Report to Audit Committee

29 June 2022
By the Interim Director of Resources
INFORMATION REPORT

Not exempt

Treasury Management Activity and Prudential Indicators 2021/22

Executive Summary

This report covers treasury activity and prudential indicators for 2021/22. At 31 March 2022, the Council's investments totalled £83.3m (£59.0m 2021) with no external debt.

During 2021/22, the Council's cash balances were invested in accordance with the Council's treasury management strategy and its associated indicators apart from one indicator where the actual interest rate sensitivity exceeded the estimate. This was a result of cash balances being much higher than estimated due to a combination of slower outflows in capital spend and developer contributions, higher revenue reserves, residual Covid-19 grants and the £150 energy bill rebate being held by the Council at year-end.

Interest of £0.942m (£0.858m in 2020/21) was earned on investments, an average return of 1.2% (1.5% in 2020/21). This was £0.150m over the budget of £0.792m. Investment property income was £3.47m (£3.56m 2020/21), which was £0.13m below the £3.6m estimate.

Investment income from treasury operations has recovered after the pandemic helped by the upturn in interest rates in the latter part of the year. Income from investment properties is recovering but there is still an overhang from the pandemic with some income subject to discussions with tenants.

Recommendations

The Committee is recommended to:

i) Note the Treasury Management stewardship report for 2021/22.
ii) Note the actual prudential indicators for 2021/22.

Reasons for Recommendations

i) The annual treasury report is a requirement of the Council's reporting procedures.
ii) This report also covers the actual Prudential Indicators for 2021/22 in accordance with the requirements of the relevant CIPFA Codes of Practice.

Background Papers

"Capital Strategy 2021/22 incorporating Investment and Treasury Management Strategy" - Audit Committee 16 December 2020
"Budget for 2021/22" - Cabinet 28 January 2021; Council 10 February 2021

Consultation: Arlingclose Ltd – the Council's Treasury Management advisers
Wards affected: All
Contact: Julian Olszowka, Group Accountant (Technical), 01403 215310

Background Information

1 Introduction

1.1 This report covers treasury management activity and prudential indicators for 2021/22. It meets the requirements of the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

1.2 In line with the CIPFA Codes, the Council adopts prudential indicators for each financial year and reports on performance relative to those indicators. This requirement is designed to demonstrate that capital spending is prudent, affordable and sustainable and that treasury management decisions are taken in accordance with good professional practices. This report compares the approved indicators with the outturn position for 2021/22. Actual figures have been taken from or prepared on a basis consistent with the Council's Statement of Accounts. It should be noted that those statements are not yet signed off by the auditor.

1.3 The original prudential indicators for 2021/22, together with a Capital Strategy and Treasury Management Strategy 2021/22, were agreed by Council on 10 February 2021 having been approved by this Committee on 16 December 2020.

1.4 CIPFA published a revision to Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. Although this is only fully implemented in the 2023/24 Appendix A gives a foretaste of the changes.

2 The Council's Capital Expenditure and Financing 2021/22

2.1 This is one of the required prudential indicators and shows total capital expenditure for the year and how this was financed. The estimates include revisions to the original indicators approved by the Council on 9 February 2022 as a part of the budget report.

2021/22 £m	**Actual £000**	**Estimate £000**	**Variance £000**
Total capital expenditure*	4.7	5.5	(0.8)
Resourced by:			
External resources	3.3	2.3	1
Internal Resources	1.4	3.2	(1.8)
Debt (unfinanced capital spend)	**0.0**	**0.0**	0.0
Total financing	**4.7**	**5.5**	(0.8)

*Capital expenditure here differs from capital outturn report by capitalised salaries

2.2 The capital spend in 2021/22 was under the budget as revised in the 2022/23 budget report. The underspend resulted in a reduced need for financing from internal resources such as revenue reserves and capital receipts with a larger amount being financed by external sources such as government grants and developer contributions.

3 The Council's Overall Borrowing Need

3.1 The Council's underlying need to borrow is termed the Capital Financing Requirement (CFR). It represents the accumulated net capital expenditure which has not been financed by revenue or other resources. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources.

3.2 The Council is required to make an annual revenue charge, the Minimum Revenue Provision (MRP), to reduce the CFR – effectively a repayment of the borrowing need. The Council's 2021/22 MRP Policy, as required by the Department for Levelling Up, Housing and Communities (DLUHC) Guidance, was approved on 10 February 2021 as a part of the 2021/22 Budget report.

3.3 The Council's CFR for the year is shown below, and represents a key prudential indicator because it is a measure of the Council's underlying indebtedness. As there was no additional unfinanced expenditure the only movement in the CFR is its reduction by the Minimum Revenue Provision.

Capital Financing Requirement	Actual £m	Estimate £m	Variance £m
Opening balance 1 April 2021	34.6	34.6	0.0
Debt/unfinanced capital expenditure	0.0	0.0	0.0
less Minimum Revenue Provision	(0.9)	(0.9)	0.0
Closing balance 31 March 2022	**33.7**	**33.7**	**0.0**

4 Treasury Position at 31 March 2022

4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Interim Director of Resources can manage the Council's actual borrowing position by either borrowing to the level of the CFR or choosing to utilise other available funds instead, sometimes termed under-borrowing. The Council is under-borrowed as it has no external debt.

4.2 Although the Council is under-borrowed relative to its CFR, it also holds investments and the summary treasury position on the 31 March 2022 compared with the previous year is shown below. This is a snapshot of investments on the date and the rates will not necessarily be equal to the whole year average figures.

Treasury position	31 March 2022		31 March 2021	
	Principal £m	Average Rate	Principal £m	Average Rate
Fixed Interest Rate Debt	-	-	-	-
Investments	83.3	1.5%	59.0	1.7%

4.3 Returns for shorter term cash which were at historically low levels at the beginning of 2021/22 started to recover at the end of the year as inflation mounted and central banks changed tack. This was just beginning to feed into the Council's returns and should benefit the 2022/23 budget position.

4.4 The Council cash levels increased in the year due to a combinations of factors. Capital spend was subdued as was the dispensing of developers contributions that the Council was holding. The revenue position of the Council improved more quickly than expected from the pandemic feeding into higher reserves. There was also the overhang of various Covid-19 related grants. Added to that the Council was passed the funds for the energy bill rebate scheme of £5.6m on the penultimate day of the year. It is likely the funds have passed the high-water mark as the flow of grants from central government seems to have ended.

4.5 For most of 2021/22 the abundance of cash in the overall finance system also meant there was a limited pool of good quality counterparties offering positive rates. In the early part of the year the Council had to invest with central government at close to zero rates. This meant that the excess cash did not translate to greatly increased income. The tide changed with the December rise in bank rate and two more increases started to help the income from short term cash helping it to a £25,000 positive variance against budget.

4.6 The Council's pooled funds includes a diversified selection of equity, bonds and property and they provided the overwhelming majority of the income in the year. The dividends they pay had been negatively affected by the pandemic but recovered more quickly than envisaged in the budget providing the majority of the positive income variance of about £125,000.

5 Prudential Indicators

5.1 **Gross Debt and the Capital Financing Requirement CFR** - In order to ensure that borrowing levels are prudent over the medium term the Council's external debt must only be for a capital purpose. Gross debt should not, therefore, except in the short term, exceed the CFR for 2021/22 plus the expected CFR movement over 2022/23 and 2023/24. As there is no external debt planned and the CFR is over £33m and in the budget plans of the Council it is not projected to decrease significantly over the relevant future period, the Council has complied with this prudential indicator.

5.2 The **Authorised Limit** is the "Affordable Borrowing Limit" required by section 3 of the Local Government Act 2003. The Council set the Authorised Limit at £15m for 2021/22. The table below demonstrates that during 2021/22 the Council has maintained gross borrowing within its Authorised Limit.

5.3 The **Operational Boundary** is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached. This indicator was set at £0m. There was no gross borrowing in the year.

5.4 **Actual financing costs as a proportion of net revenue stream** - This indicator shows the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. This is a gauge of the affordability of capital spend. Net financing costs are close to zero, as the interest income is about the same as the financing cost which is purely the MRP.

	2021/22
Authorised Limit	£15m
Operational Boundary	£0m
Maximum gross borrowing position in the year	£0m
Minimum gross borrowing position in the year	£0m
Financing costs as a proportion of net revenue stream	Actual 0% Estimate 0%

5.5 **Interest rate exposure** – This indicator is set to control interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates are shown in the table below. The impact of change in interest rates is calculated on the assumption that maturing investment will be replaced at current rates.

	actual	**Limit**
Limit one-year revenue impact of a 1% rise in interest rates	£0.32m	£0.2m
Limit one-year revenue impact of a 1% fall in interest rates	-£0.32m	-£0.2m

5.6 This indicator was set in December 2020 when the projected investment balance for the end of 2021/22 was £32m. The actual value was £83m. The end of year projection has normally been exceeded as capital spend and the outflow of developer contributions is usually lower than projected but in 2021/22 this effect was compounded by other factors.

5.7 In the original projection the effect of the pandemic was expected to considerably worsen the revenue position of the Council and it was not a given that Government support would materialise. In reality the Council was supported by a wide range of Covid-19 grants including compensation for lost income covering a range of services. Income also bounced back more quickly than expected where there was no government support. So the expected fall in reserves didn't happen and Council reserves actually increased.

5.8 The Council was also the conduit for a generous range of Central Government Covid-19 grants for businesses and households which have not been fully dispensed or reclaimed by Government. Right at the end of the year the Government continued its use of councils to disburse funds with £5.6m of energy rebate. It is expected that the high-water mark has been passed as rebates and grants are paid out or paid back to the Government although there are factors such as the current planning position that provides a headwind against the quick recovery of capital spend and developer contributions outflow.

5.9 Looking at the specific nature of the risk it should also be noted that the risk we are considering is that we will be disadvantaged by a 1% decrease in interest rates. As interest rates were just starting to increase from close to zero in March 2022 the chance that they would reverse course was very low.

5.10 For 2022/23 the indicator has been increased to £250,000 to recognise the levels of cash being held. The reduction in cash balances together with a more normal interest rate environment should make meeting the indicator more manageable.

5.11 **Maturity structures of fixed borrowing -** These gross limits are set to reduce the Council's exposure to large fixed rate loans falling due for refinancing. Although the Council has no borrowing this indicator is required by the CIPFA code.

Maximum percentage of borrowing in each age category	**upper**	**lower**	**actual**
Under 12 months	100%	0%	0%
12 months to 2 years	100%	0%	0%
2 years to 5 years	100%	0%	0%
5 years to 10 years	100%	0%	0%
10 years and above	100%	0%	0%

5.12 **Total Principal Funds Invested over a year** – This limit contains the Council's exposure to the possibility of loss that might arise as a result of it having to seek early repayment or redemption of investments. The limits and actuals on the long-term principal sums invested to final maturities beyond the period end are below and actuals were well within limits.

£m	2021/22	2022/23	2023/24
Actual principal invested beyond year-end	2.5	0	0
Limit on principal invested beyond year-end	12	10	8

Economic and treasury management context for 2021/22

5.13 The Council's treasury management activities are critically affected by what is happening in the general economy which is subject to continuing uncertainty. The Council has engaged Arlingclose Ltd to advise on various aspects of Treasury Management and a part of that advice, a commentary on the economic background and the finance sector during 2021/22, is included as Appendix B to this report.

Debt management activity during 2021/22

5.14 No new borrowing was undertaken. As the CFR shown above is £34m the Council is using its internal resources in lieu of borrowing. This lowers overall treasury risk by reducing both external debt and temporary investments and was judged to be the best way of funding capital expenditure. Current borrowing costs are still low by historic levels (e.g. PWLB 50 year loan around 1.8%)

6 **Investment activity in 2021/22**

6.1 The Council's objectives are to give priority to the security and liquidity of its funds before seeking the best rate of return. Its surplus cash is therefore held with local authorities, highly credit-rated banks, approved building societies and diversified pooled funds. The Council's treasury management activity fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Treasury Management Code of Practice and the DLUHC Investment guidance. These require the Council to approve an investment strategy before the start of each financial year.

6.2 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.3 The Council's longer term cash balances comprise revenue and capital reserves and its core cash resources are shown in the table below. The Council is borrowing internally to cover its CFR which reduces the funds to be invested. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. As the resources available exceed the CFR the Council holds net investments as shown below.

Balance Sheet Resources	31 March 2022 £m
General fund CFR	-34
Less Usable reserves	97
Less working capital	20
Total	**83**

6.4 The breakdown of investments held at period end

	31.3.21 Balance £m	Movement £m	31.3.22 Balance £m	31.3.22 Rate %
Call accounts	2.7	1.4	4.1	0.1
Money Market Funds – call	18.0	-7.5	10.5	0.5
Money Market Funds – cash plus or short bonds	9.4	3.9	13.3	0.5
Short-term deposits	4.0	25.5	29.5	0.8
Pooled Funds - Property	4.7	0.9	5.6	3.9
Pooled Funds – Multi-Asset	7.0	-0.1	6.9	3.9
Pooled Funds – Equity	5.1	0.5	5.6	3.8
Pooled Funds – Bonds	6	-0.3	5.7	2.2
REIT	2.1	0.0	2.1	1.6
Total Investments	**59.0**	**24.3**	**83.3**	**1.5**

6.5 **Yield** - The investment income budget for the year 2021/22 was £0.792m (£0.933m in 2020/21). The actual interest received was £0.942m (£0.858m in 2020/21). Cash balances were well above budget although for most of the year this didn't greatly help returns as cash rates were very low for most of the year and only started to recover late in the year. Pooled funds income largely exceeded expectations with equity returns being particularly strong. Because of the large short term cash balances the overall return was pushed down to 1.2% (1.5% in 2020/21).

6.6 **Security** – A benchmark is used as a way of expressing the credit risk of the whole portfolio of counterparties that the Council invests with. The Council has adopted a benchmark of an equivalent credit rating of A against which the portfolio was assessed at the end of each month. The portfolio average credit rating was a minimum of A+ in the year which is one notch above the benchmark.

6.7 **Liquidity benchmark** – The Council needs to ensure it has a sufficient level of liquidity so it has funds available when necessary. To ensure liquidity the Council set a benchmark of the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing. For 2021/22 the benchmark amount was £3m. The actual funds available were in excess of the benchmark for the whole year; the lowest amount available overnight was £13m.

6.8 **Compliance with strategy** – The strategy was compiled with throughout 2021/22 with the exception of the interest sensitivity indicator discussed in paragraph 5.5 above.

6.9 **Pooled funds** – The Council holds £23.8m in unrated pooled funds comprising equity, bonds and property. These funds yield 3.5% which is significantly more than the other investments available. An increased return generally brings an increase in risk and in this case the risk is to the capital value of the investments. The value of the investments at the year-end was £1.5m above the initial investment. However, it should be remembered that these investments are longer term so the capital losses or gains should not be overemphasised as the Council will hold the funds through periods of volatility.

6.10 **Variable Net Asset Value Money Market Funds** – The Council uses Low Volatility Net Asset Value Money Market Funds for day to day liquidity. The low volatility refers to the fact that each unit of the fund costs £1 to buy and is redeemed at £1. To facilitate this, the investments within the funds are short term and liquid and so returns are close to Bank of England bank rate. As the Council has cash it can invest over the medium term it has £13.3m in money market funds which can invest in longer term instruments like short term bonds and consequently should have higher yields but where the value of a unit invested can change. At a time of rising rates these type of funds can lag behind the shorter duration money market funds as their overall average rates do not respond as quickly to the new rates. They also suffer a reduction in capital value as they have older bonds with lower rates which will take longer to mature so that the newer higher interest bonds can replace them. The value of these funds was £130,000 less than the purchase price on 31 March 2022

6.11 **Social Housing REIT –** In 2019/20 the Council invested £2m in a REIT specialising in supported social housing. The pandemic had significantly delayed its development of sites so dividends have been lower than expected at 1.6%. The expectation is that the REIT will continue to develop its operations and grow its dividends. There was a small capital gain of £60,000 at the year-end.

6.12 Although the volatility of capital values is a concern, the Council is in the position to avoid crystallising any capital losses as it has funds available for three to five year period. In the accounts these unrealised capital gains or losses will not have an impact on the General Fund as the Council can defer them to the Pooled Investment Fund Adjustment Account until 2023/24. This date may be extended and DLUHC is expected to consult on this shortly.

Non-Treasury investments

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

6.14 At year end the Council held £59.7m of directly owned property and £0.4m loans to local bodies for service purposes. These investments generated £3.47m of investment income for the Council after taking account of direct costs and making provision for possible losses, representing a rate of return of 5.8%. Income was slightly down on the estimated income of £3.6m at a return 6.3% in the original 2021/22 strategy. It should be noted that although the Council has made a provision for losses there are ongoing discussions with the tenants who have claimed that their trading has been adversely affected by the pandemic.

6.15 The income from these non-treasury investments provides an important contribution to financing of the Council's overall service delivery. To ensure stable income flows the Council has a core of longer term leases. The Council's properties have very high occupancy in the high 90% and so can place reasonable reliance on a stable flow of rents. That said there is a significant retail element which will not be immune from the well-recognised risks to the sector.

6.16 Below is a breakdown of performance grouping assets by type.

Property by type £millions		**31.3.2022 actual**		**2021/22**	
	Purchase cost / 31st March 2007 value	**Gains or losses**	**Value in accounts**	**Capital Gain or loss in year**	**Income Return In year**
Retail – legacy	2.7	2.0	4.7	-0.2	7.5%
Retail – Swan Walk	9.5	-7.6	1.9	0.0	11.6%
Light industrial - legacy	9.3	10.3	19.6	1.6	6.0%
Healthcare – legacy	6.5	1.9	8.4	0.1	6.0%
Office - legacy	1.3	0.7	2.0	0.1	4.8%
Retail - recent	14.6	-5.1	9.5	-0.2	5.0%
Light industrial – recent	6.3	3.7	10.0	0.3	3.8%
Healthcare – recent	0.6	0.3	0.9	0.0	5.5%
Education -recent	1.8	-0.1	1.7	0.0	10.2%
Leisure - recent	1.5	-0.6	0.9	0.0	4.8%
Total properties	**54.1**	**5.5**	**59.6**	**1.7**	**5.8%**
Realised assets *Note 1*	**0.1**	**0.4**	**0.5**	**0.4**	**n/a**

Note 1 Industrial unit sale see 6.19 below

6.17 The purchase cost figures above need to be viewed with care as no reliable purchase cost is available for the legacy categories and Swan Walk so the base valuation is the earliest full valuation we have, which is from 2007 when retail was probably at its peak value. Overall capital values are above notional "purchase cost" with the light industrials compensating for retail weakness. In terms of percentage return, care should be taken as the denominator is the valuation at 31 March 2022 and this is subject to revaluation.

6.18 The return for Swan Walk is an estimate as the accounts for the year ending last October have not yet been supplied to the Council. Swan Walk was badly affected by the pandemic with many tenants seeking reductions in their rents and the leasehold was also sold by Aviva. Officers have been pursuing the managing agents for the accounts but the managing agents have explained that the delay is because of the need to reconcile any pandemic-related debts and apportion the rents and write offs between the former and present leaseholder.

6.19 The table includes a line for a realised asset. A unit in a small Henfield-based industrial site was sold to the tenant at a price that was attractive relative to the continuing value of the unit to the Council. Based on the notional purchase price on the same basis as the table above the gain on sale was over £450,000. Relative to the current revalued value of the asset the gain was over £300,000. Following the local authority accounting rules any gain is not recognised in the income of the Council but results in a capital receipt that can only be used to finance new capital spend. The gain is reflected in the table above to recognise it as a return due to the Council's commercial portfolio.

6.20 The 2021/22 strategy also set a series of performance indicators shown below.

Indicator	2021/22 Actual	2021/22 Forecast
Commercial investments: Property Overall value	**£59.7m**	**£56m**
Debt to net service expenditure ratio	0%	0%
Commercial income to net service expenditure ratio	34%	32%
Net income return target	5.8%	6.3%
Operating overheads of property section attributable to commercial property as a proportion of net property income	6.6%	6.4%
Average Vacancy levels	2%	2%
Tenant over 5% of overall income	6	5
Weighted Average Unexpired Lease Term (WAULT)	8yr 6m	9yr
Bad debts written off	£163,888	£200,000

6.21 The overall value of investment property has exceeded the estimate made in December 2020 mostly due to revaluations gains of £4m in the revaluations of 31 March 2021 and 2022.

6.22 Other indicators are generally in line with forecasts.

6.23 The Weighted Average Unexpired Lease Term (WAULT) excludes the Swan Walk lease which is an outlier at 122 years and would skew the figure up to 14 years. Overheads as a percentage of income was slightly over estimate.

6.24 Arun House income just slipped above 5% in the year to make 6 tenants, however the lease on this property expires at the end of July 2022.

6.25 Bad debts written off in the year 2021/22 are due to the pandemic and some discussions with tenants affected by the pandemic are ongoing. The final write off amounts will only be known when discussions are concluded and they will be reflected in the 2022/23 reporting. A provision of £29,000 was added in 2021/22.

6.26 The valuation figures are based on the unaudited accounts. If there are significant changes for the final audited accounts, the changes in treasury management activity and prudential indicators will be reported to the committee.

7 Resource consequences

7.1 This report provides information only; no staffing or financial resources are required as a result of it.

8 Legal Considerations and Implications

8.1 There are no legal consequences.

9 **Risk Assessment**

9.1 The framework of indicators and reporting against them provides an effective system of risk control.

10 **Procurement implications**

10.1 There are no procurement implications.

11 **Equalities and Human Rights implications / Public Sector Equality Duty**

11.1 There are no impacts on any relevant groups and no Equalities Impact Assessment is required.

12 **Environmental Implications**

12.1 There are no direct environmental impacts from this report.

13 **Other Considerations**

13.1 There are no Data Protection implications or issues concerning Crime & Disorder.

Appendix A - Revised CIPFA Codes, Updated PWLB Lending Facility Guidance

In August 2021 HM Treasury significantly revised guidance for the Public Works Loan Board (PWLB) lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year which is the approach being taken.

To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR (e.g. by not financing capital spend) unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.

Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version. The Council will follow the same process as with the Prudential Code, i.e. delaying changes in reporting requirements to the 2023/24 financial year.

Appendix B Arlingclose Commentary on 2021/22

Economic Background: The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.

Bank Rate was 0.1% at the beginning of the reporting period. April and May saw the economy gathering momentum as the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022. Rising, persistent inflation changed that.

UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% y/y from 4.4%.

The government's jobs furlough scheme insulated the labour market from the worst effects of the pandemic. The labour market began to tighten and demand for workers grew strongly as employers found it increasingly difficult to find workers to fill vacant jobs. Having peaked at 5.2% in December 2020, unemployment continued to fall and the most recent labour market data for the three months to January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%. Headline 3-month average annual growth rate for wages were 4.8% for total pay and 3.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 0.1% while regular pay fell by 1.0%.

With the fading of lockdown – and, briefly, the 'pingdemic' – restraints, activity in consumer-facing sectors improved substantially as did sectors such as oil and mining with the reopening of oil rigs but materials shortages and the reduction in the real spending power of households and businesses dampened some of the growth momentum. Gross domestic product (GDP) grew by an upwardly revised 1.3% in the fourth calendar quarter of 2021 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

Having increased Bank Rate from 0.10% to 0.25% in December, the Bank of England hiked it further to 0.50% in February and 0.75% in March. At the meeting in February, the Monetary Policy Committee (MPC) voted unanimously to start reducing the stock of its asset purchase scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.

In its March interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February Monetary Policy Report. The Committee also noted that although GDP in January was stronger than expected with business confidence holding up and the labour market remaining robust, consumer confidence had fallen due to the squeeze in real household incomes.

Financial markets: The conflict in Ukraine added further volatility to the already uncertain inflation and interest rate outlook over the period. The Dow Jones started to decline in January but remained above its pre-pandemic level by the end of the period while the FTSE 250 and FTSE 100 also fell and ended the quarter below their pre-March 2020 levels.

Bond yields were similarly volatile as the tension between higher inflation and flight to quality from the war pushed and pulled yields, but with a general upward trend from higher interest rates dominating as yields generally climbed. The 5-year UK benchmark gilt yield began the quarter at 0.82% before rising to 1.41%. Over the same period the 10 year gilt yield rose from 0.97% to 1.61% and the 20-year yield from 1.20% to 1.82%. The Sterling Overnight Rate (SONIA) averaged 0.39% over the quarter.

Credit review: In the first half of FY 2021-22 credit default swap (CDS) spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but then fell back. Fitch and Moody's revised upward the outlook on a number of UK banks and building societies on the Authority's counterparty to 'stable', recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.

Fitch also revised the outlook for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable. The agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme was credit positive for the financial services sector in general and the improved economic outlook meant some institutions were able to reduce provisions for bad loans. However, in 2022, the uncertainty engendered by Russia's invasion of Ukraine pushed CDS prices modestly higher over the first calendar quarter, but only to levels slightly above their 2021 averages, illustrating the general resilience of the banking sector.

Having completed its full review of its credit advice on unsecured deposits, in September Arlingclose extended the maximum duration limit for UK bank entities on its recommended lending list from 35 days to 100 days; a similar extension was advised in December for the non-UK banks on this list. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.