Cumberland Council

Treasury Management Strategy Statement & Investment Strategy

Minimum Revenue Provision Policy

2024-2025

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1. Introduction

1.1 Background

1.1.1 For public sector organisations, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as "the management of the organisation's borrowing, investments and cash flows, including its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks".

1.1.2 This definition expects a 'best value' approach in which authorities should seek to minimise the cost of borrowing (or maximise the returns from investment), subject to the over-riding management of risks, with risk limitation being more important than return (yield).

1.1.3 The statutory framework for treasury management and capital finance within local authorities (the Prudential Framework) is laid out in a series of legislations, statutory guidance and codes of practice, the key elements of which are:

- The Local Government Act 2003 - ('the 2003 Act')
- The Local Authorities (Capital Finance and Accounting)(England) Regulations 2003 (as amended) - ('the 2003 Regulations')
- Department for Levelling Up, Housing & Communities (DLUHC) (formerly the Ministry of Housing, Communities & Local Government (MHCLG)) Guidance on Local Government Investments - third edition (February 2018)
- DLUHC guidance on Minimum Revenue Provision - fourth edition (February 2018)
- The Prudential Code for Capital Finance in Local Authorities - 2021 Edition - ('the Prudential Code')
- The Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes 2021 Edition - ('the Treasury Management Code').

1.1.4 Consistent with the definition of treasury management set out in paragraph 1.1.1 above, the treasury management and investment strategies contained in this document are focused on borrowing and investments in financial instruments held for treasury management purposes (i.e. investments that arise from the Authority's cash flows or treasury risk management activity and which ultimately represent balances that need to be invested until the cash is required for use in the course of business). Investments in financial and non-financial assets (for example investment property, loans supporting service outcomes and investments in subsidiaries and joint ventures) made for commercial or service purposes, rather than for treasury management purposes, are dealt with in the Authority's Capital Strategy.

1.1.5 Investments for commercial purposes (or commercial investments) represent those taken or held primarily for financial return (previously known as investment assets bought primarily for yield) and are not linked to treasury management activity or directly form part of delivering services. This includes investments in non-financial assets such as commercial property, where they are held primarily for financial return. Investments of this type will usually constitute capital expenditure under the 2003 Act. 'Commercial' in this context refers to the purpose of the investment. Commercial investments are not taken to meet treasury management cash flow needs and do not result from treasury risk management activity to prudently manage the risks, costs or income from existing or forecast debt or treasury investments. They are additional investments voluntarily taken primarily in order to generate net financial return or profit.

1.1.6 Investments for service purposes (or service investments) are those taken or held primarily and directly for the delivery of public services (including housing, regeneration and local infrastructure) or in support of joint working with others to deliver such services. Service investments may or may not involve financial returns. However, obtaining those returns will not be the primary purpose of the investment. Service investments will normally constitute capital expenditure under the 2003 Act.

1.1.7 The latest versions of the Prudential Code for Capital Finance in Local Authorities (the Prudential Code) and Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (the Treasury Management Code) were issued by the Chartered Institute of Public Finance and Accountancy in December 2021. The 2021 editions replace the 2017 versions of the Codes.

1.1.8 Substantive changes introduced by the 2021 edition of the Prudential Code included:

- strengthened provisions in relation to borrowing in advance of need in order to profit from additional sums borrowed with the relevant parts of the Code augmented to be clear that borrowing for debt-for-yield investment is not permissible under the Prudential Code. This recognises that commercial activity is part of regeneration but underlines that such transactions do not include debt-for yield as the primary purpose of the investment or represent an unnecessary risk to public funds.

- the inclusion of proportionality as an objective of the Prudential Code and the addition of a requirement to carry out an assessment to ensure risks associated with service and commercial investments are proportionate to an authority's financial capacity – i.e. that plausible losses could be absorbed in existing budgets or usable reserves without unmanageable detriment to local services
- a new requirement for capital strategies to report investments under the following headings: service, treasury management and commercial investments
- a requirement to monitor Prudential Indicators on a quarterly basis.

1.1.9 The main changes introduced by the updated Treasury Management Code (2021 Edition) and the accompanying guidance for local authorities included:

- the inclusion of Investment Management Practices and other recommendations relating to non-treasury investments within the Treasury Management Practices (TMPs) alongside existing TMPs.
- the recommended introduction of the Liability Benchmark as a treasury management indicator for local government bodies
- incorporation of Environmental, Social and Governance (ESG) risks into TMP1 (Risk Management)
- a requirement for the purpose and objective of each category of investments to be described within the Treasury Management Strategy.

1.1.10 With the exception of the new prudential and treasury management indicators for net income from service and commercial investments and the liability benchmark, the Treasury Management and Investment Strategies for 2024-25 satisfy all core principles of the revised Codes.

1.2 Reporting requirements

1.2.1 Provisions contained in the Local Government Act 2003, statutory guidance and regulations issued by the Department for Levelling Up, Housing & Communities (DLUHC) (formerly the Ministry of Housing, Communities & Local Government (MHCLG)) and Codes of Practice issued by CIPFA in relation to treasury management and capital finance, require local authorities to prepare and approve, before the start of each financial year:

- a Treasury Management Strategy Statement (TMSS) and Investment Strategy setting out its proposed treasury management activities for the year and policies for the prudent management of its investments

- a statement of its policy on making Minimum Revenue Provision (MRP) indicating how, in the forthcoming financial year, the duty to make prudent MRP will be discharged
- a set of prescribed prudential and treasury indicators for the forthcoming and following years - including the Authority's Authorised Borrowing Limit - demonstrating that its capital expenditure plans are affordable and proportionate and that external borrowing is within prudent and sustainable levels.

1.2.2 The Treasury Management Code also requires authorities to ensure the Full Council receives:

- a mid-year report providing:
  - an update on the economic environment and interest rate forecasts underlying the adopted strategies
  - details of variations (if any) from agreed policies/practices contained in the approved Treasury Management and Investment Strategies
  - details of investing and borrowing activities undertaken
  - confirmation of compliance with treasury and prudential indicators
- after the year-end, an annual report on the performance of the treasury management function, the effects of the decisions taken and the transactions executed in the past year and on any circumstances of non-compliance with the Authority's Treasury Management Policy Statement and TMPs.

1.2.3 This document, prepared in accordance with the statutory framework and codes of practice referred to above, sets out the Authority's:

- Treasury Management Strategy Statement (TMSS) and Investment Strategy for 2024-25
- Minimum Revenue Provision (MRP) Policy Statement for 2024-25
- Prudential and treasury indicators for the three year period 2024-25 to 2026-27, alongside revised indicators for 2023-24.

1.2.4 The TMSS and Investment Strategy, MRP policy and the prudential and treasury indicators, must be approved by Full Council prior to the commencement of the financial year to which they relate.

1.2.5 To enable the Audit Committee to fulfil its responsibilities for ensuring effective scrutiny of treasury management strategy and policies, the Authority's Treasury Management Practices (TMPs) require treasury management reports, including this report, to be submitted to the Audit Committee prior to their consideration by Full Council.

2. Treasury Management Strategy Statement

2.1 Current treasury position

2.1.1 The Authority's treasury portfolio position at 31 December 2023 is summarised in table 1. Table 1 also shows a comparison of the Authority's actual external debt (borrowing) postion with the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 1: Investment and borrowing

	At 31 Dec 2023 £000	At 30 Sept 2023 £000	At 1 April 2023 £000
Investments			
Specified Investments:			
Call & notice accounts	9,353	13,263	5,539
Fixed Term accounts	80,000	85,000	62,500
Money Market Funds	39,885	49,285	20,115
Non-specified investments:			
CCLA Property Investment Fund	3,000	3,000	3,000
Equities	1	1	1
Total investments	**132,239**	**150,549**	**91,155**
Borrowing			
PWLB	237,868	237,916	244,207
LOBO Loans	16,000	16,000	16,000
Other borrowing	98	98	98
Other long-term liabilities (PFI & Leases)	94,278	94,914	95,936
Total (gross) debt	**348,244**	**348,928**	**356,241**
Capital Financing Requirement	425,906	426,643	433,256
(Under)/Over borrowing	(77,662)	(77,715)	(77,015)

2.1.2 At 31 December 2023 the Authority's PWLB loan portfolio consisted of fixed rate:

- maturity loans totalling £219.0m (1 April 2023: £224.7m)
- annuity loans of £1.158m (1 April 2023: £1.261m)
- EIP loans of £17.710m (1 April 2023: £18.246m).

2.1.3 Interest rates applying to individual loans within the Authority's PWLB loan portfolio range from 1.21% to 9.5%. At 31 December 2023 the weighted average rate of interest payable on the Authority's PWLB loan portfolio stood at 3.62% (1 April 2023: 3.67%).

2.1.4 At 31 December 2023 the weighted average life of the Authority's PWLB loan portfolio and weighted average time to maturity was approximately 25 years.

2.1.5 At 31 December 2023 the Authority had two Lender Option Borrower Option (LOBO) loans of £11m and £5m. The interest rates on these loans are 4.45% and 7.55%. The loans had remaining contractual terms of 19 and 18 years respectively.

2.1.6 At 31 December the weighted average interest rate on the Authority's loan portfolio as whole was 3.73 % (PWLB: 3.62% other loans 5.39%).

2.2 Treasury Indicators: limits on borrowing and lending activity

2.2.1 The Local Government Act 2003 requires a local authority to create and keep under review, limits on how much money it can afford to borrow by way of loans and other forms of credit (for example finance leases). The processes authorities must follow in setting these limits (the 'Authorised Limit for external debt') are set out in the Prudential Code which authorities must 'have regard to'. An authority is free to vary its affordable borrowing limit, subject to approval by Full Council, provided there is good reason for doing so. However, breach of the Affordable Borrowing Limit is prohibited by the 2003 Act and any borrowing above the affordable borrowing limit is ultra-vires.

2.2.2 In addition to the Authorised Limit, the Prudential and Treasury Management Codes and accompanying sector guidance, include a number of other key treasury management indicators designed to ensure the Authority operates its treasury activities within well-defined limits. These include:

- setting an operational boundary for external debt based on the expectations of the most likely maximum external debt for the year and reflecting the authority's plans for capital expenditure, estimated capital financing requirement (CFR) and cash flow requirements for the year for all purposes
- ensuring that gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current and the following two financial years.
- placing upper limits on long-term treasury management investments

- placing upper and lower limits on the maturity structure of its borrowing.

2.2.3 Details of the Authority's prudential and treasury indicators are set out in section 5.

2.3 Prospects for interest rates

2.3.1 The Authority has appointed Link Group (Link Treasury Services) as its treasury advisor. Part of the service provided by Link is to assist the Authority to formulate a view on interest rates. Link Group issued its latest interest rate forecasts on 8 January 2024. These latest forecasts, set out in Table 1 alongside the previous forecast (issued 7 November 2023) included in the 2023-24 Mid-year Treasury Review, take into account the Bank of England's November Monetary Policy Report and the decisions and forward guidance issued by the Bank's Monetary Policy Committee at its meetings on 1 November 2023 and 14 December 2023.

2.3.2 The view set out in the latest forecast is for short, medium and long-dated interest rates to remain elevated over the near term as the Bank of England seeks to squeeze inflation out of the economy. However, the overall longer run trend is for gilt yields and PWLB rates to fall back over the forecast period as inflation falls.

Table 2: Forecast interest rates 2024-2027

Quarter ending	Bank Rate %		PWLB Borrowing Rates[1]							
			5 year %		10 year %		25 year %		50 year %	
	23-24 Mid-Yr	TMSS	23-24 Mid-Yr	TMSS	23-24 Mid-Yr	TMSS	23-24 Mid-Yr	TMSS	23-24 Mid-Yr	TMSS
actual 31.1.24	-	5.25	-	4.59	-	4.73	-	5.29	-	5.08
Mar-24	5.25	5.25	4.90	4.50	5.00	4.70	5.30	5.20	5.10	5.00
Jun-24	5.25	5.25	4.80	4.40	4.80	4.50	5.10	5.10	4.90	4.90
Sep-24	5.00	4.75	4.70	4.30	4.70	4.40	4.90	4.90	4.70	4.70
Dec-24	4.50	4.25	4.40	4.20	4.40	4.30	4.70	4.80	4.50	4.60
Mar-25	4.00	3.75	4.20	4.10	4.20	4.20	4.50	4.60	4.30	4.40
Jun-25	3.50	3.25	4.00	4.00	4.00	4.10	4.30	4.40	4.10	4.20
Sep-25	3.25	3.00	3.80	3.80	3.80	4.00	4.20	4.30	4.00	4.10
Dec-25	3.00	3.00	3.70	3.70	3.70	3.90	4.10	4.20	3.90	4.00
Mar-26	3.00	3.00	3.60	3.60	3.70	3.80	4.10	4.20	3.90	4.00
Jun-26	3.00	3.00	3.50	3.60	3.60	3.70	4.00	4.10	3.80	3.90
Sep-26	3.00	3.00	3.50	3.50	3.60	3.70	4.00	4.10	3.80	3.90
Dec-26	3.00	3.00	3.50	3.50	3.50	3.70	4.00	4.10	3.80	3.90
Mar-27	-	3.00	-	3.50	-	3.70	-	4.10	-	3.90

[1]*Certainty rates are calculated by subtracting 0.2% from the standard new loan rates.*

Bank Rate

2.3.3 The UK Bank Rate started 2023-24 at 4.25%. Subsequent increases during the first half of 2023-24 saw the rate rise to 4.5% in May, 5.00% in June and to a 15-year high of 5.25% in August as the Bank of England continued with its efforts to combat ongoing inflationary pressures.

2.3.4 After 14 consecutive increases starting in December 2021 the Bank of England's Monetary Policy Committee kept rates on hold in September, November and December 2023. Following the MPC's decision to keep rates on hold for a third consecutive time at its December meeting, the latest forecast now anticipates the MPC will keep the Bank Rate at 5.25% until at least the second half of 2024 to combat on-going inflation and wage-growth pressures.

2.3.5 The first cut in the Bank rate is currently forecast to occur Q3 (July to September) 2024, but, as always, any decision by the MPC to reduce the Bank Rate will be driven by the economic data. The paths for policy rates implied by financial markets suggest rates are at or near their peaks in the UK, US and euro area. However, although the Bank Rate is not currently expected to rise above 5.25% the timing of the first cut may not materialise until the latter stages of 2024. In the current forecast the Bank Rate is expected to fall to 4.25% by the end of 2024 and to 3% by the end of 2025. The low point of the interest cycle is also expected to be 3%.

2.3.6 In the November Monetary Policy Report, CPI inflation was expected to continue to fall rapidly in the near-term returning the Bank of England's 2% target by the end of 2025. Meanwhile wage growth was expected to remain elevated in the near-term before falling back in 2024. There does however remain considerable uncertainty around the pace at which CPI inflation will return sustainably to the 2% target with the balance of risks currently skewed to the upside. Among the current upside risks to inflation are energy prices - given events in the Middle East - and the underlying tightness of labour market conditions. In the Bank's most recent forecasts CPI inflation is projected to fall temporarily to the 2% target in 2024 Q2 before increasing again in Q3 and Q4 to around 2.75% by the end of this year. It then remains above target over nearly all of the remainder of the forecast period, falling to around 2.3% in 2026 Q1 2026 and 1.9% in 2027 Q1.

2.3.7 For the MPC the timing of any rate cuts remains one of fine judgment; cut too soon and inflationary pressures may well build up further, cut too late and any downturn or recession may be prolonged.

2.3.8 In the upcoming months, interest rate forecasts will be guided by economic data releases, and by clarifications from the MPC over its monetary policies and from the Government over its fiscal policies. Future forecast will also be guided by international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

Bond Yields and PWLB Rates

2.3.9 The forecast borrowing rates shown in table 2 are based on the PWLB Certainty Rate (standard new loan rate minus 20 basis points) which has been accessible to most authorities since 2012.

2.3.10 Whilst gilt yields and PWLB rates are expected to remain elevated in the near-term as the Bank of England seeks to squeeze inflation out of the economy, the overall longer-run trend is for gilt yields and PWLB rates to fall back over the forecast period as inflation falls through 2024.

2.3.11 It is however acknowledged that, in the short-term, geo-political events, sovereign debt issues, emerging market developments and sharp changes in investor sentiment could contribute to short-term volatility in financial markets and borrowing rates.

2.3.12 Since the start of the current financial year (2023-24) there has been significant volatility in gilt yields and hence PWLB rates. The general situation is for this volatility and unpredictability in gilt yields to endure as investor fears and confidence ebb and flow between favouring relatively more “risky” assets i.e. equities, or the “safe haven” of government bonds.

2.3.13 PWLB rates are offered at a fixed margin above the Government’s cost of borrowing, as measured by gilt (UK Government bond) yields. The main influences on gilt yields are the bank rate, inflation expectations and movements in US treasury yields. Therefore while monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact of US treasury yields on UK gilt yields.

2.3.14 As the US financial markets are, by far, the biggest financial markets in the world, any trend in treasury yields will invariably impact and influence financial markets in other countries. Although UK gilt yields and US treasury yields do not always move in unison, since 2011 there has, on average, been a 75% correlation between movements in 10-year US treasury yields and 10-year UK gilt yields.

2.3.15 What happens outside of the UK therefore remains critical to the movement in gilt yields, although arguably it is US monetary policies that will have the greatest impact on global bond markets. The European Central Bank (ECB) has made it clear that policy tightening is at, or close to, the terminal rate (currently 4%), whilst the US Federal Open Market Committee (FOMC) held its Bank Rate equivalent in the range of 5.25% - 5.5% for a third consecutive time in December but indicated 75bps cuts in 2024, reflecting policymakers' dual focus on returning inflation to the 2% target while avoiding excessive monetary tightening. US policymakers emphasised that the extent of any additional policy tightening would consider the cumulative impact of previous interest rate hikes, the time lags associated with how monetary policy influences economic activity and inflation, and developments in both the economy and financial markets. Markets currently expect both the ECB and the US Federal Reserve to start cutting rates in 2024.

2.3.16 Movement in the short part of the curve is expected to be driven to a large degree by Bank Rate expectations, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, but also by the market's appetite for significant gilt issuance.

2.3.17 There is also the small matter of a General Election coming into sight on the horizon. This may prompt a loosening of Government fiscal policy at the same time as the Bank's monetary policy is still trying to take momentum out of the economy. This could result in the Bank Rate staying elevated for a little longer than currently forecast.

2.3.18 The PWLB (certainty) rate forecasts included in table 2 are based around a balance of risks. Key downside risks to current forecasts for UK gilt yields and PWLB rates include:

- labour and supply shortages proving more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus could keep gilt yields high for longer)
- the pace and strength of the Bank of England's monetary policy action over recent months proving to be too quick or too far and subsequently

brings about a deeper and longer UK recession than currently anticipated

- UK/EU trade arrangements having a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues
- geopolitical risks, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, leading to increased safe haven flows.

2.3.19 Meanwhile, potential upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer-term PWLB rates, include:

- the pace and strength of recent increases in the Bank Rate, by the Bank of England proves too timid, allowing inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates the Bank Rate staying higher for longer than currently expected
- sterling weakens because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt
- longer-term US treasury yields rise strongly and push gilt yields up higher as a consequence of inflation in the US remaining more stubborn than the market currently anticipates
- projected gilt issuance, inclusive of natural maturities and quantitative tightening, prove to be too much for the markets to comfortably digest without higher yields compensating.

2.3.20 At present, the balance of risks to economic growth in the UK is even.

Investment rates

2.3.21 The upturn in investment rates experienced during 2022-23 continued during the first half of 2023-24, with overnight rates increasing by around 100 basis points (bps) consistent with the 100bps increase in the Bank Rate between April and September 2023. The Sterling Overnight Index Average (SONIA) overnight and one-month term rates (forward- looking rates), which opened the year at around 4.18% and 4.17%, closed the first half of 2023-24 at 5.19% and 5.20% respectively. Meanwhile the three-month rate rose from 4.30% to 5.29% between April and September 2023. For longer maturities, the six-month and one year rates rose by 92 and 87 basis points to close at 5.39% and 5.45% respectively.

2.3.22 During Q3 (October to December) the MPC's decision to hold the Bank Rate at 5.25% saw the movement in the SONIA overnight and one-month term rates remain flat at 5.19% and 5.20% respectively. Meanwhile growing expectations of future cuts to policy rates saw maturities for longer maturities (i.e. 3-month, six-month and 12 month rates) fall by between 8 and 73 basis points over the 3 month period.

2.3.23 Although investment rates are expected to remain elevated in the near term the overall trend over the forecast period is for rates to reduce in line with the expected movements in the Bank Rate. Appendix A sets out forecast returns on investments for maturities on up to 12 months.

2.3.24 A more detailed commentary on the economic background underpinning current interest rate forecasts is included in Appendix B.

2.4 Borrowing strategy

2.4.1 The Authority is currently maintaining an under-borrowed position (see table 1). This means the capital borrowing need (the Capital Financing Requirement - CFR) has not been fully funded with loan debt. By utilising cash supporting the Authority's reserves and favourable in-year cash flow, the Authority has been able to avoid the need to borrow up to the level of the CFR.

2.4.2 This has allowed the Authority to minimise borrowing costs and reduce treasury risk by reducing its external investment balances. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. The Authority will therefore seek to continue with this policy during 2024-25 to the extent permitted by its liquidity requirements and the effective management of its interest rate exposures.

2.4.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2024-25 treasury operations. Treasury staff will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in long and short-term rates, long-term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered
- if it was felt that there was a significant risk of a much sharper rise in long and short-term borrowing rates than currently forecast, the

portfolio position will be re-appraised with the likely action being that fixed rate funding will be drawn whilst interest rates are still lower than they are projected to be in the next few years.

2.4.4 Any decisions taken in this regard will be reported to members at the next available opportunity.

2.4.5 The Authority manages interest rate exposures through the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates.

2.4.6 Interest rate cash flow risk associated with the Authority's short and long term borrowing (i.e. the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances), will be managed principally by borrowing at fixed rates.

2.4.7 Given the current pattern of interest rates and interest rate forecasts any new borrowing in 2023-24 and 2024-25 is expected to focus on borrowing over shorter terms (of up to say two years) whilst the market continues to wait for inflation, and therein gilt yields and PWLB rates, to drop back later in 2024 and beyond.

2.4.8 At the end of December 2023 PWLB loans accounted for 94% of the Authority's total debt (loan) portfolio with two Lender Option Borrower Option (LOBO) loans accounting for all but a small portion of the remaining total loan debt. Borrowing from the PWLB is expected to remain the primary source of any new borrowing drawn down in 2023-24 and 2024-25. However, short-dated fixed Local Authority to Local Authority monies may also be considered.

2.5 Policy on borrowing in advance of need (borrowing primarily for financial return)

2.5.1 The Local Government Act 2003 allows local authorities to borrow or invest for ''any purpose relevant to its functions, under any enactment'', or "for the purpose of the prudent management of its financial affairs". This allows the temporary investment of funds borrowed for the purposes of expenditure in the near future.

2.5.2 The statutory investment guidance issued by DLUHC contains the statement that authorities "must not borrow more than, or in advance of its needs purely in order to profit from the investment of the extra sums borrowed". The informal commentary to the investment guidance sets out the view held by Central Government that the statement covers borrowing taken on to fund the acquisition of non-financial as well as financial investments.

2.5.3 Legitimate examples of prudent borrowing under the Prudential Code include:

- financing capital expenditure primarily related to the delivery of 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
- refinancing current borrowing, including adjusting levels of internal borrowing, to manage risk, reduce costs or reflect changing cash flow circumstances
- other treasury management activity that seeks to prudently manage treasury risks without borrowing primarily to invest for financial return.

2.5.4 In meeting the requirements of the Prudential Code and statutory investment guidance, the Authority will not borrow to invest primarily for financial return or (in respect of the requirements of the statutory guidance) borrow more than, or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.

2.5.5 Investment or spending decisions that increase the Authority's capital financing requirement, and which may therefore lead to new borrowing, are not considered appropriate unless directly and primarily related to the functions of the Authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.

2.5.6 Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

2.5.7 Following the changes to the PWLBs lending terms, effective from 26 November 2020, the PWLB will no longer lend to local authorities that plan to buy commercial (investment) assets primarily for financial return. In order to protect the Authority's ongoing access to the PWLB as a source of borrowing, the Authority will, in context of its Capital Strategy, only include in its capital programme capital expenditure on projects and schemes that have characteristics consistent with the PWLB's lending criteria. The Authority will not acquire commercial assets primarily for financial return.

2.6 Debt rescheduling

2.6.1 Debt rescheduling includes the premature repayment of loans and the replacement of existing loans with new loans on different terms (repayment method, loan period, interest rate). The reasons for rescheduling include:

- aligning long-term cash flow projections and debt levels in order to redistribute the burden of debt financing costs between years of account
- generating savings in risk adjusted interest costs
- rebalancing the interest rate structure of the debt portfolio to reduce exposures to interest rate risk
- changing the size and/or maturity profile of the debt portfolio to reduce refinancing risk exposures and/or align the debt maturity profile with the underlying need to borrow for capital purposes (the capital financing requirement).

2.6.2 The historic nature of the Authority's inherited PWLB loan portfolio and exclusive use of fixed rate loans means interest rates applying to individual loans within the Council's PWLB loan portfolio range from 1.21% to 9.5%. The weighted average interest rate on the PWLB loan portfolio at 31 December 2023 was 3.62%. Residual maturities on loans currently range from under one year to 45 years.

2.6.3 In the current interest rate environment rescheduling of the existing loan portfolio may be considered whilst premature redemption rates remain elevated but only if there is surplus cash available to facilitate any repayment, or where rebalancing of the portfolio to provide more certainty is considered appropriate.

2.6.4 During 2024-25, the Authority will continue to monitor interest rate structures for opportunities to reschedule debt in order to generate savings and/or rebalance risks within the loan portfolio. All rescheduling will be reported to the Audit Committee and Full Council at the earliest meeting following its action.

2.7 Policy on the use of derivatives

2.7.1 The Authority will only use derivatives for the management of risk and for the prudent management of its financial affairs. Transactions involving standalone derivative products such as forward rate agreements, interest rate swaps and options (interest rate caps, floors and collars) require authorisation by the Chief Finance Officer (s151 Officer) and will only be entered into:

- after seeking proper advice to ensure the product is fully understood, including how underlying risks are affected and the additional risks that may result from its use (for example credit exposure to derivative counterparties)
- after seeking confirmation that the Authority has legal power to enter into the transaction
- where use of the product can be shown to reduce the overall level of financial risks the Authority is exposed to (after taking into consideration additional risks that may result from use of the derivative instrument)
- after ensuring treasury staff have received training to ensure competent use of the product.

2.7.2 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria outlined in section 3 below. The current value of any amount due from a derivative counterparty will count against the counterparty limits set out in paragraph 3.5.1.

2.8 Training

2.8.1 CIPFA's Treasury Management Code of Practice and Cross-Sectoral Guidance Notes require the responsible officer (the Chief Finance Officer) to ensure that:

- all staff involved in the treasury management function (including statutory officers) are fully equipped to undertake the duties and responsibilities allocated to them
- members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

2.8.2 In complying with these requirements the Authority regularly reviews the training needs of officers and members and will arrange training, as required, to ensure that officers and members have the requisite skills and knowledge relevant to their needs and responsibilities.

2.9 Treasury management advisors

2.9.1 The Authority currently uses the Link Group (Link Treasury Services Limited), as its external treasury management advisors. They provide a range of services to the Authority including:

- technical support on treasury matters and capital finance issues
- economic and interest rate analysis
- debt services including advice on the timing of borrowing
- debt rescheduling advice
- generic investment advice on interest rates, timing and investment instruments
- credit ratings and creditworthiness information.

2.9.2 The Authority recognises that responsibility for treasury management decisions remains with the Authority at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers. The Authority also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Authority will ensure that the terms of their appointment and the methods by which their value is assessed are properly agreed and documented, and subjected to regular review.

2.9.3 Link Treasury Services were appointed in 2022 following a competitive tendering exercise. Their current contract with the Authority commenced on 1 September 2022 and will run to 31 March 2026 with an option for this to be extended, by the Authority, for an additional one-year.

3. Annual Investment Strategy

3.1 Investment policy - objectives

3.1.1 The Authority's investment policy deals with investments in financial instruments held for treasury management purposes and is set with regard to the requirements of :

- DLUHC's Guidance on Local Government Investments ('DLUHC's Investment Guidance') (third edition), and
- CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes 2021 Edition ('the Treasury Management Code').

3.1.2 Accordingly, the Authority's primary policy objectives in relation to its treasury investment activity are to ensure:

- first, the security of principal sums invested (i.e. to protect the capital sum invested from loss)
- second, that appropriate levels of liquidity are maintained (i.e. ensuring funds invested are available to meet expenditure when needed).

3.1.3 The Authority will aim to achieve the optimum return on its investments (yield) commensurate with the proper levels of security and liquidity. However, yield will only determine investment decisions when deciding between two or more investments satisfying security and liquidity objectives.

3.2 Creditworthiness policy (credit risk management)

3.2.1 Ensuring the security of principal sums invested is achieved through active management of the Authority's credit risk exposures. This includes placing restrictions and limits on:

- the counterparties with whom investments may be placed based on the creditworthiness of the counterparty (section 3.3)
- the types of investment instruments that may be used (section 3.4)
- the amount invested with any single institution or group of institutions on the Authority's list of approved counterparties (section 3.5)
- the duration of individual investment instruments depending on the financial standing (creditworthiness) of the counterparty (section 3.6).

3.3 Approved investment counterparties

3.3.1 Counterparties with whom investments may be placed are restricted to financial institutions and other bodies of high credit quality. High credit quality financial institutions and other bodies are defined by the Authority as those with a minimum rating across all three of the main credit ratings agencies (Fitch, Moody's and Standard & Poor's) of A- (or equivalent) - long-term, and A-1 (or equivalent) - short-term. For LVNAV Money Market Funds the minimum credit rating is AAAmmf.

3.3.2 Approved investment counterparties are determined using the creditworthiness service provided by the Authority's treasury advisors Link Treasury Services. This combines credit ratings information provided by the three main credit rating agencies - Fitch, Moody's and Standard & Poor's - with ratings outlooks (indicating the likely direction of an issuer's rating over the medium term) and credit watches and watchlists (indicating that downgrading or upgrading of the credit rating could be imminent) in a weighted scoring system.

3.3.3 This is combined with an overlay of credit default swap (CDS) spreads indicating perceived market sentiment regarding the credit risk associated with a particular institution and an early warning of potential creditworthiness problems which may only belatedly lead to actual changes in credit ratings.

3.3.4 Application of Link's creditworthiness methodology produces a colour rating to indicate the relative creditworthiness of the counterparty. These colour ratings are also used to determine the maximum duration for investments made with individual counterparties (see section 3.6 below). The Link creditworthiness service thus uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it avoids placing undue reliance on the rating provided by any one agency's ratings.

3.3.5 Whilst application of Links creditworthiness methodology will typically result in approved counterparties holding a minimum credit ratings of A- (or equivalent) - long-term, and A-1 (or equivalent) - short-term, it can on occasions generate an "approved rating" for a counterparty whose rating from one rating agency is below these minimum ratings.

3.3.6 To ensure that investments are only placed with high credit quality (investment grade) counterparties (as defined in paragraph 3.3.1) application of Link's creditworthiness methodology is subject to the additional requirement for any counterparty used to hold a minimum rating of A- (or equivalent) - long-term, and A-1 (or equivalent) - short-term. This minimum rating criteria, applied by the Authority, uses the lowest common denominator method of selecting counterparties and applying limits. This means the minimum rating criteria will apply to the lowest available rating for any institution. For example, if an institution is rated by two agencies, one rating meets the Authority's criteria, the other does not, the institution will fall outside the lending criteria and will be excluded from the list of approved counterparties. The minimum rating criteria does not apply to the UK sovereign rating.

3.3.7 Credit ratings and creditworthiness information is supplied to the Authority by Link Treasury Services and monitored weekly. The Authority is also alerted by email when there is an amendment by any of the agencies to the credit rating of an institution. If as a result of a downgrade, a counterparty no longer meets the Authority's minimum credit ratings criteria, it will be removed immediately from the Authority's counterparty (dealing) list.

3.3.8 Notifications of rating changes, rating watches and rating outlooks are provided to officers almost immediately after they occur. The information contained in these notifications is considered by officers before dealing. For instance, a negative rating watch applying to a counterparty, currently at the minimum Authority criteria, will result in the counterparty being suspended from use, with all others being reviewed in light of market conditions. Link Treasury Services also provide the Authority with information relating to movements in credit default swap spreads against the iTraxx European Financials benchmark and other market data on a daily basis via its *Passport* website. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

3.3.9 Whilst credit ratings and the use of Link's Creditworthiness Service remain a key source of information in establishing the Authority's list of approved counterparties, they are not the sole determinant of the Authority's assessment of the credit quality of potential counterparties. Other information sources used to assess the suitability of potential investment counterparties include the financial press, share price and other information pertaining to the banking sector and the economic and political environments in which these institutions operate. Regardless of the credit rating assigned to an institution, if this additional information casts doubt over its financial standing then that institution will be removed immediately from the Authority's counterparty lending list.

Creditworthiness

3.3.10 Significant levels of downgrades to short and long-term credit ratings of financial institutions, including UK banks, have not materialised since the crisis in March 2020. For the most part, where changes have occurred these have been limited to Outlooks. Nonetheless, when setting minimum sovereign debt ratings, the Authority will not set a minimum rating for the UK.

Credit Default Swap (CDS) prices

3.3.11 Although bank CDS prices spiked upwards during the autumn of 2022, they have since returned to more average levels. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link Treasury Services monitor CDS prices as part of their creditworthiness service to local authorities and the Authority has access to this information via its Link's *Passport* website.

3.4 Approved instruments

3.4.1 The types of investment instruments that may be used by the Authority - subject to the counterparty and maturity limits set out in sections 3.5 and 3.6 - are shown in table 3. Permitted instruments are categorised as either "Specified" or "Non-Specified" investments, as defined in DLUHCs Investment Guidance, to distinguish those (specified) investment instruments offering relatively high security and high liquidity from those with higher credit risk (non-specified investments). All investments will be in sterling.

Table 3: Permitted investment instruments - specified & non-specified

Investment	Min Credit / Link Colour Rating	Specified	Non-Specified
Principal permitted investment instruments			
Term deposits, call and notice accounts with banks & building societies	AA- (LT) & A-1 (ST) /Green*	✓	×
UK Part nationalised Banks ('ring-fenced' entity)	AA- (LT) & A-1 (ST) /Blue*		
Term deposits with UK local authorities	AA- (LT) & A-1 (ST) /Green*	✓	×
Low Volatility Net Asset Value Money Market Funds – [LVNAV] with 60-day Weighted Average Maturity (WAM))	AAAmmf/ Yellow*	✓	×
Debt Management Account Deposit Facility	UK sovereign rating	✓	×
Local Authority Property Fund (CCLA)	-	✓	✓
Other permitted investment instruments			
Certificates of deposit issued by rated banks & building societies	AA- (LT) & A-1 (ST) /Green*	✓	×
Gilts issued by the UK Debt Management Office (DMO)	UK sovereign rating	✓	×
Treasury Bills (T-bills) issued by the UK DMO	UK sovereign rating	✓	
Gilt Funds	UK sovereign rating	✓	×
Bonds issued by Multilateral Development Banks	AAA	✓	×
Other Money Market & Collective Investment Schemes	AAA	✓	✓
Equity investments			✓

* for non UK counterparties the Country limits set out in paragraphs 3.5.2 and 3.5.3 also apply

3.4.2 A specified (treasury management) investment - offering high security and high liquidity - is defined as an investment that is:

(a) denominated in sterling with any payments or repayments payable only in sterling

(b) not a long-term investment (i.e. the authority has a contractual right to repayment within 12 months either because that is the expiry term of the investment or through a non-conditional option)

(c) not defined as capital expenditure under regulations (e.g. acquisition of share capital)

(d) made with a body or in an investment scheme of high credit quality (as defined by the Authority in paragraph 3.3.1) or with the UK Government, a local authority or a parish council or community council.

3.4.3 A non-specified investment refers to any (treasury management) investment not meeting the definition of ‘specified investments’. The Authority currently holds a limited quantity of non-specified investments. These comprise units held in the Churches, Charities and Local Authorities (CCLA) Local Authorities’ Property Fund and unquoted equity shares. At 31 December 2023 these accounted for less than 3% of the Authority’s total investment portfolio. No additional non-specified (treasury) investments are planned during 2024-25 and all new investments made in 2024-25 will be subject to a maximum maturity of 365 days.

3.4.4 Non-specified investments will only be made with prior approval of the Chief Finance Officer (s151 Officer) and will only be undertaken:

- following external credit assessment and due diligence to assess the financial strength and creditworthiness of the counterparty, and
- after taking such professional advice as is considered necessary to inform the decision to invest.

3.4.5 In the event the credit rating of the Authority’s banker falls below the minimum credit criteria referred to above, the Authority will continue to use the bank for transactional purposes but will seek to minimise balances as far as is possible.

3.5 Limits on principal sums invested with counterparties

3.5.1 With the exception of funds placed with H.M. Treasury’s Debt Management Office (DMO), the maximum amount that may be placed with any institution or group of institutions that are part of the same banking group and registered in the UK, is set out in table 4. For funds placed with the DMO’s Account Deposit Facility, there is no upper limit on the amount that may be invested.

Table 4: Upper limits on sums invested with counterparties

Colour rating	Maximum sum invested
Debt Management Deposit Account Facility DMADF	No upper limit.
Other Local Authorities	£20m per counterparty, up to a maximum of 20% of the total investment portfolio per counterparty at the time the deposit is made.
Yellow - Low Volatility NAV Money Market Funds (MMF)	£20m per MMF up to a maximum of 20% of the total investment portfolio per counterparty at the time the deposit is made.
Purple	At the time the deposit is made, up to 20% of the total investment portfolio per counterparty, subject to maximum of £20m principal per counterparty/group of counterparties within the same banking group.
Blue (Nationalised and Part Nationalised Banks only)	Maximum of £25m principal per counterparty/group of counterparties within the same banking group up to a maximum of 20% of the total investment portfolio per counterparty/banking group at the time the deposit is made.
Orange	At the time the deposit is made, up to 20% of the total investment portfolio per counterparty/banking group, subject to a maximum investment of £20m principal per counterparty/group of counterparties within the same banking group.
Red	At the time the deposit is made, up to 15% of the total investment portfolio per counterparty/banking group, subject to a maximum investment of £15m principal per counterparty/group of counterparties within the same banking group.
Green	At the time the deposit is made, up to 10% of the total investment portfolio per counterparty/banking group, subject to maximum of £10m principal per counterparty/group of counterparties within the same banking group.
No colour	Counterparty not used.

County Limits

3.5.2 Subject to the overarching counterparty criteria set out in sections 3.3 (approved investment counterparties), section 3.4 (approved instruments) and the limits on principal sums invested described above, where the country of registration of an institution has an average credit rating (i.e. an average sovereign credit rating) equal to, or better than that of the UK the Authority may consider the placement of investments on the same basis applied for UK-registered institutions.

3.5.3 Where an institution otherwise meets the approved counterparty status (derived from application of Links Creditworthiness methodology and the minimum credit ratings criteria applied by the Authority) but the country of registration has an average credit rating below that of the UK, the aggregate amount that may be placed with all institutions registered in such rated non-UK countries is limited to no more than 20% or £20m (whichever is the lesser) of the total investment portfolio.

3.6 Limits on investment maturities

3.6.1 To ensure that access to cash needed to meet forecast liquidity requirements is not impaired, decisions regarding the maturity of investments instruments must be taken having regard to the Authority's cash flow requirements. The maturity of investment instruments is also subject to the maximum maturity periods set out below (table 4). These are established to ensure that access to cash is not unduly restricted and to reduce the risk of being locked into an investment whilst the creditworthiness of the counterparty is deteriorating.

3.6.2 The maximum period for which funds may prudently be committed by the Authority is determined using the creditworthiness service provided by Link Treasury Services. As noted in section 3.3 this combines credit ratings information provided by the three main credit rating agencies - Fitch, Moody's and Standard & Poor's - with ratings outlooks and credit watches in a weighted scoring system. This is combined with an overlay of credit default swap (CDS) spreads to produce a colour rating to indicate the relative creditworthiness of the counterparty. These colour codes are in turn used to determine the maximum duration for investments made with individual counterparties.

3.6.3 To ensure sufficient liquidity to cover the Authority's cash flow requirements it is considered appropriate in the current economic climate to keep investment terms short. The Authority will however also to seek out value available in periods of up to 12 months with high credit rated institutions whilst investment rates remain elevated. Using this approach, the Authority will use the following duration bands - shown in table 5 - subject to a maximum maturity of 365 days (from the date of acquisition).

Table 5: Upper limits on investment maturities

Colour rating	Maximum duration (term to maturity)
Debt Management Deposit Account Facility DMADF	6 months (maximum set by DMO)
Other Local Authorities	365 days (2023-24 limit 2 years)
Yellow	5 years- restricted to 12 months (365 days)(see paragraph 3.6.3)
Purple	2 years - restricted to 12 months (365 days) (see paragraph 3.6.3)
Blue (Nationalised and Part Nationalised Banks only)	12 months (365 days)
Orange	12 months (365 days)
Red	6 months
Green	100 days
No colour	0 months (counterparty not to be used)

3.7 Reporting arrangements

3.7.1 The Treasury Management and Prudential Codes require the Authority to report regularly on its treasury management activities, including its performance against all forward-looking prudential and treasury management indicators set out in section 5 below. In meeting the recommended reporting requirements of the Treasury Management Code (outlined in section 1.2 above), the Chief Finance Officer (s151 Officer) will, in addition to this report, submit to the Audit Committee and Full Council:

- a mid-year review of the Council's treasury management activities covering the six months to 30 September 2024, and
- an annual treasury report after the year-end.

3.7.2 The annual report will be submitted as soon as reasonably practicable after the end of the financial year, but in any case no later than 30 September 2025.

3.7.3 A summary of treasury management activities will also be included in the quarterly finance reports submitted to the Council's Executive. This will include reporting on performance against all forward looking prudential indicators.

4. Minimum revenue provision (MRP) policy statement

4.1 Introduction

4.1.1 Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ('the 2003 Regulations') requires local authorities to 'charge to a revenue account a minimum revenue provision (MRP) for that year'. The minimum revenue provision is an annual amount required to be set aside from the General Fund to meet the capital cost of expenditure funded by borrowing or credit arrangements, that is, capital expenditure that has not been financed from grants, revenue contributions or capital receipts.

4.1.2 Regulation 27 also allows authorities to charge to a revenue account any amount, in addition to the MRP, in respect of the financing of capital expenditure incurred in the current financial year or any financial year before the current year (voluntary revenue provision - VRP).

4.1.3 The calculation of MRP is covered in regulation 28 of the 2003 Regulations. From 31 March 2008, Regulation 28, as amended by Regulation 4(1) of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 ('the 2008 Regulations'), requires each authority to:

> 'determine for the current financial year an amount of minimum revenue provision which it considers to be prudent.'

4.1.4 The 2003 Regulations (as amended) are accompanied by statutory guidance on minimum revenue provision, issued by the Department for Levelling Up, Housing & Communities (formerly the Ministry of Housing, Communities & Local Government (MHCLG)) under section 21(1A) of the Local Government Act 2003 ('the 2003 Act'). The latest version of this guidance (version four) was issued by MHCLG (now DLUHC) in February 2018.

4.1.5 In meeting the requirement to 'make prudent provision', the 2003 Act requires local authorities to 'have regard to' this guidance. This means that an authority must consider what the statutory guidance says. It does not mean that a local authority is obligated to follow the guidance. However, if an authority does decide to depart from the guidance, it must be able to show good reasons for doing so.

4.1.6 The current version of regulation 28 was implemented by the 2008 regulations. It came into force on 31 March 2008 and along with the first edition of MHCLG's (now DLUHC) statutory guidance on MRP, applies to 2007-08 and later years. The current version of regulation 28 provides Authorities with flexibility in how they calculate MRP, subject to the overriding requirement to 'make prudent provision'. Before this change, regulation 28 set out detailed formula - based on an authority's capital financing requirement - which authorities were required to follow when calculating MRP.

4.2 Options for making prudent provision

4.2.1 Neither the 2003 Regulations nor the statutory guidance formally define the term "prudent provision". The statutory guidance does however establish the broad aim of making prudent provision, which is to ensure that revenue is put aside to cover the underlying need to borrow for capital purposes (the capital financing requirement) over a period that is:

- commensurate with the period over which the capital expenditure provides benefits, or
- for historic borrowing originally supported by grant income rolled into Revenue Support Grant (RSG), over the period implicit in the determination of that original grant funding.

4.2.2 The DLUHC guidance outlines four possible 'options' as methods of calculating a prudent amount of MRP. However, approaches other than the four listed in the guidance are not ruled out, provided they are consistent with the statutory duty to make a prudent provision. This provides authorities with wide discretion in determining MRP. The statutory guidance also includes specific recommendations on the calculation of MRP in respect of finance leases and from 1 April 2024, leases where a right-of-use asset is recognised on balance sheet, on-balance PFI contracts and investment properties.

4.2.3 For on balance sheet leases and PFI contracts, the MRP requirement is regarded as met by a charge equal to the element of the rental/charge that goes to write down the balance sheet liability. Where a lease (or part of a lease) or PFI contract is brought onto the balance sheet, having previously been accounted for off- balance sheet, the MRP requirement is regarded, as having been met by including in the charge for the year in which the restatement occurs, an amount equal to the write-down for that year plus retrospective writing down of the balance sheet liability that arises from the restatement.

4.2.4 The four options for calculating MRP outlined in the DLUHC guidance, and restrictions on their use, are summarised in table 5.

Table 5: Options for prudent provision of MRP

Option	Method of calculation	Applicability and limits on use
'Option 1 Regulatory method'	Apply the statutory formula set out in the 2003 Regulations (as amended) before it was revoked by the 2008 Regulations	May only be used in relation to: ▪ Supported capital expenditure for RSG purposes incurred before 1 April 2008. ▪ Supported capital expenditure for RSG purposes incurred on or after 1 April 2008.
'Option 2 CFR method'	Multiply the (non-housing) Capital Financing Requirement at the end of the preceding financial year by 4%.	May only be used in relation to: ▪ Supported capital expenditure incurred before 1 April 2008. ▪ Supported capital expenditure for RSG purposes incurred on or after 1 April 2008.
'Option 3 Asset life method'	Amortise expenditure financed by borrowing or credit arrangement over the estimated useful life of the relevant assets using either the equal instalment or annuity method.	<u>Must</u> be used for capital expenditure incurred on or after 1 April 2008 that does not form part of the Authority's supported capital expenditure. This includes all expenditure capitalised under regulations or direction on or after 1 April 2008 falling outside the scope of 'Option 1'. <u>May</u> be used in relation to any capital expenditure whether or not supported and whenever incurred.
'Option 4 Depreciation method'	Charge MRP to revenue based on proper accounting practices for depreciation as they apply to the relevant assets. This includes any amount for impairment chargeable to the Income & Expenditure Account.	<u>Must</u> be used for capital expenditure incurred on or after 1 April 2008 that does not form part of the Authority's supported capital expenditure. <u>May</u> be used in relation to any capital expenditure whether or not supported and whenever incurred. Option 4 may not be used for calculating MRP to be charged in respect of investment properties.

4.2.5 Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, authorities applying 'Option 3' should calculate MRP by reference to the estimated useful life of the asset. Two main variants of this option exist: (i) the equal instalment method and (ii) the annuity method.

4.2.6 Both variations allow authorities to make additional voluntary revenue provision (VRP) or to finance expenditure through other methods of repayment during the repayment period (for example through the application of capital receipts). In such cases, appropriate adjustments should be made to the calculation of MRP. Where an authority uses Options 3 or 4, the CFR for the purposes of Options 1 and 2 is reduced by the amount of the relevant expenditure and cumulative provision for MRP made under Options 3 and 4.

4.3 MRP Policy adopted for 2024-25

4.3.1 Having regard to the statutory guidance on MRP issued by DLUHC (formerly MHCLG) and the 'options' for calculating MRP set out in that guidance, the Authority will calculate MRP:

- for all capital expenditure funded from borrowing incurred by sovereign councils prior to local government reorganisation on 1 April 2023, using the MRP policies applied by the Sovereign Councils prior to reorganisation
- for all (unsupported) capital expenditure funded from borrowing expenditure incurred on or after 1 April 2023 by applying Option 3 - Asset life method - using either the equal instalments or annuity method.

4.3.2 This hybrid approach to the calculation of MRP is summarised in table 1:

Table 1: Methodology for charging MRP in 2024-25

Unfinanced capital expenditure incurred by:	**Method of calculation**	
	Supported capital expenditure incurred before 1 April 2008	**Supported & unsupported capital expenditure incurred after 1 April 2008**
Allerdale Borough Council	**Option 2** - CFR method - 4% of Capital Financing Requirement at the end of the preceding financial year	**Option 3** - Asset Life Method, using either the equal instalments or annuity method
Carlisle City Council	N/A [CFR attributable to pre 2008 expenditure: £nil/£negative]	3% of opening CFR net of Adjustment A (calculated in accordance with the formula set out in the Statutory Guidance). For 2024-25 the calculated MRP also includes a reduction of £241k in respect of a prior year overpayment of MRP following a change in MRP policy in 2017-18.
Copeland Borough Council	**Option 2** - CFR method - 4% of Capital Financing Requirement at the end of the preceding financial year	**Option 3** - Asset Life Method, using either the equal instalments or annuity method
Cumbria County Council	2% straight line basis, net of Adjustment A. 2% calculated on CFR at 31.3.16 (net of Adjustment A) plus 2% of the reduction in MRP taken between 2017-18 to 2020-21, following a change in MRP policy in 2016-17.	**Option 3** - Asset Life Method, using either the equal instalments or annuity method
Cumberland Council	N/A	**Option 3** - Asset Life Method, using either the equal instalments or annuity method

4.3.3 For credit arrangements, such as on balance sheet PFI and leasing arrangements, MRP will be calculated in line with statutory guidance by charging as MRP an amount equal to the element of the rent/charge that goes to write down the balance sheet liability.

4.3.4 In applying ‘Option 3’:

- MRP should normally begin in the financial year following the one in which the expenditure was incurred. However, in accordance with the statutory guidance, commencement of MRP may be deferred until the financial year following the one in which the asset becomes operational
- the estimated useful lives of assets used to calculate MRP should not exceed a maximum of 50 years except as otherwise permitted by the guidance
- if no life can reasonably be attributed to an asset, such as freehold land, the estimated useful life should be taken to be a maximum of 50 years
- for expenditure capitalised by virtue of a capitalisation direction or regulation 25(1) of the 2003 regulations, the ‘asset’ life should equate to the value specified in the statutory guidance.

5. Prudential and treasury indicators 2024-25 to 2026-27

5.1 Indicators required by the Prudential Code

5.1.1 The Prudential Code requires local authorities to self-regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans, by setting estimates and limits, and by publishing actuals for a range of prudential indicators. It also requires them to ensure their treasury management practices are carried out in accordance with good professional practice.

5.1.2 The prudential and treasury indicators required by the Prudential Code, the Treasury Management Code and accompanying sector guidance issued by CIPFA, are designed to support and record local decision making. They are not designed to be comparative performance indicators and should not be used for this purpose. The prudential and treasury indicators for the forthcoming and following years must be set before the beginning of the forthcoming year. They may be revised at any time, following due process, and must be reviewed, and revised if appropriate, for the current year when the prudential indicators are set for the following year.

5.1.3 From 2024-25 the Code of Practice on Local Authority Accounting is expected to adopt the requirements of IFRS 16 - Leases. This will impact on the accounting treatment of both existing leases in place at 1 April 2024 as well as new leases entered into on or after 1 April 2024. These changes will have implications for the prudential and treasury indicators set out in this section, including estimates of capital expenditure, external debt (other long-term liabilities), Capital Financing Requirement, the Authorised Limit for External Debt and the Operational Boundary.

5.1.4 Precise measurement of the impact of IFRS 16 is dependent on the completion of balance sheet disaggregation work at 1 April 2023 and a detailed impact assessment based on data up to and including 1 April 2024. In the meantime, with the exception of the Authorised Limit and Operational Boundary, the prudential and treasury indicators for 2024-25 to 2026-27 set out in this section exclude the anticipated impact of adopting IFRS 16.

Estimates of capital expenditure

5.1.5 The estimate of capital expenditure indicator summarises the Authority's capital expenditure plans for the forthcoming year and the following two financial years. Estimates of capital expenditure include both those agreed previously and those forming part of the current (2024-25) budget cycle.

5.1.6 Capital expenditure is defined as in section 16 of the Local Government Act 2003 and includes all expenditure capitalised in accordance with proper practices together with any items capitalised in accordance with regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended), or by virtue of a capitalisation direction issued under section 16(2) of the 2003 Act. Estimates of capital expenditure include any capital expenditure that it is estimated might (depending on option appraisals) or will be dealt with as other long-term liabilities (e.g. on-balance sheet leases).

Table 6: Capital expenditure

Planned Capital Expenditure	2023-24 Approved[1] £000	2023-24 Revised[2] £000	2024-25 Estimate £000	2025-26 Estimate £000	2026-27 Estimate £000
Approved in 2023-24 (& prior years) [1]	174,107	174,107	77,855	44,636	23,003
Budgets carried forward from 2022-23	0	73,674	0	0	0
In-year adjustments to Q2 2023-24	0	1,562	0	0	0
Current budget (Q2)	**174,107**	**249,343**	**77,855**	**44,636**	**23,003**
Programme revisions Q3	0	41,810	0	0	0
Reprofiling adjustments	0	(119,487)	71,282	48,205	0
Other Growth/(Savings)	0	(1,090)	86,259	30,335	0
Capitalisation Direction	40,000	40,000	0	0	0
Reprofile use of Capitalisation Direction	0	(27,150)	27,150	0	0
Uplift to Capitalisation Direction ask	0	0	14,080	12,133	0
Total expenditure	**214,107**	**183,426**	**276,626**	**135,309**	**23,003**

[1] Approved capital programme for 2023-24;

[2] Updated to reflect carry forward of budget from 2022-23, additional capital bids/savings, reprofiling and reallocation adjustments included in the current capital budget for 2023-24 and the reprofiling and other adjustments proposed as part of the 2024-25 budget setting round.

5.1.7 Further information regarding the Authority's capital expenditure plans is set out in the 2024-25 Revenue and Capital Budget report (presented to the Executive on 13 February 2024 and Full Council on 6 March 2024).

5.1.8 Table 7 shows how these capital expenditure plans will be financed through the application of capital and revenue resources. Any excess of capital expenditure over resources applied (unfinanced expenditure) will result in a corresponding increase in the underlying need for borrowing (the capital financing requirement).

Table 7: Financing of capital expenditure

	2023-24		Estimate		
	Current £000	Revised £000	2024-25 £000	2025-26 £000	2026-27 £000
Total expenditure	**214,107**	**183,426**	**276,626**	**135,309**	**23,003**
Financed by:					
Capital receipts	1,079	1,278	1,433	88	0
Capital grants/contr'ns	135,785	135,071	208,715	93,103	12,270
Revenue/Reserves	1,780	1,951	1,373	0	0
Total financed	**138,644**	**138,300**	**211,521**	**93,191**	**12,270**
Unfinanced expenditure:					
Supported borrowing[1]	0	0	0	0	0
Unsupported borrowing	75,463	45,126	65,105	42,118	10,733
Leasing	0	0	0	0	0
Financed & unfinanced	**214,107**	**183,426**	**276,626**	**135,309**	**23,003**

[1] Following the Spending Review 2010 there have been no new supported borrowing allocations since 2010-11 (although the level of assumed outstanding debt is still included in the calculation of formula grant allocations). This form of financial support has been discontinued from 2011-12.

Estimates of the Capital Financing Requirement

5.1.9 The Capital Financing Requirement (CFR) is a measure of an authority's underlying need to borrow for capital purposes. It represents the historic cost of capital expenditure that has yet to be financed by setting aside resources (grants, contributions, capital receipts or direct revenue financing). It does not necessarily correspond with an authority's actual borrowing position. The level of external debt will be determined in accordance with an authority's treasury management strategy and practices and authorities should not associate borrowing with particular items of expenditure unless required to do so by legislation or official guidance.

5.1.10 Capital expenditure that is not financed up-front through the application of capital grants, contributions, capital receipts or a direct charge to revenue, will increase the Capital Financing Requirement. Charging the minimum revenue provision or a voluntary revenue provision against the general fund will reduce the CFR. The CFR includes items of capital expenditure included in the Authority's balance sheet that are associated with other long-term liabilities, such as on-balance sheet leases, deferred purchases and similar arrangements, but excluding the underlying liability.

5.1.11 Table 8 sets out estimates of the Authority's capital financing requirement at the end of 2023-24 and the following three financial years.

Table 8: Capital financing requirement

	2023-24		Estimate		
	Approved £000	Revised £000	2024-25 £000	2025-26 £000	2026-27 £000
CFR -1 April - Borrowing	356,516	337,320	371,375	423,327	449,265
CFR -1 Apr.- leases & PFI	95,835	95,936	93,641	90,610	86,939
CFR - IFRS 16 impact	0	0	0	0	0
Total CFR at 1 April	**452,351**	**433,256**	**465,016**	**513,937**	**536,204**
CFR - 31 Mar. - Borrowing	420,490	371,375	423,327	449,265	441,826
CFR - 31 Mar.- leases & PFI	93,520	93,641	90,610	86,939	82,719
CFR - IFRS 16 impact	0	0	0	0	0
Total CFR at 31 March	**514,010**	**465,016**	**513,937**	**536,204**	**524,545**
Movement in CFR	**61,659**	**31,760**	**48,921**	**22,266**	**(11,659)**
Represented by:					
Unfinanced expenditure	75,463	45,126	65,105	42,118	10,733
Less: MRP/VRP	(11,477)	(11,071)	(13,153)	(16,181)	(18,172)
Less: MRP(PFI & leases)	(2,315)	(2,295)	(3,031)	(3,671)	(4,220)
Other movements	(12)	0	0	0	0
Movement in CFR	**61,659**	**31,760**	**48,921**	**22,266**	**(11,659)**

Gross debt and the capital financing requirement (CFR)

5.1.12 A fundamental provision of the Prudential Code and a key indicator of prudence is that over the medium term, debt will only be for a capital purpose. To ensure this is the case, the Prudential Code requires that gross external debt should not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

5.1.13 This requirement allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes. If in any of these years there is a reduction in the CFR, this reduction is ignored in estimating the cumulative increase in the CFR used for comparison with gross external debt. Gross debt refers to the sum of borrowing and other long-term liabilities (credit arrangements) such as on-balance sheet leases.

Table 9: Gross debt & the CFR 2022-23

	£000	Limit 2024-25 £000
Forecast CFR at 31 March 2024		465,016
Adoption of IFRS 16 - Leases at 1 April 2024		0
Estimated additional CFR for:		
2024-25 (see table 8)	48,921	
2025-26 (see table 8)	22,266	
2026-27 (see table 8)	0	71,187
Limit		**536,203**
Gross Debt 2024-25 (maximum)[1]		
Estimated gross debt at 31 March 2024 - existing borrowing	253,421	
Estimated (maximum) net additional borrowing - 2023-24	67,938	
Estimated (maximum) net additional borrowing - 2024-25	67,605	
Estimated PFI & on balance sheet lease liabilities at 1 April 2024	93,641	
Estimated Value of new leases 2024-25 (inc. IFRS 16 impact)	-	
Estimated gross debt 2024-25		**482,605**
Excess of CFR over gross debt		**53,598**

[1] Additional debt excluding repayments made

5.1.14 At 31 December 2023, the Authority was under-borrowed against its capital financing requirement by approximately £77.7m. The Authority does not anticpate any difficulties in complying with this indicator during 2024-25 or the following two financial years.

5.1.15 Forward projections for borrowing and the CFR re summarised in the following table. The projections are predicated on the assumption that in year cash flows and reserve balances will be available to maintain an underborrowed position of approximately £50m in 2023-24 and 2024-25.

Table 9a: Forward Projections of borrowing and the CFR (based on budget)

	1.4.23 £000	31.3.24 £000	31.3.25 £000	31.3.26 £000	31.3.27 £000
Borrowing	260,305	321,359	373,269	412,821	415,230
Other long-term liabilities	95,936	93,641	90,610	86,939	82,657
Total Gross Debt	**356,241**	**415,000**	**463,879**	**499,760**	**497,887**
CFR - borrowing	337,320	371,375	423,327	449,265	441,826
CFR - Other long-term liabilities	95,936	93,641	90,610	86,939	82,719
CFR - total	**433,256**	**465,016**	**513,937**	**536,204**	**524,545**
(Under)/over borrowing	(77,015)	(50,016)	(50,058)	(36,443)	(26,658)

Authorised limit for external debt

5.1.16 The Authorised Borrowing Limit represents the statutory limit on borrowing determined under section 3 of the Local Government Act 2003 (Affordable Limit). It imposes an upper limit on the Authority's gross external debt (excluding investments), separately identifying borrowing (external loans) from other long-term liabilities (for example on-balance sheet lease liabilities). Breach of the Affordable Borrowing Limit is prohibited by section 2(1)(a) of the Local Government Act 2003.

5.1.17 The Authorised Borrowing Limit is set with reference to the Authority's capital expenditure plans, capital financing requirement (or underlying borrowing requirement) and the potential need to borrow to meet temporary revenue borrowing requirements, pending the receipt of amounts due to the Authority. The Affordable Borrowing Limit also includes headroom over and above the Operational Boundary (see below) to accommodate any unusual or unforeseen cash movements. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table 10: Authorised Limit for External Debt

	2023-24 Original Limit £000	2023-24 Revised Limit £000	2024-25 Limit[1] £000	2025-264 Limit[1] £000	2026-27 Limit[1] £000
Borrowing	445,000	400,000	450,000	475,000	475,000
Other long-term liabilities	106,000	106,000	104,000	101,000	97,000
Other LT liabilities: IFRS 16[1]	-	-	15,000	15,000	15,000
Total	**551,000**	**506,000**	**569,000**	**591,000**	**587,000**

[1]allowance for the impact on other long term liabilities arising from the anticipated changes to the 2024-25 Code of Practice on Local Authority Accounting in relation to the adoption of IFRS 16 Leases.

Operational boundary for external debt

5.1.18 The Operational Boundary represents the limit beyond which (gross) external debt is not expected to exceed. It is based on expectations of the maximum external debt of a local authority according to probable events (that is the most likely (prudent), but not worst case scenario) and is consistent with the maximum level of external debt projected by these estimates. The Operational Boundary links directly to the Authority's plans for capital expenditure, estimates of the capital financing requirement and cash flow requirements for the year for all purposes but without the additional headroom included within the Authorised Limit. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table 11: Operational boundary for external debt

	2023-24 Original Limit £000	2023-24 Revised Limit £000	2024-25 Limit[1] £000	2025-26 Limit[1] £000	2026-27 Limit[1] £000
Borrowing	420,000	375,000	425,000	450,000	450,000
Other long-term liabilities	96,000	96,000	94,000	91,000	87,000
Other LT liabilities: IFRS 16[1]			10,000	10,000	10,000
Total	**516,000**	**471,000**	**529,000**	**551,000**	**547,000**

[1]allowance for the impact on other long term liabilities arising from the anticipated changes to the 2024-25 Code of Practice on Local Authority Accounting in relation to the adoption of IFRS 16 Leases.

5.1.19 In the TMSS for 2023-24 the Operational Boundary and Authorised Limits for borrowing, in the three financial years 2024-25 to 2026-27, were set £420m and £445m respectively.

Estimates of the ratio of financing costs to net revenue stream

5.1.20 This indicator of affordability highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs.

5.1.21 Estimates of financing costs comprise the aggregate of the following amounts included in the Authority's original and revised budgets:

- interest charged to the General Fund with respect to borrowing
- interest payable under on-balance sheet leasing arrangements and any other long-term liabilities
- premiums and discounts from debt restructuring charged or credited to the amount to be met from government grants and local taxpayers
- amounts payable or receivable in respect of financial derivatives
- minimum revenue provision plus any additional voluntary contributions
- any amounts for depreciation/impairment charged to the amount to be met from government grants and local taxpayers.

5.1.22 Estimates for net revenue stream for current and future years are taken from the Authority's estimates of the amounts to be met from government grants and local taxpayers, using the equivalent figures from the Authority's original and revised budgets.

Table 12: Ratio of Financing Costs to Net Revenue Stream

	2023-24 Original %	2023-24 Revised %	2024-25 Estimate %	2025-26 Estimate %	2026-27 Estimate %
Ratio total	12.42%		12.89%	14.00%	14.48%
Borrowing	8.13%		8.69%	9.85%	10.41%
Leases	4.29%		4.20%	4.15%	4.08%

5.1.23 Calculation of the amounts set out in table 12 reflect the unringfenced financing included in the 2024-25 revenue budget proposals and the latest iteration of the Authority's Medium Term Financial Plan accompanying those proposals. As such the net revenue stream used in calculating the ratios above incorporates all grants included in the Authority's Core Spending Power. This includes the Authority's Social Care Grant allocation. In more recent years however use of this grant has been restricted to use in meeting adult and children's social care needs. If this grant is excluded from the calculation of the net revenue stream the ratio totals for financial years 2024-25, 2025-26 and 2026-27 increase to 14.19%, 15.37% and 15.87% respectively.

5.2 Indicators required by the Treasury Management Code (sector guidance)

5.2.1 In addition to the indicators required by the Prudential Code there are also a number of treasury indicators required by the sector guidance for local authorities that accompanies the Treasury Management Code. These are:

- upper and lower limits to the maturity structure of its borrowing
- upper limits for long-term treasury management investments.

5.2.2 These treasury management indicators specify ranges (rather than targets) designed to limit the Authority's exposure to liquidity and refinancing risks.

Upper and lower limits to the maturity structure of borrowing

5.2.3 This indicator highlights potential exposures to refinancing risk arising from concentrations of debt falling due for refinancing and is designed to facilitate reductions in the Authority's exposure to refinancing at times of volatile or high interest rates.

5.2.4 It is calculated as the amount of projected borrowing maturing in each period as a percentage of total projected borrowing. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Table 13: Lower/upper limits on % borrowing maturing in each period

	1.4.23 Actual	31.3.24 Forecast existing loans only	31.3.24 Forecast	2023-24		2024-25	
				Lower limit	Upper limit	Lower limit	Upper limit
	%	%	%	%	%	%	%
Under 12 months	2.68	6.23	5.13	0	20	0	40
12 months to 2 years	6.03	0.48	18.11	0	40	0	40
2 years to 5 years	1.27	1.17	0.97	0	40	0	40
5 years to 10 years	8.32	14.40	11.85	0	40	0	40
10 years to 20 years	19.57	13.99	11.51	0	100	0	100
20 years to 30 years	10.47	21.41	17.61	0	100	0	100
30 years to 40 years	32.45	22.59	18.58	0	100	0	100
40 years to 45 years	15.37	15.78	12.99	0	100	0	100
45 years to 50 years	3.84	3.95	3.25	0	100	0	100

Upper limits for long-term treasury management investments

5.2.5 A local authority that invests, or plans to invest, for treasury management purposes in fixed interest instruments for periods longer than a year, or in other instruments only appropriate for longer-term investment, is required to set an upper limit for each forward financial year period for the maturing of such investments. Longer-term instruments with no fixed maturity date include pooled bond, equity and property funds (but not money market funds), as well as directly held equities. Investments taken or held for service purposes or commercial purposes should not be included in this indicator.

5.2.6 The purpose of these limits for principal sums invested for periods longer than 365 days is for the local authority to contain its exposure to the possibility of loss that might arise as a result of its having to seek early repayment or redemption of principal sums invested.

5.2.7 The indicator is calculated as follows:

- total principal sum invested to final maturities beyond the period end for years one, two, three, etc.
- total amounts invested in longer-term instruments with no fixed maturity date.

Table 14: Upper limits on long-term treasury management investments

	2023-24 Limit £000	2024-25 Limit £000	2025-26 Limit £000	2026-27 Limit £000
Principal sums invested - fixed maturities	Lower of £4m and 10% of the portfolio at any time during the financial year			
Principal sums invested - investments with no fixed maturity date				

5.2.8 For its cash flow generated balances, the Authority will seek to utilise its call and notice accounts, money market funds and short-dated deposits (overnight to 12 months). The Authority will not invest for periods of more than 365 days during 2024-25.

5.3 Indicators not yet adopted (required from 2023-24)

5.3.1 The following prudential and treasury management indicators have not yet been adopted:

- estimates of net income from commercial and service investments to net revenue stream
- the liability benchmark.

Estimates of net income from commercial and service investments to net revenue stream

5.3.2 Net income from commercial and service investments comprises net income from financial investments (other than treasury management investments), together with net income from other assets held primarily for financial return, such as commercial property. Costs netted-off gross income comprise investment management costs and any other direct revenue costs of investment. Borrowing costs (interest and MRP) are not be deducted for the purposes of this indicator, which is intended to show the financial exposure of the Authority to the loss of income.

5.3.3 Estimates for net revenue stream for current and future years are taken from the Authority's estimates of the amounts to be met from government grants and local taxpayers, using the equivalent figures from the Authority's original and revised budgets.

Liability benchmark

5.3.4 The liability benchmark is a projection of the amount of loan debt outstanding the Authority needs each year to fund its existing debt liabilities, planned prudential borrowing and other cash flows. The liability benchmark is the combination of four balances:

i. Existing loan debt outstanding i.e. the Authority's existing loans that are still outstanding in future years.

ii. Loans (borrowing) CFR calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP, taking account of approved prudential borrowing.

iii. Net loans requirement: the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.

iv. Liability benchmark (or gross loans requirement) equal to the net loans requirement plus short-term liquidity allowance. Short-term liquidity allowance means an adequate (but not excessive) allowance for a level of excess cash to be invested short term to provide access to liquidity if needed (due to short-term cash flow variations, for example).

5.3.5 The liability benchmark provides a measure of how well the existing loans portfolio matches the Authority's planned borrowing needs. This is shown by the gap between the Authority's existing loans that are still outstanding at a given future date and the Authority's future need for borrowing (as shown by the liability benchmark. The liability benchmark identifies the maturities needed for new borrowing in order to match future liabilities and provides a mechanism for preventing future over-borrowing as well as a measure of financing or refinancing risk.

5.3.6 Work required to implement these remaining indicators is currently ongoing.

6. Appendices

A. Interest Rate Forecasts 2024 - 2027

B. Economic Background

C. Credit Ratings

D. Public Works Loan Board (PWLB) lending arrangements – effective from 26 November 2020

Appendix A: Interest Rate Forecasts 2024 – 2027

PWLB rates and forecast shown below have taken into account the 20bp certainty rate reduction from the new Standard Loan rate of 100bps over Gilts effective as of the 26 November 2020.

Link Group Interest Rate View	08.01.24												
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25%	5.25%	4.75%	4.25%	3.75%	3.25%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
3 month av. earnings	5.30%	5.30%	4.80%	4.30%	3.80%	3.30%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
6 month av. earnings	5.20%	5.10%	4.60%	4.10%	3.70%	3.30%	3.10%	3.10%	3.10%	3.10%	3.10%	3.10%	3.10%
12 month av. earnings	5.00%	4.90%	4.40%	3.90%	3.60%	3.20%	3.10%	3.10%	3.10%	3.10%	3.10%	3.20%	3.20%
5 yr PWLB	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.80%	3.70%	3.60%	3.60%	3.50%	3.50%	3.50%
10 yr PWLB	4.70%	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.90%	3.80%	3.70%	3.70%	3.70%	3.70%
25 yr PWLB	5.20%	5.10%	4.90%	4.80%	4.60%	4.40%	4.30%	4.20%	4.20%	4.10%	4.10%	4.10%	4.10%
50 yr PWLB	5.00%	4.90%	4.70%	4.60%	4.40%	4.20%	4.10%	4.00%	4.00%	3.90%	3.90%	3.90%	3.90%
Bank Rate													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
Link Group	5.25%	5.25%	4.75%	4.25%	3.75%	3.25%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Capital Economics	5.25%	5.00%	4.50%	4.00%	3.50%	3.00%	3.00%	3.00%	-	-	-	-	-
5yr PWLB Rate													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
Link Group	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.80%	3.70%	3.60%	3.60%	3.50%	3.50%	3.50%
Capital Economics	4.50%	4.30%	4.20%	4.00%	3.90%	3.80%	3.80%	3.70%	-	-	-	-	-
10yr PWLB Rate													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
Link Group	4.70%	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.90%	3.80%	3.70%	3.70%	3.70%	3.70%
Capital Economics	4.50%	4.40%	4.20%	4.10%	4.10%	4.10%	4.10%	4.10%	-	-	-	-	-
25yr PWLB Rate													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
Link Group	5.20%	5.10%	4.90%	4.80%	4.60%	4.40%	4.30%	4.20%	4.20%	4.10%	4.10%	4.10%	4.10%
Capital Economics	5.10%	4.80%	4.60%	4.30%	4.40%	4.40%	4.50%	4.60%	-	-	-	-	-
50yr PWLB Rate													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
Link Group	5.00%	4.90%	4.70%	4.60%	4.40%	4.20%	4.10%	4.00%	4.00%	3.90%	3.90%	3.90%	3.90%
Capital Economics	4.70%	4.60%	4.50%	4.30%	4.30%	4.30%	4.40%	4.40%	-	-	-	-	-

Appendix B: Economic Background

UK GDP

B.1 Whilst concerns of a deep recession have largely receded, weakening global economic conditions, the lagged impact of higher interest rates and persistent inflation coupled with low productivity and policy uncertainty in the run up to a general election, are expected to provide significant headwinds to economic growth in the near term. As a consequence economic growth during 2024 is expected to be tepid at best.

B.2 UK GDP growth weakened in 2023, with this weakness particularly pronounced in market sector output. This reflected the significant tightening of monetary policy implemented since the end of 2021 to contain the persistence of second-round effects on inflation as well as continued weakness in potential supply growth.

B.3 Following growth of 0.3% quarter on quarter (q/q) in Quarter 1 (Q1) of 2023 and 0.0% (revised down from 0.2%) in Q2, UK gross domestic product (GDP) fell by 0.1% in Quarter 3 (July to Sept) 2023 (revised down from no growth), The contraction reflected broad-based falls across household consumption, business investment and housing investment. This represents the weakest performance in four quarters. Compared with the same quarter a year ago, real GDP is estimated to have expanded by 0.3% y/y in Quarter 3 2023, the same as in Q2. In output terms there was a 0.2% fall in the services sector, which offset a 0.4% increase in construction output and a 0.1% increase in the production sector.

B.4 UK GDP in Q3 2023 was 1.4% higher compared to the pre-pandemic level of Q4 2019. This compares with Eurozone GDP being 3.0% higher, with GDP in France up by 1.7% and in Germany up by 0.3%. The other G7 economies had higher growth than the UK over this period, including the US where GDP was 7.3% higher.

B.5 Monthly GDP declined further in October, falling by 0.3% (-0.1y/y) but rebounded in November 0.3 (+0.2 y/y), such that GDP is expected to have been broadly flat across 2023 Q4 as a whole.

B.6 Overall, GDP growth is expected to remain subdued throughout 2024 as the drag from higher interest rates is protracted. However falling inflation and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025. In their November 2023 Economic and fiscal outlook, the Office for Budget Responsibility's (OBR) GDP growth forecast was 0.6% in 2023 and 0.7% in 2024. Meanwhile the Treasury's January 2024 survey of independent forecasts showed an average forecasts for GDP growth of 0.4% for 2023 and 0.4% for 2024.

Inflation

B.7 Sharp rises in inflation during 2021 and 2022 saw CPI inflation peak at a 41 year high of 11.1% in October 2022 before easing back to 10.1 % in March 2023. Since then, CPI inflation has continued to fall during 2023 through a combination of statistical effects, falling energy prices, and other factors such as the easing of global cost pressures. However, despite this fall inflation remains well above the Bank of England's 2% target and given the continued persistence of services inflation - supported by strong pay growth - is not expected to return to target until 2025.

B.8 The rise in inflation during 2021 and 2022 reflected, for the most part, the direct impact of large increases in global energy and other tradable goods prices, though services inflation also increased. The rise in global energy prices was exacerbated by the economic impact of Russia's invasion of Ukraine. It also contributed significantly to rises in the wholesale price of many agricultural and other tradeable commodities.

B.9 However, even before the war, consumer prices were being pushed upwards by various global factors including the pattern of economic recovery from the worst of the pandemic, the rotation of consumer spending towards goods and away from services, and by supply constraints in certain sectors. Inflation was initially believed to be temporary. However, this succession of global shocks contributed to inflationary pressures in the UK being more persistent than expected.

B.10 While global factors were the original drivers of high inflation not all of the excess inflation can be attributed to global events. Domestic factors, including a tight labour market and the pricing strategy of firms also contributed to the rise in inflation. Core services CPI inflation, which excludes volatile items such as food and energy, also rose significantly driven by the tight labour market and strong nominal pay growth.

B.11 CPI inflation in the 12 months to October 2023 was 4.6%, down from 6.7% in both September and August, and below market expectations of 4.8%. This marked the lowest rate since October 2021 and reflected a large fall in the housing, electricity, gas and other fuels category which contributed 1.6 percentage points out of the overall monthly fall. This fall was due in part to the recent reduction in energy prices following Ofgem's decision to lower the cap on household bills. It also reflected the base effects of last Octobers sharp increase in energy prices dropping out of the annual comparison. On a monthly basis, the CPI was unchanged.

B.12 The cost of housing and utilities fell by 3.5% (compared to a 6.9% increase in September), with both gas and electricity costs falling by the most since January 1989. Additionally, food inflation eased to 10.1%, the lowest since June 2022. Consumer prices have also slowed for transport (0.5% vs 0.7%), restaurants and hotels (7.5% vs 8.6%), furniture, household equipment, and maintenance (3.1% vs 3.7%), clothing and footwear (6.2% vs 6.9%), and miscellaneous goods and services (5.1% vs 5.3%).

B.13 After rising from 6.2% in March 2023 to 6.8% in April and then to 7.1% in May (its highest rate since 1992), the core inflation rate eased to 5.7% in October, the lowest since March 2022.

B.14 Services inflation rose during 2022, from 3.2% in January to 6.8% in December. After dipping to 6% in January 2023, it then ticked up again rising to 6.6% in February and March, 6.9% in April and 7.4% in May – the highest rate since 1992. The services inflation rate has since dipped below 7% in August (6.8%) and September (6.9%) before falling to 6.6% in October. Services prices are seen as less exposed to global factors and more dependent on domestic costs. Inflation in services is also considered to be more persistent than inflation in goods. Driven by a combination of high energy costs and labour costs, services inflation remains significantly higher than its pre-pandemic level (circa 2.5%) and is expected to remain elevated in the near-term.

B.15 The forecasts contained in the Bank of England's November Monetary Policy Report show a continued fall in CPI inflation in the near term, to around 4.75% in 2023 Q4, 4.5% in 2024 Q1 and 3.75% in 2024 Q2. This decline was expected to be accounted for by lower energy, core goods and food price inflation and, beyond January, by some fall in services inflation. In the MPC's November report the most likely, or modal, projection conditioned on the market-implied path for the Bank Rate, was for CPI inflation to return to the 2% target by the end of 2025. It then falls below the target thereafter, as an increasing degree of economic slack reduces domestic inflationary pressures.

B.16 There are however considerable uncertainties around the pace at which CPI inflation will return sustainably to the 2% target with the risks associated with the Bank's modal inflation projection currently skewed to the upside. This primarily reflects the possibility of more persistence in domestic wage and price-setting, but also the increasing upside risk to inflation from energy prices given events in the Middle East. In the Bank's most recent forecasts CPI inflation is projected to fall temporarily to the 2% target in 2024 Q2 before increasing again in Q3 and Q4 to around 2.75% by the end of this year. It then remains above target over nearly all of the remainder of the forecast period, falling to around 2.3% in 2026 Q1 2026 and 1.9% in 2027 Q1.

B.17 Services inflation was expected to remain elevated but broadly stable throughout 2023 Q4, before increasing temporarily in January 2024. Thereafter services inflation is expected to fall back gradually from February 2024 as wage growth moderates and non-labour input cost pressures ease.

B.18 CPI inflation subsequently fell from 4.6% in October to 3.9% in November before rising unexpectedly to 4% in December 2023; the first time the rate has increased since February 2023. Meanwhile core CPI (excluding energy, food, alcohol and tobacco) rose by 5.1% in the 12 months to December 2023, the same rate as in November. The CPI goods annual rate slowed from 2.0% to 1.9%, while the CPI services annual rate increased from 6.3% to 6.4%.

B.19 The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). This represents the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. This was below the 6.9% forecast in the Bank's November Monetary Policy Report with the data providing signs of easing in domestic inflationary pressures.

Labour Market

B.20 Whilst the labour market remains tight in a historical context, 2023-24 has seen evidence of a loosening in labour market conditions against a backdrop of monetary tightening and subdued economic activity. There is however a significant level uncertainty regarding the strength of the labour market, with ongoing concerns over the quality of published data leading to significant changes to more recent employment, unemployment and economic inactivity statistics.

B.21 Updated estimates from the ONS issued in early February 2024 indicate that over the last five months, the employment rate has remained broadly flat, while the unemployment rate may have fallen, offset by an increase in the rate of economic inactivity; however, some uncertainty remains in these estimates.

B.22 The UK Employment Rate remained unchanged at 75.7% in the three months to September 2023, unchanged from the previous quarter (April to June). This was up from the 75.5% recorded in the in corresponding July to September of 2022 but below the 75.9% recorded for Q1 of 2023. Employment levels increased by 54,000 in the last quarter and by 244,000 over the course of the last 12 months. However, the employment rate remains below the pre-pandemic level of 76.3%.

B.23 In the three months to November 2023 the adjusted employment rate edged up from 75.7% to 75.8% (subsequently revised down to 75.0%).

B.24 The unemployment rate (based on the ONS' experimental estimate of unemployment) for the three months July to September 2023 was 4.2%. This was unchanged from the previous quarter but 0.6 percentage points higher than the corresponding July to September period last year. Although the unemployment rate has risen over recent months, it still remains low in a historical context. In the Bank of England's November projections, the unemployment rate is expected to rise further over the forecast period increasing to 4.7% in Q4 2024, 5.0% in 2025 Q4 and 5.1% in 2026 Q4.

B.25 In the three months September to November the UK adjusted experimental unemployment rate remained unchanged at 4.2%, although this has since been revised down to 3.9%.

B.26 Whilst the rise in unemployment during 2023 was relatively muted, the impact of monetary policy tightening has been felt much more acutely on vacancies. In Q3 of 2023 (July to September) the number of vacancies fell to 981,000; a fall of 51,000 on the previous quarter (April to June) and a reduction of 263,000 on the same quarter last year. That is the first time it has fallen below 1m since July 2021. Although vacancies were still 180,000 higher than the pre-pandemic quarter (January to March 2020), they have been falling every quarter since April to June 2022, suggesting on-going loosening of labour market conditions.

B.27 The number of job vacancies in the United Kingdom fell by 49,000 in the quarter to 934,000 in October to December 2023, suggesting that businesses are showing reluctance to hire permanent employees amid the ongoing economic uncertainty. This marks the 18th consecutive quarterly decline, setting the record for the longest consecutive run of quarterly falls ever recorded and reaching the lowest number of vacancies since April to June 2021. Vacancies decreased in 12 out of the 18 industry sectors, with the most significant decline observed in arts, entertainment, and recreation, as well as transport and storage. Year-on-year, total vacancies decreased by 226,000, reflecting a decline of 19.4%. However, they still stand 133,000 above the pre-coronavirus pandemic levels reported between January and March 2020.

B.28 The ONS vacancies to unemployment ratio, a key measure of labour market tightness, has been falling since August 2022, reflecting both a steady fall in the number of vacancies and rising unemployment. In mid-2022, the number of vacancies was higher than the number of unemployed people (with a peak ratio of 1.1). In the period July to September 2023, that number had shifted to around 1.5 unemployed people for every vacancy (a ratio of around 0.7). From a figure of 0.68 in September the ratio has since fallen to 0.66 in October and 0.65 in November. Despite the steady downwards trajectory of the vacancies to unemployment ratio, it currently remains just above its 2019 Q4 level.

B.29 One of the key reasons why the labour market has tightened since the pandemic is because of a marked increase in the number of people inactive in the labour market. Underpinning this increase in inactivity has been the rise in long-term sickness. The economic inactivity rate - those without a job and not actively searching for one - for the period July to September 2023 was unchanged from the previous quarter at an estimated 20.9%; 0.1 percentage points lower than the quarter January to March 2023 and 0.7 percentage points lower than the 21.6% inactivity rate for the corresponding July to September period last year. Whilst participation rates have recovered from earlier depressed levels the inactivity rate remains 0.7 percentage points higher than before the pandemic. The number of economically inactive people in July to September 2023 was 280,000 above pre-pandemic levels (December 2019 to February 2020).

B.30 In the three months to November 2023 the economic inactivity rate was initially reported to have fallen slightly, from 20.9% to 20.8%. Inactivity fell by 4,000 from the three month period July to September and by 268,000 on the corresponding three month period of last year (September to November 2022). The inactivity rate was for September to November was however subsequently revised up from 20.8% to 21.9%.

B.31 Despite the cooling in labour market condition and an easing of pay growth in over the second half of 2023 pay growth remains elevated overall. Annual growth in regular pay (excluding bonuses) was 7.7% in July to September 2023. Although this was slightly down on the previous periods and the 8.5% peak reported in the period May to July, it was still among the highest annual growth rates since comparable records began in 2001. Annual growth in employees' average total pay (including bonuses) was 7.9% in July to September 2023. This represented one of the largest annual growth rates seen outside of the coronavirus pandemic period. However, this total growth rate was affected by the civil service one-off non-consolidated payments made in July and August 2023.

B.32 Annual average regular pay growth for the public sector was 7.3% in the period July to September 2023; the highest regular annual growth rate since comparable records began in 2001. For the private sector the recorded growth of 7.8%, was among the largest annual growth rates seen outside of the coronavirus (COVID-19) pandemic period, when the growth rate peaked at 8.4% in April to June 2021. Annual average total pay growth in July to September 2023 was 7.7% for the private sector and 8.6% for the public sector.

B.33 In the three months to November of 2023, average weekly earnings including bonuses in the UK increased 6.5% year-on-year, the least in eight months and below market forecasts of a 6.8% rise. Wage growth slowed in both the public sector (6.6% vs 7.2% in the three months to October) and the private sector (6.4% vs 7.1% in the three months to October). Meanwhile, regular pay which excludes bonus payment, went up 6.6%, the lowest growth in ten months, below a 7.2% rise in the previous two periods and matching expectations.

B.34 Despite continued high inflation real terms annual growth in earnings (adjusted for inflation using the Consumer Prices Index including owner occupiers' housing costs (CPIH)) both including and excluding bonuses was positive. In the three months to November total pay (including bonuses) rose in real terms by 1.3% (July to September 1.4%) and by 1.4% for regular pay excluding bonuses (July to September 1.3%).

B.35 Although the precise near-term path of pay growth remains uncertain, lower inflation expectations and a looser labour market are expected to lead to a further decline in pay growth during 2024 although rates are expected to remain high.

Bank Rate

B.36 The UK Bank Rate started 2023-24 at 4.25%. Subsequent increases during the first half of 2023-24 saw the rate rise to 4.5% in May, 5.00% in June and to a 15-year high of 5.25% in August as the Bank of England continued with its efforts to combat ongoing inflationary pressures.

B.37 After 14 consecutive rises the Bank of England’s Monetary Policy Committee voted, by a majority of 5-4, to maintain the Bank Rate at 5.25% at its meeting on 20 September 2023. Four members preferred to increase the Bank Rate by 0.25 percentage points to 5.5%. The Committee also voted unanimously to reduce the stock of UK government bond purchases held for monetary policy purposes, and financed by the issuance of central bank reserves, by £100 billion over the next twelve months, to a total of £658 billion. Given the weak August CPI inflation release, a loosening in labour market conditions and the downbeat activity surveys this appeared to have convinced the Bank of England that it has already raised rates far enough.

B.38 The minutes of the September meeting were little changed from those from August, in repeating the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long". Like the US Federal Reserve, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again stated that "...if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required."

B.39 The aim of this narrative appears to reflect the Bank's desire to ensure the markets do not decide that a peak in rates will be soon followed by rate cuts and that looser financial conditions, with the potential to undermine its attempts to quash inflation through monetary tightening, do not materialise. This point was underlined by the comments made by Bank's Governor after the September meeting in which he stated that while the MPC has paused, it was not inevitable that a cut would soon follow, stressing that "we have not had any discussion on the Monetary Policy Committee about reducing rates because that would be very, very premature". The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at a future meeting.

B.40 The minutes of the September meeting suggested the Committee expected services inflation to be volatile over the coming few months, while it also seemed to play down the impact of the recent surge in pay growth, saying that the headline measure appeared inconsistent with other wage metrics. This may indicate the Committee now has greater tolerance to data surprises, which could add to expectations that rates have peaked.

B.41 At its next meeting on 1 November 2023, the MPC again voted to keep the Bank Rate unchanged at 5.25% for a second consecutive time. However, unlike the Federal Reserve's unanimous decision the previous day, the vote was more balanced at 6-3.Three members preferred to increase the Bank Rate by 0.25 percentage points, to 5.5% to counteract on-going inflationary pressures.

B.42 In terms of messaging there was no dovish shift in the accompanying guidance with the Bank once again stating that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". On this it cited the recent rise in global bond yields and the upside risks to inflation from "energy prices given events in the Middle East". So, like the Federal Reserve, the Bank of England appeared to be keeping the door open to the possibility of further rate hikes. It also repeated the phrase that policy will be "sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably in the medium term". Meanwhile a new addition to the guidance, underlining the Bank's commitment to policy maintenance, stated that the "MPC's projections indicate that monetary policy is likely to need to be restrictive for an extended period of time". Indeed, The Bank's Governor was at pains in his press conference to drum home to markets that the Bank means business in squeezing inflation out of the economy.

B.43 Overall, the meeting underlined market views that policy rates have peaked, given there was little in the report to counter the previously held view that the Committee has a greater tolerance to upside data surprises. However, while the next move is expected to be a cut, this may not materialise until the latter stages of 2024, with the Bank's Governor reiterating that it was "much too early to be thinking about rate cuts". In terms of market reaction, gilt yields pulled lower, while market rate expectations for the second half of next year also eased, given that many believe that the economic outlook painted by the Bank remains too optimistic.

B.44 As widely expected, the Bank of England's MPC kept the Bank Rate unchanged at 5.25% for a third consecutive time at its December meeting. As in November, and in contrast to the US Federal Reserve's unanimous decision, the vote was more balanced at 6-3, with the three dissenting votes still favouring a further tightening (as concerns about "sticky" inflation remained in place). Adding to the divergence between the two central banks, the Federal Reserve's dot plot suggested no member expected policy rates to be tightened further, with a median expectations of three cuts for 2024.

B.45 In contrast, the MPC continued to push back against what it evidently sees as sterling market over exuberance for possible rate cuts in 2024. In the minutes of the December meeting the Bank maintained its hawkish tone by repeating the message that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". It also reiterated that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

B.46 At the time of the meeting, the Bank did not appear to have taken any comfort from subsiding price pressures in the US and the Eurozone. The Bank also downplayed the softer-than-expected wage and inflation figures since its November meeting, stating in relating to earnings growth that "...it is important not to over-interpret developments in any one measure". The minutes of the December meeting also stated the MPC's view that "it was too early to conclude that services price inflation and pay growth were on a firmly downward path". Adding that "both of these metrics of inflation persistence remained higher than in other major advanced economies, possibly reflecting less favourable supply-side developments and stronger second-round effects in the United Kingdom". These second-round effects "were likely to be slow to unwind and, with the labour market still tight, the extent to which wage and price-setting would take account of the downward path of CPI inflation was not clear. The risks to CPI inflation in the medium term remained skewed to the upside including from events in the Middle East."

B.47 Overall, the tone was similar to that of previous meetings, with the strong suggestion that the Committee is concerned that if markets push too far, too fast on rate cut expectations, then this could undo much of the work on trying to squeeze inflation out of the economy. As noted by the Bank's Governor in his post meeting statement, "...there is still some way to go" in the fight to control inflation.

B.48 Despite the Banks hawkish bias the forecast reductions in CPI and core inflation over the first half of 2024 suggests rates will be cut sharply in the second half of 2024 if not before.

B.49 Since the MPC's December rate decision, the Bank's hawkish bias has also not prevented the markets from forming a view that rates will be falling soon. Accordingly, swap rates and gilt yields have reduced significantly during December despite a partial rebound upwards since the turn of the year. Q3 also saw a steady fall in 10-year gilt yields as investors revised their interest rate expectations lower. The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% in early January, with further declines likely if the falling inflation story is maintained

B.50 Current market expectations for cuts this year have lost some impetus since the start of the year, with stronger than expected inflation figures weighing in particular. Having begun the year with some chatter over a cut in March, this has now been progressively pushed out, first to May and now to June as the uptick in inflation outweighed both the sharp fall in wage increases seen in the latest employment print, and December's weak retail sales

B.51 The Purchasing Managers Index, (PMI) figures for November and December of 50.7 and 51.7 in December, have added to the recent shift higher in rate expectations, which has seen a June move increasingly called into question. In a similar vein, the next move down to 4.75% is not fully priced in for August, with September now in focus, while a further cut to 4.5% now only fully priced in for November. Thereafter, markets are also wavering over whether December will see a further cut, to 4.25%.

B.52 On the investment front, the decision to pause for a third consecutive at the MPCs December meeting and the subsequent shift lower in market sentiment has added further downside pressure on longer-term market rates. However, some of this downside pressure has been reversed, ebbing and flowing as changes to market sentiment remain somewhat volatile.

Appendix C: Credit Ratings

International long-term credit ratings

Fitch	Moody's	Standard & Poor's	Definition
Investment Grade			
AAA	Aaa	AAA	Highest quality/Best quality/Extremely strong
AA	Aa	AA	Very high quality/High quality/Very strong
A	A	A	High quality/Upper medium grade/Strong
BBB	Baa	BBB	Good quality/Medium grade/Adequate
Non-investment/speculative grade			
BB	Ba	BB	Speculative/Lower medium grade/Speculative-less vulnerable
B	B	B	Highly speculative/Low grade/More vulnerable
CCC	Caa	CCC	Poor quality/Currently vulnerable
CC	Ca	CC	High default risk/Highly speculative/Currently highly vulnerable
C	C	C	High default risk/Extremely poor/Imminent default
D		D	In default

Note: Fitch Ratings and Standard and Poor's ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories. Moody's append numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa to denote relative status.

International short-term credit ratings

Fitch	Moody's	Standard & Poor's	Definition
Investment Grade			
F1+	Prime-1	A-1+	See Long term ratings AAA to A (Highest Quality/ Superior/Strong ability to repay short-term debt obligations)
F1		A-1	
F2	Prime-2	A-2	See Long term ratings A- to BBB+ (Good/Strong/Satisfactory)
F3	Prime-3	A-3	See Long term ratings BBB to BBB- (Fair/Acceptable/Adequate)
Non-investment/speculative grade			
B	Not Prime	B	Speculative/ Not Prime/ Speculative
C	-	C	High default risk/ - / Vulnerable
D	-	D	Default/ - /Default

Appendix D: Summary of Public Works Loan Board (PWLB) lending arrangements - effective from 26 November 2020

D.1 The Public Works Loan Board (PWLB), is an internal function of HM Treasury The purpose of the PWLB is to offer long-term, affordable loans to support local authority investment in service delivery, housing, economic regeneration, treasury management, and financial intervention action (previously known as preventative action), under the prudential regime.

D.2 Changes to the PWLB's lending terms, effective from 26 November 2020, mean that while the PWLB will continue to support service spending, housing, economic regeneration, financial intervention action, and treasury management (including refinancing), it will no longer lend to local authorities that plan to buy investment assets primarily for financial return. The latest revision to the PWLB's Lending terms was published on 23 November 2023.

D.3 Local authorities are permitted to borrow for planned capital expenditure ahead of the need for cash in order to reduce financing and interest rate risks, as long as it is done in accordance with prudent treasury management principles. However, and in line with the Prudential Framework, HMT expects local authorities to only borrow the amount needed to finance capital expenditure and not borrow extra amounts purely to invest and make a financial return. The PWLB may not approve new loans if there is evidence that the local authority is engaging in this practice.

D.4 All ongoing capital expenditure committed to from 26 November 2020 must comply with the PWLB's lending terms in order to access PWLB borrowing. However, any transaction or project (including those categorised as investment assets bought primarily for financial return) commenced or contractually agreed to proceed on or prior to 26 November 2020 will not affect access to the PWLB. Access to the PWLB is similarly unaffected affected by capital expenditure to maintain existing commercial properties.

D.5 Under the PWLB's lending terms a local authority planning to acquire investment assets bought primarily for financial return in any of the three years covered by its capital expenditure and financing plans (i.e. capital expenditure and financing plans for the current financial year and two subsequent financial years), will not be permitted to borrow from the PWLB. This restriction applies regardless of whether the transaction would notionally be financed from a source other than the PWLB.

D.6 Following changes made to the PWLB's lending terms in June 2023 where, despite these lending terms an authority acquires an investment asset primarily for financial return after 15 June 2023 it will not being able to access the PWLB in the financial year in which the transaction takes place and the following financial year. The Authority will also not be permitted to use the PWLB to refinance this transaction at any point in the future. Prior to the change in the lending terms in June 2023 the restriction in access to the PWLB applied only in the year of acquisition and to any refinancing of the transaction at any point in the future.

D.7 Following this period of restriction, the authority may resume borrowing from the PWLB provided no further investment primarily for financial return is undertaken and subject to the restriction on the use of the PWLB to refinance any borrowing used to acquire an investment that was, at the time of purchase, primarily for financial return.

D.8 Investment assets bought primarily for financial return (previously known as investment assets bought primarily for yield) are assets that serve no direct policy purpose but are held primarily to generate an income. An 'investment asset' includes a capital or property asset, or interest or right that generates a balance sheet asset (such as, but not limited to a loan, sale and leaseback agreement).

D.9 Investment assets bought primarily for financial return would usually have one or more of the following characteristics:

a. buying land or existing buildings to let out at market rate

b. buying land or buildings that were previously operated on a commercial basis which is then continued by the local authority without any additional investment or modification

c. buying land or existing buildings other than housing which generate income and are intended to be held indefinitely, rather than until the achievement of some meaningful trigger such as the completion of land assembly

d. buying a speculative investment asset (including both financial and non-financial assets) that generates yield without a direct policy purpose.

D.10 Individual projects and schemes may have characteristics of several different categories. In such cases, the section 151 officer or equivalent of the authority is required to exercise their professional judgment to assess the main objective of the investment and consider which category is the best fit. Responsibility for assessing whether a project complies with the terms of the PWLB lending guidance rests with the authority's section 151 officer.

D.11 The PWLB's lending terms do not prevent local authorities from making a significant investment to improve and/or change the use of an asset not owned by the authority where it serves a direct policy purpose. Local authorities may also deliver policy objectives through a third party (such as a housing authority, joint vehicle or joint venture with a private sector investor, local authority-owned company etc.). If a local authority wishes to deliver policy objectives jointly (such as through an equity investment in a joint company) or on-lend money to deliver objectives in an innovative way, that spending must to be reported in the most appropriate category (service spending, housing, economic regeneration, financial intervention, or treasury management) based on the eventual use of the money.

D.12 Further details of the categories that between them cover all acceptable capital activity if the local authority wishes to borrow from the PWLB, i.e. (i) service spending, (ii) housing, (iii) regeneration, (iv) financial intervention (previously known as preventative action), (v) treasury management, are set out in the following table.

Categories of capital expenditure consistent with accessing PWLB loans

Category	Description
Service Spending	Expenditure on assets that form part of the authority's public service delivery. This consists of activity that would normally be captured in the following areas of the DLUHC Capital Outturn Return (COR): education, highways & transport, social care, public health, culture & related services, environmental & regulatory services, police, and fire & rescue services and central services. The COR is not an exhaustive list and the section 151 officer can categorise similar items of expenditure as service delivery, even if they are not normally captured in the COR. Expenditure on an asset that is held primarily to generate an income which is used to support wider service spending, but serves no direct policy purpose**, should not** be categorised as service delivery.
Housing	Activity normally captured in the HRA and General Fund housing sections of the COR, or housing delivered through a local authority housing company. This is given separately from 'service spending' because of the relative concentration of cross-subsidy and other innovative financing arrangements in housing projects. Housing can include all spending on delivering new homes, maintaining or improving existing homes, and purchasing built homes to deliver housing services. This is the case irrespective of the financial arrangements of the housing project or housing delivery. However, the government expects that the location and value of any housing expenditure be appropriate to meet the local authority's housing needs and to have a tangible impact within the local authority's borders.
(Economic) Regeneration	Regeneration involves direct investment in assets to generate additional social or economic benefits, Regeneration projects would usually have one or more of the following characteristics: a. the project is addressing an economic or social **market failure** by

Category	Description
	providing services, facilities, or other amenities that are of value to local people and would not otherwise be provided by the private sector b. the local authority is making a significant **investment** in the asset beyond the purchase price: developing the assets to improve them and/or change their use, or otherwise making a significant financial investment c. the project involves or generates significant **additional** activity that would not otherwise happen without the local authority's intervention, creating jobs and/or social or economic value While some parts of a regeneration project may generate rental income, these rents should be **recycled within the project or applied to related regeneration projects**, rather than being applied to wider services.
Financial Intervention Action (formerly Preventative Action)	Financial intervention action involves direct financial support to local companies or acquiring assets as a way to protect jobs, prevent social or economic decline. In contrast to regeneration, preventative action is concerned with preserving existing activity as opposed to creating additional activity but is not an 'investment asset bought primarily for financial return' as yield is not the primary motive of the activity. . Financial intervention action would have <u>all</u> of the following characteristics: a. the intervention **prevents a negative outcome**, such as by buying and conserving assets of community value that would otherwise fall into disrepair, or providing support to maintain economic activity that would otherwise cease b. there is **no realistic prospect of support** from a source other than the local authority c. the local authority has an **exit strategy**, and does not propose to hold the investment for longer than is necessary to achieve the objectives that justified the intervention d. the intervention takes the form of grants, loans, sale and leaseback, equity injections, or other forms of business support **that generate a balance sheet asset.** This category can also be used for taking up rights issuances of new shares, where a local authority jointly owns a company with private investors, where it does not better fall into one of the alternative categories. The Government does not anticipate that local authorities would spend significant sums on Financial intervention action. Local authorities that are considering such action should ensure they have assessed the compliance of the proposed action with all relevant subsidy control provisions in domestic and international law.
Treasury management	Treasury management includes refinancing or extending existing debt from any source, the externalisation of internal borrowing or borrowing to manage cash flow. The PWLB will lend for **refinancing** even if the local authority is planning activity that makes them otherwise ineligible for PWLB support. However local authorities must not pursue a deliberate strategy of using private borrowing or internal borrowing to support investment in an asset that the PWLB would not support and then refinancing or externalising this with PWLB loans. Investments in commercial property or speculative financial instruments are not considered treasury management.

D.13 Under the PWLB's lending arrangements, an authority wishing to borrow from the PWLB, must submit a high-level description of its capital spending and financing plans for the current financial year and two subsequent financial years, including its expected use of PWLB borrowing. Local authorities will be able to revise these plans in-year as required. Plans, submitted in a return through DLUHC's online data collection system (DELTA) are required to include:

a) the amount of planned new long-term (more than one year) borrowing

b) the amount of planned capital expenditure that will be financed by borrowing

c) further information about the planned capital expenditure (whether financed through borrowing or other sources) including

   - the amount of planned annual capital expenditure in each category which between them cover all acceptable capital activity if the local authority wishes to borrow from the PWLB i.e. (i) service spending, (ii) housing, (iii) regeneration,(iv) financial intervention, (v) treasury management

   - a short description of the main projects in each of these categories covering at least 75% of the spending in that category

d) an assurance from the section 151 officer or equivalent that the local authority does not intend to buy investment assets bought primarily for yield.

D.14 Submission of an updated return to DLUHC is required where previously submitted capital spending and financing plans are no longer considered current. This includes circumstances where:

- the authority has committed to any significant new items of capital expenditure or removed any significant items of capital expenditure since the return was last submitted,

- the amounts for planned new long-term borrowing or planned capital expenditure that will be financed by borrowing has changed by more than 10%, or

- the Authority's borrowing plans have been submitted for re-approval by the council or another delegated authority.

D.15 When applying for a new loan, the authority will be required to confirm that:

- the submitted capital spending and financing plans remain current
- they are not planning to use the PWLB to refinance any investment assets bought primarily for financial return transactions which were made after 26 November 2020.

D.16 If the authority cannot provide both of these assurances, the loan application will be rejected.

D.17 The application process also requires confirmation of the assurance, that the Authority does not intend to buy investment assets primarily for yield, remains valid. Where a local authority cannot provide this assurance then, unless the authority is borrowing for refinancing or the externalisation of internal borrowing, the loan application will be rejected. This does not include the refinancing of any investment assets bought primarily for financial return transactions which were made after 26 November 2020.

D.18 If the government has concerns before a loan is issued, over whether a planned transaction is an acceptable use of the PWLB, HM Treasury will suspend advance of the loan pending further review.

D.19 If it subsequently concludes that the project is an inappropriate use of the PWLB, the government may ask the authority to cancel the project as a condition of accessing the PWLB. The authority may also, as a condition of ongoing access to the PWLB, be required to provide additional information about their future capital plans to assure the government that the plans do not contain any other activity that would not be an appropriate use of PWLB support. If the local authority refuses to give these assurances, they will not be allowed to borrow from the PWLB.

D.20 If HM Treasury concludes that a transaction in question which has already concluded (and was agreed after 26 November 2020) was not an appropriate use of the PWLB, HM Treasury:

i. as a condition of ongoing access to the PWLB, will require the authority to provide additional information about their future capital plans, to assure the government that the plans do not contain any other activity that would not be an appropriate use of PWLB support

ii. may offer the authority a higher interest rate on their PWLB loan

iii. may require borrower to agree a plan to unwind the transaction to a reasonable timetable as a condition of the loan being approved, where the transaction was in clear breach of the rules.

D.21 If the local authority refuses to agree to any requirements they may not be allowed to borrow from the PWLB.

D.22 If after a loan is issued, HM Treasury concludes that a transaction was not an appropriate use of the PWLB (and was agreed after 26 November 2020), and that the information provided in the application to the PWLB was materially incorrect or misleading, HM Treasury may:

i. as a condition of ongoing access to the PWLB, require the local authority to provide additional information about their future capital plans, to assure the government that the plans do not contain any other activity that would not be an appropriate use of PWLB support

ii offer the authority a higher interest rate on future PWLB loans

iii. require that the borrower agree a plan to unwind the transaction to a reasonable timetable.

D.23 HMT also retains the right to require the borrower to repay a PWLB loan in full (including any applicable exit charges) in cases where there is a clear breach of the rules.

D.24 The full text of the PWLB's lending criteria can be found on the PWLB website at https://www.dmo.gov.uk/responsibilities/local-authority-lending/lending-arrangements/