

Somerset West and Taunton Council

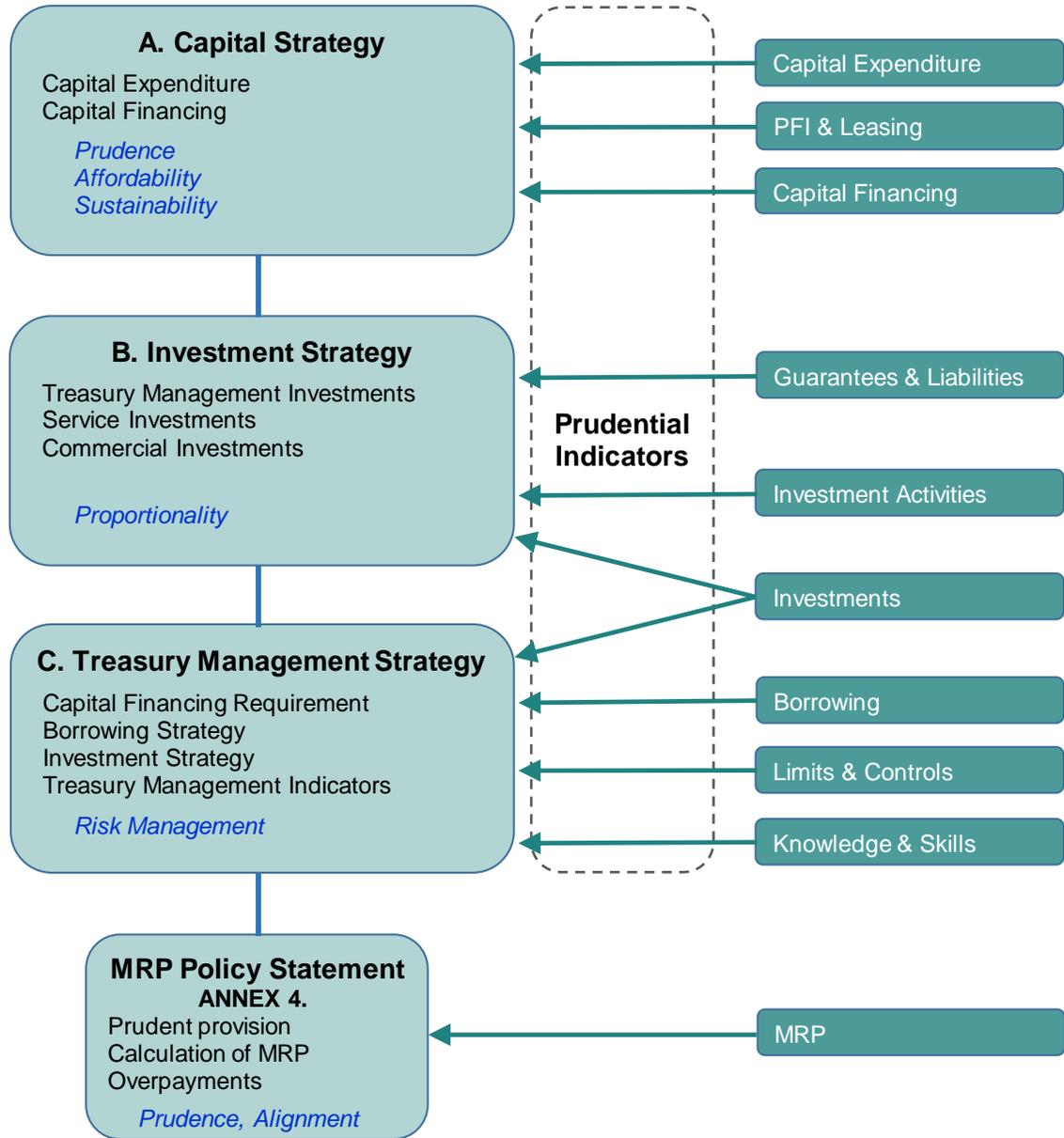
Capital, Investment and Treasury Strategies 2022/23 to 2024/25

1 Introduction and Background – The CIPFA Prudential Code

- 1.1 In a significant move by the Government in 2004, local authorities were given substantial freedoms to borrow for the purposes of “Capital Investment.” This followed many years of restrictions on borrowing for capital expenditure. Regardless of those freedoms, statute requires local authorities to follow professional codes of practice.
- 1.2 The Chartered Institute of Public Finance and Accountancy (CIPFA), acting on behalf of the Government, introduced the Prudential Code of Practice to accompany these new freedoms. Authorities in England and Wales are required by regulation to have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out their duties under Part 1 of the Local Government Act 2003. Throughout this document we shall refer to this code as the Prudential Code.
- 1.3 The Prudential Code underpins the system of capital finance. It has continuously placed responsibilities on councils and their Members to ensure that a range of mechanisms are in place for defining, monitoring and controlling capital, investment and borrowing activities. One key aspect of the mechanism was the setting of prudential indicators. Set locally, prudential indicators measure and control the impact of capital expenditure, borrowing costs and investment risks on local authorities.
- 1.4 The CIPFA Prudential Code sits alongside a second code, the CIPFA Treasury Management Code of Practice. Acting in tandem, the two Codes broadly oblige authorities to exercise transparency and accountability and to allocate responsibility for capital investment and treasury management decisions. Authorities must follow both codes of practice.
- 1.5 Some nationally significant events have occurred since the Prudential Code was first published. Widely publicised in the media, each of these events have led to tightening of the Code over the years. In recent years one such aspect has caught the attention of the Government, that being the substantial increase in local authority borrowing that correlates with an increase in commercial investment. A recent report by the National Audit Office (‘Local Authority Investment in Commercial Property’) established that, since 2016, there had been a rapid expansion in authorities acquiring commercial property outside their geographical areas for the purposes of generating yield. These ‘investments’ usually relied on borrowing to finance their cost, with substantial sums made up of borrowing from the government through the Public Works Loan Board (PWLB).
- 1.6 In response, the Treasury withdrew availability of new borrowing from PWLB by local authorities that invested in commercial property after 26 November 2020.

- 1.7 Subsequently, the Government's concerns led to revisions to the Prudential Code and a new edition was published on 20 December 2021.
- 1.8 The Code's revised reporting requirements include changes to the capital strategy, prudential indicators and investment reporting. The requirements of the revised Prudential Code applied with immediate effect following publication; in particular this includes the stipulation that an authority must no longer borrow to invest primarily for a financial return. The only aspect that authorities may choose to defer are the revised reporting requirements set out by the Code. This deferral recognises the timing of the revised Code's publication and the limited time available for authorities to respond in developing reporting mechanisms. The reporting changes may be deferred until the 2023/24 financial year although, in updating the three Strategies contained in this document, we have introduced some of the new elements where data is available.
- 1.9 Shaped by the Prudential Code, this collection of Capital, Investment and Treasury Strategies for 2022/23 to 2024/25 complement with each other. This collection of Strategies also supports, and is supported by, the Revenue and Capital Budgets for the General Fund and Housing Revenue Account, both for next financial year (2022/23) and in the Medium-Term Financial Plan. Contained within them are the tools demonstrating that affordability, sustainability and prudence have been exercised in the setting of those budgets.
- 1.10 **It is important to take into account that, whilst the tables, charts, Prudential Indicators and data referred to in the following strategies relate to and support the Council's budget and Medium-Term Financial Plan (to be presented to Full Council in February 2022), continually changing circumstances will result in revisions to the forecasts and estimates contained throughout this document.** The document, as a general rule, draws upon and aligns with the estimates contained in the budgets reported.
- 1.11 To accommodate the merger of the County and District Councils in Somerset into one Unitary Council on 1 April 2023, the Prudential Indicators, and most of the data sets in this collection of Strategies, cover actual results for 2020/21, forecasts for 2021/22 and estimates for the three-year period 2022/23 to 2024/25. This contrasts with earlier years' reports, which extended as far forward as five years. Estimates for financial years beyond 2022/23 (after which the Unitary Council commences) are included because the Prudential Code requires indicators for prudence to be set over a minimum three-year rolling period. The indicators are set out as though Somerset West and Taunton Council were to continue with its present objectives.
- 1.12 The diagram overleaf illustrates how the three Strategies are laid out in this document, along with the Council's Minimum Revenue Provision (MRP) Statement.

CAPITAL, INVESTMENT AND TREASURY STRATEGIES



A. Capital Strategy

1 Introduction

- 1.1 This capital strategy report gives a high-level overview of how capital expenditure and capital financing that contribute to the provision of local public services.
- 1.2 Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework summarised throughout the three Strategies contained within this document.
- 1.3 Somerset West and Taunton was created on 1 April 2019, with its assets, its liabilities and functions transferred from the predecessor councils – Taunton Deane Borough Council and West Somerset District Council. Both Councils transferred a legacy borrowing requirement in respect of General Fund services which represented a small proportion of the value of capital assets transferred. In respect of its Housing services, Taunton Deane Borough Council transferred its Housing stock assets and associated borrowing requirement to the new Council. Plans to meet the costs of the legacy borrowing requirement are embedded in both General Fund and Housing Revenue Account budgets and respective ongoing medium- and long-term financial plans.

2 Capital Expenditure

Governance arrangements for developing the Capital Programme

- 2.1 New capital schemes and projects are added to the capital programme as part of the annual budget setting process. However, the Council's governance arrangements allow for new schemes and projects to be added to, or removed from, the programme during the year, subject to appropriate officer and Member approvals and review by the Members' Scrutiny process.
- 2.2 The annual programme is developed where managers bid in September/ October for projects to be considered, with an outline scheme appraisal and specific funding proposals where required (namely for capital projects that are not on-going programmes of work). Bids are collated within the Finance department to summarise the potential expenditure requirement (including one-off capital costs and ongoing revenue costs). Bids should also identify the capital financing options, including

setting aside monies from the revenue account in future years to recognise the cost of any borrowing needed for capital investment. The process of setting aside monies is referred to as Minimum Revenue Provision, or MRP. The Council's Asset Management Strategy and Plan also inform the programme, as well as strategic development and improvement programmes.

- 2.3 The draft programme is presented initially to the Senior Management Team and priority proposals are then taken forward to Scrutiny Committee for review and comment. The Executive will then consider and recommend the final draft Capital Programme to Full Council. Here the Programme is considered for approval alongside the annual revenue budgets in February. The complete process ensures that affordable projects support delivery of future service objectives. Capital investment should be proportionate to the capacity of the Council's short-term and long-term resources.

Capital Programme

- 2.4 The Capital Programme is a primary record of all approved capital projects in which the Council plans to invest. Covering each of the Council's directorates, it sets out the Council's commitment to continue to invest in its operational asset portfolio and wider investment to support housing, economy and place-shaping priorities. It undergoes a major review annually so that the resources required to deliver the capital programme may be recognised in the revenue budgets, taking into account the availability of capital resources and the financing cost implications.
- 2.5 Progress against the Capital programme is also monitored regularly throughout each financial year. Cumulative expenditure is updated monthly, and spending departments informed. Formal reporting to senior management and the Council's Audit and Scrutiny Committee occurs every quarter, alongside revenue budget monitoring. Therefore, the Council's governance arrangements provide scope for new schemes and projects to be added to or removed from the programme during the course of a financial year in response to changing needs and resources.

Capital Expenditure Estimates

- 2.6 Capital expenditure is incurred where the Council spends money on constructing or acquiring assets such as land and buildings, including housing, vehicles, plant and equipment, all of which will be used for more than one year, as well as larger-scale maintenance works that extend the life of, or enhance, the Council's existing assets. In local government capital expenditure can also include supporting the acquisition of assets by other bodies; in such cases, the Council may provide service loans and grants to local organisations enabling them to buy assets that contribute to achievement of the Council's corporate objectives or service provision. The Council is largely constrained in what it may deem as capital expenditure, with allowable items needing to meet the definitions set within capital regulations. Items that fail to meet these definitions must be charged as revenue expenditure in the year. The Council's policies also determine that assets costing below

£10,000 will not be capitalised and are similarly charged as revenue expenditure. This is reflected in the Council's Statement of Accounts each year.

- 2.7 The information included in the table below shows totals for the Council's actual capital spend in 2020/21, together with budgets and estimates for the financial years 2021/22 onwards:

TABLE 1	ACTUAL AND ESTIMATES OF CAPITAL EXPENDITURE					
	2020/21	2021/22	2022/23	2023/24	2024/25	2021-25
CAPITAL PROGRAMME	Actual	Forecast	Estimate	Estimate	Estimate	Totals
	£000	£000	£000	£000	£000	£000
General Fund Services	19,260	23,593	39,554	38,844	8,997	110,988
Capital Property Investments	44,074	54,875	0	0	0	54,875
Housing services (HRA)	9,146	17,822	30,406	32,144	29,953	110,325
Lease Liabilities (accounting change)	0	0	279	361	379	1,019
Totals	72,480	96,290	70,239	71,349	39,329	277,207

Capital Investment relating to the General Fund

- 2.8 The main General Fund capital projects relating to mainstream services focus on investment in new and existing operational assets and on issuing capital grants to support the delivery of the Council's services and strategic priorities. This includes schemes such as technology, regeneration and infrastructure projects, contributions to major transport and flood alleviation projects, and grants for accessibility adaptations and equipment to support independent living. The most-substantial projects contained within the capital programme, including both mainstream and commercial properties, with expenditure between 2021/22 and 2024/25 include the following:

Major General Fund Schemes - Estimated total Capital Expenditure from 2021/22 to 2024/25	£million
Investment Properties	55.930
Other Regeneration Schemes/ Projects	33.484
Firepool Block 1 Construction	13.427
Firepool Phase 1 Carparks	10.352
Projects supported by Community Infrastructure Levy	7.404
Flooding Alleviation	6.000
Firepool Phase 1 infrastructure	5.156
Blue Anchor Coast Protection	3.528
Coal Orchard Construction	2.723
Active Travel	2.258

Commercial Property Investments

- 2.9 The Commercial Property Investment Strategy was developed to invest £100million between 2020/21 and 2021/22 to create a diversified, cross-sector, institutional grade property portfolio which will bring in gross additional income to the General Fund. The Strategy follows a reduction in Council income streams and increasing volatility around other funding sources, requiring Somerset West and Taunton Council to generate new sources of additional revenue to support front line services. Acquisition of the Council's capital investment portfolio of commercial properties was successfully completed on 17 December 2021. The Council has no plans to extend its investment in this field any further. The Council's Commercial Property Investments are covered in detail within the Investment Strategy, Section B of this document.

Capital Investment relating to the Housing Revenue Account

- 2.10 The Housing Revenue Account (HRA) is a ring-fenced, self-financing, account used to manage the Council's housing stock of some 5,700 properties. The Council acts as the Landlord to the tenants of those properties. The HRA has its own ring-fenced revenue account, capital programme and reserves. This ensures that council housing neither subsidises, nor is itself subsidised by, Council Tax payers.

- 2.11 The HRA Capital Programme's main purpose is to invest in the housing portfolio to replace major components periodically, to ensure that the decent homes standard and warmer homes standards are maintained and that fire safety regulations are adhered to.
- 2.12 The programme also includes major works to related assets such as garages, meeting/ community halls and shops, and home aids and adaptations in tenants' homes where there are mobility issues. The introduction of a new accounting standard (IFRS 16) requires the Council to recognise lease costs as capital expenditure so that assets are recognised on the Council's balance sheet. This is envisaged to occur from 1 April 2022.
- 2.13 The current capital programme also includes a significant investment in social housing development. There is the North Taunton Woolaway Project which is a regeneration scheme to replace properties that were coming to the end of their useful life. Part of this project will also increase the housing stock portfolio, along with other schemes such as Seaward Way, Oxford Inn and the Zero Carbon Pilot, to deliver vital additional affordable homes.
- 2.14 The HRA Capital Programme is funded from an appropriate combination of Major Repairs Reserves (accumulated from depreciation), revenue contributions, capital receipts, capital grants and borrowing.

Asset Management

- 2.15 Asset Management falls within the responsibilities of both the External Operations and Climate Change Directorate and the Housing and Communities Directorate. The Council also manages the commercial property investment portfolio through the Commercial Property Investment Board and the Major and Special Projects team within the Development and Place Directorate, with access to the Council's internal specialists and appointed managing agents.
- 2.16 The Council has a core team of qualified property professionals who advise on acquisitions, disposals and day-to-day management and condition of all Council assets.
- 2.17 The property specialists continually assess maintenance and work programmes to preserve the Council's properties so that they may retain their functionality for providing services, meeting the Council's responsibilities and complying with health and safety requirements. Such responsive work feeds into the Capital Programme where investment in or upgrading of assets is required, or into revenue budgets where maintenance of assets is needed.
- 2.18 The assets already within the Council's ownership are actively managed on a day-to-day basis to minimise costs and risks and to maximise any receipts and income potential, adopting the principles of Value for Money. An important aspect will be

the identification of expenses and receipts to specific property assets to enable non-performing investments or properties with excessive costs to be identified and considered for disposal

- 2.19 In proactively managing the Council's diverse portfolio of properties, the asset management teams make recommendations to the Council's Senior Management Team, Executive, and Council both at a strategic level and as part of day-to-day operations.
- 2.20 The Investment Properties portfolio is managed under special governance arrangements contained within the Council's Commercial Investment Property Strategy, approved December 2019 and revised January 2022. Further details of the portfolio are set out in the Investment Strategy, Section B of this document.
- 2.21 In line with the revised requirements of HM Treasury and the CIPFA Prudential Code, disposals will be closely considered on an on-going basis.

3 Capital Financing

- 3.1 All capital expenditure must be financed, and there are a range of potential funding sources the Council may use, including its own resources or financing available from external sources. The main headings for the options available to finance capital expenditure include the following:
 - Capital receipts from asset disposals and repayments of loans to external organisations,
 - Capital grants, mainly originating from the Government or other local authorities,
 - Contributions from other bodies, such as Section 106 (s106) contributions and Community Infrastructure Levy (CIL),
 - Revenue Contributions to Capital, comprising sums applied from the Revenue Budget or Revenue Reserves,and any expenditure not financed by the above items is added to the Council's Capital Financing Requirement (CFR) and will be financed from:
 - Debt financing, such as borrowing, capital market bonds, leasing, etc.

Capital Financing Plan

- 3.2 The planned financing of the capital expenditure (sumarised in Table 1, above) is illustrated in Table 2 (overleaf):

TABLE 2	CAPITAL FINANCING PLAN					
	2020/21 Actual £000	2021/22 Forecast £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2021/25 Totals £000
External sources:						
Grants and contributions	5,411	3,462	18,502	1,847	1,059	24,870
S106	2,369	1,535	1,011	0	0	2,546
CIL	926	815	1,951	10,400	0	13,166
 subtotal - External	8,706	5,812	21,464	12,247	1,059	40,582
Internal sources:						
Capital receipts	2,097	2,799	5,987	3,670	2,535	14,991
Major Repairs Reserve	4,361	12,150	9,952	7,896	8,133	38,131
Revenue contribns & reserves	3,116	304*	1,507	0	0	1,811
 subtotal - Internal	9,574	15,253	17,446	11,566	10,668	54,933
Debt						
Loans taken out HRA	3,470	4,142	17,135	20,578	19,285	61,140
Loans taken out GF	50,730	71,083*	13,915	26,597	7,938	119,533
Loans taken out subtotal	54,200	75,225	31,050	47,175	27,223	180,673
Leases	0	0	279	361	379	1,019
 subtotal - Debt	54,200	75,225	31,329	47,536	27,602	181,692
TOTAL	72,480	96,290	70,239	71,349	39,329	277,207

*** NOTE to Table 2:** Table 2 does not reflect the recommendation to be made to Full Council for the transfer of £2million from General Reserves to fund a supplementary increase in the Revenue Contribution to Capital Outlay budget for the financing of capital expenditure in 2021/22. The impact of this recommendation would be to increase "Revenue contribution & reserves" line in 2021/22 from £304,000 to £2,304,000 and to reduce the "Loans taken out GF" line from £71,083,000 to £69,083,000.

3.3 The allocation of resources does vary over time. For example, additional income may be available through asset sales (which generate capital receipts) or by obtaining new external grant funding. The Capital Financing Plan set out in Table 2 is a snapshot that aligns with the Council's budget, tabled for consideration in February 2022. However, as stated above, the

financing of capital expenditure is a dynamic process. With regular changes in financing sources, it is overseen by the Council's s151 Officer to optimise financing arrangements on an ongoing basis. Therefore, the estimated Plan does not commit the Council to particular methods of financing. The s151 Officer will determine the actual financing of capital expenditure incurred at the end of the financial year based on the resources that became available during the year. The outcomes are reported to and considered by Members of the Scrutiny Committees and by the Audit and Governance Committee as well as by the external audit process.

- 3.4 The mechanics of financing capital expenditure from borrowing are determined by capital regulations and Codes of Practice, which ensure that such expenditure is spread across future years to reflect that their benefits stretch across future years; this is a protection against spikes in Council Tax and Housing Rent payments so that large capital investment sums are not charged immediately.
- 3.5 The Council may defer the timing of external borrowing on a short- to medium-term by using temporary cash resources held in reserves and balances. This practice is referred to as 'internal borrowing.' It neither reduces the magnitude of borrowing required nor the level of funds held in reserves and balances. The practice simply utilises cashflow balances in the short-term until they are required for their intended purposes, which often represents good value for money and reduces investment risks. This is because, when 'surplus' cashflow is available, adding externally borrowed sums to that 'surplus' cashflow would require higher investment balances to be held in institutions which, in turn, are subject to risk of market failure (however slight those risks may be). More attention to investment risk is set out in the Treasury Management Strategy, Section C of this document.
- 3.6 Naturally, debt in the form of loans and leases must be repaid. Although borrowing from external sources may, for example, require repayment of the borrowed sum at the end of a loan period, regulations require the Council to set aside amounts annually so that financial capacity is available to repay the borrowing when it is due. This method of setting amounts aside occurs over a period of years, mainly by financing from revenue using the mechanism of Minimum Revenue Provision (MRP) or from voluntary overpayments (voluntary revenue provision), which may release revenue budgets from ongoing financial strain. Alternatively, capital receipts may be used as an alternative to taking out new borrowing, and hence remains a locally determined alternative source of capital financing.

Capital Financing Requirement

- 3.7 The Council's cumulative amount of debt finance is measured by the Capital Financing Requirement (CFR). This is an important measure that determines the maximum borrowing requirement of the Council over the course of years that Council assets may be employed for the delivery of services. The basic mechanism behind the CFR involves a cumulative value

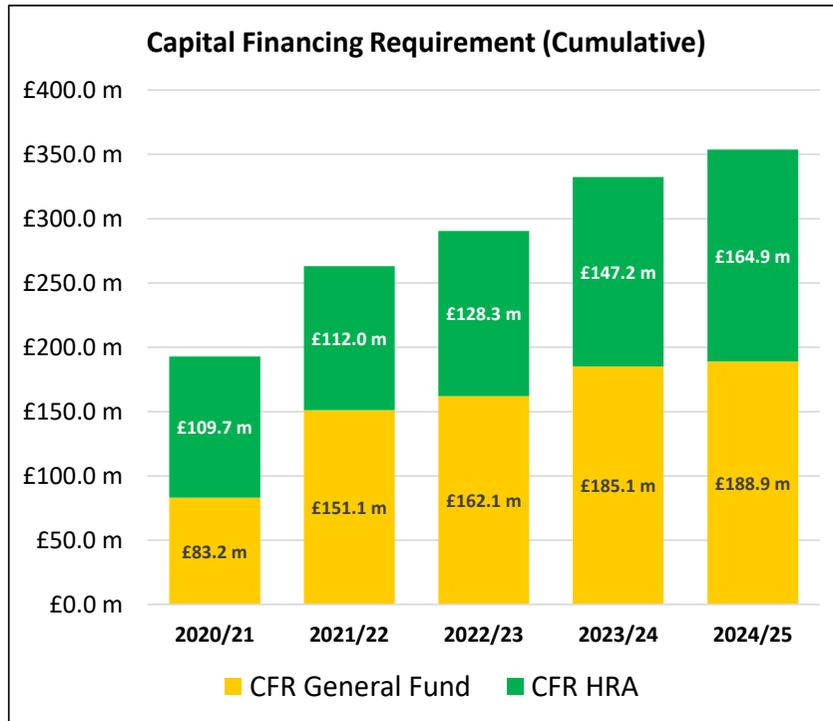
that increases over time with new unfinanced capital expenditure met from borrowing (i.e. cannot be financed from grants, capital receipts, etc); the CFR then reduces each year by MRP repayments and voluntary overpayments.

- 3.8 The CFR is expected to increase by £27.33million during 2022/23 (comprising £11.06million for the General Fund and £16.27million for the HRA). Based on the above annual forecasts for capital expenditure and the profile of capital financing (Tables 1 and 2) the Council's estimated cumulative CFR for 2021/22 to 2024/25 is shown below in Table 3, alongside the actual results from the final accounts for 2020/21:

TABLE 3	ACTUAL AND ESTIMATED CAPITAL FINANCING REQUIREMENT				
	2020/21 Actual £000	2021/22 Forecast £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
General Fund					
CFR balance b/fwd	33,955	83,203	151,089	161,530	184,435
Expenditure	63,335	78,468	39,554	38,844	8,997
Accounting adj - Leases	0	0	124	184	196
MRP/VRP	-1,395	-3,197	-2,983	-3,876	-4,309
Capital receipts used	-740	-1,797	-2,668	0	0
Grants and contributions	-11,952	-5,588	-23,586	-12,247	-1,059
GF CFR balance c/fwd	83,203	151,089	161,530	184,435	188,260
HRA					
CFR balance b/fwd	107,981	109,717	112,038	128,307	147,240
Expenditure	9,146	17,822	30,406	32,144	29,953
Accounting adj - Leases	0	0	155	176	183
MRP	-1,821	-1,821	-1,021	-1,821	-1,821
Capital receipts used	-1,357	-1,002	-3,319	-3,670	-2,535
Grants and contributions	-4,232	-12,678	-9,952	-7,896	-8,133
HRA CFR balance c/fwd	109,717	112,038	128,307	147,240	164,887
Total CFR balance c/fwd	192,920	263,127	289,837	331,675	353,147

NOTE to Table 3: Similarly as noted with Table 2, Table 3 does not reflect the recommendation to be made to Full Council to apply £2million General Reserves to fund capital expenditure in 2021/22. The impact of this recommendation would be to add a new line with £-2m RCCO which, in turn, would reduce the cumulative CFR totals by £2m.

3.9 Table 3 shows that the Council’s proposed capital strategy and capital investment plans are expected to increase the overall indebtedness position over the next 3 years (2022/23 to 2024/25) for both the General Fund and the Housing Revenue Account. The outcome for CFR is also illustrated in the graph, overleaf, which separates out the General Fund and HRA.



3.10 It is important to ensure capital plans are affordable and the Council can meet the costs of this debt over both the short- and long-term. The Council’s Medium Term Financial Plan is therefore an important monitor because it includes the impact of debt financing costs on revenue budgets in future years. This is supported by the appraisal process for capital schemes over the life of the assets being acquired. In relation to Housing Revenue Account assets, which are predominantly of high value and long life, the HRA Business Plan sets out the impact of capital expenditure over a 30-year period. Other measures of affordability are contained within the prudential indicators set out in the Treasury Management Strategy, Section C of this document.

3.11 From the graph, we see a significant increase in the General Fund CFR from 2020/21 to 21/22 as a result of the final year of investment in commercial properties. A less-pronounced spike occurs in 2023/24 as a result of investment in regeneration, flood alleviation and development of the Firepool scheme.

- 3.12 Taking on borrowing and other forms of debt should follow a planned approach, taking account of economic conditions that influence interest rates, ensuring the Council is protected from risks (e.g. by spreading maturity dates to protect against interest rate volatility), and requiring a range of skills, controls and procedures. The Treasury Management and Borrowing Strategy is set out in Section C of this document. Setting out the Council's Borrowing Strategy, it also takes forward the link between the CFR and borrowing.
- 3.13 Meanwhile, having access to alternative sources to finance capital expenditure reduces dependence on borrowing. Details of the alternative sources of capital financing are provided in Annex 1 to this document.

4 Revenue Budget Implications

- 4.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans/ leases and capital debt repayment provisions are charged to revenue, offset by any investment income receivable. The net annual charge is referred to as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, Business Rates and general government grants.

TABLE 4	General Fund Proportion of financing costs to revenue stream				
	2020/21 Actual £'000	2021/22 Forecast £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Financing costs	£1.51m	£4.03m	£3.93m	£5.56m	£5.99m
Proportion of net revenue stream	6.76%	21.53%	23.10%	38.25%	38.76%

- 4.2 The percentage of financing costs to net revenue stream increases significantly over the medium term. This is through a combination of increased capital investment – predominantly for commercial and regeneration purposes – and the expected reduction in funding primarily related to business rates, new homes bonus and Government support for Covid. Although this indicator identifies increased risk, the majority of increased financing costs are planned to be offset by income from commercial and regeneration investment. Through prudent investment, it is anticipated that investment income will be less

volatile and more predictable than other financing income such as business rates and government grants. This is reflected in the financial strategy and medium term financial plan.

- 4.3 Similarly for the Housing Revenue Account, Table 5 shows how the financing costs may be set out as a proportion of the HRA revenue stream, primarily comprising rents and service charges.

TABLE 5	HRA Proportion of financing costs to revenue stream				
	2020/21 Actual £'000	2021/22 Forecast £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Financing costs	£4.26m	£4.49m	£3.90m	£5.13m	£5.39m
Proportion of net revenue stream	15.78%	16.23%	13.74%	17.25%	17.10%

- 4.4 All capital investment must be sustainable in the long-term through revenue support by the Council or its partners. All capital investment decisions consider the revenue implications both in terms of servicing the finance and running costs of the new assets. The impact of the revenue implications is a significant factor in determining approval of projects. The use of capital resources has been incorporated into the Council's MTFP.

5 Liabilities

- 5.1 In addition to capital debt as detailed above, the Council is committed to making future payments to cover its pension deficit, which was valued at £140.2m as at 31 March 2021. This balance is due to be paid over a 20-year period, and the deficit and annual contributions are revalued every three years. It has also set aside £0.945m to cover provisions for probable costs. As with all local councils, SWT Council will always remain at risk of having to set aside sums for contingent liabilities, but has not identified any need to set aside monies at the time of writing; however, payment remains contingent on, as yet, unknown events occurring which will be incorporated into the Council's annual Statement of Accounts, in accordance with proper accounting practice.

6 Sustainability

- 6.1 Due to the long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The S151 Officer is satisfied that the Capital Programme, proposed as part of the 2022 budget approval process, is prudent, affordable and sustainable because:
- the Council has adequate means of financing and repaying any required borrowing, which is profiled across varying time periods to reduce risks of cost spikes arising from acute economic events.
 - the Council maintains a balanced budget that can adequately fund the expenditure with sufficient contingency reserves and balances to accommodate emergencies and unexpected events.
 - Continued development of the Capital Programme links to the Annual Plan.
 - Regular capital monitoring and scrutiny processes ensure the performance of capital investment against the approved Capital Programme.
 - Whole Life Appraisal – a systematic assessment of all relevant expenses, income and performance associated with the acquisition, procurement, ownership, refurbishment and potential disposal of an asset over its life thus allowing the Council to plan our medium- and long-term financial commitments. Projects are assessed for how they meet specific service needs, generate savings or an income stream to the Council, and how they mitigate risks.

B. Investment Strategy

1 Introduction

1.1 The Council invests funds that it holds for four broad purposes:

- i) **treasury management investments** - surplus cash resulting from its day-to-day receipts and payments activities, for example when income is received in advance of expenditure.
- ii) **service investments** - to support local public services by lending to or buying shares in other organisations.
- iii) **commercial investments** to earn investment income to meet the wider needs of the Council.
- iv) **regeneration investments** - to realise the Council's key objective to stimulating change in the local community and business environment that would be unlikely if left solely to market activity.

1.2 Treasury investment balances arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

1.3 The Council's policy on treasury investments is to **prioritise security and liquidity over yield**, therefore the Council's primary focus is on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high quality banks to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property. Whilst yield is not the primary objective, it is important to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which investments to buy; the Council may request its money back at relatively short notice in accordance with individual funds' requirements.

1.4 As part of the Council's financial strategy, the aim is to evolve the balance within the investment portfolio to improve the net income available through treasury management to fund services, whilst maintaining a prudent balance between **security, liquidity and yield, in that order of priority**. The yield curve has reduced in the last 12 months to such an extent that returns through long-term treasury investment are minimal. It is therefore anticipated that investment will remain in the near

term, maximising security and liquidity/ flexibility. The assessment of adequate general reserves also incorporates an element of risk to investment income assumptions.

TABLE 6	Treasury Management Investments				
	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual £'000	Forecast £'000	Estimate £'000	Estimate £'000	Estimate £'000
Near term investments	44,761	30,500	30,000	20,000	20,000
Long term investments	3	3	3	3	3
Total	44,764	30,503	30,003	20,003	20,003

- 1.5 Further details of existing treasury investments can be found in the Treasury Management Strategy, Section C, below.
- 1.6 **Risk Management** - The effective management and control of risk is a prime objective of the Council's treasury management activity. The Treasury Management Strategy sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.
- 1.7 Decisions on treasury management and borrowing are made daily and are, therefore, delegated to the s151 Officer and his staff who must act in line with the Treasury Management Strategy approved by Full Council. Reports on treasury management activities are presented to the Audit and Governance Committee mid-year and at year-end. In line with the new Prudential Code, the reporting arrangements will increase this frequency to quarterly with effect from 2023/24.

2 Treasury Management Investments

- 2.1 The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of treasury management investments is expected to fluctuate between £20m and £50m at the extreme, and depending upon major cashflow movements during the 2022/23 financial year.

- 2.2 The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.
- 2.3 Full details of the Council's policies and its plan for 2022/23 for treasury management investments are covered in the treasury management strategy later in this document.

3 Service Investments – Loans

- 3.1 The Council lends money to local businesses, local charities, other local authority partnerships, and local residents to support local public services and priorities, and to stimulate local economic growth. Currently the Council has loans invested with:
- Somerset County Cricket Club – delivering the new Pavilion and bringing international cricket to Somerset.
 - Hestercombe House and Gardens – enabling loan for development feasibility work
 - Somerset Waste Partnership – for waste vehicles, with added benefit of keeping waste contract costs down
 - Residents – housing related mortgages
 - Centre for Outdoor Activity and Community Hub (COACH) – purpose-built community centre including a café, conference suite, changing rooms, boat store and home to five community sports clubs.
- 3.2 The Council has included provision in its Capital Programme to provide further loan finance to the Somerset Waste Partnership for new vehicles in 2021/22 and for waste containers in 2022/23 towards delivery against the Recycle More scheme under the new waste contract.
- 3.3 The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to minimise this risk and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows (see overleaf):

TABLE 7	Loans for Service Purposes			
	Actual as at 31 March 2021 Balance Owing £'000	Loss Allowance £'000	Net figure in accounts £'000	2022/23 Approved Limit £'000
Category of borrower:			0	
Businesses	1,573	-71	1,502	1,600
Charity / Community	28	-1	27	28
Local Authorities	4,280	0	4,280	6,800
Residents	377	-15	362	1,200
Total	6,258	-87	6,171	9,628

- 3.4 Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.
- 3.5 The Council assesses the risk of loss before entering into this type of service loans arrangement by working up a robust business case and applying due diligence to all requests for service loans, carrying out proportionate monitoring of credit risk of borrowers. For example, with loans to key businesses, the Council's finance specialist team (qualified accountants) will review financial statements whilst service officers will maintain communication with the borrower in order that emerging risks are identified promptly. The Council will use credit rating information where available, and will use external specialist advisors if appropriate.
- 3.6 In view of the public service objective, the Council is willing to take more risk than with treasury investments; however, it still plans for such investments to generate a positive investment return after all costs are covered, and decisions upon granting such loans are made on the basis that repayment to the Council remains a firm and realistic commitment.
- 3.7 Decisions on service investments are made by the relevant service manager in consultation with the s151 officer and must meet the criteria and limits laid down in the investment strategy. Most loans are capital expenditure and purchases will, therefore, also be approved by Committee or through delegated powers as part of the capital programme.

Investment and Regeneration Activities

- 3.8 Local authorities have a key role in facilitating the long-term regeneration and economic growth of their local areas and they may wish to hold investments to facilitate this. When determining whether to acquire, the Council needs to recognise the contribution the asset will make. The contribution could be classified as direct service delivery and/or place-making, for example economic growth, business rates growth, responding to market failure or sustainability of certain asset classifications. Further details of the Council's regeneration schemes are contained in Annex 2 of this document.

4 Service Investments – Shares

- 4.1 The Council does not currently hold any direct investment in the shares of subsidiaries, its suppliers or local businesses.

5 Commercial Investments – Property

- 5.1 The Council invests in a diverse investment property portfolio both locally and nationally with the intention of generating surplus income that will be spent on local public services delivered within the district.
- 5.2 The Council holds some assets that were initially acquired for service purposes such as benefitting the local economy but these have since been reclassified as investment properties. They are now established and the main purpose for holding the assets is for rental income. The following table summarises the commercial property investment programme and, for completeness, shows local investment properties held as part of the Council's mainstream support to aid local regeneration and business within the SWT District:

TABLE 8	Properties held for investment purposes	£'000
Commercial Properties held for yield (acquired during 2020/21 and 2021/22)		
Aztec West		9,573
The Range		5,781
B&Q		6,998
Wickes		9,819
JLR		6,130
Quinton Business Park		5,766
Audi, Cardiff		7,190
Coast Road Retail Park		12,585
Fenick House		4,783
Reflex, Barwell		5,425
Reflex, Ossett		2,624
Steelite		22,270
Subtotal, Commercial Investments		98,944
Investment Properties held to support local business and regeneration		
Land at Brunel Way		265
The Arcade (Formerly The Carousel or K's)		297
Roughmoor Enterprise Centre (Employment Workspace)		1,404
Blackdown Business Park, Wellington (4 Units)		1,344
Gaumont Theatre (Mecca Bingo), Corporation Street, Taunton		1,530
Other properties with values below £250k		1,141
Total all properties		104,925

- 5.3 With central government financial support for local public services declining, the Council established a programme of investing in commercial property for the purpose of generating a financial gain that ensures the continuation of the Council's services to the local community and local businesses. Acquisition of the Council's capital investment portfolio of commercial properties was successfully completed on 17 December 2021. The Council has no plans to extend its investment in this field any further. Total commercial investments hold a purchase value of £98.9million. Table 9, below, shows the forecast net income contributions between 2021/22 and 2024/25. These levels of return have been prudently set, taking account of the

risk of higher interest rates for borrowing in the latter years, as well as setting aside sums for debt repayment and to add to reserves.

TABLE 9	Net income from commercial and service investments to net revenue stream			
	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Net income from commercial investments	£3.72m	£4.49m	£3.36m	£3.36m
Proportion of net revenue stream	19.84%	26.38%	23.11%	21.76%

5.4 With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures are summarised as follows:

- The commercial investment net income is underpinned by very strong governance and due diligence, which helps to minimise risks. The Council finalised its planned investment in December 2021, with the budget estimates reflecting the completed portfolio. The risks associated with this investment include market and economic risks as well as potential volatility in income, financing, and management costs. This is mitigated through prudent budgeting and earmarked investment risk reserves.
- The Government’s decision to restrict access to PWLB means alternative sources of long-term borrowing may be needed in future. There are competitive alternatives available, as evidenced by financing having already been secured from other local authorities, however this represents a risk in terms of estimating future borrowing costs.
- Property investment income: Whilst income volatility is expected to be low, no investment is risk-free. For financial planning sensitivity analysis purposes, 5% adverse volatility would impact income by c£360k. This risk is mitigated through the Investment Risk Reserve.
- Risk of rising interest rates and the wider economy may impact on investment income and borrowing costs.

5.5 As an overriding approach to mitigate the above, a uniformly prudent approach to budget estimates and debt repayment has been taken, with adequate funds held in an investment risk reserve. An assessment of the consolidated cash flows, investment and borrowing requirements will be completed through the LGR Finance Workstream. This will inform the development of longer treasury management strategies including borrowing and refinancing requirements.

- 5.6 Decisions on commercial investments are delegated by the Council to the Investment Board in line with the criteria and limits approved by Full Council in December 2019, and refreshed in December 2020. Property and most other commercial investments are also capital expenditure and purchases have been reported as part of the Council's capital programme. Performance of the investment portfolio are reported to the Executive and also incorporated within the overall financial monitoring reports throughout the year.
- 5.7 The Investment Properties portfolio is managed in line governance arrangements contained within the Council's Commercial Investment Property Strategy, approved December 2019 and revised January 2022. The original Strategy formed the basis upon which an intricate process of due diligence, review and accountability has been employed in building the investment property portfolio, all of which have been actively achieved throughout the acquisition process. The revised Strategy focuses on ongoing management, including how property will be managed during the transition phase to a new Unitary Council for Somerset. Management of the Investment Properties extends to monitoring deliverables, risks, performance, asset values and ongoing value for money.
- 5.8 Further to publication of the latest CIPFA Prudential Code in December 2021, Somerset West and Taunton Council fully recognises that the Prudential Code has brought about changes to how local authorities invest primarily for financial return and, forthwith, the Council is committed to adhering to the Prudential Code's determination that:
- 'In order to comply with the Prudential Code, an authority must not borrow to invest primarily for financial return.
 - It is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.'

Other Property Investment Matters

- 5.9 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. The Council also recognises that asset values may increase or decrease over the course of time due to conditions in the property market; as a pre-requisite for all investments aligned with property, it is necessary to take a long-term perspective on performance, valuation and security, enforcing the assumption that capital values are likely to hold or grow over the life of these assets.
- 5.10 As an integral part of the preparation of the Council's annual accounts for 2021/22, a fair value assessment of the Council's investment property portfolio is to be taken by the Council's valuers, in line with proper accounting practice. Should the

2021/22 year-end accounts value these properties below their purchase cost, then an update will be reported to Full Council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

- 5.11 **Risk assessment:** The Council has conducted detailed assessment of the risks of loss before entering into purchases of its property investment portfolio by undertaking considerable due diligence, including commissioning surveys and specialist property valuation advice and proactively challenging findings and assumptions along the way. This will have included considerations of the strength of local market conditions to give confidence on future re-letting, the financial strength of business tenants and also considers possible alternative uses, if appropriate. The Council, through its Investment Board, actively monitors the portfolio to ensure tenant obligations for maintaining assets are fulfilled.
- 5.12 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice. It can take a considerable period to sell in certain adverse market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council actively manages cash flow through its treasury management arrangements and plans to under-borrow against its CFR so that it can temporarily borrow at short notice if required.

6 Regeneration Schemes

- 6.1 Some of the key schemes under development are briefly described in Annex 2 to this document, and their progress is regularly reported to the Senior Management Team and to Members of the Council.

7 Financial Guarantees

- 7.1 Although not strictly counted as investments, since no money has exchanged hands yet, financial guarantees carry similar risks to the Council and are included here for completeness.
- 7.2 The following guarantees were transferred to the Council from TDBC and WSC on 1 April 2019:
- South West Audit Partnership Limited Pension Liability £0.268m (as at 31 March 2019)
 - Somerset Waste Partnership Pension Liability (minimal)

8 Proportionality

8.1 The Council is dependent on income generating investment activity to achieve a balanced revenue budget. Table 10 below shows how the Council is dependent on achieving the expected net income from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net income, the Council's contingency plans for continuing to provide these services include holding adequate funds in an earmarked Investment Risk Reserve as well as carrying adequate General Reserves. Budget estimates are also set using prudent assumptions about net income from the portfolio including an allowance for voids / non-collection.

TABLE 10	Proportionality of Investments				
	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Forecast	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Gross Service expenditure	90,862	100,286	103,295	106,393	109,585
Investment income	-860	-4,578	-5,205	-4,065	-4,065
Proportion of income to expenditure	0.9%	4.6%	5.0%	3.8%	3.7%

- NOTES to Table 10:**
- i) Investment income, in this table, includes both treasury investments and commercial investments.
 - ii) Gross service expenditure is indicative and based on a 3% inflationary increase from 2022/23 onwards, so is not linked to formal MTFP projections for the General Fund and HRA.

8.2 Investment income shown in the above table is the gross income included in the budget estimates, disregarding asset management and capital financing costs. The falling proportion % illustrates a decreasing level of investment balances which, in turn, places pressure on funding services as other funding sources diminish, in particular government grants and the risk of business rates volatility.

9 Investment Indicators

9.1 The Council has set the following quantitative indicators to allow elected Members and the public to assess the Council's total risk exposure from its investment decisions.

Total investment exposure:

9.2 This indicator shows the Council's total exposure to potential investment losses. It includes amounts the Council is contractually committed to lend but has yet to draw down, as well as guarantees the Council has issued.

TABLE 11	Total Investment Exposure				
	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Forecast	Estimate	Estimate	Estimate
<i>All values at year end</i>	£'000	£'000	£'000	£'000	£'000
Treasury Management Investments:					
Strategic Funds	17,000	17,000	17,000	17,000	17,000
Other	27,761	13,500	13,000	13,000	13,000
Service investments - loans	5,642	6,342	6,294	5,656	5,083
Commercial investments	44,063	99,123	97,141	95,198	93,294
Total investments	94,466	135,965	133,435	130,854	128,377
Commitments to lend	0	1,274	0	300	300
Guarantees on pension liabilities	268	268	268	268	268
Total commitments and guarantees	268	1,542	268	568	568
Total Exposure	94,734	137,507	133,703	131,422	128,945

How investments are funded:

9.3 Government guidance is that these indicators should include how investments are funded. Conversely, capital regulations specify that the Council should not normally associate individual assets with individual liabilities, therefore it is difficult to comply in complete terms with the funding indicator. However, the following investments could be regarded as having been funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received just prior to need.

TABLE 12	Investments funded by borrowing				
	2020/21 Actual £'000	2021/22 Forecast £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Service investments - loans	5,642	6,342	6,294	5,656	5,083
Commercial investments - property	44,063	99,123	97,141	95,198	93,294
Commitments to lend	0	0	0	0	0
Total funded by borrowing	49,705	105,465	103,435	100,854	98,377

NOTE to Table 12: Similarly as noted with Tables 2 and 3 above, Table 12 does not reflect the recommendation to be made to Full Council to apply £2million General Reserves to fund capital expenditure in 2021/22 and a proposal to apply a Voluntary Overprovision (VRP) of £1m. The impact of this would be to reduce the “Commercial investments - property” line by £3m in each year from 2021/22 onwards. These adjustments will be incorporated at the point of Full Council meeting on 24 February 2022.

Rate of return received:

- 9.4 The Council seeks to achieve a commensurate rate of return in line with this investment objectives and risk appetite. For service loans, the rate of return will be set with the aim of covering financing costs (or opportunity costs) plus a premium for risk. The acquired portfolio of property investments for yield is budgeted to return 7% gross.

C. Treasury Management Strategy

1 Introduction

- 1.1 Treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The Council has borrowed and invested substantial sums of money and is, therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are, therefore, central to the Council's prudent financial management.
- 1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a Capital Strategy, Investment Strategy and Treasury Management Strategy before the start of each financial year. This combined document fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
- 1.3 Investments held for service purposes and for commercial income generation are considered in the Investment Strategy, set out above within this document, Section B.

2 External Context

- 2.1 The treasury strategy appropriately considers the wider economic picture. The Council's treasury advisor, Arlingclose, has provided a summary commentary on this wider context and their own interest rate forecasts, and is provided in Annex 2. to this document.

3 Local Context

3.1 On 31 December 2021, the Council held £170.5million of borrowing, (£105.5million long-term and £65.0million short-term) and £39.2m of treasury investments. These balances are summarised in Table 13 below.

TABLE 13	Existing Investment & Debt Portfolio Position as at 31 December 2021	
	Actual Portfolio £m	Average Rate £m
External Borrowing		
Public Works Loan Board	102.5	2.62%
Banks	3.0	4.25%
Local Authorities	65.0	0.08%
Total gross external debt	170.5	1.68%
Treasury Investments		
Banks (unsecured)	-1.3	0.01%
Money Market Funds	-15.6	0.07%
Strategic Pooled Funds	-17.0	3.11%
Other investments	-5.3	3.29%
Total treasury investments	-39.2	1.82%
Net Debt	131.3	

3.2 Forecast changes in these sums are shown in the balance sheet analysis in Table 14 (see note below).

NOTE: TABLE 14 – Balance Sheet Summary and Forecast – this table is not currently included because emerging changes made to the proposed revenue budgets need to be incorporated into the forecasts and estimates for the Balance Sheet and CFR. Officers are currently constructing the effect of these changes, although their outcomes are not proportionally significant.

- 3.3 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 investments. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.
- 3.4 The Council has an increasing CFR due to annual additions to the Capital Programme. The full impact of investment property acquisitions has also been built in during 2020/21 and 2021/22. The trend of increased capital expenditure and forecast repayments of external borrowing indicates new borrowing capacity of up to £188million over the forecast period.
- 3.5 Table 14 shows that the Council expects to comply with this recommendation over the medium term.

Total Debt Position

- 3.6 A local authority should not exceed its CFR, except in the short-term. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Projected levels of the Council's total outstanding external debt compared with the CFR are shown in the two graphs, below. As can be seen from both graphs and Table 15, below, the Council expects to comply with this in the medium term for both the General Fund and the Housing Revenue Account.
- 3.7 The two graphs look markedly different. For the General Fund, the graph illustrates the short-term nature of debt currently committed to, which drops away sharply, with an increasing CFR reflecting the addition of borrowing needed to finance future capital programmes. This will require maturing debt to be replaced. For the HRA, the gap remains much smaller because the portfolio of HRA borrowing has been committed to for much longer periods of time. Once again, the CFR increases with future years' borrowing needs.

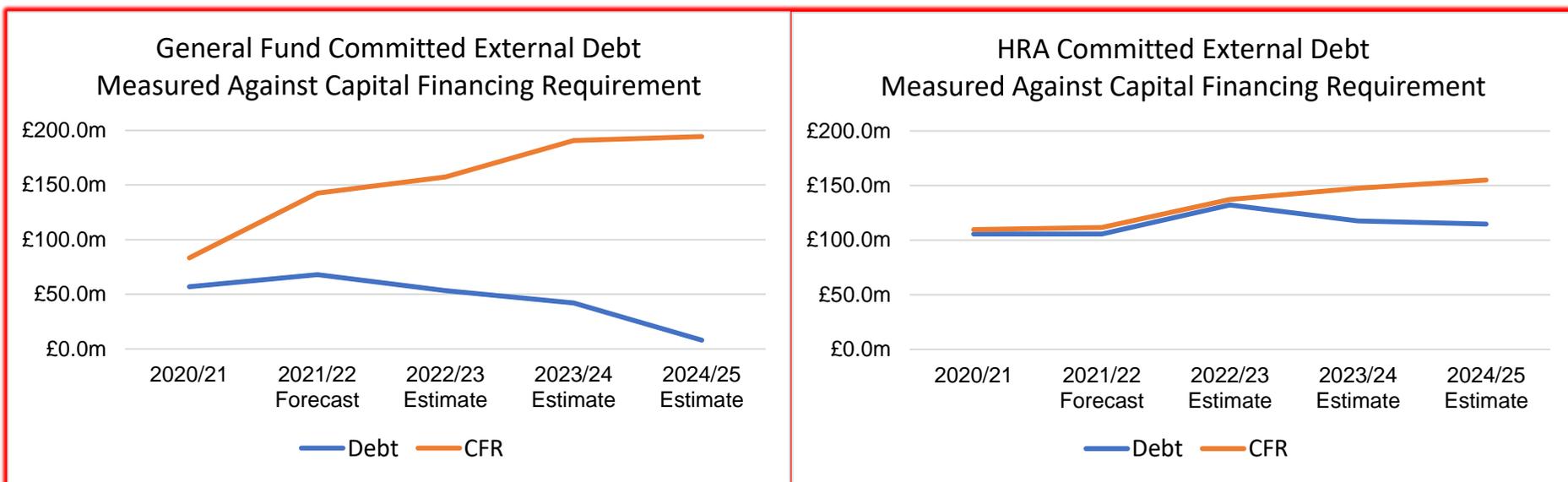


TABLE 15	Prudential indicator - Gross debt and the CFR				
	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual £'000	Forecast £'000	Estimate £'000	Estimate £'000	Estimate £'000
General Fund Debt	57,000	68,000	82,039	108,820	116,954
HRA debt	105,500	105,500	122,790	143,544	163,012
Total Debt	162,500	173,500	204,829	252,364	279,966
General Fund CFR	83,203	151,089	162,145	185,050	188,875
HRA CFR	109,717	112,038	128,307	147,240	164,887
Total CFR	192,920	263,127	290,452	332,290	353,762

4 Borrowing Strategy

- 4.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing. The Council is typically cash rich in the short-term as revenue is earned before it is spent but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing need.
- 4.2 Due to previous spending and financing decisions prior to the amalgamation of authorities into Somerset West and Taunton Council, £79.5million of external PWLB borrowing was transferred to the Council on 1 April 2019. This stemmed from the Government's directive for local councils with an HRA to borrow funds in respect of the housing assets they owned at that time (a process called Self Financing). By 1 April 2021, the portfolio of external long-term borrowing was £162.5million at an average interest rate of 1.78%. Treasury and cash investments as at 1 April 2021 amounted to £54.1million.
- 4.3 The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in the future, particularly with the forthcoming transfer to a single Unitary Council on 1 April 2023. Interest on short-term borrowing has been extremely attractive in recent years and the opportunity to minimise the cost of new borrowing has been fully utilised during 2021/22. Meanwhile, long-term borrowing remains available at historically low rates of interest too. Therefore, being responsive to interest rate movements (particularly with increasing levels of inflation), the optimum balance between long-term and short-term debt will be sought for any new borrowing required to finance the Capital Programme. For example, as short-term rates are trending upwards at the time of writing, the benefit of longer-term fixed rates will begin to take precedence since they provide future certainty, diluting the risk associated with future upward interest rate movements in a complex economy.
- 4.4 Substantial flexibility will also be applied to borrowing on the approach to formation of the new Somerset Unitary Council. This is because the borrowing and investment balances and cashflow of the County and District councils, when consolidated, will require a new borrowing strategy that defines the longer-term approach. For this reason, except for HRA loan renewals and HRA debt aligned with long-term assets, such as new housing, longer-term borrowing will tend to be confined to a debt below 10-years' duration.
- 4.5 A combination of cashflow balances, cashflow movements into and out of the Council and the need for sufficient levels of liquidity, both to absorb payment commitments and to act as contingency funds to finance unforeseen emergencies, will require an ongoing level of cash and investment balances. For these reasons, it is intended that investment and cashflow balances will be retained at a level that is generally above £30million (that sum including sums on loan to external

organisations, being £5.2million, and pooled investments, being approximately £17million). More details on investments are set out in section 8 of this document, further below.

- 4.6 Putting this into context, the interest rates currently observed in the markets (early February 2022) for the Council's borrowing vary between cheaper short-term loans (currently available at around 0.5%) and long-term fixed rate loans where the future cost is more certain but higher (currently 1.5%-2.5%). By contrast, with cashflow investments envisaged to be earning between 0.0% and 0.28% (current year to February 2022), internal borrowing will be used as far as practically possible, with the added advantage that the risk of potential investment losses from bank defaults (albeit a minimal risk) is minimised with this approach.

Public Works Loans Board (PWLB)

- 4.7 A common source of borrowing for local authorities is the Treasury, through the Debt Management Office, which took over the responsibilities of the previous Public Works Loans Board (although the term PWLB is still commonly used). There are several advantages to using the PWLB as a source of borrowing, such as:
- Funds can be accessed quickly – usually within five-days' notice.
 - It is relatively simple to arrange, although the application process has become more-lengthy because HM Treasury seeks to examine applying authorities' applications closely to confirm that the borrowing need is sound, affordable and is unrelated to past or future investment in property for the purposes of yield.
 - The Council does not require a credit rating, and
 - Borrowing is not linked to any specific asset, but it can provide the resources needed to meet the overall capital financing requirement.
- 4.8 To discourage borrowing for property assets primarily for yield, the government issued a revised procedure for accessing PWLB loans in November 2020. This reduced the cost of loans but also demanded a commitment from the borrowing Council's Chief Financial Officer that there would be no use of PWLB funds towards property assets primarily for yield after 26 November 2020.
- 4.9 Because SWT Council has undertaken investment in properties with the objective of generating a yield, the Council is currently unable to access new borrowing from PWLB. However, the Council's Treasury Team has observed considerable availability of funds to borrow from other Local Authorities, which is set to continue. In practical terms, this has provided a sound and affordable source of borrowing and provides a certain basis for new borrowing in the foreseeable future. The

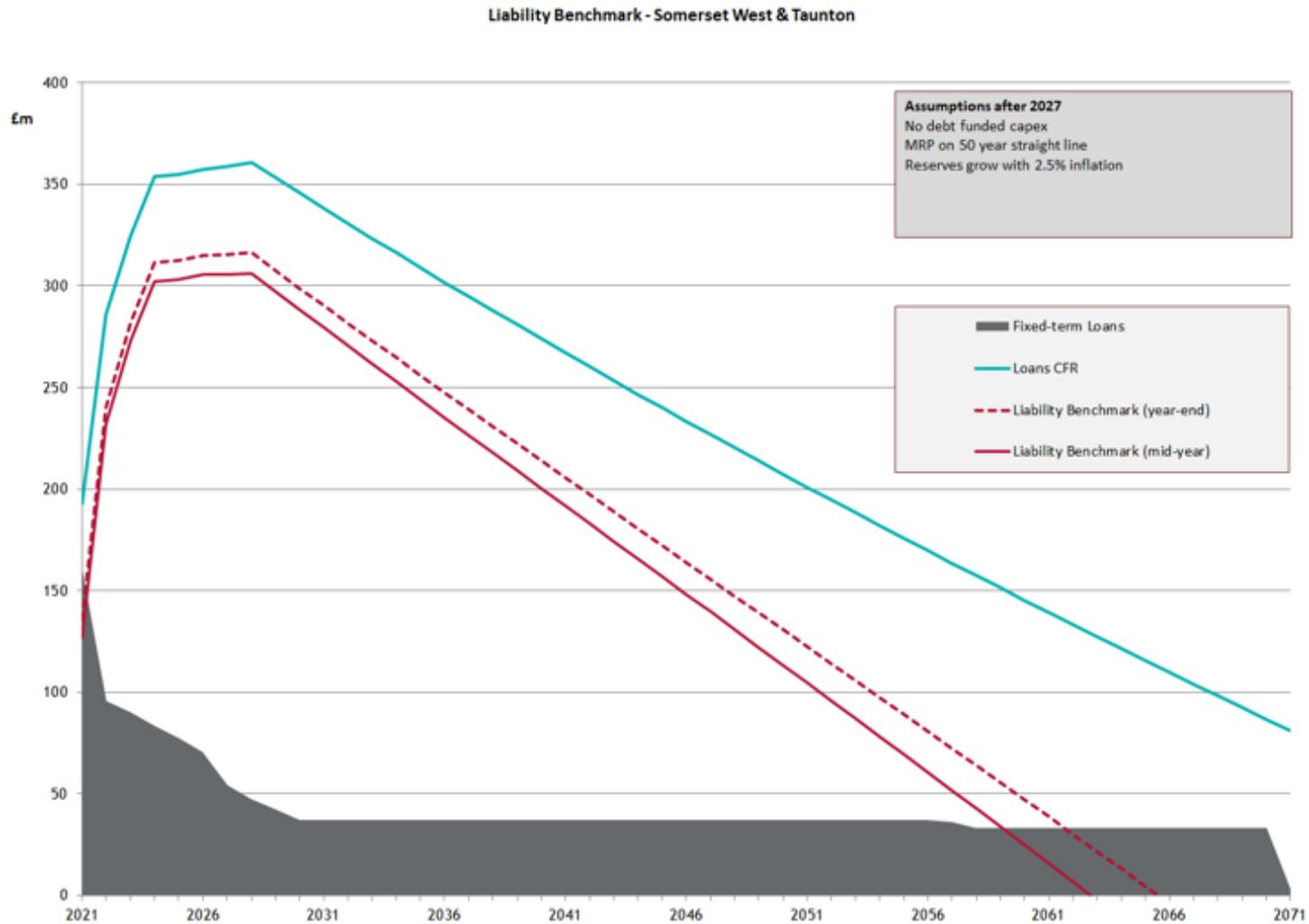
Council is also able to renew any borrowing with the PWLB that comes to maturity, and advantage will be taken of that source too. Other potential options do exist such as the Municipal Bond Agency, which provides a pool of short-term borrowing.

- 4.10 Guidance from HM Treasury indicates that PWLB may still be used to refinance historic borrowing even if the Council is actively investing in property assets primarily for yield. This is likely to be a preferable treasury option, for example regarding existing HRA loans that mature over the next 10 years that will need to be refinanced to meet the current HRA Business Plan.
- 4.11 A more-comprehensive measure is given by the Liability Benchmark. The Liability Benchmark is a measure of how well the existing loans portfolio matches the authority's planned borrowing needs. It stems from projections of the Council's balance sheet in future years. The Liability Benchmark is effectively the net borrowing requirement of a local authority plus an allowance for cashflow liquidity. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (usable reserves and cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments necessary to manage day-to-day cash flow requirements.
- 4.12 The table that follows (Table 16) assumes that cash and investment balances are kept to a minimum level of £17.0m initially, increasing to £20.0m towards the end of the four-year period of review . This benchmark is anticipated to be £217.5m in 2021/22 and is forecast to rise to a maximum of £312.5m by 2024/25.

NOTE: TABLE 16 – Balance Sheet Summary and Forecast – this table is not currently included because emerging changes made to the proposed revenue budgets need to be incorporated into the forecasts and estimates for the Balance Sheet and CFR. Officers are currently constructing the effect of these changes, although their outcomes are not proportionally significant.

- 4.13 Any years where actual loans are lower than the benchmark indicate a future borrowing requirement, which is seen to occur from 2021/22 onwards, and reflects new borrowing activity by the Council, primarily for Commercial Property Investments and Housing projects; any years where actual loans outstanding exceed the benchmark represent an overborrowed position, which will result in excess cash requiring investment, which was the case by the end of the in 2020/21 financial year as we took advantage of internal borrowing. Clearly, scope for internal borrowing will now drop out.

4.14 Depicting the borrowing path over a longer period of time, the Council's treasury management advisors, Arlingclose, have prepared a graphical illustration (using data as at 31 March 2021) of the borrowing position, as follows:



5 Borrowing In Advance of Need

- 5.1 Local authorities are not permitted to borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. However, the Prudential Code does specify that “Treasury investments may... include the investment of borrowing proceeds where it has been prudent for an organisation to borrow in advance of the need for cash, eg in order to reduce financing and interest rate risks.” The Council’s policy adopts and complies with these stipulations and it shall not borrow in advance of need, unless in the short-term in respect of near-term approved capital projects in order to ensure the adequacy of liquidity and to manage investment rate risks.

Affordable Borrowing Limit

- 5.2 This is a particularly important indicator. The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower “operational boundary” is also set as a warning point should debt approach this limit. The Operational Boundary has been calculated based on the forecast CFR plus a tolerance for variations in spending plans during the year and possible volatility in availability of internal and external resources.

TABLE 17	Authorised limit & Operational boundary for external debt				
	2020/21 Actual £'000	2021/22 Forecast £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Operational Boundary:					
Borrowing	212,000	280,000	300,000	350,000	370,000
Leases	0	0	10,000	10,000	10,000
Total Operational Boundary	212,000	280,000	310,000	360,000	380,000
Authorised limit:					
Borrowing	280,000	320,000	350,000	350,000	370,000
Leases	0	0	20,000	20,000	20,000
Total Authorised limit	280,000	320,000	370,000	370,000	390,000

- 5.3 The total borrowing limit applies to the combined borrowing requirement for the General Fund and the Housing Revenue Account. Although borrowing is managed on the basis that individual borrowing pools exist for the General Fund and Housing Revenue Account, for cash flow purposes the above limits relate to the whole-Council position.
- 5.4 Borrowing levels are expected to grow; this is regarded as affordable on the basis that the majority of the costs of debt are offset by income growth within the Council's financial strategy, either through return on investment in property, which provides a net surplus to fund services, or through investment in regeneration schemes, which may also generate income, or through service loans, which will all be anticipated to be repaid.
- 5.5 The Council currently holds £170.5million of loans (including short term) as at 31 December 2021, compared to £162.5million on 1 April 2021, as part of its strategy for funding previous years' capital programmes (Table 17). The balance sheet forecast in Table 16 shows that the Council expects to hold external borrowing of up to £204.8million in 2022/23. The Council may also borrow additional sums to pre-fund future years' requirements, providing
- i. this does not exceed the authorised limit for borrowing of £340.0million, and
 - ii. This remains within the allowable parameters of the CIPFA Prudential Code (namely up to two years prior to approved expenditure need).
- 5.6 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans, should the Council's long-term plans change, is a secondary objective; the preference is to avoid this possibility, especially in the event that an interest premium or penalty may be applied by the lender.
- 5.7 Given the significant cuts to public expenditure and in particular local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Whilst short-term interest rates have begun to follow an upward trend since mid-December 2021, they currently remain lower than long-term rates. In these conditions, it would be more cost effective in the short term to either use internal resources, or to borrow short term loans instead. However, with cashflow balances substantially reduced following the significant investments as part of the capital programme in 2020/21 and 2021/22, there is a growing need to source external borrowing. A balance will be made between long-term and short-term borrowing. In relation to short-term borrowing, the emphasis has now shifted on extending that towards the one-year period to protect against further interest rate rises forecast during 2022/23. This adds stability to the interest costs leading up to the Unitary Council formation in April 2023. Further external borrowing will take advantage of any medium-term borrowing opportunities so that the risk of interest rate volatility may be cushioned; this will apply to General Fund borrowing, and paves the way for the new Unitary Council to reshape its

borrowing strategy into future years. For HRA borrowing, advantage is envisaged to be taken of historically low long-term borrowing rates, with maturity dates more commensurate with life of the housing assets being developed.

- 5.8 Internal borrowing has been used to good effect during 2021/22, realising interest cost savings as a result. A further benefit has been to reduce overall treasury risk because levels of investments have been contained, thus eliminating exposure to investment losses that may have occurred in the event of the failure of financial institutions. The Treasury Management Strategy, in part, shapes the timing of external borrowing and the balance of external / internal borrowing, whilst money market conditions form another influencing factor alongside the Council's liquidity and cashflow position.
- 5.9 The Council (and its predecessor councils) has previously raised the majority of its long-term borrowing from the PWLB. Where it remains possible to renew existing debt through the PWLB (new loans no longer being available to SWT because of its property investments) and, if that option presents better value for money, loan renewals from PWLB will be employed.
- 5.10 The Council will also consider loans from other sources including banks, pension funds and other local authorities. Local authority to Local Authority lending has represented a particularly viable option for this Council in taking new borrowing and considerable use has been made of this market during 2021/22 with very reasonable rates of interest payable. Innovative methods of securing borrowing from other local authorities have ensured good value for money has been achieved in brokerage costs too.
- 5.11 Beyond these options, the Council will, if necessary, investigate the possibility of utilising the Municipal Bonds Agency, or issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding.
- 5.12 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period (although forward loan interest rates will usually factor in an allowance for interest rate risk during the intervening period).
- 5.13 Additionally, the Council may borrow further short-term loans to cover unplanned cash flow shortages.
- 5.14 The approved sources of long-term and short-term borrowing are:
 - HM Treasury's PWLB lending facility (formerly the Public Works Loan Board), but only for loan renewals
 - Any institution approved for investments (see below), including Local Authorities
 - Any other bank or building society authorised to operate in the UK
 - Any other UK public sector body

- UK public and private pension funds (except Somerset County Pension Fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

5.15 Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Sale and leaseback

5.16 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues issue bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrowing and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the Council's Audit and Governance Committee or Full Council (depending upon the timescale of meetings and needing to apply for borrowing).

5.17 **Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

5.18 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

6 Treasury Investment Strategy

6.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the first six months of 2020/21 to 30th September 2021, the Council's investment balance ranged between £30.157m and £73.287m, although investment levels are anticipated to remain at the lower end of this range in the forthcoming year following extensive capital investment and application of plus repayment of government Covid grants.

- 6.2 **Objectives:** The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 6.3 **Negative interest rates:** The COVID-19 pandemic increased the risk of the Bank of England setting its Bank Rate at or below zero. Prior to the two recent increase increases in Base Rate (December 2021 and February 2022), this risk has passed in the short to medium term at least. In the event of negative rates, however, since investments cannot pay "negative income", negative rates will be instead be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.
- 6.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to maintain current investment levels in secure and/or higher yielding asset classes during 2022/23. The majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, money market funds, whilst deposits have also previously been held with other local authorities. This diversification will represent a continuation of the strategy adopted in earlier years, with an enhanced opportunity to utilise strategic investment pooled funds as a means of adding a level of diversity and long-term value to the investment portfolio.
- 6.5 **Business Models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's 'business model' for managing them. The Council aims to achieve value for money from its internally managed treasury investments by a business model of collecting the contractual cash flows and, therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved Counterparties

- 6.6 The Council may invest its surplus funds with any of the counterparty types in table 18, below. These deposits are subject to the cash limits indicated (per counterparty) and the time limits shown.

TABLE 18	Treasury investment counterparties and limits		
	Time limit	Counterparty limit	Sector Limit
The UK Government	50 years	Unlimited	N/A
Local authorities and other government entities	25 years	£7million	Unlimited
Secured investments	25 years	£7million	Unlimited
Banks (unsecured)	13 months	£7million	Unlimited
Building societies (unsecured)	13 months	£7million	£7million
Registered providers (unsecured)	5 years	£7million	£20million
Money market funds	N/A	£7million	Unlimited
Strategic pooled funds	N/A	£7million	Combined £18million initial investment
Real estate investment trusts	N/A	£7million	
Other investments	5 years	£5million	£7million

- 6.7 **Minimum Credit rating:** (*) Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
- 6.8 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
- 6.9 **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral

credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

- 6.10 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
- 6.11 **Registered providers (unsecured):** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
- 6.12 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.
- 6.13 **Strategic Pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.
- 6.14 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.
- 6.15 **Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

- 6.16 **Operational bank accounts:** In so far as the UK bank appointed to supply the Council with its main banking services maintains a credit rating not lower than BBB- and with assets in excess of £25billion, the aggregate level of balances held with the bank shall equate with the counterparty limit set for individual unsecured bank deposits (namely £7million). This includes both operational group balances and investment account balances, but excludes Head Office Collection accounts, merchant accounts and cash in transit.
- 6.17 In times of banking stress, and in the event that the appointed bank's credit rating falls below BBB-, the Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services supplied by its appointed bank. Whilst balances held at the appointed bank are not classed as investments, they remain subject to the risk of a bank bail-in. Nevertheless, in the event of such an eventuality, in order to provide a suitable platform for the Council to conduct its day-to-day banking transactions and receive remittances, a threshold of £1,200,000 will be applied to the daily bank balance, above which balances should not be held after concluding each day's treasury and dealing activities. This threshold will be the subject of review at least twice each year in such circumstances, to coincide with annual Treasury Management reporting to Members. At his/her discretion, the Assistant Director Finance (S151 Officer) may introduce a reduction to this threshold if circumstances in the banking sector indicate the need.
- 6.18 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty
- 6.19 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.
- 6.20 **Other information on the security of investments:** The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management

adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

6.21 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

Investment Limits

6.22 The Council’s usable revenue reserves available to cover investment losses are forecast to be £72.6million on 31 March 2022. In order that no more than 10% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £7million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

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

Investment Limits	Cash Limit
Any group of pooled funds under the same management	£21m per manager
Negotiable instruments held in a broker's nominee account	£21m per broker
Foreign Countries	£7m per country

6.24 **Liquidity management:** The Council uses an in-house spreadsheet based cash flow forecasting model to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council’s medium-term financial plan and cash flow forecast.

6.25 The Council will spread its liquid cash over more than one provider (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties encountered with any one provider.

7 Treasury Management Indicators

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

Security

7.2 The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit (Rating)	e.g. A-

Liquidity

7.3 The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within (3) months	£20m

Interest Rate Risk

7.4 The borrowing and investment strategies employed during the acquisition of commercial properties have protected the Council's position whereby internal borrowing has been adopted in preference to obtaining now borrowing from the money markets. The two primary benefits have been to minimise net interest costs for the Council in the short-term and reducing the risk of Council potential exposure to "bail-in", that being the loss of capital investment because of the recovery processes employed in the event of a financial institution's failure. With the completion of the commercial investment portfolio, cashflows has reduced and the dominating level of cashflow investments will switch to borrowing. As a result, risks aligned with movements in investment returns will substantially reduce with lower investment balances. To quantify this, we forecast

(at the time of writing) that the remaining investments held during 2022/23 would carry a combined risk of variation in capital value and interest yield of approximately +/- £132k for a 1% movement in interest rates. These investment sums, which total approximately £17million, will be held as a contingency measure for unexpected cashflow movements and emergencies. Further liquid sums will also be held to accommodate the cashflow movements throughout the year; these attract a very low yield, so present negligible levels of interest rate volatility. Meanwhile, the Council's investment strategy and treasury operations do focus on preserving security, liquidity and yield as a basis for risk limitation.

Maturity Structure of Borrowing

7.5 This indicator is set to control the Council's exposure to refinancing risk. The limits set for each category within this indicator is wide since the indicator is only to cover the risk of replacement loans being unavailable, not interest rate risk. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing Rate Risk Indicator	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Principal Sums Invested For Periods Longer Than a Year

7.6 The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price Risk Indicator	2022/23	2023/24	2024/25
Limit on principal invested beyond year end	£25m	£25m	£25m

8 Related Matters

- 8.1 **Financial Derivatives:** Local councils have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 8.2 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 8.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
- 8.4 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.
- 8.5 **Housing Revenue Account:** On 1 April 2012, the Council's predecessor (TDBC) notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. The General Fund pool will be further divided between mainstream borrowing and borrowing for commercial investments. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.
- 8.6 **Markets in Financial Instruments Directive:** The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the

Council's treasury management activities, the Assistant Director Finance (S151 Officer) believes this to be the most appropriate status.

9 Capacity, Knowledge and Skills

- 9.1 Officers involved in making decisions on borrowing and investment processes are governed by internal procedures and processes and external statutory guidance in the form of the CIPFA Treasury Management Code, the CIPFA Prudential Code and HM Treasury Investment guidance. Internally limits are set in the annual Treasury Management Strategy Statement and the overriding Treasury Management Practices. The Council team dealing with investment assessments and management are professionally qualified and experienced in their field of property, finance and legal work, with access to training as required. Whilst internal skills are commensurate with the authority's risk appetite and activities, specialist advice will also be obtained for complex and non-traditional issues, as required.
- 9.2 Training for officers is encouraged and actively subscribed to. Elected Members also benefit from targeted training and updates on Treasury Management matters, economic and market news and on how to perform their functions in decision-making, scrutiny and challenge. The Council uses a combination of internal expertise and external specialists to provide training, advice and information.
- 9.3 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Assistant Director Finance (s151 Officer) is a qualified accountant with many years' relevant experience. There are several other professionally qualified Finance Business Partners and Specialists within the Council's Finance Team, and the Council pays towards staff to study towards relevant qualifications including AAT and CCAB/CIMA. All officers involved in the treasury and investment management function have access to relevant technical guidance and training events to enable them to acquire and maintain the appropriate level of expertise, knowledge and skills to undertake their duties and responsibilities.
- 9.4 The Council also employs qualified property specialists / surveyors to manage land and property assets, and to contribute to key asset decisions.
- 9.5 Legal specialist advice is provided to the Council through the SHAPE legal partnership.
- 9.6 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants who are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers and

various property consultants as required. This cost-effective approach ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

9.7 Those charged with governance (Members of the Audit and Governance Committee and the Executive) recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively. The Section 151 Officer will ensure that elected Members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs, responsibilities and understanding of sometimes complex issues.

10 Financial Implications

10.1 The budget for treasury investment income and debt interest in 2022/23 is summarised as follows:

TABLE 19	Interest income and costs		
	2022/23		
	Forecast Investment Income	Forecast Interest cost	Forecast Net income or cost
	£'000	£'000	£'000
General Fund	-714.5	948.2	233.7
HRA	-82.8	2,883.0	2,800.2
Total	-797.3	3,831.2	3,033.9

10.2 If actual levels of investments and borrowing, or actual interest rates differ from those forecast, performance against budget will be correspondingly different. Significant variances will be identified in budget monitoring reports to the Senior Management Team and the Executive.

11 Other Options Considered

11.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Assistant Director Finance (S151 Officer), having consulted the Portfolio Holder for Corporate Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Sources of Capital Finance other than Borrowing/ Debt

The Capital Strategy identifies the main sources of capital financing. Whilst borrowing is used once all other allocated sources have been applied, those other sources comprise the following options.

1. Grants and Contributions

- 1.1. The Council will seek to access external funding towards its capital investment plans where funds are available and our capital schemes are within scope of such grant funding conditions. Grants may include Government schemes, two examples of which have in previous years included the Housing Infrastructure Fund and the Future High Streets Fund. We also receive contributions from other bodies such as developers in the form of S106 contributions, and Community Infrastructure Levy paid by local developments to support local infrastructure (see below). It is often the case that the Council will need to put some of its own resources towards a scheme so that it may attract the external funding. This can be effective in leveraging in funds to enable larger infrastructure investments to progress and where the Council's own resources cannot adequately finance the costs.
- 1.2. The balance of capital grants unapplied held by SWT on 31 March 2021 was £14.659m. The General Fund 2022/23 Budget report includes financing from capital grants amounting to £24.870m (excluding Community Infrastructure Levy and s106 contributions) towards the current approved Capital Programme covering 2022/23 to 2024/25. Grant bids are usually a competitive process therefore expenditure is usually only built into the approved capital programme once the funding has been confirmed.

2. Section 106 Contributions (s106)

- 2.1. S106 contributions are paid across to the Council by other bodies, mainly including developers, and are made under planning agreements towards certain obligations. Contributions that related to district council services within SWT are paid to the Council. There are usually restrictions on the nature of costs that the funds can be used for, such as public art, play areas and equipment and affordable housing provision. S106 contributions can be used to fund both revenue and capital costs and are therefore allocated to capital and revenue budgets accordingly.
- 2.2. Under the planning agreement for the development of Hinkley Point C nuclear power station, significant mitigation funds have been paid by EDF to the Council as the planning authority. These s106 contributions are used to contribute to enhanced service costs and may also be used for capital projects.

2.3. Decisions regarding the allocation of funds may be taken under thresholds determined within the Council Financial Procedure Rules. The allocation of funds to specific projects funded by the Hinkley Point C s106 contribution are considered by the Hinkley Point Planning Obligations Board, who will make recommendations to the Executive for schemes up to £250k, and by Full Council for other larger sums.

3. Community Infrastructure Levy (CIL)

3.1. The Council operates an approved CIL policy, with the levy payable on development in certain areas within the District. CIL is recognised as capital income and therefore provides resources to contribute to eligible infrastructure investment such as transport and roads, education, town centre regeneration and flood alleviation schemes. 15% (or 25% with an adopted Neighbourhood Plan) of CIL income is passed to town or parish councils, and 5% is allocated to fund administration costs.

3.2. The Policy is approved by Council and implemented by Officers. Council determines the allocation of CIL income to investment themes as part of the annual capital programme approval process.

4. Capital Receipts from Asset Disposals

4.1. When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts income.

4.2. The Council estimates it will receive £4.96million of capital receipts in the coming financial year, 2022/23; for the period 2021/22 to 2024/25, anticipated capital receipts are set out in Table 5, overleaf:

TABLE 20	Capital receipts income estimates				
	2020/21 Actual £'000	2021/22 Forecast £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
General Fund:					
Asset Disposals	1,085	675	1,295	0	0
General Fund Total	1,085	675	1,295	0	0
HRA:					
Right to buy sales	2,824	1,002	3,319	3,670	2,535
Other	46	589	350	350	350
HRA Total	2,870	1,591	3,669	4,020	2,885
Total Receipts	3,955	2,266	4,964	4,020	2,885

4.3. The generation of capital receipts will be driven in part by the Asset Management Strategy, where the Council proposes a programme of proactive disposal of assets that are not performing to an acceptable level or are identified as surplus to requirements. Further decisions for the disposal of assets will either occur as a result of ongoing assessment of how properties are performing in support of services and as a result of demand for the purchase of Right To Buy council houses.

5. Revenue Contributions to Capital

5.1. The Council proposes to support the financing of part of the Capital Programme through direct contributions of revenue funding. Annual contributions are determined through the setting of Capital Programme priorities and affordability within the Revenue Budget. Revenue contributions are predominantly directed towards recurring annual investments, with the advantage of reducing debt financing costs. Revenue Contributions are included in the Revenue MTFP and the Capital Programme financing plan, as summarised in Table 2 above.

5.2. Within the budget considerations for 2022/23, bids adding to £1.592million have been added to the General Fund Capital Programme for the financial year. £1.364million of the additional expenditure is expected to be financed directly by an in-year revenue contribution, the balance being met from s106 contributions. The intention of this strategy is to contain the Council's borrowing requirement, which will benefit future years' budgets by reducing the cost of financing borrowing (debt repayments and interest).

5.3. The Housing Revenue Account does not currently have capacity to utilise revenue resources to finance capital expenditure although, given the low interest rates currently applied to long-term borrowing, cost benefits are anticipated into the longer-term by taking advantage of this interest rate opportunity.

Regeneration Schemes

The Council has a vision for a Garden Town. The Garden Town is symbolic of Taunton's ambitions to be flourishing, distinctive, and healthy. In developing its plans for the town, involving the communities is at the heart of the Council's approach. This will help shape the approach to creating a healthy, vibrant and attractive place to live and work. This vision is realised through a range of forward-thinking regeneration schemes.

Some of the key schemes under development by the Council are briefly described below. Their progress is regularly reported to the Senior Management Team and to Members of the Council.

- **Coal Orchard Re-Development**

The Coal Orchard is a mixed use commercial and residential scheme based on a brown field site with river frontage in the heart of Taunton town centre, immediately adjacent to the Brewhouse Theatre and former Coal Orchard car park. All the land for this development is owned by the Council. The overall project is largely complete, with remaining works programmed for completion during 2022/23. Development of this important regeneration site has been progressed by the Council because planning restrictions may have prevented any commercial entity making progress. The outcomes will ensure building density and height is curtailed whilst ensuring a significant public realm contribution is achieved to link up existing pedestrian and cycle ways, opening up the river frontage and creating a new sense of place.

- **Firepool Re-Development**

As a part of the wider 2040 Garden Town Vision, the approved for Firepool Development and Infrastructure exceeds £2.2million. The Masterplan includes mixed residential, retail and office accommodation, whilst blending in a landmark boulevard with water gardens, an amphitheatre and dedicated cycle and pedestrian access in a high-quality environment. It also provides a highly sustainable solution that will be as close to zero carbon as practicable. The intention is that this supports the Town Centre by encouraging new and longer visits to the Town. It is a regeneration site that may also offer income earning opportunities. Whilst planning permission has been delayed due to the county-wide Phosphates issues, this has fortuitously allowed SWT to use a part of the site to accommodate a vaccination centre, successfully supporting the Somerset COVID vaccination programme.

- **Social Housing Development**

The HRA has four pre-approved social housing development schemes (North Taunton Regeneration Project, Seaward Way, Oxford Inn and Zero Carbon Pilot) supported by a government social housing financing scheme and its "1-4-1 Agreement".

The current approved budget is £100m to be spent over the next 10 years. Under the programme 347 new low carbon affordable homes will be delivered between 2023 and 2031. All homes will provide significantly lower fuel bills to customers than with other similar sized homes.

- **North Taunton Woolaway Project**

With this major redevelopment scheme, the Council plans to transform the North Taunton Woolaway Project area and build quality, energy efficient new homes where people will want to live. Not only will the regeneration of North Taunton Woolaway bring more new homes, it aims to support growth within the local economy, offering health, environmental and employment opportunities. The project offers the Council the opportunity to maximise the social investment for the benefit of the community now and in the future. Comprising several building phases, including one refurbishment phase, the first home will be let in 2022.

- **Seaward Way, Minehead**

This is a zero carbon affordable housing scheme. The council has a contractor appointed who is currently working under a pre contract services agreement (PCSA). The PCSA will allow the council and contractor to agree a price for the scheme and move into start on site (estimated January 2022). The scheme and tenants will benefit from a high standard of insulation, photovoltaic panels, air source heat pumps and battery storage. The scheme is complex, typically because of issues involving flooding and drainage that make the scheme relatively expensive, particularly the common infrastructure necessary to mitigate these issues, and the engineering necessary in the ground to raise levels and provide retaining structures to the residential development where required. These challenges resulted in a lengthy planning approval process for the project.

Common to all development projects in the county of Somerset, there is a common risk for all regeneration activity relating to the actual and potential presence of phosphates in the ground. The Environment Agency has identified that current amounts indicate contamination and there needs to be mitigation going forward. The nature of the problem and mitigation needed are likely to cause elapsed time beyond the originally anticipated timetables, plus added costs. This issue forms a major part of consideration for all new development projects, each one taken on a case-by-case basis.

External Context

The Council's external Treasury Management advisors, Arlingclose, provide a range of services to support the Treasury Management function. This includes specialist advice, economic and market data, guidance, technical material and training. They are also instrumental in providing commentary to support the Treasury Management Strategy, based on their own expert views. Naturally, global and domestic events, as well as the release of economic data, all influence markets and views will change and need updating. The views set out below are those of Arlingclose as at December 2021.

Economic Background: 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.

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, however notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% y/y in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Credit outlook: Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

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.

Interest rate forecast: The Council'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.

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.

Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

To complement the above economic background, Arlingclose has provided the following supplementary information:

Arlingclose Economic & Interest Rate Forecast – December 2021

Underlying assumptions:

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.
- Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.
- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.
- These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.
- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.

- Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.
- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Forecast:

- The MPC will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.
- Arlingclose therefore expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside, however becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.
- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.
- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.
- The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market rate													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

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

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

PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Minimum Revenue Provision (MRP) Statement

1 Policy Statement

- 1.1 Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the former Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the HM Treasury Guidance) most recently issued in 2018.
- 1.2 The broad aim of the Treasury Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.
- 1.3 The Treasury Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.
- 1.4 The predecessor Councils (TDBC and WSC) both adopted an MRP calculation method which spread the total Capital Financing Requirement over the weighted average useful life of each Council's asset base on a straight line basis. The calculation took into consideration the materiality of each asset and its recorded remaining useful life. The weighted average was then applied to the class of asset then applied across the whole fixed asset base. That gave a robust basis to support the asset life applied to MRP calculations and be appropriate for audit scrutiny.
- 1.5 Following the creation of the Somerset West and Taunton Council on 1 April 2019, it was proposed to apply the same methodology for the opening balance General Fund CFR using the combined weighted average useful life of the consolidated asset base transferred to SWTC on 1 April. This is considered a prudent approach to charging for the legacy CFR transferred to SWTC from its predecessor Councils.
- 1.6 For capital expenditure incurred since 1 April 2021, the proposed methods for calculating MRP are as follows:

- For Property Plant and Equipment (PPE) assets, MRP will be calculated over the weighted average useful life of each Council's asset base at the start of each financial year on a straight line basis.
- For assets acquired by leases or the Private Finance, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.
- For capital grants and contributions to third parties MRP will be calculated on a straight-line basis over 25 years from the 1 April following the year in which the grants or contributions are incurred.
- For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from the principal repayments to reduce the capital financing requirement in respect of those loans. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the Treasury Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.
- For Investment Properties, MRP will be calculated over 50 years, or over the professionally assessed useful life of the asset if lower than 50 years. MRP may be calculated using either annuity or straight-line basis as determined by the Assistant Director Finance (S151 Officer).

1.7 MRP is charged based on the opening balance CFR carried forward from the previous year. Therefore Capital expenditure incurred during 2022/23 will not be subject to a MRP charge until 2023/24.

2 Capital Financing Requirement and MRP Estimates

2.1 Based on the Council's latest estimate of its capital financing requirement (CFR) on 31 March 2022, the budget estimate for MRP has been set as follows:

3 MRP Overpayments

3.1 **Overpayments:** In earlier years, the Council has made no voluntary overpayments of MRP that are available to reduce the revenue charges in later years. It is not planned to make an overpayment in 2021/22 or 2022/23 for the General Fund, however the Assistant Director Finance (S151 Officer) may determine such an overpayment during the year and report this through the Outturn Report. Meanwhile, the MRP for 2022/23 is forecast as follows:

Capital Financing Requirement (CFR) and Minimum Revenue Provision (MRP)	31-Mar-22 CFR (Revised) £000	2022/23 MRP Estimate £000
General Fund	151,089	2,983

NOTE to Table: This table does not reflect the recommendation to be made to Full Council to apply £2million General Reserves to fund capital expenditure in 2021/22 and a proposal to apply a Voluntary Overprovision (VRP) of £1m. The impact of this would be to reduce the “CFR (Revised)” by £2m and to add £1m Voluntary Overpayment in addition to the MRP Estimate of £2.983m. These adjustments will be incorporated at the point of Full Council meeting on 24 February.

3.2 In 2022/23, a voluntary overpayment will be applied from the HRA, as shown below:

Capital Financing Requirement (CFR) and Voluntary Overpayments	31-Mar-22 CFR (Revised) £000	2022/23 Voluntary Over- payments Estimate £000
Housing Revenue Account	112,038	1,021