

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement
and Annual Investment Strategy

2022/23

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1. INTRODUCTION

2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact on future TMSS/AIS reports and the risk management framework

CIPFA published the revised codes on 20 December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. This Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to Full Council for approval.

The revised codes will have the following implications:

- a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;
- address Environmental, Social and Governance (ESG) issues within the Capital Strategy;
- require implementation of a policy to review commercial property, with a view to divest where appropriate;
- create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);
- ensure that any long term treasury investment is supported by a business model;
- a requirement to effectively manage liquidity and longer term cash flow requirements;
- amendment to TMP1 to address ESG policy within the treasury management risk framework;
- amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;
- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

In addition, all investments and investment income must be attributed to one of the following three purposes: -

Treasury management

Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances that are only held until the cash is required for use. Treasury

investments may also arise from other treasury risk management activity that seeks to manage the risks prudently, costs or income relating to existing or forecast debt or treasury investments.

Service delivery

Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment, which are funded by borrowing, are permitted only in cases where the income is “either related to the financial viability of the project in question or otherwise incidental to the primary purpose”.

Commercial return

Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council’s financial capacity – i.e., that ‘plausible losses’ could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not borrow to invest primarily for financial return.

As the Treasury Management Strategy Statement and Annual Investment Strategy deals solely with treasury management investments, the categories of service delivery and commercial investments will be dealt with as part of the Capital Strategy report. However, as investments in commercial property have implications for cash balances managed by the treasury team, it will be for each authority to determine whether they feel it is relevant to add a high level summary of the impact that commercial investments have, or may have, if it is planned to liquidate such investments within the three year time horizon of this report, (or a longer time horizon if that is felt appropriate).

Members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS report.

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.

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.

Scrutiny

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

1.3 Treasury Management Strategy for 2022/23

The strategy for 2022/23 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, DLUHC Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

1.4 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.

1.5 Treasury management consultants

The Council uses Link Group, 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 conventional treasury investments, (the placing of residual cash from the Council's functions), and may include non-treasury investments. Non-treasury investments require specialist advisers, and the Council will seek to appoint suitable specialist advisers in relation to such activity, as and when required.

1.6 Treasury management investments and other investments

The Treasury Management Strategy Statement and Annual Investment Strategy deals solely with treasury management investments. In order to give an holistic view of the Council's borrowing need, the report summarises service related loans to third parties and commercial investment activities. Other than this, these investments are not dealt with in this document.

2 THE CAPITAL PRUDENTIAL INDICATORS 2022/23 – 2024/25

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 and financing

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)	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
General Fund	4,119	18,194	5,385	1,937	652
Loans to third parties	1,115	900	0	0	0
Commercial activities	0	0	0	0	0
HRA	7,658	4,726	4,906	4,906	4,906
Total Capital Expenditure	12,892	23,820	10,291	6,843	5,558

The above 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	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
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Total Capital Expenditure	12,892	23,820	10,291	6,843	5,558
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Capital receipts	(3,149)	(600)	(600)	(600)	(600)
Capital grants	(4,000)	(4,617)	(2,372)	(917)	(795)
Capital reserves	(1,972)	(4,226)	(4,406)	(4,406)	(4,406)
Revenue	(1,193)	(1,000)	0	0	0
Financed in year	(10,314)	(10,443)	(7,378)	(5,923)	(5,801)

Net financing need for the year / (Surplus Receipts)	2,578	13,377	2,913	920	(243)
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The net financing need for the following items **included** in the above tables is:

	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
General Fund loans to third parties	1,115	900	0	0	0
Commercial Activities	0	0	0	0	0
Net financing need for the year	1,115	900	0	0	0
Percentage of total net financing need %	43.3%	6.7%	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:

	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Capital Financing Requirement					
CFR General Fund	2,647	15,153	18,158	18,453	18,576
CFR HRA	83,062	83,062	83,062	83,062	83,062
CFR Loans	4,145	4,910	4,212	4,111	3,007
CFR Commercial activities	2,739	2,671	2,604	2,539	2,476
Total CFR	92,593	105,796	108,036	108,165	107,121
Movement in CFR	2,422	13,203	2,240	129	(1,044)

Movement in CFR represented by					
Net financing need for the year / (Surplus Receipts)	2,578	13,377	2,913	920	(243)
Less MRP/VRP and other financing movements*	(156)	(174)	(673)	(791)	(801)
Movement in CFR	2,422	13,203	2,240	129	(1,044)

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

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).

DLUHC 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.

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 DLUHC 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 2021 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 2021 and the position as at 31 December 2021 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
	31.3.21	31.3.21	31.12.21	31.12.21
Treasury investments	£000	%	£000	%
Banks	1,000	1.9%	6,000	7.2%
Building Societies - unrated	6,000	11.1%	6,000	7.2%
Building Societies - rated	12,000	22.1%	20,300	24.3%
Local Authorities	3,000	5.6%	3,000	3.6%
DMADF (H.M.Treasury)	1,000	1.9%	9,500	11.4%
Money Market Funds	0	0.0%	7,650	9.2%
Total managed in house	23,000	42.6%	52,450	62.9%
Money Market Funds*	31,047	57.4%	30,965	37.1%
Property Funds	0	0.0%	0	0.0%
Total managed externally	31,047	57.4%	30,965	37.1%
Total treasury investments	54,047	100.0%	83,415	100.0%
Treasury external borrowing				
Local Authorities	0	0.0%	0	0.0%
PWLB	88,762	100.0%	87,857	100.0%
Total external borrowing	88,762	100.0%	87,857	100.0%
Net treasury investments / (borrowing)	(34,715)	0.0%	(4,442)	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.

	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Actual Gross External Debt					
Borrowing at 1 April	93,759	92,756	92,468	90,939	89,993
Other long-term liabilities (OLTL) at 1 April	0	0	0	0	0
Gross External Debt at 1 April	93,759	92,756	92,468	90,939	89,993
Expected change in borrowing	(1,003)	(288)	(1,529)	(946)	(523)
Expected change in OLTL	0	0	0	0	0
Gross External Debt at 31 March	92,756	92,468	90,939	89,993	89,470
Capital Financing Requirement	92,593	105,796	108,036	108,165	107,121
Under / (over) borrowing	163	13,328	17,097	18,172	17,651

Within the above figures, the level of debt relating to financing of loans to third parties or to commercial activities is as follows:

	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Purpose of the Debt:					
To finance loans to third parties	1,096	3,293	2,620	2,546	2,469
Commercial Activities	0	0	0	0	0
Percentage of total external debt %	1.18%	3.56%	2.88%	2.83%	2.76%

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 2022/23 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	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Debt HRA/ General Fund	91,661	89,175	88,319	87,447
Other long term liabilities	2,000	2,000	2,000	2,000
Loans to third parties	3,293	3,293	2,620	2,546
Commercial Activities	0	0	0	0
Total	96,954	94,468	92,939	91,993

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	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Borrowing	101,131	98,654	97,134	96,197
Other long term liabilities	2,000	2,000	2,000	2,000
Total	103,131	100,654	99,134	98,197

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

Within the above, headroom for the General Fund 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	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
HRA debt cap	87,844	87,844	87,844	87,844
HRA CFR	83,062	83,062	83,062	83,062
HRA headroom	4,782	4,782	4,782	4,782

3.3 Prospects for interest rates

See the Appendix, section 5.2.1

3.4 Borrowing strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and 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 2022/23 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, borrowing will be postponed.*
- *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.

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 there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of PWLB rates over gilt yields was reduced by 100 bps in November 2020.

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 Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. The purpose of this report is to deal solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments are reported in this Treasury Management Strategy Report only in order to give an holistic view.

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

- DLUHC'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 Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

The above guidance from the DLUHC and CIPFA places 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 or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year. *(Note: the operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The lack of a credit rating means that non-rated building societies are automatically included in the non-specified investments category).*
 - 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, (except for investments in non-rated building societies), 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**, (see section 5.1.4).
7. All investments will be denominated in **sterling**.
8. As a result of the change in accounting standards for 2022/23 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 4.5). 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, though the categorisation of investments in non-rated building societies has been clarified.

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 S.151 Officer 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.

Credit rating information is supplied by the Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. 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 to be sufficiently comprehensive and iterative 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 flexibility, 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. 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		
	Criteria	Maximum Money and/ or % Investment Limit
External (Long Term) Investment Fund		
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	£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
<i>The "deposits" referred to in the above table relate either to cash, floating rate notes or certificates of deposit.</i>		

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 S.151 Officer 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.

The current forecast shown in appendix 5.2.1 includes a forecast for a first increase in Bank Rate in May 2022, though it could come in February.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year, (based on a first increase in Bank Rate in quarter 2 of 2022) are as follows:

Average earnings in each year for placements up to about 3 months	
2022/23	0.50%
2023/24	0.75%
2024/25	1.00%
2025/26	1.25%
Long term later years	2.00%

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.

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 compounded SONIA (*Sterling Overnight Index Average*).

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	15,499
Payden & Rygel - Sterling Reserve Fund	AAAf	S1	15,466
			30,965
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.			

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5.1 CAPITAL PRUDENTIAL & TREASURY INDICATORS 2022/23 – 2024/25

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 (Gross)	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
General Fund	4,119	18,194	5,385	1,937	652
Loans to third parties	1,115	900	0	0	0
Commercial Activities	0	0	0	0	0
HRA	7,658	4,726	4,906	4,906	4,906
Total Capital Expenditure	12,892	23,820	10,291	6,843	5,558

The above excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.

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.

	2020/21 Actual %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %
General Fund	(0.80)	(0.11)	3.28	3.26	2.72
HRA	13.62*	14.90	13.61	13.51	12.87
Loans to Third Parties/ Commercial Activities	(1.96)	(1.92)	(1.28)	(1.24)	(1.18)
Total	10.86	12.87	15.61	15.53	14.41

*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 figure for Loans to Third Parties/ Commercial activities reflects the commencement of the return from a property investment made in 2019/20. Note that the Council has not borrowed to finance Commercial Activities.

b. HRA ratios

	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
HRA debt	84,666	84,658	84,649	84,640	84,631
HRA debt cap	87,844	87,844	87,844	87,844	87,844
HRA revenues	18,702*	17,182	18,617	18,504	19,079
	%	%	%	%	%
Ratio of debt to revenues %	452.7%*	492.7%	454.7%	457.4%	443.6%

*revised

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

	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
HRA debt	£84.666m	£84.658m	£84.649m	£84.640m	£84.631m
Number of HRA Dwellings	4,170	4,170	4,170	4,170	4,170
Debt per Dwelling	£20,304	£20,302	£20,300	£20,297	£20,295

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 2022/23			
		Lower	Upper
Under 12 months	2022/23	0%	20%
12 months to 2 years	2024/25	0%	20%
2 years to 5 years	2025/26 – 2026/27	0%	20%
5 years to 10 years	2027/28 – 2031/32	0%	25%
10 years to 20 years	2032/33 – 2041/42	0%	45%
20 years to 30 years	2042/43 – 2051/52	0%	20%
30 years to 40 years	2052/53 – 2061/62	0%	20%
40 years to 50 years	2062/63 – 2071/72	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 5– 20 onwards.

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-treasury loans, the current projected maturity structure of borrowing is shown below:

Maturity structure of fixed interest rate borrowing 2022/23			
		£000	%
Under 12 months	2022/23	4,409	4.41%
12 months to 2 years	2023/24	4,225	4.23%
2 years to 5 years	2024/25 – 2026/27	14,829	14.83%
5 years to 10 years	2027/28 – 2031/32	16,079	16.08%
10 years to 20 years	2032/33 – 2041/42	39,420	39.43%
20 years to 30 years	2042/43 – 2051/52	293	0.29%
30 years to 40 years	2052/53 – 2061/62	0	0.00%
40 years to 50 years	2062/63 – 2071/72	8,252	8.25%
51 years to 60 years	2072/73 – 2081/82	12,478	12.48%
Total		99,985	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. Currently the Council has £30.965m 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.

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 20.12.21. These are forecasts for certainty rates, gilt yields plus 80bps:

Link Group Interest Rate View		20.12.21													
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00	
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10	
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20	
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00	
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30	
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50	
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30	

Additional notes by Link on this forecast table: -

- *LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.*
- *Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.*

Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16 December 2021.

As shown in the forecast table above, the forecast for Bank Rate now includes four further increases following the one in December 2021 to 0.25%; these being one in quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

Significant risks to the forecasts

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns. 25% of the population not being vaccinated is also a significant risk to the NHS being overwhelmed and lockdowns being the only remaining option.
- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.
- **The Monetary Policy Committee** acts 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.
- **The Monetary Policy Committee** tightens monetary policy too late to ward off building inflationary pressures.

- **The Government** acts too quickly to cut expenditure to balance the national budget.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Longer-term US treasury yields** rise strongly and pull gilt yields up higher than forecast.
- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- **Geopolitical risks**, for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is now to the downside, including risks from Covid and its variants - both domestically and their potential effects worldwide.

Forecasts for Bank Rate

It is not expected that Bank Rate will go up fast after the initial rate rise, as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four further increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.
- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. Then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?

- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer-spending power, without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- It looks as if the economy coped well with the end of furlough on 30 September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages that then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.
- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide simply to take away such emergency cuts, on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. **As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.**

US treasury yields. During the first part of 2021, US President Biden's, and the Democratic party's, determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package already passed in December 2020. This was then followed by additional Democratic ambition to spend \$1trn on infrastructure, (which was eventually passed by both houses later in 2021), and an even larger sum on an American families

plan over the next decade; this is still caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme had enabled a rapid opening up of the economy during 2021.
2. The economy was growing strongly during the first half of 2021, although it has weakened overall during the second half.
3. It started from a position of little spare capacity, due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing substantial stimulus through monthly QE purchases during 2021.

It was not much of a surprise that a combination of these factors would eventually cause an excess of demand in the economy which generated strong inflationary pressures. This has eventually been recognised by the Fed at its December meeting with an aggressive response to damp inflation down during 2022 and 2023.

At its 3 November Fed meeting, the Fed decided to make a start on tapering its \$120bn per month of QE purchases so that they ended next June. However, at its **15 December meeting**, it doubled the pace of tapering so that they will end all purchases in February. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that Treasury yields will rise over the taper period and after the taper ends, all other things being equal. The Fed also forecast that it expected there would be three rate rises in 2022 of 0.25%, from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy.

There are also possible **DOWNSIDE RISKS** from the huge sums of cash that the UK populace has saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to monitor.

There is likely to be **exceptional volatility and unpredictability in respect of gilt yields and PWLB rates** due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields: (see below)? Over 10 years since 2011, there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK, if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures actually turn out to be in both the US and the UK and so put upward pressure on treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?

- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets, as happened in the “taper tantrums” in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases eventually needed to suppress inflation, are likely to be faster and stronger than Bank Rate increases in the UK. This is likely to put upward pressure on treasury yields which could then spill over into putting upward pressure on UK gilt yields.

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming up, and that there are no major ruptures in international relations, especially between the US and Russia, China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

The balance of risks to medium to long-term PWLB rates: -

- There is a balance of upside risks to forecasts for medium to long term PWLB rates.

10.1.22 UPDATE TO FORECASTS

The Fed minutes for their December 14-15 meeting were released last week. These showed there is a very likely going to be an acceleration in the pace of monetary tightening policies including a faster rate of increase in the Fed rate and running down the stock of QE purchases. This has led to a sharp jump up in treasury yields, and also in gilt yields in this country.

It is also now clearer that there could be a 50% increase in the price cap on fuel prices from 1 April 2022 in this country: this could boost inflation significantly and would then put added pressure on the Bank of England to raise Bank Rate faster, as inflation would be unlikely to come down as fast as previously expected. What is still an unknown is whether the Government will damp down the calculation of inflation figures by providing some kind of subsidy for gas and electricity costs e.g., it could make loans to energy companies by spreading increased costs incurred this year over several future years, as those loans are gradually repaid.

There has therefore been a sharp increase in the balance of upside risks to the forecasts for gilt yields, PWLB rates and Bank Rate.

A new era for local authority investing

– a fundamental shift in central bank monetary policy

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the European Central Bank, to tolerate a higher level of inflation than in the previous two decades, when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on ‘achieving broad and inclusive “maximum” employment in its entirety’ in the US, before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate, and the ECB now has a similar policy.
- **For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.**
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path that makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower, as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK, this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

Investment and borrowing rates

- **Investment returns** are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.
- **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 and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates that had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps 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 current 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.** Our long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing available for authorities seeking to avoid a "cost of carry" but also wishing to mitigate future re-financing risks.

- If an authority chooses to avoid borrowing to finance new capital expenditure or to replace maturing debt, as an alternative to running down reserves, there will be a *cost of carry*, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances.

Borrowing strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and 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 2022/23 treasury operations. The S151 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 borrowing rates, then borrowing will be postponed.*
- *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.

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

5.2.2 Interest Rate Forecasts 2021 – 2025

PWLB forecasts shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Group Interest Ra 20.12.21													
	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30
Bank Rate													
Link	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
Capital Economics	0.50	0.75	0.75	1.00	1.25	1.25	1.25	1.25	-	-	-	-	-
5yr PWLB Rate													
Link	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
Capital Economics	1.80	1.90	2.10	2.20	2.20	2.30	2.40	2.40	-	-	-	-	-
10yr PWLB Rate													
Link	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
Capital Economics	2.00	2.10	2.20	2.30	2.30	2.40	2.50	2.50	-	-	-	-	-
25yr PWLB Rate													
Link	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
Capital Economics	2.20	2.30	2.50	2.70	2.70	2.70	2.80	2.90	-	-	-	-	-
50yr PWLB Rate													
Link	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30
Capital Economics	1.90	2.00	2.20	2.40	2.50	2.60	2.70	2.90	-	-	-	-	-

5.3 ECONOMIC BACKGROUND

COVID-19 vaccines.

These were the game changer during 2021, which raised high hopes that life in the UK would be able, largely, to return to normal in the second half of the year. However, the bursting onto the scene of the Omicron mutation at the end of November rendered the initial two doses of all vaccines largely ineffective in preventing infection. This has dashed such hopes and raises the spectre again that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that this mutation is very fast spreading, with the potential for total case numbers to double every two to three days, although possibly it may not cause so much severe illness as previous mutations. Rather than go for full lockdowns, which heavily damage the economy, the government strategy this time is focusing on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection; a booster has been shown to restore a high percentage of immunity to Omicron to those who have had two vaccinations. There is now a race on between how quickly boosters can be given to limit the spread of Omicron, and how quickly hospitals will fill up and potentially be unable to cope. In the meantime, workers have been requested to work from home and restrictions have been placed on large indoor gatherings and hospitality venues. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in sectors like restaurants, travel, tourism and hotels, which had been hit hard during 2021, but which could now be hit hard again by either, or both, of government restrictions and/or consumer reluctance to leave home. Growth will also be lower due to people being ill and not working, similar to the pingdemic in July. The economy, therefore, faces significant headwinds, although some sectors have learned how to cope well with Covid. However, the biggest impact on growth would come from another lockdown, if that happened. The big question still remains as to whether any further mutations of this virus could

develop that render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- In December, the Bank of England became the first major western central bank to put interest rates up in this upswing in the current business cycle in western economies, as recovery progresses from the Covid recession of 2020.
- The next increase in Bank Rate could be in February or May, dependent on how severe an impact there is from Omicron.
- If there are lockdowns in January, this could pose a barrier for the MPC to putting Bank Rate up again as early as 3 February.
- With inflation expected to peak at around 6% in April, the MPC may want to be seen to be active in taking action to counter inflation on 5 May, the release date for its Quarterly Monetary Policy Report.
- The December 2021 MPC meeting was more concerned with combating inflation over the medium term than supporting economic growth in the short term.
- Bank Rate increases beyond May are difficult to forecast, as inflation is likely to drop sharply in the second half of 2022.
- However, the MPC will want to normalise Bank Rate over the next three years so that it has its main monetary policy tool ready to use in time for the next downturn; all rates under 2% are providing stimulus to economic growth.
- We have put year-end 0.25% increases into Q1 of each financial year from 2023 to recognise this upward bias in Bank Rate - but the actual timing in each year is difficult to predict.
- Covid remains a major potential downside threat in all three years, as we ARE likely to get further mutations.
- How quickly can science come up with a mutation proof vaccine, or other treatment, – and for them to be widely administered around the world?
- Purchases of gilts under QE ended in December. Note that when Bank Rate reaches 0.50%, the MPC has said it will start running down its stock of QE.

MPC MEETING 16 DECEMBER 2021

- The Monetary Policy Committee (MPC) voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.
- The MPC disappointed financial markets by not raising Bank Rate at its November meeting. Until Omicron burst on the scene, most forecasters, therefore, viewed a Bank Rate increase as being near certain at this December meeting, due to the way that inflationary pressures have been comprehensively building in both producer and consumer prices, and in wage rates. However, at the November meeting, the MPC decided it wanted to have assurance that the labour market would get over the end of the furlough scheme on 30 September without unemployment increasing sharply; their decision was, therefore, to wait until statistics were available to show how the economy had fared at this time.
- **On 10 December we learnt of the disappointing 0.1% m/m rise in GDP** in October, which suggested that economic growth had already slowed to a crawl, even before the Omicron variant was discovered in late November. Early evidence suggests growth in November might have been marginally better.

Nonetheless, at such low rates of growth, the government's "Plan B" COVID-19 restrictions could cause the economy to contract in December.

- **On 14 December, the labour market statistics** for the three months to October and the single month of October, were released. The fallout after the furlough scheme was smaller and shorter than the Bank of England had feared. The single-month data were more informative and showed that LFS employment fell by 240,000, unemployment increased by 75,000 and the unemployment rate rose from 3.9% in September to 4.2%. However, the weekly data suggested this did not last long, as unemployment was falling again by the end of October. What's more, the 49,700 fall in the claimant count and the 257,000 rise in the PAYE measure of company payrolls suggests that the labour market strengthened again in November. The other side of the coin was a further rise in the number of vacancies, from 1.182m to a record 1.219m in the three months to November, which suggests that the supply of labour is struggling to keep up with demand, although the single-month figure for November fell for the first time since February, from 1.307m to 1.227m.
- These figures by themselves, would probably have been enough to give the MPC the assurance that it could press ahead to raise Bank Rate at this December meeting. However, the advent of Omicron potentially threw a spanner into the works, as it poses a major headwind to the economy, which, of itself, will help to cool the economy. The financial markets, therefore, swung round to expecting no change in Bank Rate.
- **On 15 December, we had the CPI inflation** figure for November which spiked up further from 4.2% to 5.1%, confirming again how inflationary pressures have been building sharply. However, Omicron also caused a sharp fall in world oil and other commodity prices; (gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies).
- **Other elements of inflation are also transitory** e.g., prices of goods being forced up by supply shortages, and shortages of shipping containers due to ports being clogged have caused huge increases in shipping costs. But these issues are likely to clear during 2022, and then prices will subside back to more normal levels. Gas prices and electricity prices will also fall back once winter has passed and demand for these falls away.
- Although it is possible that the Government could step in with some **fiscal support for the economy**, the huge cost of such support to date is likely to pose a barrier to incurring further major economy-wide expenditure, unless it is very limited and targeted on narrow sectors like hospitality, (as announced just before Christmas). The Government may well, therefore, effectively leave it to the MPC, and to monetary policy, to support economic growth – but at a time when the threat posed by rising inflation is near to peaking!
- This is the adverse set of factors against which the MPC had to decide on Bank Rate. For the second month in a row, the MPC blind-sided financial markets, this time with a **surprise increase in Bank Rate from 0.10% to 0.25%**. What's more, the hawkish tone of comments indicated that the MPC is now concerned that inflationary pressures are indeed building and need concerted action by the MPC to counter. This indicates that there will be more increases to come with financial markets predicting 1% by the end of 2022. The 8-1 vote to raise the rate shows that there is firm agreement that inflation now poses a threat, especially after the CPI figure hit a 10-year high this week. The MPC

commented that “there has been significant upside news” and that “there were some signs of greater persistence in domestic costs and price pressures”.

- On the other hand, it did also comment that “**the Omicron variant is likely to weigh on near-term activity**”. But it stressed that at the November meeting it had said it would raise rates if the economy evolved as it expected and that now “these conditions had been met”. It also appeared more worried about the possible boost to inflation from Omicron itself. It said that “the current position of the global and UK economies was materially different compared with prior to the onset of the pandemic, including elevated levels of consumer price inflation”. It also noted the possibility that renewed social distancing would boost demand for goods again, (as demand for services would fall), meaning “global price pressures might persist for longer”. (Recent news is that the largest port in the world in China has come down with an Omicron outbreak, which is not only affecting the port but also factories in the region.)
- On top of that, there were no references this month to inflation being expected to be below the **2% target in two years’ time**, which at November’s meeting the MPC referenced to suggest the markets had gone too far in expecting interest rates to rise to over 1.00% by the end of the year.
- These comments indicate that there has been a material reappraisal by the MPC of the inflationary pressures since their last meeting and the Bank also increased its forecast for inflation to peak at 6% next April, rather than at 5% as of a month ago. However, as the Bank retained its guidance that only a “**modest tightening**” in policy will be required, it cannot be thinking that it will need to increase interest rates that much more. A typical policy tightening cycle has usually involved rates rising by 0.25% four times in a year. “Modest” seems slower than that. As such, the Bank could be thinking about raising interest rates two or three times next year to 0.75% or 1.00%.
- In as much as a considerable part of the inflationary pressures at the current time are indeed **transitory**, and will naturally subside, and since economic growth is likely to be weak over the next few months, this would appear to indicate that this tightening cycle is likely to be comparatively short.
- As for the timing of the next increase in Bank Rate, the MPC dropped the comment from November’s statement that Bank Rate would be raised “in the coming months”. That may imply another rise is unlikely at the next meeting in February and that May is more likely. However, much could depend on how adversely, or not, the economy is affected by Omicron in the run up to the next meeting on 3 February. Once 0.50% is reached, the Bank would act to start shrinking its stock of QE; (gilts purchased by the Bank would not be replaced when they mature).
- **The MPC’s forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows:
 -
 - Raising Bank Rate as “the active instrument in most circumstances”.
 - Raising Bank Rate to 0.50% before starting on reducing its holdings.
 - Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
 - Once Bank Rate had risen to at least 1%, it would start selling its holdings.

- **US.** Shortages of goods and intermediate goods like semi-conductors, have been fuelling increases in prices and reducing economic growth potential. In November, **CPI inflation hit a near 40-year record level of 6.8%** but with energy prices then falling sharply, this is probably the peak. The biggest problem for the Fed is the mounting evidence of a strong pick-up in cyclical price pressures e.g., in rent, which has hit a decades' high.
- **Shortages of labour** have also been driving up wage rates sharply; this also poses a considerable threat to feeding back into producer prices and then into consumer prices inflation. It now also appears that there has been a sustained drop in the labour force, which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023, while core inflation is likely to remain elevated at around 3% in both years, instead of declining back to the Fed's 2% central target.
- Inflation hitting 6.8% and the feed through into second round effects, meant that it was near certain that the **Fed's meeting of 15 December** would take aggressive action against inflation. Accordingly, the rate of tapering of monthly \$120bn QE purchases announced at its November 3 meeting was doubled so that all purchases would now finish in February 2022. In addition, Fed officials had started discussions on running down the stock of QE held by the Fed. Fed officials also expected three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy. The first increase could come as soon as March 2022 as the chairman of the Fed stated his view that the economy had made rapid progress to achieving the other goal of the Fed – “maximum employment”. The Fed forecast that inflation would fall from an average of 5.3% in 2021 to 2.6% in 2023, still above its target of 2% and both figures significantly up from previous forecasts. What was also significant was that, this month, the Fed dropped its description of the current level of inflation as being “transitory” and instead referred to “elevated levels” of inflation: the statement also dropped most of the language around the flexible average inflation target, with inflation now described as having exceeded 2 percent “for some time”. It did not see Omicron as being a major impediment to the need to take action now to curtail the level of inflationary pressures that have built up, although Fed officials did note that it has the potential to exacerbate supply chain problems and add to price pressures.

See also comments in paragraph 5.2.1 under PWLB rates and gilt yields.

- **EU.** The slow role out of vaccines initially delayed **economic recovery** in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery was then within 0.5% of its pre Covid size. However, the arrival of Omicron is now a major headwind to growth in quarter 4 and the expected downturn into weak growth could well turn negative, with the outlook for the first two months of 2022 expected to continue to be very weak.
- **November's inflation figures** breakdown shows that the increase in price pressures is not just due to high energy costs and global demand-supply imbalances for durable goods as services' inflation also rose. Headline inflation reached 4.9% in November, with over half of that due to energy. However, oil and gas prices are expected to fall after the winter and so energy inflation is expected to plummet in 2022. Core goods inflation rose to 2.4% in November, its second highest ever level, and is likely to remain high for some time, as it will take a long time for the inflationary impact of global imbalances in the demand and supply of durable goods to disappear. Price pressures also increased in the services sector, but wage growth remains subdued and there are no signs of a trend of faster wage growth, which might lead to *persistently* higher services inflation - which would get the ECB concerned. The upshot is that the euro-zone is set for a prolonged period

of inflation being above the ECB's target of 2% and it is likely to average 3% in 2022, in line with the ECB's latest projection.

- **ECB tapering.** The ECB has joined with the Fed by also announcing at its meeting on 16 December that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases for over half of next year. However, as inflation will fall back sharply during 2022, it is likely that it will leave its central rate below zero, (currently -0.50%), over the next two years. The main struggle that the ECB has had in recent years is that inflation has been doggedly anaemic in sticking below the ECB's target rate despite all its major programmes of monetary easing by cutting rates into negative territory and providing QE support.
- The ECB will now also need to consider the impact of **Omicron** on the economy, and it stated at its December meeting that it is prepared to provide further QE support if the pandemic causes bond yield spreads of peripheral countries, (compared to the yields of northern EU countries), to rise. However, that is the only reason it will support peripheral yields, so this support is limited in its scope.
- The EU has entered into a **period of political uncertainty**, where a new German government formed of a coalition of three parties, with Olaf Scholz replacing Angela Merkel as Chancellor in December 2021, will need to find its feet both within the EU and in the three parties successfully working together. In France, there is a presidential election coming up in April 2022, followed by the legislative election in June. In addition, Italy needs to elect a new president in January, with Prime Minister Draghi being a favourite, due to having suitable gravitas for this post. However, if he switched office, there is a significant risk that the current government coalition could collapse. That could then cause differentials between Italian and German bonds to widen, when 2022 will also see a gradual running down of ECB support for the bonds of weaker countries within the EU. These political uncertainties could have repercussions on economies and on Brexit issues.
- **CHINA.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of **2020**; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021.
- However, the pace of economic growth has now fallen back in **2021** after this initial surge of recovery from the pandemic and looks likely to be particularly weak in 2022. China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. Chinese consumers are also being very wary about leaving home and so spending money on services. However, with Omicron having now spread to China, and being much more easily transmissible, this strategy of sharp local lockdowns to stop the virus may not prove so successful in future. In addition, the current pace of providing boosters at 100 billion per month will leave much of the 1.4 billion population exposed to Omicron, and any further mutations, for a considerable time. The **People's Bank of China** made a start in December 2021 on cutting its key interest rate marginally so as to stimulate economic growth. However, after credit has already expanded by around 25% in just the last two years, it will probably leave the heavy lifting in supporting growth to fiscal stimulus by central and local government.
- Supply shortages, especially of coal for power generation, were causing widespread power cuts to industry during the second half of 2021 and so a sharp disruptive impact on some sectors of the economy. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved

directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

- **JAPAN.** 2021 has been a patchy year in combating Covid. However, recent business surveys indicate that the economy has been rebounding rapidly in 2021 once the bulk of the population had been double vaccinated and new virus cases had plunged. However, Omicron could reverse this initial success in combating Covid.
- The Bank of Japan is continuing its **very loose monetary policy** but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was actually negative in July. New Prime Minister Kishida, having won the November general election, brought in a supplementary budget to boost growth, but it is unlikely to have a major effect.
- **WORLD GROWTH.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum in the second half of the year, though overall growth for the year is expected to be about 6% and to be around 4-5% in 2022. Inflation has been rising, due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. While headline inflation will fall sharply, core inflation will probably not fall as quickly as central bankers would hope. It is 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, and vice versa. This is likely to reduce world growth rates from those in prior decades.
- **SUPPLY SHORTAGES.** The pandemic and extreme weather events, followed by a major surge in demand after lockdowns ended, have been highly disruptive of extended worldwide supply chains. Major queues of ships unable to unload their goods at ports in New York, California and China built up rapidly during quarters 2 and 3 of 2021 but then halved during quarter 4. Such issues have led to a misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. The latest additional disruption has been a shortage of coal in China, leading to power cuts focused primarily on producers, (rather than consumers), i.e., this will further aggravate shortages in meeting demand for goods. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods available to purchase.

5.4 CRITERIA FOR SPECIFIED AND NON-SPECIFIED INVESTMENTS

The DLUHC issued Investment Guidance in 2018, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds, which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently and that priority is given to security and liquidity before yield. In order to facilitate this objective, the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council will apply its principles to all investment activity.

The S151 Officer has produced treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments are required to be in Sterling, be of 'high credit quality' and of not more than one-year maturity or those that could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. They also include investments which were originally classed as being non-specified investments, but which would have been classified as specified investments apart from originally being for a period longer than 12 months once the remaining period to maturity falls to under twelve months.

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

- Investments in Banks incorporated in the UK with a credit rating by Standard and Poor's, Moody's and / or Fitch rating agencies 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 by Standard and Poor's, Moody's and / or Fitch rating agencies 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 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 up to agreed limits, in UK Building Societies with an asset basis of over £1 billion and rated by Standard and Poor's, Moody's and / or Fitch rating agencies. (*Non-rated UK Building Societies fall into the non-specified investments category*).
- Corporate bonds rated AAA of less than one-year duration.
- The UK Government (such as the Debt Management Account Deposit Facility, UK treasury bills or a gilt with less than one year to maturity).

- UK Local, Police and Fire Authorities with a limit of £3m on the amount invested with each.

** following the Money Market Fund Regulations of 21 July 2018, only public debt CNAV MMFs, (those investing 99.5% into government debt instruments etc.), remain as CNAVs. All other CNAVs converted to LVNAVs. VNAVs were unaffected by the changes.*

Non-Specified Investments are all investments over 1 year in duration and/or not meeting the definition of high credit quality listed above. *(Note: the operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may make investments up to 9 months up to agreed limits in non-rated Building Societies with an asset basis of over £1 billion).*

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, (excluding in building societies), 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 2021/22 AS AT 31 December 2021

(Time limit 365 days unless specifically stated)

UK High Street Banks			
<i>UK or Irish bank with presence in UK and a short-term Fitch rating of F1 or higher</i>	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 plc (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). (* Unrated building societies are non-specified investments).				
		Total Assets of Building Society £000	Assets > £1 Billion	Max Investment £
1	Nationwide	251,920,000	Yes	3,000,000
2	Yorkshire	57,785,900	Yes	3,000,000
3	Coventry	50,780,500	Yes	3,000,000
4	Skipton	26,658,000	Yes	3,000,000
5	Leeds	20,724,700	Yes	3,000,000
6	Principality	10,911,600	Yes	3,000,000
7	West Bromwich	5,707,600	Yes	3,000,000
8	Newcastle*	4,860,600	Yes	2,000,000
9	Nottingham	3,770,900	Yes	2,000,000
10	Cumberland*	2,700,362	Yes	2,000,000
11	National Counties*	2,433,439	Yes	2,000,000
12	Progressive*	1,815,795	Yes	2,000,000
13	Cambridge*	1,700,971	Yes	2,000,000
14	Monmouthshire*	1,385,868	Yes	2,000,000
15	Newbury*	1,233,682	Yes	2,000,000
16	Leek United*	1,208,245	Yes	2,000,000
17	Saffron*	1,147,799	Yes	2,000,000
18	Furniss*	1,098,338	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 £
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 2021 and for the position as at 31 December 2021 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	Actual	Actual	Current	Current
	31.3.21	31.3.21	31.12.21	31.12.21
	£000	%	£000	%
Treasury investments				
Banks				
Lloyds Bank Call Account	0	0.0%	1,000	1.2%
Lloyds Bank Bonus Call Account	0	0.0%	1,000	1.2%
Bank of Scotland Call Account	0	0.0%	2,000	2.4%
Santander Business Reserve Account	0	0.0%	1,000	1.2%
Santander Business Notice Account	1,000	1.9%	1,000	1.2%
Building Societies - unrated				
Cambridge Building Society	2,000	3.7%	0	0.0%
Cumberland Building Society	2,000	3.7%	0	0.0%
National Counties Building Society	0	0.0%	2,000	2.4%
Newcastle Building Society	0	0.0%	2,000	2.4%
Progressive Building Society	2,000	3.7%	2,000	2.4%
Building Societies - rated				
Coventry Building Society	3,000	5.5%	3,000	3.6%
Leeds Building Society	3,000	5.5%	2,300	2.7%
Nationwide Building Society	3,000	5.5%	3,000	3.6%
Principality Building Society	0	0.0%	3,000	3.6%
Skipton Building Society	0	0.0%	3,000	3.6%
West Bromwich Building Society	0	0.0%	3,000	3.6%
Yorkshire Building Society	3,000	5.6%	3,000	3.6%
Local Authorities				
Thurrock Borough Council	3,000	5.6%	3,000	3.6%
DMADF (H.M.Treasury)	1,000	1.9%	9,500	11.4%
Money Market Funds				
CCLA - Public Sector Deposit Fund	0	0.0%	3,000	3.6%
Goldman Sachs - Sterling Liquid Reserves Fund	0	0.0%	1,650	2.0%
Morgan Stanley Sterling Liquidity Fund	0	0.0%	3,000	3.6%
Total managed in house	23,000	42.6%	52,450	62.9%
Money Market Funds*				
Payden Sterling Reserve Fund	15,535	28.7%	15,466	18.5%
Royal London Asset Management Cash Plus Fund	15,512	28.7%	15,499	18.6%
Total managed externally	31,047	57.4%	30,965	37.1%
Total treasury investments	54,047	100.0%	83,415	100.0%
Treasury external borrowing				
Local Authorities	0	0.0%	0	0.0%
PWLB	88,762	100.0%	87,857	100.0%
Total external borrowing	88,762	100.0%	87,857	100.0%
Net treasury investments / (borrowing)	(34,715)	0.0%	(4,442)	0.0%
<i>* market value</i>				

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 investments and treasury management, with a long-term timeframe.
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensuring that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- 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 (*TM Code p54*): -
 - *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.*