HIWFRA Full Authority

Purpose: Approval

Date: **14 DECEMBER 2021**

Title: **BUDGET UPDATE REPORT**

Report of Chief Financial Officer

SUMMARY

1. In previous years the Budget Update report has followed the Medium Term Financial Plan (MTFP) presented in September and has provided an update on this plan in advance of the Budget and Precept Report in February. Due to the uncertainty around the medium term financial position, no MTFP was produced this September. This report therefore provides a first look at the budget setting process for 2022/23, an update on the development of the MTFP and an update on the financial position of the Authority in 2021/22.

2. The position in 2021/22 to date is a positive one, with an underspend against the budget of £0.897m currently forecast. Further detail is provided in paragraphs 12-17.

3. The setting of the budget for 2022/23 has worked alongside the development of the priorities for year three of the Safety Plan. As part of this work Executive Group, informed by directorates, have considered requests for additional funding and opportunities for delivering efficiencies. This report requests approval for changes to the base budget as an outcome of this work.

4. This report also sets out a high-level view of the medium term financial position for the Fire Authority based on the announcements made as part of the Autumn Budget on 27th October 2021. A full MTFP will be produced and presented to the Authority alongside the Budget and Precept Report at the February meeting.

5. This report also covers two pensions matters. The first is a recommendation for an increase to the cost cap envelope relating to the cost of pensions for temporary promotions, covered in paragraphs 52 – 54. The second is an update to the LGPS discretions policy on additional voluntary contributions, covered in paragraphs 55 to 56 and Appendix D.

BACKGROUND

6. A series of single year financial settlements have made forward financial planning for the Authority challenging. Prior to the Autumn Budget and Spending Review, the Authority had no visibility of its financial prospects beyond March 2022.

7. The Autumn Budget and Spending Review contained limited information about the specifics of the funding settlement for Fire. Therefore, this report is based on a number of assumptions. Inevitably the final settlement will differ in some respects from these assumptions. Any changes will be reflected in the Budget and Precept report and the MTFP.

FINANCIAL PRINCIPLES

8. Given the coming multi-year settlement and the development of an MTFP, it seemed an appropriate time to formalise a set of financial principles for the Authority. These principles will guide the development of the MTFP and will provide a useful reference point for future financial decision making.

9. These principles are not a fundamental change in our approach to the Authority's finances. This approach has served us well and means that we are in a stable financial position. Rather the aim is to clearly articulate these principles to ensure that Members and officers have a shared understanding of the underlying principles that continue to shape our approach.

10. The principles were discussed and agreed by Executive Group as part of the early planning for setting the 2022/23 budget. They are set out for Member approval as Appendix A.

11. The rest of the report assumes that these principles have been adopted.

2021/22 BUDGET MONITORING

12. The forecast position for the Authority in 2021/22 is an underspend of £0.897m. This position includes £0.575m of COVID related expenditure matched by grant funding carried forward from the previous financial year. A breakdown of the position is set out below.

	Budget	Forecast	Over / (under) spend
	£’000	**£’000**	**£’000**
Employee costs	61,841	60,191	(1,650)
Premises	8,449	8,628	179
Transport	1,792	2,010	218
Supplies and Services	9,947	10,200	253
Third Party Payments	2,481	2,319	(162)
Income	(3,480)	(3,304)	176
Net expenditure	***81,028***	***80,044***	***(984)***
Funding	(81,028)	(80,941)	87
Net position	**-**	**(897)**	**(897)**

13. Currently, additional COVID related expenditure, including some amounts related to COVID recovery are covered by grant funding. The position above includes this funding and the associated forecast expenditure. If there were to be further COVID response costs with no associated additional funding, these costs would become a pressure on the bottom line.

14. The majority of the underspend is made up of lower employee costs, mainly within the Operations directorate. This underspend has been achieved by proactively managing staff costs within the area.

15. There is currently a forecast overspend on premises, largely relating to pressures on reactive maintenance. The property team are working to contain this pressure and will reprioritise work to bring spend in line with budget by year end.

16. The forecast overspend on transport mainly relates to travel costs for firefighters covering absence on other stations. These costs are related to and more than offset by the underspend on pay costs. We have also seen an impact from higher fuel prices.

17. Supplies and services overspends relate primarily to the costs of ICT contractors to fill ICT vacancies and a pressure on the Networked Fire Services Partnership (NFSP) budget. ICT contractor costs are offset by staff vacancies and work is underway to address the NFSP budget pressure.

<u>2022/23 BUDGET SETTING</u>

18. The process of setting the budget for 2022/23 is underway. Budget setting is inextricably linked to the development of the annual Safety Plan priorities, so these processes run in tandem.

19. The Budget and Spending Review did not contain specific information about the Fire financial settlement. Specific detail will not be available until the Local Government funding settlement announcement is made in December 2021. However, the key points that are currently assumed from the settlement are as follows:

    - Council tax rises for Fire Authorities will be limited to 1.99% (without a referendum)

    - Grant funding is assumed to increase by 1.8%

    - There is an assumption that current specific grants will continue.

20. The Fire Sector had made representations to Government about the benefits of a £5, rather than 1.99%, Council Tax referendum limit. Based on the announcements it seems that the referendum limit will remain at 1.99%, making the medium term financial position of the Authority significantly more challenging.

21. Billing authorities have recently provided more up to date information on changes to the Council Tax base. Based on this information, an increase of 1% is assumed. No information on collection fund surpluses or deficits is available so an assumption of no surplus or deficit has been made. Again, any changes to these assumptions will affect the position.

22. A number of assumptions about expenditure have also been included in the financial modelling. The Station Investment Programme (SIP) is funded from prudential borrowing. As the projects that form part of the SIP progress

the repayment of this borrowing has to be factored into the budget, with a further £580,000 required next year.

23. Reasonable assumptions about pay and non-pay inflation are included as part of the budget setting process. However, inflation on some non-pay items is currently significantly higher than would normally be expected. It is difficult to predict if these elevated rates will continue or if there are short term factors affecting prices. Therefore, an inflation contingency of £300,000 is proposed, to be managed centrally to support areas of the service disproportionately affected by inflationary rises.

24. Due to the high levels of uncertainty no MTFP was produced in 2021/22. There was an underlying budget deficit of £778,000 which was met by a one-off draw from the Grant Equalisation Reserve. This becomes the starting point for 2022/23 budget setting.

25. In line with our financial principles, we will aim to set a fully balanced budget for 2022/23 (i.e., without the use of reserves). However, given the relatively short period of time between the details of the financial settlement becoming available and the start of the next financial year, it may not be possible to achieve this. In that case we may need to temporarily reduce our contributions to reserves while plans are developed to deliver further efficiencies or service reductions.

DELIVERY PRESSURES

26. Given the financial pressures on the Authority, it is more important than ever to limit increases in base expenditure. In previous years there has been the opportunity for areas across the organisation to put forward a case for growth in their budgets to deliver organisational benefit. This year this process was not carried out. Instead, Executive Group had the opportunity to identify only essential delivery pressures. Some of these were brought forward from last year as they were not affordable within the budget at that time. Executive Group have considered and robustly challenged these pressures and are proposing only the highest priority areas for inclusion in the 2022/23 base budget. The total cost of these delivery pressures is £592,000. A full breakdown, including the split between pressures brought forward and new pressures, is included as Appendix B.

27. In addition to the agreed delivery pressures, a medium term need to increase contributions to ICT reserves to support a timely refresh of ICT equipment was also noted as a requirement. The level of additional funding needed (£218,000) means that an on-going contribution is unlikely to be affordable next year. Instead, the pressure will be addressed in future years

as part of the MTFP. A one-off contribution to ICT reserves from underspend will instead be made during 2022/23 subject to affordability.

28. Although these pressures have been identified as high priority for including within the 2022/23 budget, until the final settlement has been announced it is not clear whether they will be affordable and ultimately, savings may be required in other areas in order to accommodate them in the budget. Therefore, it is recommended that these delivery pressures are proposed for inclusion in the 2022/23 budget subject to affordability based on the outcome of the funding settlement.

29. In order to deliver the priorities set out in the 2022/23 Safety Plan, one off investment will be required. This investment can be funded from the Transformation Reserve, a reserve held by the Fire Authority for this purpose. The total investment required will be included in the Budget and Precept report.

CAPITAL INVESTMENT PRIORITIES

30. As a sector Fire receives no capital funding from Government. In order to provide essential funding to invest in our estate and vehicles, the Authority has an existing strategy of making annual contributions to the Capital Payments Reserve to fund future capital investment.

31. As noted in the Reserves Strategy presented to the Authority in February 2021, although the current balance on the Capital Payments Reserve remains high, the total balance and future contributions are fully committed to the current vehicles replacement programme and other previously agreed capital schemes.

32. Despite the annual contributions to capital, there is insufficient reserve funding available to support new major capital schemes. The Authority has agreed to fund the Cosham and Redbridge schemes that form part of the Station Investment Programme (SIP) from prudential borrowing. Prudential borrowing provides access to significant funds for investment but the interest payments and provision for the repayment of capital (known as the Minimum Revenue Provision or MRP) become a growth pressure on the revenue budget.

33. An additional £580,000 has been built into the revenue budget to cover the SIP prudential borrowing and future increases will be included in the MTFP.

34. As part of the budget setting process and developing early thoughts around the MTFP, Executive Group also considered future capital investment priorities. The affordability of these schemes will need to be considered

when the details of the financial settlement are available. The indication that the council tax referendum limit will remain at 1.99% means that the funding of these essential schemes is now extremely challenging.

35. The first priority is to complete the essential estates improvement works on the Isle of Wight. The Authority agreed £1.1m for the first phase of this work in September 2020. In order to complete the work a further £3.1m is likely to be required from 2022/23 – 2023/24.

36. In July 2021 the Authority agreed funding for Carbon Reduction Surveys. The funding to complete the necessary works that these surveys identify will also need to be considered as part of the capital programme from 2023/24.

37. Funding to retrospectively apply the Station Improvement Design Principles to existing stations also needs to be considered. This work will concentrate on addressing fireground decontamination and providing inclusive facilities.

38. New schemes as part of the SIP in Fareham and Gosport, East Cowes and Newport are also under consideration. A £200,000 provision for a potential Gosport site is included in the existing capital programme. Although the original site under consideration is no longer available, this allocation will be retained to allow a suitable site to be secured. There is an existing delegation in place for this deposit to be used to secure a suitable site in advance of a full business case being approved by the Authority.

39. The full details of the forward capital programme will be included in the Budget and Precept Report in February 2022. This will include options for funding the proposals. Reports or business cases will be brought to the Authority to seek approval for the specific schemes, but it seemed useful at this point to provide a sense of the scale of the potential capital investment requirements. The current indications about the financial settlement suggest that funding these high priority schemes will be extremely challenging.

40. It is also worth noting that there are currently additional cost pressures on capital schemes on both materials and labour relating to COVID and supply chain issues.

EFFICIENCY MEASURES

41. In order to balance the financial position of the Fire Authority over the medium term, it will be necessary to develop and deliver efficiency measures. Depending on the details of the medium term financial settlement it may also be necessary to look at options for service reductions.

42. Executive Group have considered what level of efficiencies may be achievable. Efficiency savings of £212,000 have already been identified, relating to the deletion of the vacant Assistant Chief Officer post and some smaller non-pay savings.

43. In addition, Executive Group have committed to develop an efficiency and effectiveness plan which will deliver efficiencies during 2022/23 and 2023/24. Initial high-level thinking suggests that £1.15m could be delivered during 2022/23 with a further £1.15m in the following financial year.

44. Progress on the development and delivery of the efficiency and effectiveness plan will be monitored within the service and reported to the Authority during 2022/23.

BUDGET POSITION

45. The final 2021/22 budget setting position was a deficit budget of £778,000. This deficit was met by a one-off draw from and a one-off reduction in the contribution to the Grant Equalisation Reserve (GER).

46. The starting position for 2022/23 budget is that this deficit of £778,000 is rolled forward. There are several other known changes that impact this position. Most of these changes have been covered elsewhere in the report.

47. It is worth remembering at this point that the position during the budget setting process was a 0% public sector pay award. In fact, a 1.5% pay award was agreed for grey book staff with the green book pay award still subject to negotiation. Therefore, there is an estimated £900,000 unbudgeted pressure from these pay awards. A contingency of £500,000 was included within the budget for unforeseen costs during the first year of the new Fire Authority. This contingency was fully used to fund the pay award, leaving a net deficit of £400,000 for the pay award.

48. The known changes are as follows:

	£'000
Inflation contingency	300
Removal of Council Tax Support Grant	695
Revenue implications of the Station Investment Programme	580

2022/23 forecast pay and non-pay inflation	1,250
2022/23 National Insurance increase	350
2022/23 delivery pressures	592
Full year effect of the 2021/22 unbudgeted pay award	900
Removal of contingency	(500)
2022/23 efficiency measures	(1,362)
2022/23 forecast Council Tax increase (including council tax base increase)	(1,480)
2022/23 forecast grant increase	(770)
Net impact	**555**

49. Adding these changes to the deficit brought forward of £778,000 would mean a deficit position of £1.333m prior to the announcement of the detailed settlement. This position is based on the development and implementation of an efficiency and effectiveness plan during 2022/23. It is clear that the delivery of efficiency measures is essential to balancing the 2022/23 budget. There are potential one-off changes that could be made which would allow the deficit to be managed in 2022/23. The potential mitigations are as follows:

	£'000
Utilise remaining GER balance	472
No contribution to the GER	625
Use of 2021/22 underspend	236

Total mitigations	**1,333**

50. These mitigations would bring the balance on the GER to £0 and would reduce the ability of the service to make full use of the underspend to support future change activities from the Transformation Reserve.

51. In the event that the financial settlement is significantly worse than forecast, or efficiency savings cannot be made to this level, it may be necessary to temporarily reduce the reserve contributions currently built into the base budget. This may result in the need to fund some capital schemes from borrowing that are currently funded from reserves, creating greater future revenue pressures. For this reason, this should be viewed as a last resort.

<u>PENSIONS</u>

52. In August 2016 the Authority made decisions about temporary promotions and their treatment in terms of pensions for different cohorts of employees. These decisions committed the Authority to pay for the difference between their benefits based on temporary promotion and their legislative benefits.

53. The maximum cost envelope for accepted members was £256,000 for lump sums and £35,700 for annual pensions. The majority of members have since retired and the costs have been contained within the original estimates. However, due to factors that could not have been anticipated when the original estimates were made, it is necessary to seek approval from the Fire Authority to increase the cost cap envelope as follows:

    (a) For lump sums from £256,000 to £291,000 (increase of £35,000)

    (b) For annual pensions from £35,700 to £38,700 (increase of £3,000).

54. The proposal to increase the cost cap envelope was noted by the HIWFRA Firefighters Pension Board at its April meeting.

55. In addition, there is a proposal to allow members of the Local Government Pension Scheme to purchase Additional Voluntary Contributions (AVC) in the form of a Salary Sacrifice Shared Cost AVC. This is a tax efficient way for employees to increase their pension.

56. The mechanism for this to be approved is via an amendment to the LGPS discretions policy, attached as Appendix D. There are no financial implications of making this change as the cost of paying into the scheme is borne by the employee and not the service.

TREASURY MANAGEMENT

57. The mid-year Treasury Management Report is attached as Appendix C. It provides an update of the Authority's return on investment as at 30th September 2021.

SUPPORTING OUR SAFETY PLAN AND PRIORITIES

58. Ensuring that funding is appropriately accounted for is vital for all public sector organisations. Good budget management in the past has allowed underspends to be achieved, which have been added to reserves to fund future investment and change activities.

59. As resources are scarce and a good deal of uncertainty remains, it is essential that spend is carefully prioritised and that resources are directed to the highest priority areas in line with the Safety Plan.

CONSULTATION

60. Consultation on the budget proposals will take place with businesses and Unions as part of the budget setting process for 2022/23.

RESOURCE IMPLICATIONS

61. Decisions made in this report will be reflected in the final 2022/23 Budget and Precept Report, to be presented to the Authority in February 2022.

IMPACT ASSESSMENTS

62. The proposals within this report are considered compatible with the provisions of relevant equality and human rights, Data Protection and Health and Safety Legislation.

LEGAL IMPLICATIONS

63. The Fire Authority is required to set a balanced budget and council tax level by 1 March 2022. This report provides background information and initial proposals which will be expanded on in the Budget and Precept report.

OPTIONS

64. The process of setting a budget is a series of options about how best to use the resources available to deliver organisational priorities. This report has provided some information about the proposed options based on the current best available information. Full detail on the options proposed will be

provided to the Authority as part of the Budget and Precept Report and MTFP in February 2022.

RISK ANALYSIS

65. Over recent years financial management processes within the service have improved meaning that the risk of unexpected financial pressures has reduced.

66. Uncertainty over the medium term financial position and potential funding cuts are risks identified in the organisational risk register. The outcome of the Budget and Spending Review will impact on these risks. However, the Authority is in a stable financial position and has reserves that could be drawn on to mitigate this risk in the short term while plans to address funding shortfalls are developed.

EVALUATION

67. This report provides an update to the Authority on the budget setting progress to date. Full details will be provided as part of the Budget Setting and Precept report in February 2022.

68. Evaluation of the impact of the growth pressures and high level efficiencies will be picked up as part of business as usual processes within the service.

CONCLUSION

69. It is recommended that the Authority consider the content of this report, including areas where there is still uncertainty about the medium term position.

RECOMMENDATIONS

70. That the financial principles in Appendix A be approved by the HIWFRA Full Authority

71. That the budget monitoring position be noted by the HIWFRA Full Authority

72. That the increase to the cost cap envelope is approved by the HIWFRA Full Authority.

73. That the Delivery Pressures set out in Appendix B be approved by the HIWFRA Full Authority for inclusion in the 2022/23 budget subject to affordability

74. That the mid-year review of treasury management activities set out in Appendix C be approved by the HIWFRA Full Authority

75. That the updated LGPS Discretions Policy set out in Appendix D be approved by the HIWFRA Full Authority

APPENDICES ATTACHED

76. Appendix A – Financial Principles

77. Appendix B – Delivery Pressures

78. Appendix C – Treasury Management Mid-Year Report

79. Appendix D – LGPS Discretions Policy

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APPENDIX A – FINANCIAL PRINCIPLES

The following financial principles have been developed by Executive Group to guide budget setting and medium term financial planning:

1. A corporate approach will be taken to the development of budgets and savings programmes

2. Savings delivery will be planned so that savings are delivered at the optimum time to balance the budget

3. Financial planning assumptions will be realistic and prudent and will take account of pay and price inflation

4. One off and recurring growth will be limited

5. Revenue contributions to reserves for capital investment, IT and other equipment replacement will be maintained

6. The revenue budget and capital investment will be aligned with strategic priorities and risks

7. Reductions in planned reserve contributions will be used as a last resort to balance the budget.

APPENDIX B – DELIVERY PRESSURES

Category	Narrative	Value (£'000)
ICT reserve contributions	An increase in the annual contribution to the ICT reserve to cover the current projected costs of the refresh of equipment for increasing provision to include IOW equipment.	89
Equipment reserve contributions	An increase in the annual contribution to the Equipment reserve to cover the current projected costs of the refresh of equipment for increasing provision to include IOW equipment.	65
Sub-total	***Pressures delayed from 2021/22***	***154***
Strategic partnerships resource	2 FTE additional resources to secure our ability to foster influential relationships with stakeholders and to understand and meet the needs of our communities. Supporting our evolving understanding of risk and our commitment to make evidence based decisions	65
Communications resources	2 FTE additional resources to strengthen our communications team and to add more specialist skills to our creative communications capabilities, allowing us to create more engaging communications to our staff and the communities we serve.	80
Driver training	1 FTE additional resource plus costs of providing driver training following the increase in duration of driver training courses from one to three weeks.	83
Recruitment resource	1 FTE dedicated resource to take a strategic overview of recruitment across the organisation.	60

HR resource	Additional HR resource to deliver organisational priorities and continue the strong focus on our people.	80
ICT base budget increase	Net increased required to address resourcing pressures within the ICT team, other pressures have been managed via savings	27
Carbon reduction post	Approved in principle by the Authority as part of the Carbon Reduction Pathway report in July 2021	43
Sub-total	***Newly identified pressures***	438
Total		**592**

APPENDIX C – TREASURY MANAGEMENT MID-YEAR REPORT

Treasury Management Mid-Year Monitoring Report 2021/22

Purpose of the Report

1. Hampshire and Isle of Wight Fire and Rescue Authority has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2017. The CIPFA Code requires the Fire and Rescue Authority to approve a treasury management strategy before the start of the year and a semi-annual and annual treasury outturn report. The purpose of this report is therefore to meet this obligation by providing an update on the performance of the treasury management function at the mid-year point.

Summary

2. This report fulfils the Fire and Rescue Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and provides an update on the performance of the treasury management function at the mid-year point.

3. The Fire and Rescue Authority's treasury management strategy was most recently updated and approved at a meeting of Hampshire & Isle of Wight Fire & Rescue Authority (Shadow Authority) in February 2021. The Fire and Rescue Authority has borrowed and invested 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 risk are therefore central to the Fire and Rescue Authority's treasury management strategy.

4. Treasury management in the context of this report is defined as: "the management of the organisation'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."

5. This mid-year report sets out the performance of the treasury management function from the beginning of April to the end of September 2021, to include the effects of the decisions taken and the transactions executed.

6. Overall responsibility for treasury management remains with the Fire and Rescue Authority. No treasury management activity is without risk and the

effective identification and management of risk are therefore integral to the Fire and Rescue Authority's treasury management objectives.

7. All treasury activity has complied with the Fire and Rescue Authority's Treasury Management Strategy and Investment Strategy for 2021/22, and all relevant statute, guidance and accounting standards. In addition, support in undertaking treasury management activities has been provided by the Fire and Rescue Authority's treasury advisers, Arlingclose.

8. The 2017 Prudential Code includes the requirement to produce a Capital Strategy, a summary document approved covering capital expenditure and financing, treasury management and non-treasury investments. The latest iteration of the Fire and Rescue Authority's Capital and Investment Strategy, complying with CIPFA's requirement, was approved by the Hampshire & Isle of Wight Fire & Rescue Authority (Shadow Authority) in February 2021.

External Context

9. The following sections outline the key economic themes in the UK against which investment and borrowing decisions have been made to date in 2021/22.

Economic commentary

10. The coronavirus pandemic continued to dominate the news during the period, with economic resurgence following the rapid vaccination programme.

11. The Bank of England (BoE) has held Bank Rate at 0.1% since March 2020 and has maintained its Quantitative Easing programme at £895bn since November 2020. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% from 2.9%, in part reflecting tighter supply conditions. CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation.

12. The BoE's Monetary Policy Committee (MPC) does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating the economy's spare capacity and achieving the 2% inflation target sustainably.

Financial markets

13. Ongoing monetary and fiscal stimulus together with improving economic growth prospects and successful vaccine rollout programmes continued to boost equity markets over the period. In the UK, the FTSE 250 index continued making gains over pre-pandemic levels and the more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

14. Inflation worries continued during the period but declines in bond yields between April and June suggest bond markets may be expecting any general price increases to be less severe, or more transitory, than was previously thought. However, an increase in gas prices in the UK and European Union, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instances, lead to higher prices. UK government bonds remained positive over the period.

Credit review

15. Credit default swap spreads were flat over the period and are broadly in line with their pre-pandemic levels. Credit default swaps are used as an indicator of credit risk, where higher premiums indicate higher perceived risks.

16. Over the period credit ratings agencies, Fitch and Moody's, upwardly revised to stable the outlook on a number of UK banks and building societies on Arlingclose's counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

17. The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

18. On 24 September 2021 Arlingclose published its review of its credit advice on unsecured deposits, judging that the UK has seen six months of positive GDP growth, and while forward-looking indicators suggest that economic growth has entered a slower phase as the UK heads into autumn, and the risks around both the continuing pandemic and a period of economic adjustment post government support remain, the likelihood of

further significant economic fallout from the pandemic impacting on the financial viability of certain banks has diminished. As a result Arlingclose has updated its treasury management advice, allowing maximum durations of 100 days for unsecured investments with some UK banks on their list of recommended counterparties.

Local Context

19. At 31 March 2021 the Fire and Rescue Authority's underlying need to borrow for capital purposes was £10.3m as measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment and amounted to £29.5m. These factors are summarised in Table 1.

Table 1: Balance sheet summary	**31/03/21 Balance £m**
CFR	10.3
Less: External borrowing	
- Public Works Loan Board	(7.1)
Internal Borrowing	**3.2**
Less: Usable Reserves	6.3
Less: Working Capital	(35.8)
Net Investments	**(26.3)**

20. The Fire and Rescue Authority's strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, to reduce risk and keep interest costs low. The treasury management position at 30 September 2021 and the movement since 31 March 2021 are shown in Table 2.

Table 2: Treasury management summary	**31/03/21 Balance £m**	**Movement £m**	**30/09/21 Balance £m**	**30/09/21 Rate %**
Long-term borrowing	(6.65)	-	(6.65)	4.69
Short-term borrowing	(0.45)	-	(0.45)	4.50
Total borrowing	**(7.10)**	**-**	**(7.10)**	**4.68**
Long-term investments	8.00	1.00	9.00	4.19
Short-term investments	14.00	1.00	15.00	0.07
Cash and cash equivalents	4.79	10.69	15.48	0.01
Total investments	**26.79**	**12.69**	**39.48**	**0.98**

Net investments	**19.69**	**12.69**	**32.38**	

Note: the figures in Table 2 at 31 March 2021 are from the balance sheet in the Fire and Rescue Authority's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

21. The increase in net investments of £12.69m shown in Table 2 reflects an increase in investment balances and no change in borrowing, in line with the Fire and Rescue Authority's policy on internal borrowing. Further details are provided in the Borrowing Activity and Treasury Investments Activity sections of this report.

Borrowing Update

22. Local authorities can borrow from the Public Works Loan Board (PWLB) provided they have not purchased an investment asset primarily for yield since 26 November 2020 and can confirm they are not planning to do so in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 / Section 95 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

23. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

24. Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

25. The Fire and Rescue Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB if required.

26. CIPFA has recently released a further consultation on its Prudential Code (more information provided at paragraph 62 of this report) ahead of the new Code being released in December 2021. The consultation documents include the guidance that authorities 'must not borrow to invest for the primary purpose of financial return', and the sector was concerned that the documentation also seemed to read that those authorities who were invested in pooled funds would not be able to access borrowing from the PWLB. However CIPFA have subsequently published early guidance on not borrowing to invest which covers existing commercial investments:

27. “The Code’s statement that authorities ‘must not borrow to invest for the primary purpose of financial return’ is not intended to require the forced sale of existing commercial investments, whether commercial properties or financial investments. Selling these investments and using the proceeds to net down debt does, however, reduce treasury risks on both sides of the balance sheet and is therefore an option which should be kept under review, especially if new long term borrowing is being considered.”

28. Responses to this consultation are expected by 16 November 2021 before the final Code is released in December 2021, and the Fire and Rescue Authority as well as its adviser, Arlingclose, intends to respond to this consultation.

Revised PWLB Guidance

29. HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an ‘investment asset primarily for yield’. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26th November 2020 is allowable even for an ‘investment asset primarily for yield’.

- Capital plans should be submitted by local authorities via a DELTA return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.

- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.

- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.

- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

Changes to PWLB Terms and Conditions from 8 September 2021

30. The settlement time for a PWLB loan has been extended from two working days (T+2) to five working days (T+5). In a move to protect the PWLB

against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.

Borrowing Activity

31. At 30 September 2021 the Fire and Rescue Authority held £7.1m of loans (which represents no change since from 31 March 2021) as part of its strategy for funding previous years' capital programmes. The mid-year treasury management borrowing position and movement since 31 March 2021 are shown in Table 3.

Table 3: Borrowing position	**31/03/21 Balance £m**	**Net movement £m**	**30/09/21 Balance £m**	**30/09/21 Weighted average rate %**	**30/09/21 Weighted average maturity (years)**
Public Works Loan Board	(7.10)	-	(7.10)	4.68	9.7
Total borrowing	**(7.10)**	**-**	**(7.10)**	**4.68**	**9.7**

Note: the figures in Table 3 at 31 March 2021 are from the balance sheet in the Fire and Rescue Authority's statement of accounts but adjusted to exclude accrued interest.

32. The Fire and Rescue Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Fire and Rescue Authority's long-term plans change is a secondary objective.

33. Short-term interest rates have remained much lower than long-term rates and the Fire and Rescue Authority has therefore considered it to be more cost effective in the near term to use internal resources than to use additional borrowing. In line with this strategy, no new borrowing has been taken out during the period.

34. This borrowing strategy has been monitored with the assistance of Arlingclose and has enabled the Fire and Rescue Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

Treasury Investment Activity

35. The Fire and Rescue Authority holds invested funds representing income received in advance of expenditure plus balances and reserves held. During the six-month period from 1 April to 30 September 2021, the Fire and Rescue Authority's investment balances have ranged between £23.3m and £42.4m due to timing differences between income and expenditure.

36. Table 4 shows investment activity for the Fire and Rescue Authority as at 30 September 2021 in comparison to the reported activity as at 31 March 2021. The increase in total investments since 31 March 2021 reflects the fact that the balance at 31 March is typically the lowest of the year due to the annual pension grant being received in July each year, which is then paid out to pensioners on a monthly basis.

Table 4: Treasury investment position	**31/03/21 Balance £m**	**Net movement £m**	**30/09/21 Balance £m**	**30/09/21 Income return %**	**30/09/21 Weighted average maturity (years)**
Short term investments					
Banks and building societies:					
- Unsecured	4.84	2.49	7.33	0.06	0.1
- Secured	-	5.00	5.00	0.08	0.5
Government:					
- DMADF	-	3.00	3.00	0.01	0.1
- Local authorities	11.00	(9.00)	2.00	0.09	0.6
Money market funds	2.95	10.20	13.15	0.01	0.0
	18.79	**11.69**	**30.48**	**0.04**	**0.4**
Long term investments					
Banks and building societies					
- Secured	1.00	1.00	2.00	0.28	1.4
	1.00	**1.00**	**2.00**	**0.28**	**1.4**
Long term investments – higher yielding strategy					
Pooled funds:					
- Pooled property*	3.25	-	3.25	4.46	N/A
- Pooled equity*	2.00	-	2.00	7.00	N/A

- Pooled multi-asset*	1.75	-	1.75	4.94	N/A
	7.00	**-**	**7.00**	**5.30**	**N/A**
Total investments	**26.79**	**12.69**	**39.48**	**0.98**	**0.2**

* The rates provided for pooled fund investments are reflective of annualised income returns over the year to 30 September 2021 based on the market value of investments 12 months earlier.

Note: the figures in Table 4 at 31 March 2021 are from the balance sheet in the Fire and Rescue Authority's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

37. The Fire and Rescue Authority made a payment of £3.9m on 1 April 2020 to prepay its employer's Local Government Pension Scheme (LGPS) contributions for 3 years. By making this payment in advance the Fire and Rescue Authority was able to generate an estimated saving of £0.26m over 3 years on its pension contributions. It is expected that cash balances will steadily increase over this three year period in addition to the normal cash movements due to timing differences between income and expenditure.

38. Investment balances have subsequently increased and were £12.69m higher at 30 September 2021 in comparison to the position at 31 March 2021. This is in part explained by the Fire and Rescue Authority not having to make monthly employer's pension contributions in 2021/22 (having already paid in advance for 3 years in April 2020) and the balance of grants received but not yet applied. The impact of the coronavirus pandemic has created significant uncertainty, resulting in the need for significant assumptions within financial forecasts and a difference in timing between income and expenditure, both in terms of the direct response to the pandemic and in carrying out regular service delivery plans.

39. The CIPFA Code and government guidance both require the Fire and Rescue Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Fire and Rescue Authority's objective when investing money is therefore to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults alongside managing the risk of receiving unsuitably low investment income. The Fire and Rescue Authority's Treasury Management Strategy Statement (TMSS) sets out how it will manage and mitigate these risks.

40. The security of investments has been maintained by following the counterparty policy and investment limits within the TMSS, taking advice from Arlingclose on changes in counterparty credit worthiness, and making

use of secured investment products that provide collateral. The Fire and Rescue Authority invests in liquid investments to ensure money is available when required to meet its financial obligations, spreading these investments across a number of counterparties to mitigate operational risk.

41. In delivering investment returns, the Fire and Rescue Authority has operated against a backdrop in which the UK Bank Rate was cut to 0.10% in March 2020 in response to the coronavirus pandemic. UK Bank Rate has remained at this rate throughout the year, having an impact on rates across the market. Returns have been at or around +0.01% for liquid investment options such as Money Market Funds (MMFs), bank call accounts and the UK Government's Debt Management Account Deposit Facility (DMADF) and have not been significantly higher for other short-term options like fixed duration loans to other local authorities and bank notice accounts. Investment income has therefore largely come from investments arranged at fixed rates of interest prior to the pandemic and through the Fire and Rescue Authority's investments in pooled funds.

42. The Fire and Rescue Authority benchmarks the performance of its internally managed investments against that of other Arlingclose clients on a quarterly basis. Internally managed investments include all investments except externally managed pooled funds but do include MMFs. The performance of these investments against relevant measures of security, liquidity and yield are shown in Table 5, providing data as at 30 June 2021 and at 31 March 2021 for comparison. The Fire and Rescue Authority's data as at 30 September 2021 is available and is shown in Table 5, however unfortunately the comparative benchmarking data was not available at the publishing date.

Table 5: Investment benchmarking (excluding pooled funds)	**Credit rating**	**Bail-in exposure %**	**Weighted average maturity (days)**	**Rate of return %**
31.03.2021	AA-	39%	87	0.22%
30.06.2021	AA-	73%	52	0.06%
Police & Fire Authorities	A+	87%	16	0.03%
All LAs	A+	67%	12	0.11%
30.09.2021	AA-	63%	80	0.16%

43. Table 5 shows the average credit rating of the portfolio has remained consistent over the first half of the financial year, and bail-in exposure rose and then fell again (as a function of the total balances for investment), settling at a low level, both measures reflecting a greater investment balance in secured investments, which are not subject to bail-in risk as they provide collateral. The change in the weighted average maturity of investments over the period reflects the change in total balances for investment due to the receipt and subsequent expenditure of grant. The average rate of return (0.16%) was lower than at 31 March 2021, but with the benefit of higher rates for fixed investments made prior to the pandemic helping to offset returns at or close to 0% for many investments across the market. The Fire and Rescue Authority compared favourably with the other police and fire authorities in the benchmarking exercise across all metrics.

Externally managed pooled funds

44. In order to minimise the risk of receiving unsuitably low investment income, the Fire and Rescue Authority has continued to invest a proportion of steady core balances in externally managed pooled funds as part of its higher yielding strategy.

45. The CIPFA Code requires the Fire and Rescue Authority to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the Fire and Rescue Authority's investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long-term security of the Fire and Rescue Authority's investments.

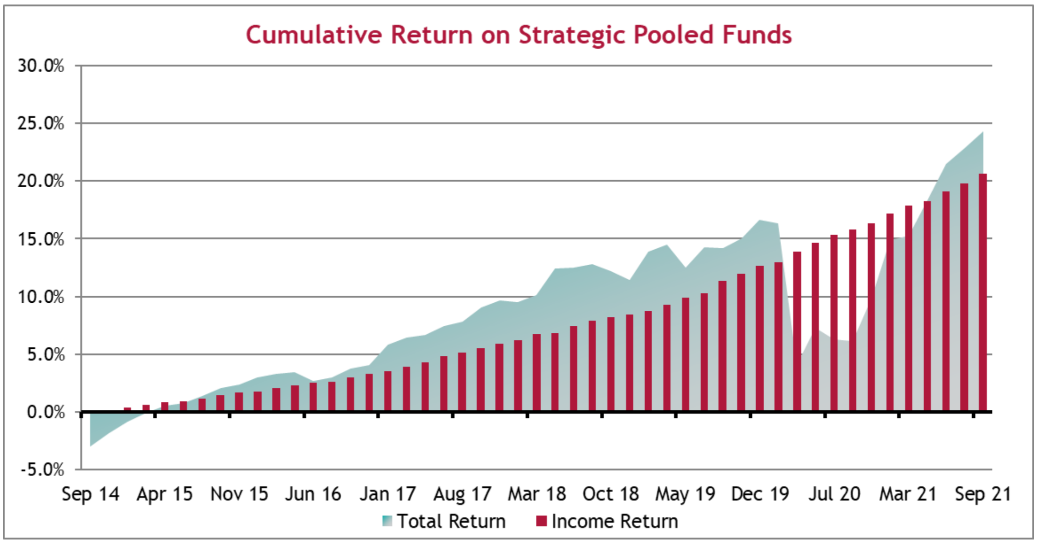
46. The Fire and Rescue Authority's investments in pooled funds fell considerably in value when the coronavirus pandemic hit world markets but have since recovered well. This recovery means these investments are now worth more in aggregate than the initial sums invested, as shown in Table 6, demonstrating the importance of taking a longer term approach and being able to ride out periods of market volatility, ensuring the Fire and Rescue Authority is not a forced seller at the bottom of the market.

Table 6 – Higher yielding investments – market value performance	Amount invested*	Market value at 30/09/21	Gain/(fall) in capital value	
			Since purchase	One year
	£m	£m	£m	£m
Pooled property funds	3.25	3.37	0.12	0.30
Pooled equity funds	2.00	2.17	0.17	0.50
Pooled multi-asset funds	1.75	1.72	(0.03)	0.14
Total pooled funds	**7.00**	**7.26**	**0.26**	**0.94**

47. The Fire and Rescue Authority's investments in pooled funds target long-term price stability and regular revenue income and bring significant benefits to the revenue budget. As shown in Table 7 the annualised income returns have averaged 4.49% pa (per annum) since purchase, contributing to a total return of 24.35% over their life.

Table 7 – Higher yielding investments – income and total returns since purchase	Annualised income return	Total return
	%	%
Pooled property funds	4.20	27.65
Pooled equity funds	5.08	32.57
Pooled multi-asset funds	4.43	8.69
Total pooled funds	**4.49**	**24.35**

48. The Fire and Rescue Authority's pooled fund investments continue to deliver income returns far in excess of what could be generated from cash investments. The cumulative total return from the Fire and Rescue Authority's investments in pooled equity, property and multi-asset funds since purchase is shown in the following graph. This highlights that the Fire and Rescue Authority has benefited from strong and steady income returns over time and the way that capital values have recovered since March 2020.



49. The IFRS 9 accounting standard that was introduced in 2018/19 means that annual movements in the capital values of investments need to be reflected in the revenue account on an annual basis, although a five year statutory override was put in place for local authorities that exempts them from complying with this requirement.

50. Pooled fund investments have no defined maturity date but are available for withdrawal after a notice period and their performance and continued suitability in meeting the Fire and Rescue Authority's investment objectives is monitored regularly and discussed with Arlingclose.

Non-Treasury Investments

51. Although not classed as treasury management activities the Fire & Rescue Authority may also make loans and investments for service purposes, for example the direct purchase of land or property. Such loans and investments will be subject to the Fire & Rescue Authority's normal approval processes for revenue and capital expenditure and need not comply with the treasury management strategy. The Fire & Rescue Authority does not have any existing non-treasury investments.

Compliance Report

52. The Fire and Rescue Authority confirms compliance of all treasury management activities undertaken during the period with the CIPFA Code of Practice and the Fire and Rescue Authority's approved Treasury Management Strategy.

53. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 8.

Table 8 – Debt limits	2021/22 Maximum £m	30/09/21 Actual £m	2021/22 Operational Boundary £m	2021/22 Authorised Limit £m	Complied?
Borrowing	(8.6)	(8.6)	(20.3)	(24.0)	✓
Other long-term liabilities	-	-	(5.0)	(5.0)	✓
Total debt	**(8.6)**	**(8.6)**	**(25.3)**	**(29.0)**	✓

54. The total actual debt as measured by the debt limits was £8.6m on 30 September 2021 which represents the use of £1.5m of the council's overdraft facility in addition to the £7.1m PWLB debt. On 30 September 2021 £1.5m principal was due to be returned to the Fire and Rescue Authority on maturity of a secured bond, however in error it was not released due to counterparty error and so the Fire and Rescue Authority was forced to use its overdraft facility with NatWest. This issue is currently being looked into by the custodian to understand why this event occurred.

55. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Treasury Management Indicators

56. The Fire and Rescue Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest rate exposures

57. The following indicator shows the sensitivity of the Fire and Rescue Authority's current investments and borrowing to a change in interest rates:

Table 9 – Interest rate risk indicator	30/09/21 Actual	Impact of +/-1% interest rate change
Sums subject to variable interest rates		
Investment	£32.5m	£0.4m
Borrowing	£0.0m	£0.0m

58. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity structure of borrowing

59. This indicator is set to control the Fire and Rescue Authority's exposure to refinancing risk. The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the Treasury Management Strategy Statement:

Table 10 – Refinancing rate risk indicator	**30/09/21 Actual**	**Upper Limit**	**Lower Limit**	**Complied**
Under 12 months	6%	50%	0%	✓
12 months and within 24 months	16%	50%	0%	✓
24 months and within 5 years	5%	50%	0%	✓
5 years and within 10 years	8%	75%	0%	✓
10 years and within 20 years	65%	75%	0%	✓
20 years and above	0%	100%	0%	✓

Principal sums invested for periods longer than a year

60. The purpose of this indicator is to control the Fire and Rescue Authority'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 were:

Table 11 – Price risk indicator	**2021/22**	**2022/23**	**2023/24**
Actual principal invested beyond year end	£9m	£7m	£7m
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	✓	✓	✓

61. The table includes investments in strategic pooled funds of £7m as although these can usually be redeemed at short notice, the Fire and Rescue Authority intends to hold these investments for at least the medium-term.

Other

Revisions to CIPFA Codes

62. In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

63. In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for 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.

- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.

- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.

- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).

- Prudential Indicators

    - New indicator for net income from commercial and service investments to the budgeted net revenue stream.

    - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.

    - Excluding investment income from the definition of financing costs.

- Incorporating Environmental, Social and Governance (ESG) issues as a consideration within TMP 1 Risk Management.

- Additional focus on the knowledge and skills of officers and elected members involved in decision making

MHCLG Improvements to the Capital Finance Framework

64. Ministry of Housing, Communities & Local Government (MHCLG – now known as Department for Levelling Up, Housing and Communities) published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that "while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk".

65. The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

66. A further consultation on these matters is expected soon.

Arlingclose's outlook for the remainder of 2021/22

	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	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

67. Arlingclose expects Bank Rate to rise in Quarter 2 2022. We believe this is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure.

68. Investors have priced in multiple rises in Bank Rate to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.

69. The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of 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. This is particularly apparent in the UK due to the impact of Brexit.

70. While Quarter 2 UK GDP expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Quarter 3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.

71. Inflation rose to 3.2% in August 2021. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

72. The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increased in wages is possible given the pressures on businesses.

73. Government bond yields increased sharply following the September Federal Open Market Committee (FOMC) and MPC minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.

74. The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

Appendix D – LGPS Discretions Policy