

## **BLAENAU GWENT COUNTY BOROUGH COUNCIL**

# **Treasury Management Strategy Statement** Annual Investment Strategy and Minimum Revenue Provision Policy Statement

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2021/22

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## **1.0 Introduction**

### **1.1 Background**

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

To date the Authority has not engaged in any commercial investments and has no non treasury investments.

### **1.2 Statutory requirements**

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. The Treasury Strategy details the expected activities of the Treasury function in the forthcoming financial year (2021/22). The Investment Strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

Statutory Instrument WSI 2008 no. 588 section 3 lays down that:

*“A local authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent.”*

Along with the above duty, the Welsh Government issued guidance in March 2008 (and further updated in November 2018) which requires that a Statement on the Authority’s policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate. The Annual MRP Policy Statement is therefore included at section 5.

### 1.3 CIPFA requirements

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019/2020, all local authorities are also required to prepare an additional report, a Capital Strategy report, which is intended to provide: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, long term policy objectives, governance procedures and risk appetite entailed by this Strategy.

The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

The primary requirements of the Treasury Management Code are:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council’s treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-Year Review Report and an Annual Report covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the

execution and administration of treasury management decisions, which in this Council is the Chief Officer Resources.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Corporate Overview Scrutiny Committee.

## 1.4 Reporting Arrangements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

**The Treasury Strategy Statement** (this report) - The first, and most important report covers:

- The capital plans (including prudential indicators)
- the treasury management strategy, how the investments and borrowings are to be organised, including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

**A mid year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and an assessment of whether the treasury strategy is being met or whether any policies require revision.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

### Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Corporate Overview Scrutiny Committee.

The table below sets out these reporting requirements:

Area of Responsibility	Council/ Committee	Frequency
Treasury Management Strategy / Investment Strategy / MRP policy	Full council	Annually before the start of the financial year
Treasury Management Strategy / Investment Strategy / MRP policy – midyear outturn report	Full Council	Mid-year
Treasury Management Strategy / Investment Strategy / MRP policy – updates or revisions at other times	Full Council	Ad hoc
Annual Treasury Outturn Report	Full Council	Annually by 30 September after the year end.
Scrutiny of Treasury Management Strategy	Corporate Overview Scrutiny Committee	Annually before the start of the financial year.
Scrutiny of Treasury Management performance	Corporate Overview Scrutiny Committee	Midyear & annually by 30 September after the year end.

### 1.5 Treasury Consultants

The Council currently uses Link Asset Services as its external treasury management advisors. The Council recognises that responsibility for Treasury Management decisions remains with the Authority at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The contract with Link Assets Services has reached the end of its initial contract period, however is able to be rolled annually. Therefore, for continuity of service the current contract will be extended to April 2022 and a tender process will be undertaken during 2021 to appoint advisors from April 2022.

### 1.6 **The role of the S151 Officer**

The role of the S151 Officer in relation to Treasury management has been embodied in the CIPFA Code of Practice for many years. The 2017 revised Code, further enhanced this role in relation to the following areas:-

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed,

## 2. The Capital Prudential Indicators 2021/2022 – 2023/2024

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

### 2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The actual capital expenditure that was incurred in 2019/2020 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

Capital Expenditure £000's					
	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Total	15,466	17,300	28,740	31,021	22,450

*Note*

*Actual figures for 2019/20 & estimated figures for 2020/2021 represent total gross capital expenditure*

*(I.e. include all expenditure including that financed from grant).*

*Estimated figures for 2021/22, 2022/23 & 2023/24 are based on the Authority's approved capital programme plus external funding approvals received at this stage and estimated spend*

The table below shows how the above capital expenditure plans are planned to be financed.

Capital Expenditure £000's	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Total	15,466	17,300	28,740	31,021	22,450
<b>Financed by:</b>					
Grants, Capital Receipts, revenue and other sources	13,314	12,654	25,167	28,177	15,777
<b>Net financing need for the year from USB and PB</b>	<b>2,152</b>	<b>4,646</b>	<b>3,573</b>	<b>2,844</b>	<b>6,673</b>

\*\* USB – Unhypothecated Supported Borrowing – borrowing that is supported through the Revenue Support Grant.

PB – Prudential Borrowing – borrowing that is not supported through the Revenue Support Grant.



## 2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure, which has not immediately been paid for (i.e. is borrowed for), will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £0.161m of such schemes within the CFR.

The CFR projections recommended for approval are shown in the table below:

Capital Financing Requirement					
	<u>2019/20</u>	<u>2020/21</u>	<u>2021/22</u>	<u>2022/23</u>	<u>2023/24</u>
	<u>Actual</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>	<u>Estimate</u>
	<u>£000</u>	<u>£000</u>	<u>£000</u>	<u>£000</u>	<u>£000</u>
CFR at start of financial year	165,016	166,407	170,525	173,183	175,509
CFR at end of financial year	166,407	170,525	173,183	175,509	178,036
<b>Movement in CFR</b>	1,392	4,118	2,658	2,326	2,527
<b><i>Movement in CFR represented by:</i></b>					
Net Financing need for the year (above)	2,152	4,646	3,573	2,844	6,673
New Finance Leases	5	150	150	2,049	150
less MRP	-765	-678	-1,065	-4,466	-4,296
	1,392	4,118	2,658	427	2,527

## 2.3 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

### 2.4 Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Ratio of financing costs to net revenue stream					
	2019/20 Actual	2020/21 Revised Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
	%	%	%	%	%
General Fund	3.19%	3.20%	3.24%	5.35%	5.30%

Note:

The estimates of financing costs for 2021/2022 include current commitments and the proposals in the budget report to be presented to Council in February/March

The net revenue stream for 2022/2023 & 2023/2024 are based on the following assumptions, which have been used as the basis for the Authority's medium term financial strategy (MTFS).

- RSG & NNDR – per MTFS assumption to remain static for 2022/2023 & 2023/2024
- Council Tax -assumes 4% increase for 2022/23 and 2023/24.
- Council Tax Base – remains at 2020/2021 level

### **3.0 Treasury Management Strategy for 2021/2022**

The capital expenditure plans set out in Section 2 provide details of the capital activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this capital activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

The suggested strategy for 2021/2022 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor, Link Asset Services.

The Strategy covers:

- 3.1 *the current treasury portfolio position;*
- 3.2 *Treasury management prudential Indicators for 2021/2022 to 2023/2024*
- 3.3 *prospects for interest rates;*
- 3.4 *the borrowing strategy;*
- 3.5 *policy on borrowing in advance of need;*
- 3.6 *debt rescheduling;*
- 3.7 *strategy on the use of usable capital receipts;*

#### **3.1 Current Treasury Portfolio Position**

The Council's treasury portfolio position at 31 March 2020, with forward projections

are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Treasury Portfolio Position					
	2019/20 actual £000	2020/21 estimate £000	2021/22 estimate £000	2022/23 estimate £000	2023/24 estimate £000
<i>External Debt:</i>					
Debt	158,129	162,764	161,771	160,148	165,525
Other Long Term Liabilities	161	266	250	1,736	1,703
Gross Debt as at 31 March	158,290	163,030	162,021	161,884	167,228
The Capital Financing Requirement	166,407	170,525	173,183	175,509	178,036
Under / (Over) Borrowing	8,117	7,495	11,162	13,625	10,808

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and it minimises counterparty risk.

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/2021 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Officer Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

### 3.2 Treasury Management Prudential Indicators for 2021/22 – 2023/24

The following section sets out the Treasury Management Prudential Indicators that are recommended for approval.

#### 3.2.1 Adoption of CIPFA Code of Practice for Treasury Management

In December 2017, CIPFA issued revised CIPFA Code of Practice for Treasury Management in the Public Services

#### 3.2.2 Treasury management limits on activity

There are four debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- **Upper Limit on Fixed Interest exposure**

Blaenau Gwent County Borough Council has always adopted a risk averse strategy in relation to variable rate debt, and should interest rates rise the Authority would wish to continue with its strategy of maintaining a stable long term portfolio by drawing longer term fixed rate funding. In order to be consistent with this strategy, the upper limit on fixed rate exposures for 2021/2022, 2022/2023 & 2023/2024 should be set at 100% of its net outstanding sums.

- **Upper Limit on Variable Interest Exposure**

In order to give the flexibility to enable debt rescheduling opportunities to be undertaken, the upper limit on variable rate exposures for 2021/2022, 2022/2023 & 2023/2024 should be set at 30% of its net outstanding sums.

- **Range of Exposures**

This means that the Chief Officer Resources will manage fixed interest exposures within the range 70% to 100% and variable rate exposures within the range 0% to 30%. This is a continuation of current practice.

- **Maturity Structure of Fixed Rate Borrowing**

It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

The amount of projected borrowing that is fixed rate and maturing in each period, as a percentage of total projected borrowing that is fixed rate, is illustrated in the table below. This is a continuation of the current practice.

	Upper Limit	Lower Limit
Under 12 months	20%	0%
12 months & within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	95%	5%

### 3.2.3 **Authorised Limit**

This is a key Prudential Indicator that represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited and reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

It is recommended that the Council approves the following Authorised Limits for its Total External Debt Gross of Investments for the next three financial years.

Authorised limit for external debt				
	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000
Borrowing	181,060	184,216	188,175	188,418
Other long term liabilities	2,182	293	275	1,910
<b>Total</b>	<b>183,242</b>	<b>184,509</b>	<b>188,450</b>	<b>190,328</b>

### 3.2.4 Operational Boundary

The proposed Operational Boundary for external debt is based on the same estimates as the Authorised Limit but reflects directly the Chief Officer Resources' prudent estimate of the most likely but not worst case scenario. It excludes the contingency included within the Authorised Limit (to allow for example for unusual cash movements), and equates to the maximum of external debt projected by this estimate. The Operational Boundary represents a key management tool for in year monitoring by the Chief Officer Resources.

It is recommended that the Council approves the following Operational Boundary Limits for the next three financial years.

Operational Boundary for external debt				
	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000
Borrowing	164,600	167,469	171,068	171,289
Other long term liabilities	1,984	266	250	1,736
<b>Total</b>	<b>166,584</b>	<b>167,735</b>	<b>171,318</b>	<b>173,025</b>

### 3.2.5 Actual External Debt

The Council's actual external debt as at 31 March 2020 was £158.1 million (including temporary borrowing), comprising 99.8% borrowing and 0.2% other long term liabilities. It should be noted that actual external debt is not directly comparable to the Authorised Limit and Operational Boundary, since the actual debt reflects the position at one point in time.

## 3.3 Prospects for Interest Rates

As part of their service, the Council’s treasury advisor for 2020/2021, Link Asset Services assist the Council to formulate a view on interest rates. The following table illustrates this :

Link Group Interest Rate View		9.11.20													
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20															
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	
<b>BANK RATE</b>	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00	
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30	
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80	
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60	

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5<sup>th</sup> November 2020, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

**Gilt yields / PWLB rates**

Gilt yields had already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the

momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9<sup>th</sup> November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

### Investment and borrowing rates

**Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

**Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England, indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management.

As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

On 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

**Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.



While this authority will not be able to avoid borrowing to finance new capital expenditure and to replace maturing debt there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns).

### 3.4 The Borrowings Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and it minimises counterparty risk.

The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer term stability of the debt portfolio. With short term interest rates currently much lower than long term rates, it is likely to be more cost effective in the short term to either use internal resources, or to borrow short term loans instead.

By doing so, the Authority is able to reduce borrowing costs and reduce overall treasury risk. The benefits of short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long term borrowing rates are forecast to rise. Link Asset Services will assist the Authority with this cost of carry and breakeven analysis.

The Authority may also consider arranging forward starting loans during 2021/2022, 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.

In addition, the Authority will borrow short term loans to cover cash flow shortages.

#### **The borrowing strategy to be adopted will therefore be:**

(Each strand of the strategy will be considered together and decisions made based on the most advantageous position for the Authority at that time).

##### ***To utilise the Authority's overdraft facility:***

- to fund unexpected daily cash deficits;
- to fund temporary cash shortfalls where there are no other sources of funding available within the marketplace.

##### ***To borrow over the short term:***

- to fund temporary cash shortfalls;
- to maintain a suitably balanced maturity profile;
- to make short term savings required in order to meet budgetary constraints;
- in anticipation of securing longer term loans at more attractive rates.



***To borrow over the long term:***

to reduce the Authority's average cost of borrowing;  
to maintain a stable, longer term portfolio;  
to maximise the potential for future debt rescheduling.

***If appropriate to avoid all new external borrowing:***

to maximise savings in the short term;  
to run down temporary investment levels;  
to minimise exposure to interest rate and credit risk.

**Sensitivity of the forecast** – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- *if it were felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.*

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/2022 treasury operations. The Chief Officer Resources will monitor interest rates in the financial markets and adopt a pragmatic approach to changing circumstances reporting any changes to the above strategy to Council at the next available opportunity.

### **3.5 Policy on borrowing in advance of need**

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement

Estimates, and will be carefully considered to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need the Council will;

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

### **3.6 Debt Rescheduling**

As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential for some residual opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the size of premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

The reasons for any rescheduling to take place will include: -

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the strategy outlined in paragraph 3.4 above
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Variations in risk will be considered when evaluating such opportunities, in order to ensure that the Authority's risk averse strategy is maintained.

All rescheduling will be reported to Council as part of the mid-year and Annual Treasury Outturn reports.

### **3.7 Strategy on the use of Usable Capital Receipts**

The long standing policy on usable capital receipts is that they are immediately invested internally, thereby helping to improve the Authority's cashflow position and reducing the level of external loans that need to be raised. This in turn reduces external interest charges from the money market. This approach is consistent with what is regarded as good practice in terms of strategic level treasury management and overall produces savings in debt servicing costs for the Authority. However, as approved sums of usable capital receipts are subsequently used to finance part of the annual capital programme each year, appropriate allowance then needs to be made for the use of these receipts in determining the estimated level of external borrowing required for that year. Hence usable capital receipts are released on a controlled basis and the annual estimates for external interest charges are adjusted accordingly.

## 4.0 **Investment Strategy**

### 4.1 **Background**

CIPFA has extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

In setting its investment strategy the Council has to comply with various legislation and Codes of practice, being:

- Part 1 of the Local Government Act 2003
- Welsh Assembly guidance on investments
- 2017 revised CIPFA Treasury Management in Public Services Code of Practice
- CIPFA Treasury Management Guidance Notes 2018

The Council's investment priorities are:

1. The security of the capital sum –ensuring that our investments are safe and not at risk of being lost;
2. The liquidity of its investments – ensuring that our investments are easily accessible i.e. not tied up for long periods of time;
3. Return on investment – once security and liquidity have been satisfied then and only then will the Council seek the maximum return on its investment.

The Borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. The Council mainly maintains temporary, short term investments (i.e. for periods of less than a year, although it very rarely invests for periods of longer than a few months) and investments will accordingly only normally be made with reference to the cash flow requirements, including the investing of sums borrowed at prevailing low interest rates in anticipation of capital spending. It needs its cash on a short term basis in order to be able to manage its daily cash flow requirements, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

### **Investment returns expectations.**

Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):

Average earnings in each year	
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Long term later years	2.00%

### **Negative investment rates**

While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is surplus of money at the very short end of the market. This has seen a number of market operators, now including the

DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

#### **4.2 Definition of Investments – Specified and non-specified**

The Local Government Act 2003 refers to specified and non-specified investments. The Welsh Assembly Government's Guidance on Local Government Investments, effective from 1st April 2010, defines the following:-

##### **Specified Investments:**

An investment is a **specified** one if **all** of the following apply:-

- (a) it is denominated in sterling and any payments or repayments in respect of it are payable only in sterling
- (b) the investment is not a long-term one i.e. one which is due to be repaid within 12 months of the date on which the investment was made or one which may require to be repaid within that period
- (c) the making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]
- (d) the investment is made with a body or in an investment scheme of \* high credit quality or with one of the following public sector bodies:
  - i. the UK Government
  - ii. a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
  - iii. a parish or community council.

\* High credit quality is defined in the creditworthiness policy in 3.0

##### **Non-specified Investments:**

- (i) An investment is non-specified if it does not meet the above definition.

As this Council maintains only short term investments (i.e. less than 365 days) then by definition it will only invest in specified investments.

#### **4.3 Credit worthiness policy**

In accordance with the guidance from the Welsh Government and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoid a concentration of risk. The key ratings

used to monitor counterparties are the Short Term and Long Term ratings derived from the three credit rating agencies, Fitch, Moody's and Standard & Poor's (S&P).

**Counterparties for investment purposes are selected using specific criteria, as follows:**

**Banks** - high credit quality – the Council will only use banks which:

- are UK banks; and/or
- are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AAA (any non UK transactions would be undertaken in Sterling).
- and have, as a **minimum**, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):

**Table 1:**

	<b>Fitch</b>	<b>Moody's</b>	<b>S&amp;P</b>
Long Term	A-	A3	A-
Short Term	F1	P-1	A-1

**Long term rating** – covers maturities of up to five years. It provides an assessment of the ongoing stability of the institutions prospective financial condition. **A** indicates high credit quality and low expectation of credit risk. The + or – suffixes are appended to a rating to denote the relative status within the long term rating category. The Moody's and S&P definitions are similar to Fitch. The Moody's numerical suffix indicates a rating at the higher end of the scale (1) to the lower end of the scale (3), with 1 having higher credit quality than 3.

**Short term rating** – covers obligations which have a maturity of less than one year. This rating places greater emphasis on the liquidity necessary to meet financial commitments. Rating **F1 (Fitch)** is the highest short term credit quality rating. It indicates the strongest capacity for timely payment of financial commitments. The Moody's and S&P definitions are similar to Fitch.

- **Part nationalised UK bank** – Royal Bank of Scotland Group (NatWest, Royal Bank of Scotland, Ulster Bank). This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks above.
- **The Council's own banker (Barclays)** – Since under existing arrangements excess surplus funds can be held overnight with the Council's Bank, unexpected credit rating downgrades to the Bank could result in these short-term investments technically being placed with a counterparty that does not meet the minimum approved credit criteria specified above. The S&P short term rating for Barclays is A-2, and has

been since 2012. A-2 means that S&P consider Barclays capacity to meet its financial commitment on its obligations as satisfactory. Fitch and Moody's both consider this to be strong. The minimum credit rating for Barclays will therefore be A-2 (S&P) with F1 for Fitch and P-1 for Moody's. Whilst this will mean that Barclay's S&P credit ratings will be slightly lower than those required for other institutions (as detailed above), investments with Barclays will be restricted to the overnight (or over weekend) sweep facility (where surplus balances are "swept" into an interest bearing account) up to a maximum of £10 million.

Should Barclays' credit ratings improve and meet the credit criteria required for other institutions (above), then the investment periods for meeting the minimum criteria will once again be applied. See below for contingency arrangements in relation to the Authority's bank.

**Table 2:**

	<b>Fitch</b>	<b>Moody's</b>	<b>S&amp;P</b>
Long Term	A-	A3	A-
Short Term	F1	P-1	A-2

- **Building societies** - The Council will *use only* the Nationwide Building Society, unless their short term credit ratings fall below the minimum specified in table 1 above for banks.
- **AAA rated Money market funds (MMFs)** – Triple A rated MMFs are considered to be highly credit rated.
- **UK Government** - The Debt Management Account Deposit Facility DMADF of the Debt Management Office (DMO). The DMO is legally and constitutionally part of HM Treasury and as an Executive Agency of Her Majesty's Treasury it operates at arm's length from Ministers. The DMO is considered to be highly credit rated.
- **UK Local authorities**, Police Authorities, parish councils etc

### ***Use of additional information other than credit ratings***

Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information must be applied before making any specific investment decision from the agreed pool of counterparties. Ratings will therefore not be the sole determinant of the quality of an institution and the

assessment will therefore also take account of information that reflects the opinion of the markets, as follows:

### **Credit default swaps (CDS)**

The Council will engage with its Treasury advisors, Link Asset Services, to maintain a monitor on market pricing such as “credit default swaps (CDS)” and overlay that information on top of the credit ratings.

CDS spreads offer a timely market perception of the risk attached to the relevant institution. These can, on occasion, pre-empt actions by the credit rating agencies whose ratings can lag behind market reaction to changes in the credit institutions situation. Since they are traded instruments, they carry in them market perception related to that entity’s credit quality. In order to “measure” the CDS data, Link use a benchmark system which allows the CDS spread of an institution to be compared against a predetermined benchmark rate. This data is then used to assess whether the market is indicating that an institution’s credit quality is a cause for concern. Where there is a cause for concern then the counterparty will be either downgraded in terms of investment period or removed from the approved list.

### **Credit Rating Agency Comments**

#### ➤ **Rating Watch negative (or on review for possible downgrade)**

Where the credit rating agencies have placed counterparties on “rating watch negative” or “on review for possible downgrade”, then this indicates that there is a reasonable probability of a rating change in a relatively short period (a few weeks). If the counterparty is on negative rating watch, then it will be downgraded in terms of the investment period or removed from the list.

#### ➤ **Negative Outlook**

This indicates the direction a rating is likely to move over a one to two year period. As the maximum fixed investment period for the Council is 6 months, then this will have no impact on the approved list.

### **Time and monetary limits applying to investments.**

The table below shows the time and monetary limits for institutions on the Council’s counterparty list are as follows:

	Long term Rating (Fitch, Moody’s, S&P)	Short term rating (Fitch, Moody’s, S&P)	Money Limit	Time Limit
Banks - higher quality	AA, Aa2, AA	F1+, P-1, A-1+	£6m	6 months



Banks - medium quality (including Nationwide BS)	A-, A3, A-	F1, P-1, A-1	£4m	3 months
Banks – part nationalised	N/A	N/A	£4m	3 months
Council's banker (not meeting Banks - medium)	A-, A3, A-	F1, P-1, A-2	£10m	overnight
DMADF	AAA	N/A	unlimited	6 months
Local authorities – per Authority	N/A	N/A	£6m	3 months
	Fund rating		Money Limit	Time Limit
Money market funds – per MMF	AAA		£6m	liquid

### Country and Group Limits

The Council has determined that it will only use approved counterparties from non UK countries with a minimum sovereign rating of AAA from Fitch (Aa2 Moody's, AAA S&P).

In addition, no more than £6m will be placed with any non-UK country at any time.

For financial institutions included within the same banking group, the counterparty limit will apply to the group.

#### **Lloyds Banking Group**

- Halifax                                      Lloyds Bank                                      Bank of Scotland

#### **RBS Group**

- National Westminster                      Royal Bank of Scotland                      Ulster Bank

### **4.4 Contingency Arrangements for the Authority's Corporate Bank**

If credit agency ratings change and the Authority's Corporate Bank fails to comply with the approved Investment Policy criteria specified above, then delegated authority, to agree appropriate and reasonable interim contingency arrangements

prior to approval by Full Council, is granted to the Members and Officers listed below:

- a. Nominated Members: Leader of the Council, Deputy Leader of the Council, Chair of Corporate Overview Scrutiny.
- b. Nominated Officer: Statutory Section 151 Officer (Chief Officer Resources)

The Statutory Section 151 Officer and at least two of the three nominated Members, must approve unanimously the appropriate and reasonable interim contingency arrangements.

#### **4.5 Monitoring of credit ratings**

Welsh Government ? guidance states that the Annual Investment Strategy must state how credit ratings are to be monitored and what action is to be taken when ratings change.

The responsibility for constructing and amending the Council's approved counterparty investment list is delegated to the Chief Officer Resources and is contained within the Treasury Management Practice Schedules. All investments will be made in accordance with this list and the limits therein.

Credit ratings for individual counterparties can change at any time. The Chief Officer Resources is responsible for applying the stated credit rating criteria above, and will add or delete counterparties as appropriate to / from the approved counterparty list when there is a change in the credit ratings of individual counterparties or in banking structures. The Authority is alerted to changes in credit ratings through its Treasury Advisors, Link Asset Services.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.
- If a body is placed on negative rating watch (i.e. there is a reasonable probability of a rating change and the likelihood of that change being negative) and it is currently near at the minimum acceptable rating for placing investments with that body, then no further investments will be made with that body.

**The only exception permitted to these criteria will be the contingency arrangement for the Authority's bank described in section 4.4**

#### **4.6 Liquidity of Investments**

Welsh Government guidance states that the Annual Investment Strategy is to

specify the maximum periods for which funds may be committed and the minimum amount to be held in investments during the financial year.

The maximum period for which funds may be committed is 365 days but the actual period of investment will depend upon future cash flow requirements and will comply with the maximum period permitted in the table above.

As the Authority only maintains temporary, short term investments with reference to its cash flow requirements, then the minimum amount of investment to be held during the financial year will be nil.

#### **4.7 Ethical investing**

Investment guidance, both statutory and from CIPFA, makes clear that the SLY principles i.e. security, liquidity and yield must remain fundamental to Local Authority investing: however ethical issues may play a subordinate role to this. It should be noted, that local authority investing, incorporates Environmental, Social and Corporate Governance (ESG) metrics into credit rating agency assessments and a growing number of financial institutions and fund managers/money market funds promote ESG products. Therefore, where appropriate the Authority will consider ESG factors when setting up any investment arrangements. For example, we would avoid investing in companies linked with fossil fuels.

#### **4.8 Investment monitoring reports**

The Council will report on its investment activity as part of its mid-year and Annual Treasury Outturn Report.

### **5. Annual Minimum Revenue Provision (MRP) Statement**

The Secretary of State recommends that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to full Council.

Under regulation 21 of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003, local authorities are required to charge to their revenue account for each financial year MRP to account for the principal cost of their debt in that financial year.

For 2007/8 and subsequent financial years, the detailed calculation has been replaced with a requirement that local authorities calculate an amount of MRP which they consider to be prudent. Local Authorities are legally obliged to “have regard” to such guidance (i.e. set a prudent MRP) – which is exactly the same duty as applies to other statutory guidance including the Prudential Code and CIPFA Treasury Management Code.

The broad aim of prudent provision is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Revenue Support Grant (RSG), reasonably commensurate with the period implicit in the determination of that grant.

The legislation does not define what constitutes a “prudent provision”. However, the MRP guidance issued by the Secretary of State (WG) interprets the term and provides some ready-made examples of acceptable methods for calculating a prudent level of MRP.

In December 2017, Council approved an amended MRP policy to be applied from 2017/18 and beyond, as follows:

**MRP on Supported Borrowing** – this will be based on a 2% straight line approach and will be applied retrospectively back to 1<sup>st</sup> April 2007.

**MRP on Unsupported Borrowing** – this will be based on Option 3 of the statutory guidance that allows for MRP provision using the asset life methodology on an annuity basis. This will be applied retrospectively back to 1<sup>st</sup> April 2007. It is applied to particular items of capital expenditure and spreads the expenditure over the useful life of the asset. MRP is chargeable in the first financial year after the relevant asset becomes operational. The annuity method MRP will be the amount presumed to be the principal element of the equal amounts that would be payable each year in respect of a loan at a specified rate of interest that would reduce the outstanding principal amount to zero at the end of the estimated useful life. The annuity method can be argued as providing a fairer charge than equal instalments as it takes into account the time value of money. The interest rate to be used in the annuity calculation is the average PWLB annuity rate for a loan with a term equivalent to the estimated life of the asset. Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

**MRP on Finance Leases** - Option 3 will apply in a modified form, to ensure that the MRP for Finance Leases is equal to the rental payable each year, with the following exception.

**Capital Receipts** – In circumstances where it is prudent to do so and to protect Council Tax payers from unnecessary MRP charges, capital receipts received under finance lease arrangements (where there is a head and sub-lease agreement) will be used to reduce the Council's overall borrowing requirement, rather than making a conventional MRP charge to revenue.

**Loans to other bodies** – where loans are made to other bodies for their capital expenditure, no MRP will be charged. However, the capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead.

**Application of retrospective sum** – the retrospective application of the supported and unsupported borrowing option back to 1<sup>st</sup> April 2007 results in a sum of £15.5 million that is to be applied for a 5-year period from 2017/18 to 2021/22 in order to reduce the MRP charge for those years.

To Note:

In November 2018, Welsh Government issued further guidance, to apply from April 2019. In summary, the changes are as follows: -

- Changing the method of calculation of MRP cannot lead to retrospective application
- MRP cannot be a negative amount
- MRP can only be nil under certain circumstances

This did not impact upon the Council's policy but precludes future changes to the method of calculation of the MRP incorporating a retrospective element.

**JW 14/1/21**