Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2021/22

1. 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 low 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, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities.

CIPFA defines treasury management as:

> *"The management of the local authority's borrowing, 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."*

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report that will provide the following:

- a high-level long-term 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 capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation as to why borrowing was required and why the Council has not adhered to the MHCLG Investment Guidance and CIPFA Prudential Code. *(Note that the Council has established a Commercial Investment Framework defining the risks, mitigation and objectives of commercial investment).*

If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

1.2.2 Treasury Management reporting

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

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
    - the capital plans, (including prudential indicators);
    - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
    - 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).

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

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

1.3 Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. The Cabinet undertakes this role.

1.4 Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

1.5 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Members undertook training on 26 June 2019 and further training will be arranged as required. The training needs of treasury management officers are reviewed periodically.

There is a post with specific responsibility for treasury management within the accountancy team and the Council is committed to ensuring the holder has relevant qualifications and has access to the training and support required to undertake this role.

In addition, the Council's treasury management team is a member of the South West Treasury Management Benchmarking Group hosted by Link Asset Services. This group has members from approximately 14 authorities and provides a forum for interpreting Treasury Management data across the area and sharing best practice. The group also allows the opportunity to consider any potential forthcoming treasury management risks, the early identification of which can aid proactive investment management.

The Council maintains an internal audit function through the South West Audit Partnership (SWAP). SWAP undertakes a periodic internal audit review of the treasury management function. In the latest audit by SWAP, which covered the 2018/19 financial year, the treasury management function was given a Reasonable Opinion.

Further review is also provided by the external audit team, who consider the reporting of treasury management data within the financial statements as part of their external audit opinion work.

1.6 Treasury management consultants

The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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 scope of investments within the Council's operations will include both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties. Commercial type investments require specialist advisers, and the Council will seek to appoint suitable specialist advisers in relation to this activity, as and when required.

1.7 Treasury Investments, Non-Financial Investments, Commercial Investments

The Capital Financing Requirement in the Treasury Management Strategy Statement, (this document), gives an holistic view of the Council's borrowing need, taking into account not only the capital expenditure planned on the Non-HRA and HRA but also the expenditure planned on Non-Financial Investments (i.e. service-related investments and loans) and Commercial Activity Investments. However, other than this, Non-Financial and Commercial investments are not dealt with in this document but in the separate Capital Strategy Statement.

2 THE CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2023/24

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

These indicators help show the effect of the financing and borrowing strategy that the Council plans to adopt over the next three financial years.

The indicators also act as an early warning system, to flag up if the Council decides to set capital programmes without the necessary finances to fund them.

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. Members are asked to approve the capital expenditure forecasts.

Capital expenditure (Gross)	**2019/20 Actual £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**
Non-HRA	**4,207**	**18,983**	**4,694**	**540**	**541**
HRA	**7,666**	**5,206**	**4,906**	**4,906**	**4,906**
Non-financial investments [1]	**0**	**1,230**	**0**	**0**	**0**
Commercial activities [1]	**2,809**	**0**	**0**	**0**	**0**
Total Capital Expenditure	**14,682**	**25,419**	**9,600**	**5,446**	**5,447**

1 *Commercial activities and non-financial investments relate respectively to areas such as capital expenditure on investment properties, loans to third parties etc.*

2 *Other long-term liabilities: the above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.*

The table below summarises the above capital expenditure plans and how they are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of capital expenditure	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Total Capital Expenditure	**14,682**	**25,419**	**9,600**	**5,446**	**5,447**
Capital receipts [3]	(12,534)	(600)	(600)	(600)	(600)
Capital grants	(1,011)	(4,749)	(1,635)	(754)	(754)
Capital reserves	(3,912)	(4,406)	(4,406)	(4,406)	(4,406)
Revenue	(2,390)	(2,147)	(979)	0	0
Financed in year	**(19,847)**	**(11,902)**	**(7,620)**	**(5,760)**	**(5,760)**
(Surplus Receipts) / Net financing need for the year [3]	**(5,165)**	**13,517**	**1,980**	**(314)**	**(313)**

3 *Capital Receipts in 2019/20 include the Non-HRA receipt from the sale of Knowle. This reduces the overall net financing need for that year.*

4 *The net financing need for non-financial investments/ commercial activities* ***included*** *in the above tables is shown below:*

Non-financial investments & commercial activities	*2019/20 Actual £000*	*2020/21 Estimate £000*	*2021/22 Estimate £000*	*2022/23 Estimate £000*	*2023/24 Estimate £000*
Capital Expenditure	*2,809*	*1,230*	*0*	*0*	*0*
Financing	*0*	*0*	*0*	*0*	*0*
Net financing need for the year	***2,809***	***1,230***	***0***	***0***	***0***
Percentage of total net financing need % [3]	***(54.3)%***	***9.1%***	***0%***	***0%***	***0%***

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 indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not been paid for immediately through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge that broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities (e.g. PFI and finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to borrow separately for these schemes. The Council currently has no such schemes within the CFR.

The Council is asked to approve the CFR projections below:

	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Capital Financing Requirement					
CFR Non-HRA	2,146	14,436	15,931	15,075	14,257
CFR HRA	80,595	80,595	80,595	80,595	80,595
CFR Non-financial investments	4,621	4,262	3,877	3,129	3,028
CFR Commercial activities	2,809	2,739	2,671	2,604	2,539
Total CFR	**90,171**	**102,032**	**103,074**	**101,403**	**100,419**
Movement in CFR	**(5,220)**	**11,861**	**1,042**	**(1,671)**	**(984)**

Movement in CFR represented by					
(Surplus Receipts) / Net financing need for the year	(5,165)	13,517	1,980	(314)	(313)
Less MRP/VRP and other financing movements*	(55)	(1,656)	(938)	(1357)	(671)
Movement in CFR	**(5,220)**	**11,861**	**1,042**	**(1,671)**	**(984)**

** MRP = Minimum Revenue Provision. VRP = Voluntary Revenue Provision. Other financing movements will include any PFI/ finance lease annual principal amounts*

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in section 2.1 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Council's remaining activity.

2.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options is provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement*:*

For all unsupported borrowing, (including finance leases), the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3).

This option provides for a reduction in the borrowing need over approximately the asset's life. The use of this option by EDDC is consistent with the prior year.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2020 the total VRP overpayments, (wholly in respect of the HRA), were £4,424,409.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service 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 service activity and the Council's capital strategy. 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.

3.1 Current portfolio position

The overall treasury management portfolio as at 31 March 2020 and for the position as at 31 December 2020 are shown below for both borrowing and investments.

A more detailed schedule of investments and borrowing can be found in Appendix 5.6.

TREASURY PORTFOLIO				
	Actual	Actual	Current	Current
	31.3.20	**31.3.20**	**31.12.20**	**31.12.20**
Treasury investments	**£000**	**%**	**£000**	**%**
Banks	2,000	4.1%	6,000	7.9%
Building Societies - unrated	6,000	12.2%	10,000	13.2%
Building Societies - rated	3,000	6.1%	20,000	26.4%
Local Authorities	0	0.0%	3,000	4.0%
DMADF (H.M.Treasury)	0	0.0%	2,200	2.9%
Money Market Funds	8,500	17.3%	3,450	4.6%
Total managed in house	**19,500**	**39.7%**	**44,650**	**59.0%**
Money Market Funds*	29,604	60.3%	31,061	41.0%
Property Funds	0	0.0%	0	0.0%
Total managed externally	**29,604**	**60.3%**	**31,061**	**41.0%**
Total treasury investments	**49,104**	**100.0%**	**75,711**	**100.0%**
Treasury external borrowing				
Local Authorities	0	0.0%	0	0.0%
PWLB	91,225	100.0%	88,802	100.0%
Total external borrowing	**91,225**	**100.0%**	**88,802**	**100.0%**
Net treasury investments / (borrowing)	**(42,121)**	**0.0%**	**(13,091)**	**0.0%**
** market value*				

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Actual Gross External Debt					
Borrowing at 1 April	90,193	93,759	98,477	97,291	95,435
Other long-term liabilities (OLTL) at 1 April	0	0	0	0	0
Gross Debt at 1 April	**90,193**	**93,759**	**98,477**	**97,291**	**95,435**
Expected change in borrowing	3,566	4,718	(1,186)	(1,856)	(1,227)
Expected change in OLTL	0	0	0	0	0
Gross debt at 31 March	**93,759**	**98,477**	**97,291**	**95,435**	**94,208**
Capital Financing Requirement	**90,171**	**102,032**	**103,074**	**101,403**	**100,419**
Under / (over) borrowing	(3,588)	3,555	5,783	5,968	6,211

Within the above figures, the level of debt relating to non-financial investments/ commercial activities is:

	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
External Debt for commercial investments / non-financial investments					
Non-Financial Investments	2,662	2,326	2,255	1,532	1,458
Commercial Activities	0	0	0	0	0
Gross debt at 31 March	**2,662**	**2,326**	**2,255**	**1,532**	**1,458**
Percentage of total external debt %	2.84%	2.36%	2.32%	1.61%	1.55%

Within the range of 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 2021/22 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 or speculative purposes.

The Section 151 Officer 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 this budget report.

3.2 Treasury Indicators: limits to borrowing activity

3.2.1 The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources. An additional £2.0m has been included to allow for potential increases in debt that might result from accounting changes following the implementation of IFRS 16 Leases on 1 April 2022: (other long-term liabilities).

Operational boundary	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Debt HRA/ non-HRA	96,159	96,151	95,036	93,902
Other long term liabilities	2,000	2,000	2,000	2,000
Non-Financial Investments	2,662	2,326	2,255	1,533
Commercial investments	0	0	0	0
Total	**100,821**	**100,477**	**99,291**	**97,435**

3.2.2 The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It 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.

1. 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.
2. The Council is asked to approve the following authorised limit:

Authorised limit	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Borrowing	104,991	104,655	103,477	101,629
Other long term liabilities	2,000	2,000	2,000	2,000
Total	106,991	106,655	105,477	103,629

The authorised limit includes an additional amount as headroom for unanticipated cash movements, including those due to slippage.

Within the above, headroom for the Non-HRA is set at £3.0m, and an additional £2.0m has been included to allow for potential increases in debt that might result from accounting changes following the implementation of IFRS 16 Leases on 1 April 2022: (other long term liabilities).

Also within the above, for the HRA, a debt cap of £87.844m set by the Government as the authorised limit has been used; although the Government abolished HRA debt caps in October 2018, the Council still uses it internally to define the maximum HRA CFR limit for its HRA self-financing regime. This internal limit is currently:

HRA Debt Limit	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
HRA debt cap	87,844	87,844	87,844	87,844
HRA CFR	80,595	80,595	80,595	80,595
HRA headroom	7,249	7,249	7,249	7,249

3.3 Prospects for interest rates

See the Appendix, section 5.2.1.

3.4 Borrowing strategy

The Council has moved from an over-borrowed position in 2019/20, (following borrowing for the HRA at the year-end, in advance of need) and 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 counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was 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 was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

In practice therefore, the borrowing strategy is dependent on the amount and timing of capital expenditure, given the market conditions at the time, and the capital-financing requirement is likely to be funded via a combination of external fund disinvestment and/or loans from the PWLB.

- *Whilst interest rates are low, the Council plans to continue to re-finance its self-financing HRA loans as they mature each year. It plans to re-finance them over 50 years.*

3.5 Cash Flow or Temporary Borrowing

In addition to borrowing for capital purposes, the Council also borrows in the short-term to meet day-to-day shortages in its call account. This borrowing requirement is inherent within the operation of this account and is normally covered overnight via the call account overdraft and cleared the next day.

In some instances, particularly around the year-end, the overdraft may not provide a sufficient short-term buffer, and in these instances, the Council can borrow via the market at fixed rates for a fixed term of less than 3 months.

Currently there is no indication that such borrowing will be required at the end of 2020/21.

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

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than the expected increase in borrowing need (CFR) over the three year planning period; and
- The authority would not look to borrow more than 12 months in advance of need.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.7 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

If rescheduling is done, it will be reported to Cabinet at the earliest meeting following its action.

4. ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

The MHCLG and CIPFA have extended the meaning of ‘investments’ to include both financial investments 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).

The Council’s investment policy has regard to the following: -

- MHCLG’s Guidance on Local Government Investments (“the Guidance”)
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
- CIPFA Treasury Management Guidance Notes 2018

The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return).

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets.

3. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 5.4 under the categories of ‘specified’ and ‘non-specified’ investments.

    a. **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.

    b. **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

4. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being £20m of the total investment portfolio at the point of investment, (see section 5.4).

5. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the table in section 4.3.

6. Only the Council’s external funds can be invested for **longer than 365 days [1]**, (see section 5.1.4).

    [1] Allowing additional day(s) for deposits due to mature on a non-business day or that span a leap year.

7. All investments will be denominated in **sterling**.

8. As a result of the change in accounting standards for 2020/21 under IFRS 9, this authority will consider the implications of investment instruments that could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23.)

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see section 4.7). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.
The above criteria are unchanged from last year.

4.2 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment section 5.4; and

- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Strategic Lead Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those that determine which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality that the Council may use, rather than defining what types of investment instruments are to be used.

Counterparty ratings are monitored on a real time basis via notifications received from Link Asset Services as the agencies publish modifications. In addition a full review of the counterparty list is carried out on a regular basis.

The security of the Council's financial assets is paramount, and whilst the strategy needs to be clear in this area it also needs be sufficiently comprehensive and itterative in order to provide operational flexibility within, what at times, is a volatile macroeconomic environment. As the financial backdrop changes it is essential that the strategy is set to enable an efficient response to those changes.

The Council manages the majority of its internal investments via money market funds and a range of banks and building societies in line with the creditworthiness criteria referred to below. Additionally the Council has opened a Debt Management Deposit Account Facility with the UK Government's Debt Management Office.

In order to address the need for flexibilty, and to ensure the spread of risk, access to an investment portal has been arranged which allows officers to review and potentially transact with a small range of money market funds directly. All money market funds considered suitable with reference to the creditworthiness criteria will be approved for use by the S.151 Officer before an account is opened. The Council currently has access to three money market funds; if appropriate operationally, consideration will be given to opening additional money market funds in the future.

This strategy was changed to include corporate bonds within its creditworthiness criteria for the first time in 2016/17. Investments in corporate bonds are limited to a duration of less than 1 year, must be AAA rated and have a maximum value of £2m per investee. The Council will not trade corporate bonds directly, but will trade via a specialist investment intermediary, whose fee is linked to the return. Given the short duration it is anticipated the majority of trades will be via the secondary market.

In the 2018/19 Treasury Management Strategy, the Council approved the inclusion of alternative investments such as Property Funds in Non-Specified Investments.

The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be carried out before investment of this type is undertaken.

4.3 Creditworthiness Criteria

The Council's proposed creditworthiness criteria are included in the table below.

Creditworthiness Criteria		
External (Long Term) Investment Fund	**Criteria**	**Maximum Money and/ or % Investment Limit**
Collective Investment Schemes (e.g. bond funds)	AAA long-term rating backed up with lowest volatility (V1/S1)	60% of External Fund total
Alternative Investment Funds e.g. property funds	The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be carried out before investment of this type is undertaken.	£10m
Cash Flow/ Internal Investments		
Deposit Building Societies	With over £5 Billion in total assets	£3m
Deposit Building Societies	With over £1 Billion in total assets	£2m
Deposit with UK incorporated banks	Minimum F1, A1 or P1 short term backed up by A long term credit rating	£2m
Deposit with banks incorporated outside the UK but entitled to accept deposits in the UK	Minimum F1+, A1+ or P1+ short term backed up by AA- long term credit rating	£2m
Money Market Funds	AAA Long Term Rating	£3m
UK Local, Police & Fire Authorities		£3m
UK Government Treasury Bills/ Gilts/ Debt Management Deposit Facility		No limit
Corporate Bonds	AAA and less than one year duration	£2m
The "deposits "referred to in the above table relate either to cash, floating rate notes or certificates of deposit.		

The Council will not invest in subsidiaries that do not have a credit rating in their own right and a separate FSA licence from the parent company.

In the event of a downgrade resulting in a counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

Any changes in counterparty ratings or other criteria that put the counterparty below the minimum criteria whilst the Council holds a deposit will be brought to the attention of the Strategic Lead Finance and the Portfolio Holder for Finance immediately, with an appropriate response decided on a case-by-case basis.

The Council's current counterparty list is included at section 5.5.

It is recommended that Cabinet approves the creditworthiness criteria above.

The proposed criteria for specified and non-specified investments are shown in Appendix 5.4 for approval.

4.4 Investment strategy

4.4.1 In-house funds.

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. While most cash balances are required in order to manage the ups and downs of cash flow, 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.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

4.4.2 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	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Long term later years	2.00%

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what deal the UK has agreed as part of Brexit.

- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter-term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

4.4.3 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, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. 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.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around 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.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home, at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

4.5 Investment performance / risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID, (compounded for external investments and uncompounded for internal investments). The Council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors in determining suitable replacement investment benchmark(s) ahead of this cessation and will report back to members accordingly.

4.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

4.7 External fund managers

The Council currently has the following amounts invested:

External Funds	Fitch International Fund Quality Rating	Fitch Fund Market Sensitivity Rating	Total Investment (market value)
			£M
Pooled Investment Vehicles, OEICS			
Royal London Asset Management - Cash Plus Fund	AAAf	S1	15.514
Payden & Rygel - Sterling Reserve Fund	AAAf	S1	15.547
			31.061

The AAAf Fund Quality Credit Rating reflects the very high credit quality of a fund, as measured by its weighted average rating factor.

The S1 Fund Market Sensitivity Rating reflects a fund's very low sensitivity to market risk factors. It also takes into account the investment advisor’s strong capabilities as well as the fund’s sound legal and regulatory environment.

5 APPENDICES

5.1 CAPITAL PRUDENTIAL & TREASURY INDICATORS 2021/22 – 2023/24

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

5.1.1 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. Members are asked to approve the capital expenditure forecasts.

Capital expenditure	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
Non-HRA	4,207	18,983	4,694	540	541
HRA	7,666	5,206	4,906	4,906	4,906
Non-financial investments [1]	0	1,230	0	0	0
Commercial activities [1]	2,809	0	0	0	0
Total Capital Expenditure	**14,682**	**25,419**	**9,600**	**5,446**	**5,447**

1 *Commercial activities and non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.*

2 *Other long-term liabilities: the above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.*

5.1.2

5.1.2 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:

a. 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.

The estimates of financing costs include current commitments and the proposals in this budget report.

	2019/20 Actual %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %
Non-HRA	(1.77)	(0.69)	2.88	3.13	2.74
HRA	15.20	14.98	14.77	14.33	13.84
Non-Financial Investments/ Commercial Activities	(0.55)*	(1.85)	(0.94)	(0.89)	(0.89)
Total	12.88	12.44	16.71	16.57	15.69

** revised*

A positive figure in the table above indicates external debt: the estimation that interest payable on borrowing is higher than investment income received.

A negative figure reflects the estimation that a higher level of investment income is received compared to that paid out in borrowing.

The negative figures in the Non-HRA figure in 2019/20 and 2020/21 reflect the impact of the receipt of the sale proceeds of Knowle on investment balances, though the sharp decline in investment interest rates have affected later years. It also reflects an increase in external debt to fund capital expenditure in the later years.

The negative figure for Non-Financial Investments/ Commercial activities increases in 2020/21, reflecting the commencement of the return from the property investment made at the end of 2019/20.

b. HRA ratio

	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000
HRA debt	84,674	84,666	84,658	84,649	84,640
HRA debt cap	87,844	87,844	87,844	87,844	87,844
HRA revenues	17,905	18,333	18,771	19,171	19,579
	%	**%**	**%**	**%**	**%**
Ratio of debt to revenues %	**472.9%**	**461.8%**	**451.0%**	**441.5%**	**432.3%**

This indicator identifies the trend in the level of debt (borrowing and other long-term obligations).

5.1.3 Maturity structure of borrowing

Maturity structure of borrowing. *(This is the amount of projected long-term borrowing that is due for repayment in each period, expressed as a percentage of total borrowing).* These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

At any point, the actual percentages of debt projected to mature in each year will add up to 100%, but the proposed indicator is for a range of approved percentages. This gives discretion within an approved range to the treasury team. It does mean that each 'set' of figures will sum to more than 100%.

The Council is asked to approve the following treasury indicators and limits:

Maturity structure of fixed interest rate borrowing 2021/22			
		Lower	**Upper**
Under 12 months	2021/22	0%	20%
12 months to 2 years	2022/23	0%	20%
2 years to 5 years	2023/24 – 2025/26	0%	25%
5 years to 10 years	2026/27 – 2030/31	0%	25%
10 years to 20 years	2031/32 – 2040/41	0%	50%
20 years to 30 years	2041/42 – 2050/51	0%	20%
30 years to 40 years	2051/52 – 2060/61	0%	20%
40 years to 50 years	2061/62 – 2070/71	0%	20%

Within the HRA, the majority of the loans are over the longer term, as aligned to the HRA business plan, resulting in the upper limit being higher from years 2 - 5 onwards. In addition, projected borrowing for commercial investments, (if any, though there is currently none), acts to increase the upper limit.

The upper limits on the maturity structure of borrowing will shift slightly each year as the maturity dates draw closer. However, the limits shown are in line with expectations based on the funding plans.

In addition to the above, the Council has an overdraft limit of £0.35m and can, if required, borrow for periods less than 3 months at fixed rates, in order to meet daily cash flow requirements. The Strategy is managed to avoid short-term fixed borrowing where possible. With the exception of the bank overdraft therefore, all borrowing the Council undertakes is at a fixed rate of interest.

The actual amounts maturing in each period are shown in the table below and reflect both the actual and potential loan commitments as referred to elsewhere within this strategy.

Based on capital borrowing plans included in the budget and plans for non-financial loans, the current projected maturity structure of borrowing is shown below:

Maturity structure of fixed interest rate borrowing 2021/22			
		£000	%
Under 12 months	2021/22	4,714	4.30%
12 months to 2 years	2022/23	3,797	3.46%
2 years to 5 years	2023/24 – 2025/26	18,804	17.16%
5 years to 10 years	2026/27 – 2030/31	18,314	16.71%
10 years to 20 years	2031/32 – 2040/41	46,643	42.55%
20 years to 30 years	2041/42 – 2050/51	318	0.29%
30 years to 40 years	2051/52 – 2060/61	0	0.00%
40 years to 50 years	2061/62 – 2070/71	8,252	7.53%
51 years to 60 years	2071/72 – 2080/81	8,770	8.00%
Total		**109,612**	**100.00%**

5.1.4 Upper Limit for Total Principal Sums invested over 365 days

This limit is set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. The Council is asked to confirm approval that only external investments, (i.e. those managed by external fund managers), can be invested for over 365 days[1]. Currently the Council has £31.061m in specified investments with external fund managers. Although these investments have been held continuously for over 365 days, in practice, the Council has been free to access the funds on quarter days without loss of income or access the funds with 3 days' notice, if necessary.

[1] Allowing additional day(s) for deposits due to mature on a non-business day or that span a leap year.

5.2 INTEREST RATES

5.2.1 The Prospects for Interest Rates

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 11.8.20. However, following the conclusion of the review of PWLB margins over gilt yields on 25.11.20, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps:

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
BANK RATE	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

Additional notes by Link on this forecast table: -

- *Please note that we have made a slight change to our interest rate forecasts table above for forecasts for 3, 6 and 12 months. Traditionally, we have used LIBID forecasts, with the rate calculated using market convention of 1/8th (0.125%) taken off the LIBOR figure. Given that all LIBOR rates up to 6m are currently running below 10bps, using that convention would give negative* *figures as forecasts for those periods. However, the liquidity premium that is still in evidence at the short end of the curve means that the rates actually being achieved by local authority investors are still modestly in positive territory. While there are differences between counterparty offer rates, our analysis would suggest that an average rate of around 10 bps is achievable for 3 months, 10bps for 6 months and 20 bps for 12 months.*

- *During 2021, Link will be continuing to look at market developments in this area and will monitor these with a view to communicating with clients when full financial market agreement is reached on how to replace LIBOR. This is likely to be an iteration of the overnight SONIA rate and the use of compounded rates and Overnight Index Swap (OIS) rates for forecasting purposes.*
- *We will maintain continuity by providing clients with LIBID investment benchmark rates on the current basis.*

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 to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, 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. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20: as this has now occurred, these forecasts do not need to be revised.

Gilt yields / PWLB rates

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore 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 so far 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 9th 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. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. *(Please note that Link has concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects.)* It also introduced the following rates for borrowing for different types of capital expenditure: -

    - **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
    - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
    - **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)

- 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 25.11.20, 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 that 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 Councils will assess their risk appetites 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.

5.2.2 Interest Rate Forecasts 2020 – 2024

PWLB forecasts are based on PWLB certainty rates.

The PWLB rates below are based on the new margins over gilts announced on 26th November 2020. PWLB forecasts shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012. There are no changes to these forecasts as at 5.1.21.

Link Group Interest Rate View 9.11.20 (The Capital Economics forecasts were done 11.11.20)
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20

	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
BANK RATE	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
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
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
5 yr PWLB	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	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	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	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Bank Rate													
Link	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
Capital Economics	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
5yr PWLB Rate													
Link	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
Capital Economics	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	-	-	-	-	-
10yr PWLB Rate													
Link	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
Capital Economics	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	-	-	-	-	-
25yr PWLB Rate													
Link	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
Capital Economics	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	-	-	-	-	-
50yr PWLB Rate													
Link	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
Capital Economics	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	-	-	-	-	-

5.3 ECONOMIC BACKGROUND

- **UK.** The key quarterly meeting of the Bank of England Monetary Policy Committee kept **Bank Rate** unchanged on 5th November. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".

- Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:
  - The economy would recover to reach its pre-pandemic level in Q1 2022
  - The Bank also expected there to be excess demand in the economy by Q4 2022.
  - CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- One key addition to **the Bank's forward guidance in August** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years due as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. **Inflation** is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.
- However, the minutes did contain several references to **downside risks**. The MPC reiterated that the "recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside". It also said "the risk of a more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. **Upside risks** included the early roll out of effective vaccines.

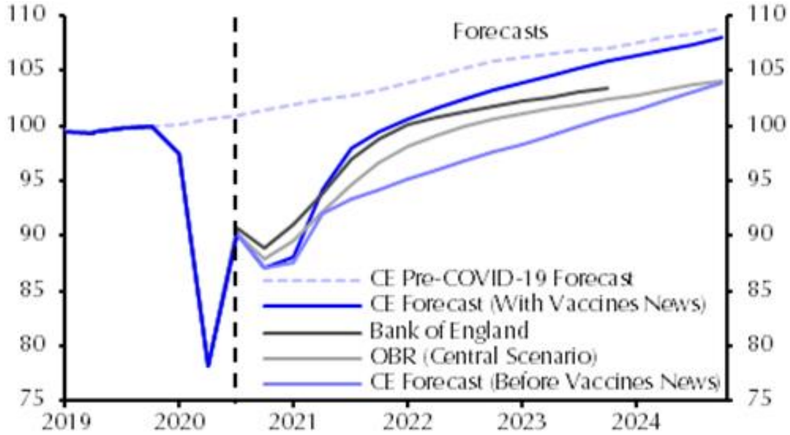
- **COVID-19 vaccines.** We had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines that might otherwise have been expected. However, this vaccine has demanding cold storage requirements of minus 70C that impairs the speed of application to the general population. It has therefore been particularly welcome that the Oxford University/AstraZeneca vaccine has now also been approved which is much cheaper and only requires fridge temperatures for storage. The Government has 60m doses on order and is aiming to vaccinate at a rate of 2m people per week starting in January, though this rate is currently restricted by a bottleneck on vaccine production; (a new UK production facility is due to be completed in June).

- These announcements, plus expected further announcements that other vaccines will be approved soon, have enormously boosted confidence that **life could largely return to normal during the second half of 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels; this would help to bring the unemployment rate down. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could begin to be eased, beginning possibly in Q2 2021, once vulnerable people and front-line workers have been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% in 2021 instead of 9%. **Public borrowing** was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. It is likely that the one month national lockdown that started on 5th November, will have caused a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.

- **December 2020 / January 2021**. Since then, there has been a rapid back tracking on easing restrictions due to the spread of a new mutation of the virus by the imposition of severe restrictions across all four nations. These restrictions were changed on January 5th to national lockdowns of various initial lengths in each of the four nations as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under severe restrictions for some months; this means that the near-term outlook for the economy is grim. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow GDP to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022. Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant caveat is that another mutation of COVID-19 does not appear that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development and vaccine production facilities are being ramped up around the world.

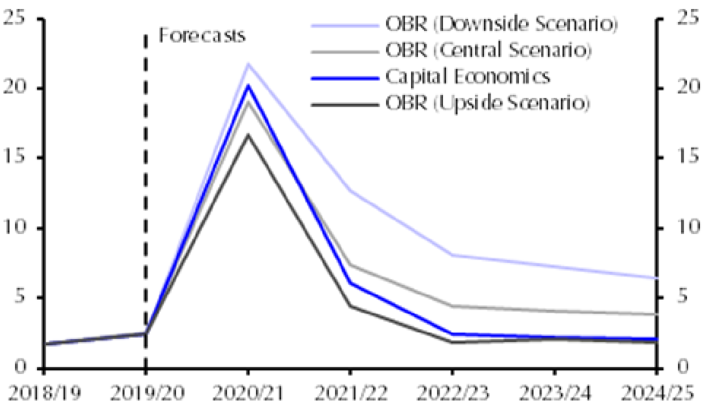
Chart: Level of real GDP   (Q4 2019 = 100)



(if unable to print in colour…... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade would have major repercussions for public finances as it would be consistent with the **government deficit** falling to around 2.5% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario that predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assumed that there is a reasonable Brexit deal and also that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.

Chart: Public Sector Net Borrowing (As a % of GDP)



(if unable to print in colour…... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

- There will still be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

- **Brexit.** While the UK has been gripped by the long running saga of whether or not a deal would be made by 31st December, the final agreement on December 24th, followed by ratification by Parliament and all 27 EU countries in the following week, has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

Monetary Policy Committee meeting of 17 December. All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy it had highlighted in November. But this was caveated by it saying "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." So, while the vaccine is a positive development, in the eyes of the MPC at least, the economy is far from out of the woods. As a result of these continued concerns, the MPC voted to extend the availability of the Term Funding Scheme with additional incentives for small and medium size enterprises for six months from 30th April until 31st October 2021. *(The MPC had assumed that a Brexit deal would be agreed.)*

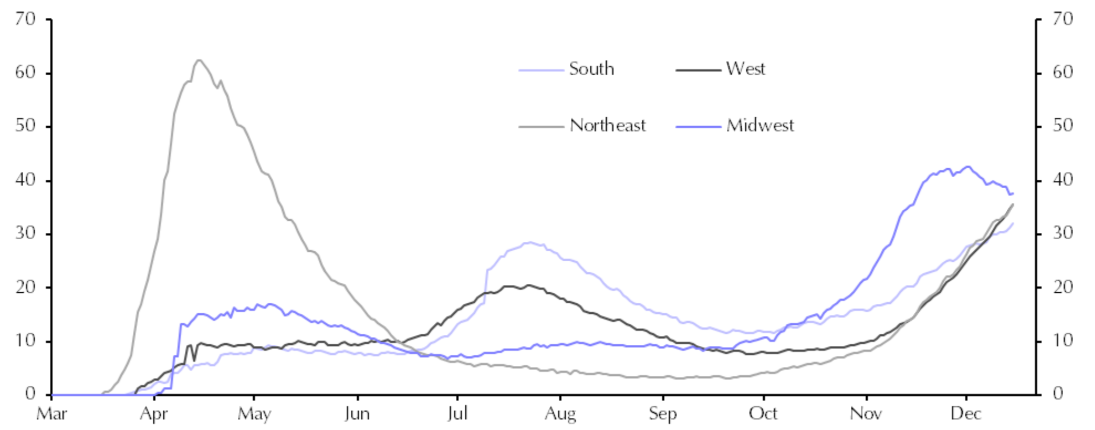
- **Fiscal policy.** In the same week as the MPC meeting, the Chancellor made a series of announcements to provide further support to the economy: -
    - An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
    - The furlough scheme was lengthened from the end of March to the end of April.
    - The Budget on 3rd March 2021 will lay out the "next phase of the plan to tackle the virus and protect jobs". This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

- The **Financial Policy Committee** (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

US. The result of **the November elections** means that while the Democrats gained the presidency and a majority in the House of Representatives, it looks as if the Republicans could retain their slim majority in the Senate provided they keep hold of two key seats in Georgia in elections in early January. If those two seats do swing to the Democrats, they will then control both Houses and President Biden will consequently have a free hand to determine policy and to implement his election manifesto.

The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the **pandemic** with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the third wave in the Midwest looks as if it now abating. However, it also looks as if the virus is rising again in the rest of the country. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter-term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

COVID-19 hospitalisations per 100,000 population



(if unable to print in colour…... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

The restrictions imposed to control its spread are once again weighing on the economy with employment growth slowing sharply in November and retail sales dropping back. The economy is set for further weakness in December and into the spring. However, a $900bn fiscal stimulus deal passed by Congress in late December will limit the downside through measures which included a second round of direct payments to households worth $600 per person and a three-month extension of enhanced unemployment insurance (including a $300 weekly top-up payment for all claimants). GDP growth is expected to rebound markedly from the second quarter of 2021 onwards, as vaccines are rolled out on a widespread basis and restrictions are loosened.

- After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

- The Fed's meeting on **5 November** was unremarkable - but at a politically sensitive time around the elections. At its **16 December** meeting the Fed tweaked the guidance for its asset purchases in the statement issued after the conclusion of today's FOMC meeting, with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that inflation will only get back to 2.0% in 2023, the vast majority expect the fed funds rate to be still at near-zero until 2024 or later. Furthermore, the new rate forecast tables reveal that officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – which will also have an influence on gilt yields in this country.

- **EU.** In early December, the figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3, the economy grew by 12.5% q/q leaving GDP down by "only" 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Q4, and in Q1 of 2021, as a second wave of the virus has affected many countries: it is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected countries.

- With inflation expected to be unlikely to get much above 1% over the next two years, **the ECB** (European Central Bank) has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities until December 2023. Three additional tranches of TLTRO (cheap loans to banks) were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022.

The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support.

However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before quarter 2 of 2021.

China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies.

However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

- **Japan.** A third round of stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That is huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal arrow should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

World growth. World growth will have been in recession in 2020. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

Summary

Central banks are, therefore, likely to support growth by maintaining loose monetary policy through keeping rates very low for longer. Governments could also help a quicker recovery by providing more fiscal support for their economies at a time when total debt is affordable due to the very low rates of interest. They will also need to avoid significant increases in taxation or austerity measures that depress demand in their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

The graph below as at 10th November, shows how the 10 and 30 year gilt yields in the UK spiked up after the Pfizer vaccine announcement on the previous day, (though they have levelled off during late November at around the same elevated levels): -

(if unable to print in colour…... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

INTEREST RATE FORECASTS

Brexit. The interest rate forecasts provided by Link in paragraph 3.3 (see Appendix 5.2.1) were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. There is therefore no need to revise these forecasts now that a trade deal has been agreed.

Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is still subject to some uncertainty due to the virus and the effect of any mutations, and how quick vaccines are in enabling a relaxation of restrictions.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **UK government** takes too much action too quickly to raise taxation or introduce austerity measures that depress demand in the economy.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next two or three years. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she will remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU which had threatened to derail the 7 year EU budget until a compromise was thrashed out in late 2020. . There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **UK -** a significant rise in inflationary pressures e.g. caused by a stronger than currently expected recovery in the UK economy after effective vaccines are

administered quickly to the UK population, leading to a rapid resumption of normal life and return to full economic activity across all sectors of the economy.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a rapid series of increases in Bank Rate to stifle inflation.

5.4 CRITERIA FOR SPECIFIED AND NON-SPECIFIED INVESTMENTS

Specified Investments are required to be in Sterling and have a maximum maturity of 1 year [1] and be of 'high credit quality'.

[1] Allowing additional day(s) for deposits due to mature on a non-business day or that span a leap year.

The definition of 'high credit quality' is set out below:

- Investments in Banks incorporated in the UK with a credit rating of at least A/F1, A1 or P1 with a limit of £2m on the amount invested.

- Investments in Banks incorporated outside of the UK but entitled to accept deposits in the UK, per the Bank of England Prudential Regulation Authority list of banks, with a credit rating of at least AA-/F1+/A1+/P1 with a limit of £2m on the amount invested.

- Investments in collective investment schemes, including money market funds, structured as Open Ended Investment Companies (OEIC's) with a long-term rating of AAA for Constant Net Asset Value (CNAV) funds and Low Volatility Net Asset Value (LVNAV) funds and AAA V1/S1 for Variable Net Asset Values (VNAV).

- Internal Investments up to 9 months [*revised from 6 months*], up to agreed limits, in UK Building Societies with an asset basis of over £1 billion.

- Corporate bonds rated AAA of less than one-year duration.

- The UK Government Debt Management Office's Debt Management Account Deposit Facility

- Local Authorities with a limit of £3m on the amount invested with each.

Non-Specified Investments are all investments over 1 year in duration and/or not meeting the definition of high credit quality listed above.

The Council amended its strategy in the 2018/19 Treasury Management Strategy Document to include Alternative Investment Instruments, such as Property Funds, in the Non-Specified Investment category. The use of these Alternative Investment Instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any such fund it may consider using. Appropriate due diligence will also be carried out before investment of this type is undertaken.

The Council limits non-specified treasury investments to £20m of the value of its investment portfolio at the point of investment, with the maximum amount invested being in line with criteria outlined in the Table above.

5.5 INTERNAL COUNTERPARTY LIST 2020/21 AS AT 31 DECEMBER 2020

(Time limit 365 days [1] unless specifically stated)

[1] Allowing additional day(s) for deposits due to mature on a non-business day or that span a leap year.

UK High Street Banks			
UK or Irish bank with presence in UK and a short-term Fitch rating of F1 or higher	**Long-Term Fitch Rating**	**Short-Term Fitch Rating**	**Max Investment £**
Lloyds Banking Group			
Lloyds Bank plc (RFB)	A+	F1	2,000,000
Lloyds Bank Corporate Markets (NRFB)	A+	F1	2,000,000
Bank of Scotland plc (RFB)	A+	F1	2,000,000
Others			
Barclays Bank UK plc (RFB)	A+	F1	2,000,000
Barclay Bank plc (NRFB)	A+	F1	2,000,000
Handelsbanken plc	AA	F1+	2,000,000
HSBC UK Bank plc (RFB)	AA-	F1+	2,000,000
HSBC Bank plc (NRFB)	AA-	F1+	2,000,000
National Westminster Bank plc (RFB)	A+	F1	2,000,000
Santander UK plc	A+	F1	2,000,000
The Royal Bank of Scotland plc (RFB)	A+	F1	2,000,000

Building Societies (time limit: up to 9 months; [*revised from 6 months*])				
		Total Assets of Building Society £000	**Assets > £1 Billion**	**Max Investment £**
1	Nationwide	245,732,000	Yes	3,000,000
2	Yorkshire	52,814,800	Yes	3,000,000
3	Coventry	48,771,000	Yes	3,000,000
4	Skipton	23,647,800	Yes	3,000,000
5	Leeds	21,161,500	Yes	3,000,000
6	Principality	10,483,100	Yes	3,000,000
7	West Bromwich	5,565,100	Yes	3,000,000
8	Newcastle	4,411,800	Yes	2,000,000
9	Nottingham	3,830,900	Yes	2,000,000
10	Cumberland	2,661,319	Yes	2,000,000
11	National Counties	2,374,092	Yes	2,000,000
12	Progressive	1,838,006	Yes	2,000,000
13	Cambridge	1,585,921	Yes	2,000,000
14	Monmouthshire	1,247,461	Yes	2,000,000
15	Newbury	1,233,682	Yes	2,000,000
16	Leek United	1,091,348	Yes	2,000,000
17	Saffron	1,070,066	Yes	2,000,000
18	Furniss	1,001,530	Yes	2,000,000

Non UK Banks			
	Long-Term Fitch Rating	Short-Term Fitch Rating	Max Investment £
Abu Dhabi (U.A.E)			
First Abu Dhabi Bank PJSC	AA-	F1+	2,000,000
Canada			
Bank of Montreal	AA-	F1+	2,000,000
Bank of Nova Scotia	AA-	F1+	2,000,000
Canadian Imperial Bank of Commerce	AA-	F1+	2,000,000
Royal Bank of Canada	AA	F1+	2,000,000
Toronto Dominion Bank	AA-	F1+	2,000,000
Finland			
Nordea Bank Abp	AA-	F1+	2,000,000
Germany			
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	AA-	F1+	2,000,000
Singapore			
DBS Bank Ltd	AA-	F1+	2,000,000
Oversea Chinese Banking Corporation Ltd	AA-	F1+	2,000,000
United Overseas Bank Ltd	AA-	F1+	2,000,000
U.S.A			
Bank of New York Mellon, The	AA	F1+	2,000,000

UK Government Debt Management Office	
	Max Investment £
The Debt Management Account Deposit Facility	Unlimited

UK Local, Police and Fire Authorities	
	Max Investment £
UK Local, Police and Fire Authorities	3,000,000

Money Market Funds	Rating	Max Investment £
CCLA - Public Sector Deposit Fund	AAA	3,000,000
Goldman Sachs Sterling Liquid Reserves Fund	AAA	3,000,000
Morgan Stanley Liquidity Funds - Sterling Liquidity Fund	AAA	3,000,000

5.6 CURRENT PORTFOLIO POSITION

The overall treasury management portfolio as at 31 March 2020 and for the position as at 31 December 2020 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	Actual	Actual	Current	Current
	31.3.20	**31.3.20**	**31.12.20**	**31.12.20**
Treasury investments	**£000**	**%**	**£000**	**%**
Banks				
Lloyds Bank Fixed Term Deposit	1,000	2.0%	0	0.0%
Lloyds Bank Call Account	0	0.0%	1,000	1.3%
Lloyds Bank Bonus Call Account	0	0.0%	1,000	1.3%
Bank of Scotland Fixed Term Deposit	1,000	2.0%	1,000	1.3%
Bank of Scotland Call Account	0	0.0%	1,000	1.3%
Santander Busiiness Reserve Account	0	0.0%	1,000	1.3%
Santander Busiiness Notice Account	0	0.0%	1,000	1.3%
Building Societies - unrated				
Cambridge Building Society	0	0.0%	2,000	2.6%
Cumberland Building Society	0	0.0%	2,000	2.6%
National Counties Building Society	2,000	4.1%	2,000	2.6%
Newcastle Building Society	2,000	4.1%	2,000	2.6%
Progressive Building Society	2,000	4.1%	2,000	2.6%
Building Societies - rated				
Coventry Building Society	0	0.0%	3,000	4.0%
Leeds Building Society	0	0.0%	3,000	4.0%
Nationwide Building Society	0	0.0%	3,000	4.0%
Nottingham Building Society	0	0.0%	2,000	2.6%
Principality Building Society	0	0.0%	3,000	4.0%
West Bromwich Building Society	3,000	6.1%	3,000	4.0%
Yorkshire Building Society	0	0.0%	3,000	4.0%
Local Authorities				
Thurrock Borough Council	0	0.0%	3,000	4.0%
DMADF (H.M.Treasury)	0	0.0%	2,200	2.9%
Money Market Funds				
Amundi Money Market Fund - short term	3,000	6.1%	0	0.0%
CCLA - Public Sector Deposit Fund	3,000	6.1%	3,000	4.0%
Goldman Sachs - Sterling Liquid Reserves Fund	0	0.0%	450	0.6%
Morgan Stanley Sterling Liquidity Fund	2,500	5.1%	0	0.0%
Total managed in house	**19,500**	**39.7%**	**44,650**	**59.0%**
Money Market Funds*				
Payden Sterling Reserve Fund	15,204	31.0%	15,547	20.5%
Royal London Asset Management Cash Plus Fund	14,400	29.3%	15,514	20.5%
Property Funds	0	0.0%	0	0.0%
Total managed externally	**29,604**	**60.3%**	**31,061**	**41.0%**
Total treasury investments	**49,104**	**100.0%**	**75,711**	**100.0%**

5.7 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

The above is a list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code. However, implicit in the recent changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial (or non-treasury/ other) investments, (which CIPFA has defined as being part of treasury management). The following are examples of the major extension in the functions of this role: -

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial (or non-treasury/ other) investments and treasury management.
- 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 (or non-treasury/ other) investments and is in accordance with the risk appetite of the authority
- ensuring that the authority has appropriate legal powers to undertake expenditure on non-financial (or non-treasury/ other) 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 (or non-treasury/ other) 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, to include the following*: -*
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

- *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*