIPFA Code and Government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is 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.

4.37 Ultra-low short-dated cash rates, which have been a feature since March 2020 when the Bank of England's Bank Rate was cut to 0.1%, have resulted in the return on Sterling low volatility net asset value money market funds (LVNAV funds) being close to zero, even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most Money Market Fund managers over the short-term, and fee cuts or waivers should result in Money Market Fund net yields having a floor of zero, but the possibility cannot be ruled out.

4.38 Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also around zero.

4.39 Given the continuing risk and low returns from short-term unsecured bank investments, the Council diversified into more secure and/or higher yielding asset classes as shown in Table 4 above. The Council identified £70m (nominal value), as available for longer-term investment and moved this sum into a diversified mix of pooled property/bond/ equity/multi-asset funds on an incremental basis.

4.40 The progression of credit risk and return metrics for the Council's investments managed in-house are shown in the extracts from the Council's external investment advisor's (Arlingclose) benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
Derbyshire – 30.09.2021	4.49	AA-	28%	161	1.17
Similar Local Authorities	4.48	AA-	56%	116	0.91
All Local Authorities	4.69	A+	69%	10	0.78

4.41 At 30 September 2021, the Council's portfolio of externally managed pooled strategic bond, equity, property and multi-asset funds amounted to £69.239m (£70m nominal value). The Council holds these funds with the aim of receiving regular revenue income and because over the long-term their prices are relatively stable.

4.42 During the initial phase of the Covid-19 pandemic, in March 2020, the sharp falls in corporate bond and equity markets had a negative impact on the value of the Council's pooled fund holdings and this was reflected in 31 March 2020 fund valuations, with every fund registering negative capital returns over a 12-month period.

4.43 Since March 2020 there has been improvement in market sentiment and this is reflected in the capital values of all the Council's pooled funds. During the first six months of 2021-22, the Council's pooled funds generated a total return of £3.709m (15.10%), comprising a £1.424m (4.52%) income return, which has been used to support services in 2021-22, and £2.285m (10.58%) of unrealised capital growth. The change in capital values and income earned is shown in Table 4.

4.44 The Council has budgeted £2.800m of income from these investments in 2021-22. As noted in paragraph 4.43 Income received in the first six months of 2021-22 was £1.424m. A further £1.400m is forecast for 2021-22, so the income on these pooled funds is expected to be in line with budget.

4.45 These pooled funds have no defined maturity date but are available for withdrawal after a notice period. Their performance and continued suitability in meeting the Council's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates. The Council is using the alternative fair value through profit and loss (FVPL) accounting method to account for these funds, which means that if there are any long term unrealised losses in the funds' fair values there will not be an impact on the Council's General Reserve balance until 2023-24 at the earliest. In light of their performance over the medium-term and the Council's latest cash flow forecasts, investment in these funds has been maintained.

Other Non-Treasury Holdings and Activity

4.46 The definition of investments in CIPFA’s revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in the Investment Guidance issued by the Department of Housing, Levelling-Up and Communities’ predecessor, the Ministry of Housing, Communities and Local Government’s (MHCLG), in which the definition of investments is further broadened to also include all such assets held partially for financial return. This includes service investments for operational and/or regeneration, as well as commercial investments which are made mainly for financial reasons.

4.47 At 31 March 2021, the Council held £12.884m of such investments. £12.384m of the balance is in respect of a regeneration loan to a local business/landlord, Buxton Crescent Ltd. This represents an increase in the period of £0.059m, which is capitalised interest from 19 July 2021 onwards, when Covid-19 restrictions were fully lifted in England. In 2021-22 it was agreed that repayments on the loan are deferred until 1 October 2023.

4.48 The other loan of £0.500m is to Chesterfield Football Club Community Trust. The loan was agreed to continue their sports and community programmes with schools and community groups in the greater Chesterfield area. £0.006m of interest on the loan was capitalised in the period. The first repayment is due on 5 October 2022.

Treasury Performance

4.49 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in Table 6 below.

Table 6: Performance

	30.09.21 Actual £m	30.09.21 (CFR) Budget £m	Over/ (Under) £m	Interest Actual %	Interest Other LA (Counties) Benchmark %
Interest paid on capital and temporary borrowing	6.146	6.793	-0.647	3.07	No data held
Interest received on treasury investments	-0.898	-1.988	1.090	1.17	0.91

Compliance Report

4.50 The Director of Finance & ICT reports that all treasury management activities undertaken during the first half of 2021-22 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

4.51 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 7 below and compliance with specific investment limits is demonstrated in Table 8 below.

Table 7: Debt Limits

	2021-22 Maximum £m	30.09.21 Actual £m	2021-22 Operational Boundary £m	2021-22 Authorised Limit £m	Complied
Total debt	426.899	407.399	675.000	707.000	✓

Table 8: Investment Limits

	Half Year Maximum* £m	2021-22 Limit £m	30.09.21 Actual £m	Complied
Local authorities and other UK Government entities	214.500	Unlimited	191.000	✓
Banks (unsecured)	129.443	30.000 per Bank, Lloyds 60.000	90.617	✓
Negotiable instruments held in a broker's nominee account	34.844	100.000	34.844	✓
Strategic pooled funds	69.414	30.000 per Fund Manager, 100.000 total	69.240	✓
Registered providers (RP) (unsecured)	10.000	10.000 per RP, 50.000 total	10.000	✓
Money Market Funds	90.000	30.000 per Fund, unlimited total	0.000	✓

*Maximum held at any one time.

Treasury Management Indicators

4.52 The Council measures and manages its exposure to treasury management risks using the following indicators.

4.53 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

	30.09.21 Actual	2021-22 Target	Complied
Portfolio average credit rating	AA-	A	✓

4.54 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of either cash available to meet unexpected payments within a rolling three-month period, without additional borrowing, or the amount it can borrow each period without giving prior notice.

	30.09.21 Actual £m	2021-22 Target £m	Complied
Total cash available within 1 month	30.617	10.000	✓
Total sum borrowed in past 3 months without prior notice	0.000	30.000	✓

4.55 The Council had sufficient liquidity, therefore there was no borrowing requirement in the past three months.

4.56 **Interest Rate Exposures**: This indicator is set to control the Council's exposure to interest rate risk.

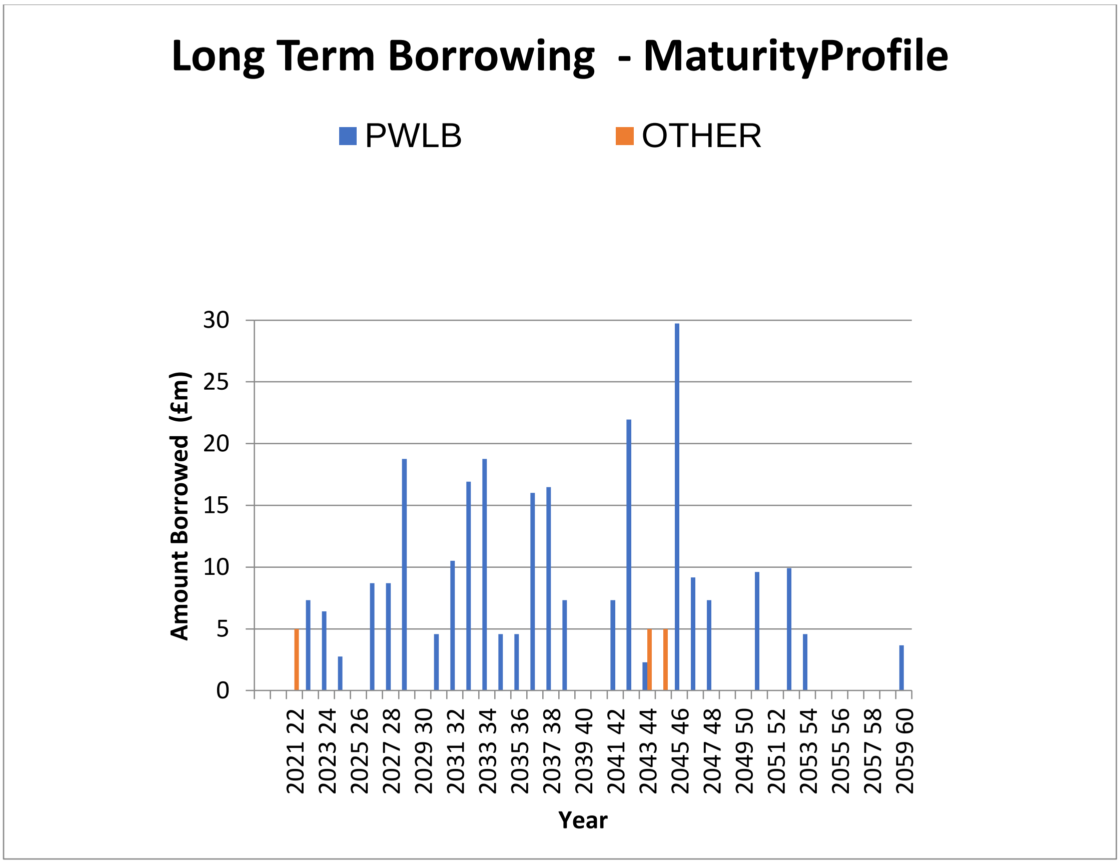
	30.09.21 Actual £m	2021-22 Limit £m	Complied
Upper limit on one-year revenue impact of a 1% rise in interest rates.	0.000	3.000	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	0.000	-3.000	✓

4.57 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The Bank of England's Base Rate remained unchanged at 0.10% during the period, so no actual increase or decrease occurred during the first six months of 2021-22.

4.58 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. 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. The upper and lower limits on the maturity structure of all borrowing were:

	30.09.21 Actual %	Upper Limit %	Lower Limit %	Complied
Under 12 months	2	60	0	✓
12 - 24 months	3	20	0	✓
24 months - 5 years	3	20	0	✓
5 - 10 years	15	20	0	✓
10 - 20 years	35	40	10	✓
20 - 30 years	36	40	10	✓
Over 30 years	6	40	0	✓

4.59 The Council’s maturity repayment profile at 30 September 2021 is shown below. A good spread of maturities is desirable. The average redemption is £7.181m per year over the next 38 years. The maximum redemption is £29.738m in 2045-46. The average duration of all the Council’s loans is approximately 17.23 years. Any new borrowing would be targeted for maturity in years with nil/low repayments.



4.60 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Loans Maturing =>	**Beyond 30.09.22 £m**	**Beyond 30.09.23 £m**	**Beyond 30.09.24 £m**
Actual principal invested beyond one year (including strategic pooled funds and non - treasury investments)	126.624	82.124	82.124
Limit on principal invested beyond one year	150.000	125.000	100.000
Complied?	✓	✓	✓

Other

4.61 **CIPFA consultations**: In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee's recommendation that the prudential framework should be further tightened, following continued borrowing by some authorities for investment purposes.

4.62 In the Prudential Code the key area being addressed is the statement 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". Other proposed changes included the sustainability of capital expenditure in accordance with an authority's corporate objectives, i.e. recognising climate, diversity and innovation, commercial investment being proportionate to budgets, expanding the capital strategy section on commercial activities, replacing the "gross debt and the CFR" with the liability benchmark as a graphical prudential indicator.

4.63 In June 2021 CIPFA provided feedback from these consultations and in September 2021 CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that:
    - local authorities must not borrow to invest primarily for financial return; and
    - it is not prudent for authorities to make any investment.

or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.

- Categorising investments as those:
  - for treasury management purposes;
  - for service purposes; and
  - for commercial purposes.
- Defining acceptable reasons to borrow money:
  - financing capital expenditure primarily related to delivering a local authority's functions;
  - temporary management of cash flow within the context of a balanced budget;
  - securing affordability by removing exposure to future interest rate rises; and
  - refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
  - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
  - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
  - Excluding investment income from the definition of financing costs.

- Incorporating Environmental, Social and Governance (ESG) issues as a consideration.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making.

4.64 **IFRS 16**: As previously reported to Cabinet in the Council's Treasury Management Annual Report 2020-21, CIPFA/LASAAC has delayed the implementation of the new IFRS 16 Leases accounting standard for a further year, to 2022-23.

4.65 **MHCLG Improvements to the Capital Finance Framework:** MHCLG published a brief policy paper in July 2021 outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that "while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk".

4.66 The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements. A further consultation by MHCLG's successor, DLUHC, on these matters is expected soon.

4.67 **Economic Outlook for the remainder of 2021-22:** the Council's external Treasury Management Advisors expect that the Bank of England's Bank Rate will rise in the second quarter of 2022.

4.68 It believes that this is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure. Investors have priced in multiple rises in Bank Rate to 1% by 2024. Whilst it believes Bank Rate will rise, it is by a lesser extent than expected by markets.

4.69 The global economy continues to recover from the Covid-19 pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressures, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

4.70 Whilst 2021 Quarter 2 UK Gross Domestic Product expanded more quickly than initially thought, the outlook appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of Government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as support for the economy is removed.

4.71 CPI Inflation rose to 4.2% in October 2021. Whilst the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the Monetary Policy Committee has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

4.72 Supply imbalances are apparent in the labour market. Whilst wage growth is currently elevated due to compositional and base factors, higher wages for certain sectors are driving inflation expectations. It is uncertain whether a broad-based increase in wages is possible given the pressures on businesses.

4.73 Government bond yields recently increased sharply when central banks communicated a lower tolerance for higher inflation than previously thought. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.

4.74 The Monetary Policy Committee has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. Whilst the economic outlook is challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

5. Consultation

5.1 No consultation is required.

6. Alternative Options Considered

6.1 Not Applicable - This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

7. Implications

7.1 Appendix 1 sets out the relevant implications considered in the preparation of the report.

8. Background Papers

8.1 The Council's Treasury Management Strategy for 2021-22 was approved at the Council meeting on 3 February 2021 as part of the Capital Programme Approvals, Treasury Management and Capital Strategy Report.

9. Appendices

9.1 Appendix 1- Implications.

10. Recommendation

10.1 That Cabinet notes the Treasury Management Mid-Year Report 2021-22 and notes the Council's compliance with the prudential indicators set by Council at its meeting of 3 February 2021 for 2021-22, in accordance with the Treasury Management in the Public Services: Code of Practice and Cross-Sectorial Guidance Notes 2017.

11. Reasons for Recommendation

11.1 The report on treasury management activities at mid-year 2021-22 highlights the borrowing strategy and investments position of the Council during the first half of the current financial year.

11.2 The report on treasury management activities mid-year 2021-22 also highlights the Council's performance and compliance with targets agreed as part of the Treasury Management Strategy 2021-22.

12. Is it necessary to waive the call-in period?

12.1 No

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This report has been approved by the following officers:

On behalf of: Director of Legal Services and Monitoring Officer Director of Finance and ICT Managing Director	

Appendix 1

Implications

Financial

1.1 As outlined in the body of the report.

Legal

2.1 None

Human Resources

3.1 None

Information Technology

4.1 None

Equalities Impact

5.1 None

Corporate objectives and priorities for change

6.1 The Council is committed to ensuring good financial management and compliance with applicable laws and regulations. The Council 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 risk remains central to the Council's Treasury Management Strategy.

Other (for example, Health and Safety, Environmental Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None