monmouthshire county council
sir fynwy

REPORT

SUBJECT:	**2022/23 Capital Strategy and 2022/23 Treasury Management Strategy**
DIRECTORATE:	**Resources**
MEETING:	**Council**
DATE:	**3rd March 2022**
DIVISION/WARDS AFFECTED:	**Countywide**

1. PURPOSE

1.1. The purpose of this report is to approve the Capital and Treasury management strategies including the Minimum revenue provision policy and borrowing & investment strategies for the 2022/23 financial year. The report summarises and highlights the key areas relating to the strategies, alongside those areas of key implications and risks resulting from it.

2. RECOMMENDATIONS

2.1. That Council approves the Capital strategy for 2022/23 as found at ***Appendix 1***.

2.2. That Council approves the Treasury management strategy for 2022/23 as found at ***Appendix 1,*** including the:

- 2022/23 Minimum Revenue Provision Policy Statement
- 2022/23 Investment & Borrowing Strategies

2.3. To approve the Prudential Indicators as outlined in sections 3 and 4 of the Treasury strategy shown in ***Appendix 1*** and that will be used in the performance monitoring of the treasury function during 2022/23.

2.4. That Council agrees that Governance & Audit Committee should continue to review the Council's treasury activities on behalf of the Council by receiving & scrutinising the mid-year report and year-end report and also scrutinising the Capital and Treasury strategies before recommending to Council for approval.

2.5. That Council receive the verbal feedback of the scrutiny undertaken on the Capital and Treasury strategies by the Governance & Audit Committee at its meeting on the 28th February 2022 and confirms that the Committee endorses the strategies.

3. KEY ISSUES

3.1. **2022/23 Capital Strategy**

3.2. The Capital Strategy sets out the longer-term context in which capital investment decisions are made and demonstrates how/that the Authority takes capital investment decisions that are in line with its Corporate priorities, give consideration to both risk/reward and impact; as well as properly taking account of stewardship, value for money, prudence, sustainability and affordability.

3.3. The capital plans of the Authority are inherently linked with the treasury management activities it undertakes, and therefore this report is brought alongside the Treasury management strategy report.

3.4. The main considerations arising from the Capital strategy shown in ***Appendix 1*** are summarised in this report below.

3.5. **Overview**

3.6. The Capital strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

3.7. It highlights that in the current climate of financial constraints and a continued Medium Term Financial Projection (MTFP) revenue budget gap, that expenditure on capital needs to remain within affordable limits. Demand for capital resources remains high and therefore inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners remain key to meeting this demand.

3.8. Within the context of significant demands for capital resources and limited availability, there is the need to develop our use of the various strategic plans across the organisation which drive the need for capital investment and develop alternative strategies to meet demand so the Councils own capital programme is prioritised within an affordable framework. This will include clearer and corporate visibility and assessment of demand for schools, highways and other operational assets.

3.9. **Capital Financing**

3.10. All capital expenditure incurred has to be physically financed. Once the finite available sources of internal financing (capital receipts, reserves/revenue) and external grant financing are extinguished the Authorities only recourse is to borrowing.

Capital financing in £m

	2021/22 budget	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**	**2025/26 budget**
External sources	14.1	3.6	2.4	2.4	2.4
Internal resources	6.0	3.6	1.9	1.8	1.7
Borrowing	9.9	22.4	8.0	5.5	5.5

Total	**30.0**	**29.6**	**12.3**	**9.8**	**9.7**

3.11. Approval of capital expenditure funded through borrowing locks the Council into committing revenue funding over a very long period (as long as 60 years). Minimum Revenue Provision (MRP) is required to be funded from revenue budgets to cover expected borrowing repayments and the level of MRP is increasing over the medium-term so the Authority needs to ensure its capital plans remain affordable and sustainable.

Proportion of financing costs to net revenue stream

Proportion of Financing Costs to net revenue stream	**2021/22 Budget**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**
Net Interest payable £m	3.6	3.9	4.1	4.1	4.5
MRP £m	6.4	6.7	7.3	7.6	7.7
Total Financing costs £m	**10.0**	**10.6**	**11.4**	**11.7**	**12.2**
Net Revenue Stream (£m)	155.1	168.9	179.3	187.6	196.3
Proportion of net revenue stream %	**6.45%**	**6.29%**	**6.38%**	**6.24%**	**6.21%**

3.12. The table above compares financing costs to the net revenue stream i.e. the amount of income from Council Tax, business rates and general government grants. The overall proportion of financing costs remains fairly static over the MTFP window which is reflective of the total revenue stream increasing in line with expected inflationary impacts whilst the financing costs increase moderately in line further capital investment made.

3.13. Total financing costs remain sustainable within the context of the Authorities overall revenue budget in so much that they are fully provided for within the medium term financial plan.

3.14. **Capital Receipts**

3.15. Any assets which are deemed to be surplus to service requirements will be identified for possible sale/income generation in consultation with the Estates department. The procedures governing disposals are captured in the Council's Surplus asset disposal policy.

Forecast Capital receipts

	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**
	£000	**£000**	**£000**	**£000**	**£000**
Balance as at 1st April	9,581	13,503	11,108	10,311	8,714
Less: capital receipts used for financing	(3,582)	(2,311)	(1,294)	(1,194)	(1,094)
Less: capital receipts used to support capitalisation directive	(2,208)	(2,650)	(508)	(508)	(508)
	3,791	8,542	9,306	8,609	7,112
Capital receipts Received	2,596	0	0	0	0
Capital receipts Forecast	7,115	2,565	1,004	104	104
Forecast Balance as at 31st March	**13,503**	**11,108**	**10,311**	**8,714**	**7,217**

3.16. The value of Capital receipts forecast after 2022/23 drops off quite considerably which is reflective of the replacement local development plan (RDLP) not proceeding as quickly as envisaged in the original delivery agreement. This will have a substantial impact on the balance of receipts available to fund future capital investment demands. It is therefore important that reliance on capital receipts used to support capitalisation direction (to fund one-off revenue costs eligible to be met from capital resources) is seen as a short term measure only.

3.17. Traditionally receipts have been earmarked to finance the Authorities future schools investment. In a change from previous practice, whilst the Council has further future schools aspirations, it is not proposed to advocate a similar approach to members in respect of tranche B. Schools based assets commonly have a useful life of 50 years +, and as such traditional long term loan funding can be sourced at competitive rates with limited annual revenue volatility. The Council derives greater revenue benefit by using capital receipts in affording replacement of short life assets, given the avoidance of proportionately more significant minimum revenue provision.

3.18. **Setting Capital Budgets**

Capital Medium Term Financial Plan

	Indicative Budget 2022/23	**Indicative Budget 2023/24**	**Indicative Budget 2024/25**	**Indicative Budget 2025/26**
Asset Management Schemes	1,929,276	1,929,276	1,929,276	1,929,276
School Development Schemes	13,681,287	50,000	50,000	50,000
Infrastructure & Transport Schemes	5,792,740	6,272,740	3,627,740	3,527,740
Regeneration Schemes	330,400	602,900	730,200	730,200
County Farms Schemes	300,773	300,773	300,773	300,773
Inclusion Schemes	1,150,000	1,150,000	1,150,000	1,150,000
ICT Schemes	682,000	413,000	413,000	413,000
Vehicles Leasing	1,500,000	1,500,000	1,500,000	1,500,000
Capitalisation Directive	2,649,500	507,500	507,500	507,500
Other Schemes	3,070,000	1,070,000	1,070,000	1,070,000
Total Expenditure	**31,085,977**	**13,796,190**	**11,278,490**	**11,178,490**

3.19. The capital MTFP and capital strategy seek to work towards a financially sustainable core capital programme, whilst balancing the need to deliver capital investment plans in line with policy commitment and need. When considering the relative merits of further capital investment, the Capital and Asset Management Working Group (CAMWG) will apply the priority matrix in the capital strategy, either endorsing or amending the proposal for onward consideration by SLT and Members through the agreed mechanisms in place.

3.20. The identified backlog capital budget pressures that currently sit outside of the above capital MTFP total £125m and indicates that there is a higher call for capital expenditure than the Authority considers it can affordably finance. This means that capital schemes will have to be prioritised or the capital available has to be spread more thinly than is ideal. All stakeholders must recognise that funding capital expenditure by borrowing only defers the charge to revenue budgets to future years, but at the same time if capital maintenance works are deferred then the total life costs of supporting an asset are likely to increase. This effect is often veiled in medium term financial planning as asset lives are much longer than four years.

3.21. Annual investment included in the capital programme for property maintenance, highways maintenance, relevant specific capital grants and the future schools programme will assist in addressing the highest priority backlog issues, focussing on worst condition first and risk. However, estate rationalisation programmes, closure/disposal of assets, asset transfers and other capital projects to refurbish or replace operational properties will also be utilised to offset the backlog funding required. This will not address the specific total backlog, but is a way of targeting the main issues in an affordable manner.

4. 2022/23 Treasury Management Strategy

4.1. The treasury management strategy sets out the Council's longer term borrowing requirement and plans, which is driven mainly by the capital programme requirements and the resulting impact on the revenue budget.

4.2. It includes how it will manage and invest its surplus cash which also have various targets/limits set as part of prudential indicators and also includes additional guidance of the Welsh Government Investment Guidance and the Minimum Revenue Provision Policy.

4.3. The strategy is a requirement of CIPFA's Prudential Code which sets out the requirement to ensure, within the frameworks set, that capital expenditure plans are:

- ***Affordable:*** Capital spend and programmes are within sustainable limits. Councils are required to take into account of current and forecast funding available to them and the totality of their capital plans and their costs in assessing affordability.

- ***Prudent:*** Councils need to set borrowing limits (called 'operational' and 'authorised limits' – as part of the suite of prudential indicators) which reflect the Councils plan for affordable capital plans and their financing costs. On investing activities, Councils need to consider the balance between security, liquidity and yield which reflects their own risk appetite but which prioritises security and liquidity over yield.

- ***Sustainable:*** Council's capital plans and the revenue cost of financing the current and future forecast borrowing/debt taken out for that needs to be sustainable in terms of the Councils overall finances and its impact on that**.**

4.4. The Governance & Audit Committee in its role as the Council's delegated body must receive as a minimum a semi-annual report and an annual report after its close on treasury management activities.

4.5. Overall responsibility for treasury management remains with the full Council. In effect, that body delegates the execution and administration of treasury management decisions to the Section 151 officer or deputy who will act in accordance with the Treasury management strategy, treasury management practices and CIPFA's Standard of Professional Practice on treasury management.

4.6. The detailed Treasury strategy for 2022/23 is included at ***Appendix 1***. Key points of interest are summarised below.

Annual Minimum Revenue Provision (MRP) Policy Statement

4.7. The annual Minimum Revenue Provision is the mechanism used for spreading the capital expenditure financed by borrowing over the years to which benefit is provided. Regulations state that the authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent. In addition, there is the requirement for an Annual Minimum Revenue Provision Policy Statement to be drafted and submitted to full Council. This is attached in ***Appendix 1***.

4.8. The Welsh Government issued revised MRP guidance in 2018. This is taken into account within the MRP Policy Statement.

Borrowing Strategy

4.9. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

4.10. The current economic environment is unprecedented and still very much represents the bottom of the treasury cost curve for an Authority like Monmouthshire who is a net borrower. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. A roughly equal balance of long and short term debt is, at the time of writing, taken as the right balance to maintain sufficient long term stability.

4.11. To that end, and at the start of December 2021, and with interest rate rises being implied in the market, the authority acted to lock in a further £20m of long term borrowing as outlined below:

Start Date	Duration (Years)	Amount	Rate	Weighted Rate
07/12/2021	45	5,000,000.00	1.43%	0.36%
07/12/2021	50	5,000,000.00	1.37%	0.34%
15/12/2021	46	2,500,000.00	1.31%	0.16%
15/12/2021	47	2,500,000.00	1.30%	0.16%
15/12/2021	48	2,500,000.00	1.29%	0.16%
15/12/2021	49	2,500,000.00	1.27%	0.16%
Total		**20,000,000.00**		**1.35%**

4.12. By doing so, the Authority was able to give some longer term certainty over borrowing costs and reduce overall treasury risk, despite some shorter term increases in overall interest cost. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

Investment Strategy

4.13. Both the CIPFA Code and the WG Guidance require the Authority 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 Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

4.14. Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority will look to increase its diversification into higher yielding asset classes, such as pooled funds, during 2022/23. The Authority continues to hold £10m of investments to meet the requirements of a professional client under the Mifid II regulations (Markets in financial instruments directive) and therefore consideration will be given to investing this balance with a more medium to long term outlook. At the time of writing £4m is held in Pooled Fund investments, with applications in process to invest a further £2m by the end of the 31st March 2022.

4.15. The approved counterparty list and limits are shown in table 3 of the Treasury strategy. The investment limits proposed complement the Authorities objective of striking an appropriate balance between risk and return, whilst minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

4.16. It is important to note that the counterparty rating limits and investment maturities act as limits and not targets and are further informed by market information alongside bespoke periodic advice from our treasury advisers as to sustainability and financial robustness of specific counterparties.

Other Considerations influencing the strategy

4.17. The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

4.18. Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

4.19. The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

4.20. Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

Prudential Indicators

4.21. The prudential indicators as required under the Prudential Code are shown in sections 3 and 4 of the Treasury strategy at ***Appendix 1*** and set out the limits and indictors that the treasury function will operate under for 2022/23.

5. REASONS

5.1. The Authority is required to produce a Capital Strategy to satisfy the requirements of the Prudential Code of Capital Finance 2017. Many elements of the strategy are already in place and it is expected that in following an overall strategy that it will improve the process of managing the Authorities assets with the ultimate aim to ensure sustainability, and maximise the financial and social value of our assets for our communities. The ongoing challenging financial conditions mean we must have robust policies and programmes in place to ensure our estate is lean, efficient, meets the needs of service users and is fit for purpose.

5.2. The Authority is required to produce a Treasury Management Strategy including annual investment and borrowing strategies in order to comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code").

5.3. The Authority is required to produce an MRP policy statement in order to comply with the Local Authorities (Capital Finance and Accounting) (Wales) Regulations, last amended in 2018.

6. OPTIONS APPRAISAL

6.1. As contained within the strategies shown at ***Appendix 1***.

7. EVALUATION CRITERIA

7.1. Not applicable.

8. RESOURCE IMPLICATIONS

8.1. In summary, the Treasury strategy remains very similar to previous years, such that the Council remains a net borrower, and utilises internal resources to reduce net borrowing costs, known as internal borrowing.

8.2. In order to keep the Authority's borrowing costs lower, the external borrowing total is split fairly equally between long and short term recurrent borrowing. The short term borrowing achieves a reduction in cost but causes an increase in interest rate risk. Although interest rates could rise, it is not expected that short term rates over the MTFP window will exceed current long term rates. The Treasury team continues to optimise its loans and investments to reduce the net cost of borrowing while ensuring that security and liquidity levels are maintained at a suitable level and the various risks are properly managed.

8.3. The levels of Treasury debt and investments at the 31st December 2021 are provided in section 2 of the Treasury strategy.

8.4. The medium-term treasury budgets, contained within the 2022/23 revenue budget proposals were constructed in accordance with the strategy documents appended to this report. Consequently, there are no additional resource implications directly arising from this report.

8.5. The Council's indicative treasury budgets for the next 4 years are:

	Indicative Base Budget 2022/23	Indicative Base Budget 2023/24	Indicative Base Budget 2024/25	Indicative Base Budget 2025/26
Interest and Investment Income	(100,000)	(100,000)	(100,000)	(100,000)
Interest Payable on external debt	3,955,189	4,205,189	4,205,189	4,594,227
Charges required under Regulation	6,715,463	7,347,290	7,602,831	7,693,289
Total Treasury Budgets	**10,570,652**	**11,452,479**	**11,708,020**	**12,187,516**

8.6. However, there are some key future financial risks on medium-term treasury budgets concerning:

- The capital medium term financial plan for 2022/26 has been shared with members as part of the capital budget setting process. Should future additions to the programme be required that are funded from borrowing, then Treasury figures and consequences on the capital financing requirement and external borrowing requirement would need to be updated.

- The risks associated with rising interest rates as indicated in the Treasury Strategy by the Interest rate risk indicator & limit. Base and short-term interest rates are expected to remain at lower levels in the medium term and the Treasury strategy allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates. However, the current and future economic environment is extremely uncertain in light of the UK Government response to the pandemic and the ongoing complexities around Brexit agreements and therefore the ongoing position will need to continue to be closely monitored.

- The Authority continues to make plans to assess the capital receipts which can be obtained from selling property assets. Without these receipts being available to fund capital expenditure, new capital programmes will need to be funded by additional borrowing.

9. WELLBEING OF FUTURE GENERATIONS (INCORPORATING EQUALITIES, SUSTAINABILITY, SAFEGUARDING AND CORPORATE PARENTING):

9.1. There are no implications directly arising from the recommendations and decisions highlighted in this report.

10. CONSULTEES:

Chief Officer, Resources (Section 151 officer)
Arlingclose – Treasury Management Advisors to Monmouthshire CC
Cabinet
SLT
Governance & Audit Committee

11. BACKGROUND PAPERS:

Appendix 1 – 2022/23 Capital strategy and 2022/23 Treasury Management Strategy including the Minimum Revenue Provision policy statement and Investment & Borrowing Strategies

12. AUTHORS:

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