

## 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.

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.”*

This authority has not engaged in any commercial investments. 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 which 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. **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

The above reports are required to be adequately scrutinised before being recommended to the Council. Finance & Performance committee receive quarterly updates on the Council borrowing and lending.

### 1.2 Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

#### Capital issues

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

#### Treasury management issues

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

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

### 1.3 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. The training needs of treasury management officers are periodically reviewed.

### 1.4 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 CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2023/24

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

### 1.5 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:

<b>Capital expenditure £m</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>
Non-HRA	1,910	3,640	10,047	2,326	1,633
HRA	6,605	9,504	6,128	5,423	4,464
<b>Total</b>	<b>8,515</b>	<b>13,144</b>	<b>16,175</b>	<b>7,749</b>	<b>6,097</b>

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

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

<b>Financing of capital expenditure £m</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>
Capital receipts	812	1,756	3,791	951	463
Capital grants	758	2,173	3,040	1,160	729
Capital reserves	6,574	8,442	6,150	4,953	4,494
Revenue	27	0	0	0	0
<b>Net financing need for the year</b>	<b>344</b>	<b>773</b>	<b>3,194</b>	<b>685</b>	<b>411</b>

## 1.6 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 immediately been paid for 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 which 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 schemes, 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 separately borrow for these schemes. The Council currently has £73.011m as at the 1<sup>st</sup> April 2020 of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
<b>Capital Financing Requirement</b>					
CFR – non housing	36,017	32,260	34,103	33,380	32,340
CFR – housing	<b>70,320</b>	<b>70,320</b>	<b>70,320</b>	<b>70,320</b>	<b>70,320</b>
<b>Total CFR</b>	<b>106,337</b>	<b>102,580</b>	<b>104,423</b>	<b>103,700</b>	<b>102,660</b>
<b>Movement in CFR</b>	<b>( 954)</b>	<b>(3,757)</b>	<b>1,843</b>	<b>( 723)</b>	<b>(1,040)</b>

<b>Movement in CFR represented by</b>					
Net financing need for the year (above)	344	773	3,194	685	411
Less MRP/VRP and other financing movements	(1,298)	(4,530)	(1,351)	(1,408)	(1,451)
<b>Movement in CFR</b>	<b>( 954)</b>	<b>(3,757)</b>	<b>1,843</b>	<b>( 723)</b>	<b>(1,040)</b>

## 1.7 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources £m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Fund balances / reserves	20,696	17,854	15,720	15,277	14,910
Capital receipts	9,098	6,023	3,151	3,024	3,386
Provisions	920	920	920	920	920
Other	2,845	2,561	2,305	2,075	1,868
<b>Total core funds</b>	<b>33,559</b>	<b>27,358</b>	<b>22,096</b>	<b>21,296</b>	<b>21,084</b>
Working capital*	1,800	1,800	1,800	1,800	1,800
Under/over borrowing	23,759	22,622	24,680	26,709	28,724
Additional Borrowing	0	0	(4,394)	(7,223)	(9,460)
<b>Expected Investments</b>	<b>8,000</b>	<b>2,936</b>	<b>10</b>	<b>10</b>	<b>20</b>

\*Working capital balances shown are estimated year-end; these may be higher mid-year.

### 1.8 Minimum revenue provision (MRP) policy statement

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

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

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

*To write off the existing balance over 37 years on a straight line basis (i.e. write the original debt off over 50 years)*

From 1 April 2008 for all unsupported borrowing (including PFI and 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);

These options provide 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 (although there are transitional arrangements in place).

Repayments included in annual PFI or finance leases are applied as MRP.

**MRP Overpayments** - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019 the total VRP overpayment was £0.117m. Where VRP has been made in prior years and reserves are available to pay off debt VRP will be reversed.

## 2 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.

### 2.1 Current portfolio position

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

Treasury Portfolio				
	Actual	Actual	Current	Current
	31.03.20	31.03.20	31.12.20	31.12.20
	£'000	%	£'000	%
<b>Treasury Investments</b>				
Banks	2,710	16%	3,564	11%
Building Societies - Unrated	12,930	75%	17,000	52%
Local Authorities	0	0%	12,000	37%
Money Market Fund	1,700	10%	0	0%
<b>Total managed in house</b>	<b>17,340</b>	<b>100%</b>	<b>32,564</b>	<b>100%</b>
<b>Treasury external borrowings</b>				
PWLB	73,011	100%	73,011	100%
<b>Total external Borrowings</b>	<b>73,011</b>	<b>100%</b>	<b>73,011</b>	<b>100%</b>
<b>Net treasury investments/(borrowing)</b>	<b>(53,671)</b>	<b>23.75%</b>	<b>(40,447)</b>	<b>44.60%</b>

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.

£m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
<b>External Debt</b>					
Debt at 1 April	85,935	82,578	79,958	79,743	76,991
Expected change in Debt	(2,941)	(2,168)	253	(2,256)	(2,530)
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	( 416)	(452)	(468)	(496)	(525)
Actual gross debt at 31 March	<b>82,578</b>	<b>79,958</b>	<b>79,743</b>	<b>76,991</b>	<b>73,936</b>
The Capital Financing Requirement	<b>106,337</b>	<b>102,580</b>	<b>104,423</b>	<b>103,700</b>	<b>102,660</b>
Under / (over) borrowing	<b>23,759</b>	<b>22,622</b>	<b>24,680</b>	<b>26,709</b>	<b>28,724</b>

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Head of Finance 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.

## 2.2 Treasury Indicators: limits to borrowing activity

**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.

Operational boundary £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Debt	93,464	95,775	95,547	95,032
Other long term liabilities	9,116	8,648	8,153	7,628
Total	102,580	104,423	103,700	102,660

**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 £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Debt	96,464	98,775	98,547	98,032
Other long term liabilities	9,116	8,648	8,153	7,628
Total	105,580	107,423	106,700	105,660

### 2.3 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. The following table gives out their view which allows for the drop in PWLB rate 1% earlier this year.

	Mar 21	Jun 21	Sep 21	Dec 21	Mar 22	Jun 22	Sep 22	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Months	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 Months	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 Months	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 Yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 Yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 Yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 Yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 16<sup>th</sup> December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts are based on an assumption that a Brexit trade deal being agreed on 31.12.20.

#### Gilt yields / PWLB rates

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9<sup>th</sup> November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

#### Investment and borrowing rates

- **Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.
- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt



yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. *(Please note that there are concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects.)* It also introduced the following rates for borrowing for different types of capital expenditure: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
  - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -
  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.
- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt the rundown of 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 as this position will, most likely, incur a revenue cost.

## 2.4 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 2021/22 treasury operations. The Head of Finance 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.

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

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

## **2.6 Debt rescheduling**

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

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

## **2.7 New financial institutions as a source of borrowing and / or types of borrowing**

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

## 2.8 Approved Sources of Long and Short term Borrowing

Our current available sources of borrowing are summarised below:

<b>On Balance Sheet</b>	<b>Fixed</b>	<b>Variable</b>
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	●

### 3 ANNUAL INVESTMENT STRATEGY

#### 3.1 Investment policy – management of risk

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

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

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The 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 MHCLG 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. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.
3. **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. 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.
  - **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 originally classified as being non-specified investments solely due to the maturity period exceeding one year.
  - **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.

5. **Non-specified and loan investment limits.** The Council has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of 5% of full investment portfolio.
6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
7. **Transaction limits** are set for each type of investment in 4.2.
8. This authority will set a limit for its investments which are invested for **longer than 365 days**, (see paragraph 4.4).
9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).
10. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
11. All investments will be denominated in **sterling**.
12. As a result of the change in accounting standards for 2020/21 under IFRS 9, this authority will consider the implications of investment instruments which 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 paragraph 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.

#### **Creditworthiness.**

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on *actual* levels of credit losses. (Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6<sup>th</sup> August

revised down their expected credit losses for the UK banking sector to “somewhat less than £80bn”. It stated that in its assessment, “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

### 3.2 Other limits

Due care will be taken to consider the exposure of the Council’s total investment portfolio to non-specified investments, countries, groups and sectors.

- a) **Non-specified treasury management investment limit.** The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being 5% of the total treasury management investment portfolio.
- b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of AA-** from Fitch or equivalent. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
- c) **Other limits.** In addition:
  - no more than 10% will be placed with any non-UK country at any time;
  - limits in place above will apply to a group of companies;
  - sector limits will be monitored regularly for appropriateness.

### 3.3 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 sections below; 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 Head of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which 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. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high-quality investment counterparties, (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the Council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA-
 and have, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where rated):
  - i. Short Term – F1
  - ii. Long Term – A-
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland ring-fenced operations. This bank can be included provided they continue to be part nationalised or meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Bank subsidiary and treasury operation -. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above
- Building Societies. The Council will use all societies which:
  - i. Meet the ratings for banks outlined above;
  - or
  - ii. Have assets in excess of £500m;
- Money Market Funds (MMFs) CNAV LNAV VNAV – £11m
- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, parish councils etc
- Housing associations
- Supranational institutions
- Property funds and corporate Bonds- We may consider these funds if they meet the creditworthiness criteria. No decision will be made on the use of these funds without the Council approval.

**Use of additional information other than credit ratings.** Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps,

rating Watches/Outlooks) will be applied to compare the relative security of differing investment opportunities.

**Time and monetary limits applying to investments.** The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	<b>Fitch Long term Rating (or equivalent)</b>	<b>Money and/or % Limit</b>	<b>Transaction limit</b>	<b>Time Limit</b>
<b>Banks 1 higher quality</b>	<b>AA-</b>	<b>£15m</b>	<b>£7m</b>	<b>2 yr</b>
<b>Banks 1 medium quality</b>	<b>A+</b>	<b>£13m</b>	<b>£6m</b>	<b>2 yr</b>
<b>Banks 1 lower quality</b>	<b>A-</b>	<b>£11m</b>	<b>£5m</b>	<b>1 yr</b>
<b>Banks 2 – part nationalised</b>	<b>N/A</b>	<b>£11m</b>	<b>£6m</b>	<b>1 yr</b>
<b>Limit 3 category – Council's banker (not meeting Banks 1)</b>	<b>-</b>	<b>£13m</b>	<b>£10m</b>	<b>1 yr</b>
<b>Building Societies</b>	<b>-</b>	<b>£15m</b>	<b>£10m</b>	<b>2 yr</b>
<b>Other institutions limit*</b>	<b>-</b>	<b>£8m</b>	<b>£5m</b>	<b>1 yr</b>
<b>DMADF</b>	<b>UK sovereign rating</b>	<b>Unlimited</b>	<b>Unlimited</b>	<b>1 Yr</b>
<b>Local authorities</b>	<b>N/A</b>	<b>£15m</b>	<b>£10m</b>	<b>5 yr</b>
<b>Housing associations</b>	<b>XXX</b>	<b>£6m</b>	<b>£3m</b>	<b>2 yr</b>
<b>Money Market Funds</b>	<b>AAA</b>	<b>£15m</b>	<b>£11m</b>	<b>liquid</b>

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

### **Creditworthiness.**

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on *actual* levels of credit losses. (Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. The Financial Policy Committee (FPC) stated that for real stress in the sector, the economic output



would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

### 3.4 Other limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

- a) **Non-specified treasury management investment limit.** The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being 5% of the total treasury management investment portfolio.
- b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of AA-** from Fitch or equivalent. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
- c) **Other limits.** In addition:
  - no more than 10% will be placed with any non-UK country at any time;
  - limits in place above will apply to a group of companies;
  - sector limits will be monitored regularly for appropriateness.

### 3.5 Investment strategy

**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.

#### **Investment returns expectations.**

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

The Bank Rates forecasts for financial year end (March) are:

- Q 1 2021 0.10%
- Q1 2022 0.10%
- Q1 2023 0.10%

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

Year	%
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.25%
2024/25	0.75%
Later years	2.00%

- The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus. It may also be affected by what, if any, deal the UK agrees as part of Brexit.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and shorter term PWLB rates until 2023/24 at the earliest.

### Negative investment rates

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

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

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

**Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

The Council is asked to approve the following treasury indicator and limit:

<b>Upper limit for principal sums invested for longer than 365 days</b>			
<b>£m</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>
Principal sums invested for longer than 365 days	£0	£0	£0

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.

### **3.6 Investment performance / risk benchmarking**

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- **0.05% historic risk of default when compared to the whole portfolio.**

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft - £1m if required.
- Liquid short term deposits of at least £1m available with a week's notice.
- Weighted average life benchmark is expected to be 1 month, with a maximum of 1 year.

Yield - local measures of yield benchmarks are

- Investments – internal returns above the 3 months LIBID rate

### **3.7 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 to FAP.

**APPENDICES**

(These can be appended to the report or omitted as required)

1. Prudential and treasury indicators
2. Interest rate forecasts
3. Economic background
4. Treasury management practice 1 – credit and counterparty risk management (option 1)
5. Treasury management practice 1 – credit and counterparty risk management (option 2)
6. Approved countries for investments
7. Treasury management scheme of delegation
8. The treasury management role of the section 151 officer

## 4 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2021/22 – 2023/24

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

### 4.1 Capital expenditure

Capital expenditure £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Corporate & Support Services	116	619	85	50
Community Services	1,322	2,179	813	813
Environmental and Planning	2,201	7,251	1,428	771
<b>Non-HRA</b>	<b>3,639</b>	<b>10,049</b>	<b>2,326</b>	<b>1,634</b>
<b>HRA</b>	<b>9,504</b>	<b>6,128</b>	<b>5,423</b>	<b>4,464</b>
<b>Total</b>	<b>13,143</b>	<b>16,177</b>	<b>7,749</b>	<b>6,098</b>

### 4.2 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.

%	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Non-HRA	8.09	8.97	9.80	11.08	11.58
HRA	34.68	33.68	32.67	31.60	29.83
<b>Total</b>	<b>42.77</b>	<b>42.65</b>	<b>42.47</b>	<b>42.68</b>	<b>41.41</b>

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

### 4.3 Maturity structure of borrowing

Maturity structure of 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.

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

<b>Maturity structure of fixed interest rate borrowing 2021/22</b>		
	<b>%</b>	<b>Amount £'000</b>
Under 12 months	4%	2,941
12 months to 2 years	4%	2,941
2 years to 5 years	12%	8,824
5 years to 10 years	21%	14,707
10 years to 20 years	41%	29,414
20 years to 30 years	8%	5,883
30 years to 40 years	5%	3,300
40 years to 50 years	5%	5,000
	<b>100%</b>	<b>73,011</b>

#### **4.4. Control of interest rate exposure**

Please see paragraphs 3.3, 3.4 and 4.4.

#### 4.5 INTEREST RATE FORECASTS 2020-2024

This appendix is in a separate downloadable file.

PWLB forecasts are based on PWLB certainty rates.

	Mar 21	Jun 21	Sep 21	Dec 21	Mar 22	Jun 22	Sep 22	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Months	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 Months	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 Months	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 Yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 Yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 Yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 Yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

## 5 ECONOMIC BACKGROUND

- **UK.** The key quarterly meeting of the Bank of England Monetary Policy Committee kept **Bank Rate** unchanged on 5.11.20. However, it revised its economic forecasts to take account of a second national lockdown from 5.11.20 to 2.12.20 which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE, announced in March to June, runs out. It did this so that “announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target”.
- Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:
  - The economy would recover to reach its pre-pandemic level in Q1 2022
  - The Bank also expected there to be excess demand in the economy by Q4 2022.
  - CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the “inflation risks were judged to be balanced”.
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it “stands ready to adjust monetary policy”, the MPC this time said that it will take “whatever additional action was necessary to achieve its remit”. The latter seems stronger and wider and may indicate the Bank’s willingness to embrace new tools.
- One key addition to **the Bank’s forward guidance in August** was a new phrase in the policy statement, namely that “it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably”. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years’ time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. **Inflation** is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.
- However, the minutes did contain several references to **downside risks**. The MPC reiterated that the “recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside”.
- **COVID-19 vaccines.** We had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9<sup>th</sup> November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, this vaccine has demanding cold storage requirements of minus 70c that impairs the speed of application to the general population. It has therefore been particularly welcome that the Oxford University/AstraZeneca vaccine has now also been approved which is much cheaper and only requires fridge temperatures for storage.



The Government has 60m doses on order and is aiming to vaccinate at a rate of 2m people per week starting in January, though this rate is currently restricted by a bottleneck on vaccine production; (a new UK production facility is due to be completed in June).

- **Public borrowing** was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.
- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. It is likely that the one month national lockdown that started on 5<sup>th</sup> November, will have caused a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.
- **Brexit.** While the UK has been gripped by the long running saga of whether or not a deal would be made by 31.12.20, the final agreement on 24.12.20, followed by ratification by Parliament and all 27 EU countries in the following week, has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.
- **Monetary Policy Committee meeting of 17 December.** All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy that it had highlighted in November. But this was caveated by it saying, "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." So, while the vaccine is a positive development, in the eyes of the MPC at least, the economy is far from out of the woods. As a result of these continued concerns, the MPC voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for six months from 30.4.21 until 31.10.21. (The MPC had assumed that a Brexit deal would be agreed.)
- **Fiscal policy.** In the same week as the MPC meeting, the Chancellor made a series of announcements to provide further support to the economy: -

- An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
- The furlough scheme was lengthened from the end of March to the end of April.
- The Budget on 3.3.21 will lay out the “next phase of the plan to tackle the virus and protect jobs”. This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).
- The **Financial Policy Committee** (FPC) report on 6.8.20 revised down their expected credit losses for the banking sector to “somewhat less than £80bn”. It stated that in its assessment, “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.
- **US.** The result of **the November elections** meant that while the Democrats gained the presidency and a majority in the House of Representatives and the casting vote in the Senate. President Biden will consequently have the ability to determine policy and to implement his election manifesto.
- **The economy** had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the third wave in the Midwest looks as if it now abating. However, it also looks as if the virus is rising again in the rest of the country. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk**.
- **World growth.** World growth will have been in recession in 2020. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

## Summary

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

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

## INTEREST RATE FORECASTS

**Brexit.** The interest rate forecasts provided by Link are based on deal on 31.12.20. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

### The balance of risks to the UK

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

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

- **UK government** takes too much action too quickly to raise taxation or introduce austerity measures that depress demand in the economy.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

Further details on the Economic Forecast are available on request.

## 6 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The MHCLG 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 adopted the Code on 01/04/2018 and will apply its principles to all investment activity. In accordance with the Code, the Head of Finance has produced its 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** – These investments are sterling investments of not more than one-year maturity, or those which 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. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, housing association, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled

investment vehicles, such as money market funds, rated XXX by Standard and Poor's, Moody's and / or Fitch rating agencies.

5. A body that is considered of a high credit quality (such as a bank or building society). For category 5 this covers bodies with a minimum Short-Term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's and / or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are in the body of the report .

**Non-specified investments** – are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any sterling investments with:

	<b>Non Specified Investment Category</b>	<b>Limit (£)</b>
a.	<b>The Council's own banker</b> if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£11m
b.	<b>Building societies not meeting the basic security requirements under the specified investments.</b> 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 use such building societies which have a minimum asset size of £500m, but will restrict these type of investments to £9m.	£15m
c.	Any <b>bank or building society</b> that has a minimum long-term credit rating of A- , for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£11m
d.	Any <b>non-rated subsidiary</b> of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to limit of £5m for a period of 6 months.	£9m

NOTE 1. This Authority will seek further advice on the appropriateness and associated risks with investments in these categories.

**The monitoring of investment counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Head of Finance, and if required new counterparties which meet the criteria will be added to the list.

## 6 APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

### ***Based on lowest available rating***

#### AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

#### AA+

- Canada
- Finland
- U.S.A.

#### AA

- Abu Dhabi (UAE)
- France

#### AA-

- Belgium
- Hong Kong
- Qatar
- **U.K.**

***THIS LIST IS AS AT 5.1.21***

## **7 TREASURY MANAGEMENT SCHEME OF DELEGATION**

### **(i) Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of /amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval.

### **(ii) Finance & Performance Committee**

- approval of division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- reviewing the treasury management policy and procedures and making recommendations to Council .

### **(iii) SLT/ Head of Finance**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

## **8 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.