

REPORT REFERENCE NO.	RC/21/5
MEETING	RESOURCES COMMITTEE
DATE OF MEETING	10 FEBRUARY 2021
SUBJECT OF REPORT	TREASURY MANAGEMENT STRATEGY (INCLUDING PRUDENTIAL AND TREASURY INDICATORS REPORT 2021-22 TO 2023-24)
LEAD OFFICER	Director of Finance & Resourcing (Treasurer)
RECOMMENDATIONS	<p><i>That the Authority be recommended to approve:</i></p> <p><i>(a). the expansion of its approved counter parties to include subsidiary entities but the terms and conditions of any such arrangement be reserved to the Authority;</i></p> <p><i>(b). the Treasury Management Strategy and the Annual Investment Strategy;</i></p> <p><i>(c). the Minimum Revenue Provision statement for 2021-22, as contained as Appendix B;</i></p>
EXECUTIVE SUMMARY	As agreed at the Authority meeting of 18 December 2017, there is a requirement for Resources Committee to review the Treasury Management Strategy for recommendation to the Authority. This report sets out a treasury management strategy and investment strategy for 2021-22, including the Prudential Indicators associated with the capital programme for 2021-22 to 2023-24 considered elsewhere on the agenda of this meeting. A Minimum Revenue Provision Statement for 2021-22 is also included for approval.
RESOURCE IMPLICATIONS	As indicated in this report
EQUALITY RISKS AND BENEFITS ANALYSIS	The contents of this report are considered compatible with existing human rights and equality legislation.
APPENDICES	<p>A. Prudential and Treasury Management Indicators 2021-22 to 2023-24.</p> <p>B. Minimum Revenue Provision Statement 2021-22.</p> <p>C. Link Treasury Solutions economic report</p>
BACKGROUND PAPERS	<p>Local Government Act 2003.</p> <p>Chartered Institute of Public Finance Accountancy's (CIPFA) Prudential Code and CIPFA Treasury Management Code of</p>

	Practice
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1. **INTRODUCTION**

Background

- 1.1. The Authority 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 Authority's low risk appetite, providing adequate liquidity initially before considering investment return.
- 1.2. The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that the Authority 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 Authority risk or cost objectives.
- 1.3. 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.
- 1.4. 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."
- 1.5. The Authority has not engaged in any commercial investments and has no non-treasury investments.

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

- 1.7. The Act therefore requires the Authority to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as paragraph 8 of this report); this sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 1.8. MHCLG issued revised investment guidance which came into force from 1 April 2018. This guidance was captured within the revised Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code 2017.

CIPFA requirements

- 1.9. 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
- 1.10. The aim of this capital strategy is to ensure that all elected members on the full Authority fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

Treasury Management reporting

- 1.11. The Authority 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. In addition, this Authority will receive quarterly update reports.

c. An Annual Treasury Report: This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.12. The above reports are required to be adequately scrutinised before being recommended to the Authority. This role is undertaken by the Resources Committee.

1.13. The Authority has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives.
- Receipt by the Authority of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a mid-year review report and an annual report (stewardship report) covering activities during the previous year.
- Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices - for the Authority the delegated body is Resources Committee - and for the execution and administration of treasury management decisions - for the Authority the responsible officer is the Treasurer.
- Delegation by the Authority of the role of scrutiny of treasury management strategy and policies to a named body - for the Authority the delegated body is Resources Committee.

Treasury Management Strategy for 2021-22

1.14. The suggested strategy for 2021-22 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Authority's treasury advisor, Link Group (Link).

1.15. The strategy for 2021-22 covers two main areas:

Capital Issues

- capital plans and prudential indicators; and
- the Minimum Revenue Provision statement.

Treasury Management Issues

- treasury limits in force which will limit the treasury risk and activities of the Authority;

- treasury Indicators;
- the current treasury position;
- the borrowing requirement;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers

Training

- 1.16. 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 following training has been undertaken by members of the Resources Committee and further training will be arranged as required.

Treasury Management Advisors

- 1.17. The Authority uses Link Group, Treasury solutions as its external treasury management advisors.
- 1.18. The Authority recognises that responsibility for treasury management decisions remains with the Authority at all times and will ensure that undue reliance is not placed upon the services of its external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, its treasury advisers.
- 1.19. The Authority 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 Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed, documented and subjected to regular review.

2. CAPITAL PRUDENTIAL INDICATORS FOR 2021-22 TO 2023-24

- 2.1. The Authority'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.

- 2.2. This prudential indicator is a summary of the Authority'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 as proposed in the Capital Programme report considered elsewhere on the agenda. Other long term liabilities such as PFI (Private Finance Initiative) and leasing arrangements which already include borrowing instruments are excluded.

Proposed Capital Expenditure	2020-21 (forecast spending)	2021-22	2022-23 (provisional)	2023-24 (provisional)
	£m	£m	£m	£m
Estates	3.344	5.889	4.400	1.700
Fleet & Equipment	3.264	4.797	7.100	5.300
Total	6.608	10.686	11.500	7.000

- 2.3. The following table summarises the financing of the capital programmes shown above. Additional capital finance sources may become available during the year, for example, additional grants or external contributions. The Authority will be requested to approve increases to the capital programme to be financed from other capital resources as and when the need arises.

Capital Financing	2020-21 (forecast spending)	2021-22	2022-23 (provisional)	2023-24 (provisional)
	£m	£m	£m	£m
Capital receipts/ contributions	0.380	0.000	0.000	0.000
Capital grants	0.000	0.000	0.000	0.000
Capital reserves	2.663	6.625	8.098	3.417
Revenue	2.037	2.037	2.037	2.300
Existing and New borrowing	1.528	2.024	1.365	1.283
Total	6.608	10.686	11.500	7.000

The Authority's Borrowing Need (Capital Financing Requirement)

- 2.4. The second prudential indicator is the Authority'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 Authority's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 2.5. The CFR does not increase indefinitely, as the Minimum Revenue Provision is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.
- 2.6. The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of scheme include a borrowing facility by the PFI via a public-private partnership lease provider and so the Authority is not required to separately borrow for these schemes. The Authority currently has £1.010m of such schemes within the CFR.
- 2.7. The Authority is asked to approve the CFR projections below as included in Appendix A:

Capital Financing Requirement (CFR)	2020-21 (forecast spending)	2021-22	2022-23 (provisional)	2023-24 (provisional)
	£m	£m	£m	£m
Non-HRA expenditure	24.851	24.758	24.264	23.771
Other Long Term Liabilities	1.010	0.907	0.791	0.656
Total CFR	25.861	25.665	25.055	24.426
Movement in CFR	(2.918)	(2.410)	(2.671)	(2.107)
Less MRP	(2.223)	(2.220)	(1.975)	(1.911)
Net movement in CFR	(0.695)	(0.191)	(0.695)	(0.196)

Core funds and expected investment balances

- 2.8. 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 overleaf are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Estimated Year end Resources	2020-21	2021-22	2022-23	2023-24
	£m	£m	£m	£m
Reserve Balances	29.824	27.090	13.901	9.529
Capital receipts/ contributions	0.380	0.000	0.000	0.000
Provisions	1.214	0.214	0.000	0.000
Other	12.432	14.455	15.821	17.104
Total core funds	43.850	41.759	29.721	26.633
Working capital*	1.000	1.000	1.000	1.000
Under/over borrowing	0.000	0.000	0.000	0.000
Expected investments	44.850	42.759	30.721	27.633

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

Minimum Revenue Provision Strategy

- 2.9. The Authority 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), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision).
- 2.10. MHCLG regulations have been issued which require the Authority to approve a **Minimum Revenue Provision Statement** in advance of each year. A variety of options are provided under which Minimum Revenue Provision could be made, with an overriding recommendation that the Authority should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits.
- 2.11. The Authority does not plan to make any Voluntary Revenue Provisions within the next three years.
- 2.12. Although four main options are provided under the guidance, the Authority has adopted:
- The Asset Life Method***
- 2.13. Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, Minimum Revenue Provision is to be made in equal annual instalments over the life of the asset. In this circumstance the asset life is to be determined when Minimum Revenue Provision commences and not changed after that.

- 2.14. Minimum Revenue Provision should normally commence in the financial year following the one in which the expenditure is incurred. However, when borrowing to construct an asset, the Authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone beginning to make Minimum Revenue Provision until that year. Investment properties should be regarded as becoming operational when they begin to generate revenues.
- 2.15. As some types of capital expenditure incurred by the Authority are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.
- 2.16. A draft Minimum Revenue Provision statement for 2021-22 is attached as Appendix B for Authority approval.
- 2.17. The financing of the approved 2021-22 capital programme, and the resultant prudential indicators have been set on the basis of the content of this statement.

Prudential Indicators for Affordability

- 2.18. The previous sections of the report cover the overall limits for capital expenditure and borrowing, but within the overall framework indicators are also included to demonstrate the affordability of capital investment plans.
- 2.19. A key indicator of the affordability of capital investment plans is the ratio of financing costs to the net revenue stream; this indicator identifies the trend in the cost of capital financing (borrowing costs net of investment income) against the Authority's net budget requirement. Annual capital financing costs are a product of total debt outstanding, the annual repayment regime and interest rates. The forecast ratios for 2021-22 to 2022-23 based on current commitments and the proposed Capital Programme are shown below.

Financing costs as a % of net revenue	2020-21 (forecast spending)	2021-22	2022-23 (provisional)	2023-24 (provisional)
Annual cost	3.92%	4.28%	3.91%	3.74%

3. BORROWING

- 3.1. The capital expenditure plans set out in Section 2 provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Authority'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.

Current borrowing position

3.2. The Authority's treasury portfolio position at 31 March 2020 and current are summarised below.

3.3.

TREASURY PORTFOLIO				
	actual	actual	current	current
	31.3.20	31.3.20	31.12.20	31.12.20
Treasury investments	£000	%	£000	%
banks	23,201	62%	12,021	29%
building societies - unrated		0%		0%
building societies - rated		0%		0%
local authorities	11,500	31%	20,000	48%
DMADF (H.M.Treasury)		0%		0%
money market funds	2,720	7%	9,644	23%
certificates of deposit		0%		0%
Total managed in house	37,421	100%	41,665	100%
bond funds		0%		0%
property funds		0%		0%
Total managed externally	0	0%	0	0%
Total treasury investments	37,421	100%	41,665	100%
Treasury external borrowing				
local authorities		0%		0%
PWLB	25,444	100%	25,397	100%
LOBOs		0%		0%
Total external borrowing	25,444	100%	25,397	100%
Net treasury investments / (borrowing)	11,977	0	16,268	0

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

External Debt	2020-21 (forecast spending)	2021-22	2022-23	2023-24
	£m	£m	£m	£m
Debt at 1 April	24.851	24.757	24.264	23.771
Expected change in Debt	(0.593)	(0.093)	(0.493)	(0.493)
Other long-term liabilities (OLTL)	1.010	0.907	0.791	0.656
Expected change in OLTL	(0.103)	(0.117)	(0.135)	0.252
Actual gross debt at 31 March	25.165	25.455	24.427	24.185
CFR	25.861	25.665	25.055	24.426
Under/ Over borrowing	0.000	0.000	0.000	0.000

- 3.4. Within the prudential indicators there are a number of key indicators to ensure that the Authority operates its activities within well-defined limits. One of these is that the Authority 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.
- 3.5. The Authority complied with this prudential indicator in the current year and is not envisaging difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Limits to Borrowing Activity

- 3.6. Two Treasury Management Indicators control the level of borrowing. They are:
- **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.

Estimated Operational Boundary	2020-21	2021-22	2022-23	2023-24
	£m	£m	£m	£m
Non-HRA expenditure	25,544	24,951	24,857	24,364
Other Long Term Liabilities	1,112	1,010	907	791
Total	26,656	25,961	25,765	25,155

- **The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Authority. 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.

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 Authority's plans, or those of a specific Authority, although this power has not yet been exercised.

3.7. The Authority is asked to approve the following authorised limit:

Estimated Authorised Limit	2020-21	2021-22	2022-23	2023-24
	£m	£m	£m	£m
Non-HRA expenditure	26,787	26,189	26,071	25,553
Other Long Term Liabilities	1,162	1,056	947	823
Total	27,949	27,244	27,018	26,376

Prospects for interest rates

3.8. The Authority has appointed Link Group as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. The following table and narrative within Appendix C - paragraphs C28 and C33 gives their view.

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

Borrowing strategy

3.9. As reported in the separate report on this agenda “Capital Programme 2021-22 to 2023-24”, it is the strategic intent of the Authority not to increase its exposure to external borrowing during the next three years. To achieve this a recommendation the Authority has supported the inclusion in the base revenue budget a revenue contribution to capital investment (£1.7m in 2021-22).

- 3.10. This being the case there is no intention to take out any new borrowing during 2021-22 as the Authority can rely on its prudent Capital Reserve. Should this position change then the Treasury Management Strategy will need to be reviewed to reflect any change to the borrowing strategy and would be subject to a further report to the Authority.

Policy on borrowing in advance of need

- 3.11. Per statutory requirements, the Authority 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 considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

Debt rescheduling

- 3.12. Officers regularly engage with Link to review the PWLB loan portfolio and consider opportunities for early repayment, this is not currently economically viable due to the penalties applied.
- 3.13. 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.
- 3.14. If rescheduling was done, it will be reported to this Committee, at the earliest meeting following its action.

4. ANNUAL INVESTMENT STRATEGY

Investment Policy

- 4.1. The Authority's investment policy has regard to the 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") and the CIPFA Treasury Management Guidance Notes 2018. The Authority's investment priorities will be security first, portfolio liquidity second, then yield.
- 4.2. In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Authority applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.
- 4.3. 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 Authority 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.

4.4. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Creditworthiness Policy

4.5. The Authority applies the creditworthiness service provided by Link Group. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's.

4.6. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

4.7. This modelling approach combines credit ratings, credit watches, credit outlooks and Credit Default Swap spreads in a weighted scoring system which is then combined with an overlay of Credit Default Swap spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Authority to determine the duration for investments and are therefore referred to as durational bands. The Authority is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Authority would not be able to replicate using in house resources.

4.8. The Link Group creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

4.9. Typically the minimum credit ratings criteria the Authority use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

4.10. All credit ratings will be monitored weekly. The Authority is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of Credit Ratings the Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

- 4.11. Sole reliance will not be placed on the use of this external service. In addition the Authority will also use market data and market information, information on government support for banks and the credit ratings of that government support.

Approved Instruments for Investments

- 4.12. Investments will only be made with those bodies identified by the authority for its use through the Annual Investment Strategy.
- 4.13. **Country Limits** The Authority will apply a sovereign rating at least equal to that of the United Kingdom for any UK based counterparty. At the time of writing this was AA long term and F1+ short term. It is possible that the credit rating agencies could downgrade the sovereign rating for the UK but as we have no minimum sovereign rating applying to the UK this approach will not limit the number of UK counterparties available to the Authority. Therefore, to ensure our credit risk is not increased outside the UK, the sovereign rating requirement for investments was amended to “Non UK countries with a minimum sovereign rating of AA-“.
- 4.14. **IFRS9 Lease Accounting** As a result of the change in accounting standards for 2019/20 under IFRS 9, the 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, 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 commencing from 1.4.18.). The Authority does not currently hold any finance leases to which this accounting standard would apply.

Non-specified Investments

- 4.15. Non specified investments are those which do not meet the Specified Investment Criteria and covers those counterparties where there is either no recognised credit rating and/or an anticipation that an investment will be for greater than one year in duration.
- 4.16. The Authority had not previously placed non-specified investments as a result of its prudent approach to place security and liquidity over yield. However, from April 2015 it was agreed that the strategy be amended to include investments with maturity of longer than 364 days. The maximum duration limit on any non-specified deposit will be determined by the colour assigned to the Counterparty on the Link Group credit list on the date the investment is placed, but typically will be for no longer than 24 months. Where such investments are placed via the Secondary Market i.e. buying the remaining term of an existing instrument, then the term will be for 24 months.
- 4.17. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the categories outlined in Table 13 overleaf.
- 4.18. The maturity limits recommended will not be exceeded. Under the delegated powers the Section 112 Officer (Treasurer) can set limits that are based on the latest economic conditions and credit ratings.

4.19. The following table shows those bodies with which the Authority will invest.

Specified Investments	Non Specified Investments
	Subsidiary entities
Deposits with the Debt Management Agency Deposit Facility	
Term Deposits with UK government, UK local authorities, highly credit rated banks and building societies (including callable deposits and forward deals)	Term Deposits with UK government, UK local authorities, highly credit rated banks and building societies (including callable deposits and forward deals) Non-credit rated building societies. <i>The total amount of non-specified investments will not be greater than £5m in value.</i>
Banks nationalised/part nationalised or supported by the UK government	Banks nationalised/part nationalised or supported by the UK government
Money Market Funds	
Non UK highly credited rated banks	
UK Government Treasury Bills	
Certificates of Deposit	
Corporate Bonds	
Gilts	

4.20. The Authority's detailed risk management policy is outlined in the Treasury Management Policy which is reviewed and considered on an annual basis.

4.21. The above criteria has been amended since last year to reflect the potential for a loan to be made to the Authority's subsidiary company, although this would be subject to terms and conditions as approved by the Authority.

Investment Strategy

4.22. In-house funds: The Authority's in-house managed funds are mainly cash-flow derived and investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

4.23. Investment returns: 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.

4.24. The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

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

4.25. **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Authority'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.

Maximum principal sums invested > 365 days			
£m	2021-22	2021-22	2022-23
Principal sums invested > 365 days	£5m	£5m	£5m

End of year investment report

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

Treasury Management Scheme of Delegation

The Authority;

- Receiving and reviewing reports on treasury management policies, practices and activities
- Approval of annual strategy
- Approval of/amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and approval
- Approval of the division of responsibilities
- Approving the selection of external service providers and agreeing terms of appointment.
- Reviewing the treasury management policy and procedures and making recommendations to the Authority.

Resources Committee;

- Receiving and reviewing regular monitoring reports and acting on recommendations

- Review of annual strategy prior to recommendation to full authority

***Role of the Section 112 officer (Director of Finance and Resourcing/
Treasurer)***

- 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.

5. SUMMARY AND RECOMMENDATIONS

- 5.1. The Authority is required to consider and approve the treasury management strategy to be adopted prior to the start of the financial year. This strategy must also include proposed prudential indicators and a Minimum Revenue Provision statement. Approval of the strategy for 2021-22 as contained in this report will also incorporate the adoption of the revised CIPFA Treasury Management Code of Practice.

AMY WEBB

Director of Finance & Resourcing (Treasurer)

APPENDIX A TO REPORT RC/21/5

PRUDENTIAL INDICATORS					
			INDICATIVE INDICATORS 2023/24 to 2024/25		
	2021/22	2022/23	2023/24	2024/25	2025/26
	£m	£m	£m	£m	£m
	Estimate	Estimate	Estimate	Estimate	Estimate
Capital Expenditure					
Non - HRA	10,636	11,400	7,000	8,200	6,400
HRA (applies only to housing authorities)					
Total	10,636	11,400	7,000	8,200	6,400
Ratio of financing costs to net revenue stream					
Non - HRA	4.28%	3.91%	3.74%	3.87%	4.26%
HRA (applies only to housing authorities)	0.00%	0.00%	0.00%	0.00%	0.00%
Capital Financing Requirement as at 31 March					
	£000	£000	£000	£000	£000
Non - HRA	24,758	24,264	23,771	26,120	27,984
HRA (applies only to housing authorities)	0	0	0	0	0
Other long term liabilities	907	791	656	509	349
Total	25,665	25,055	24,426	26,629	28,333
Annual change in Capital Financing Requirement					
	£000	£000	£000	£000	£000
Non - HRA	(196)	(610)	(628)	2,203	1,704
HRA (applies only to housing authorities)	0	0	0	0	0
Total	(196)	(610)	(628)	2,203	1,704
PRUDENTIAL INDICATORS - TREASURY MANAGEMENT					
Authorised Limit for external debt					
	£000	£000	£000	£000	£000
Borrowing	26,189	26,071	25,553	28,058	29,875
Other long term liabilities	1,056	947	823	681	527
Total	27,244	27,018	26,376	28,739	30,401
Operational Boundary for external debt					
	£000	£000	£000	£000	£000
Borrowing	24,951	24,857	24,364	26,752	28,476
Other long term liabilities	1,010	907	791	656	509
Total	25,961	25,765	25,155	27,408	28,985
Maximum Principal Sums Invested over 364 Days					
Principal Sums invested > 364 Days	5,000	5,000	5,000	5,000	5,000

<u>TREASURY MANAGEMENT INDICATOR</u>	Upper Limit %	Lower Limit %
Limits on borrowing at fixed interest rates	100%	70%
Limits on borrowing at variable interest rates	30%	0%
Maturity structure of fixed rate borrowing during 2021/22		
Under 12 months	30%	0%
12 months and within 24 months	30%	2%
24 months and within 5 years	50%	15%
5 years and within 10 years	75%	3%
10 years and above	100%	80%

MINIMUM REVENUE STATEMENT 2021-22

Supported Borrowing

The Minimum Revenue Provision will be calculated using the regulatory method (option 1). Minimum Revenue Provision will therefore be calculated using the formulae in the old regulations, since future entitlement to RSG in support of this borrowing will continue to be calculated on this basis.

Un-Supported Borrowing (including un-supported borrowing prior to 1 April 2008)

The Minimum Revenue Provision in respect of unsupported borrowing under the prudential system will be calculated using the asset life method (option 3). The Minimum Revenue Provision will therefore be calculated to repay the borrowing in equal annual instalments over the life of the class of assets which it is funding. The repayment period of all such borrowing will be calculated when it takes place and will be based on the finite life of the class of asset at that time and will not be changed.

Finance Lease and PFI

In the case of Finance Leases and on balance sheet PFI schemes, the Minimum Revenue Provision requirement is regarded as met by a charge equal to the element of the annual charge that goes to write down the balance sheet liability. Where a lease of PFI scheme is brought, having previously been accounted for off-balance sheet, the Minimum Revenue Provision requirement is regarded as having been met by the inclusion of the charge, for the year in which the restatement occurs, of an amount equal to the write-down for the year plus retrospective writing down of the balance sheet liability that arises from the restatement. This approach produces a Minimum Revenue Provision charge that is comparable to that of the Option 3 approach in that it will run over the life of the lease or PFI scheme and will have a profile similar to that of the annuity method.

Minimum Revenue Provision will normally commence in the financial year following the one in which the expenditure was incurred. However, when borrowing to construct an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone the beginning to make Minimum Revenue Provision until that year. Investment properties will be regarded as becoming operational when they begin to generate revenues.

Minimum Revenue Provision Overpayments

A change introduced by the revised MHCLG Minimum Revenue Provision Guidance was the allowance that any charges made over the statutory Minimum Revenue Provision, Voluntary Revenue Provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2020 the total Voluntary Revenue Provision overpayments were £nil.

LINK TREASURY SOLUTIONS ECONOMIC REPORT

ECONOMIC BACKGROUND

Global Outlook

UK

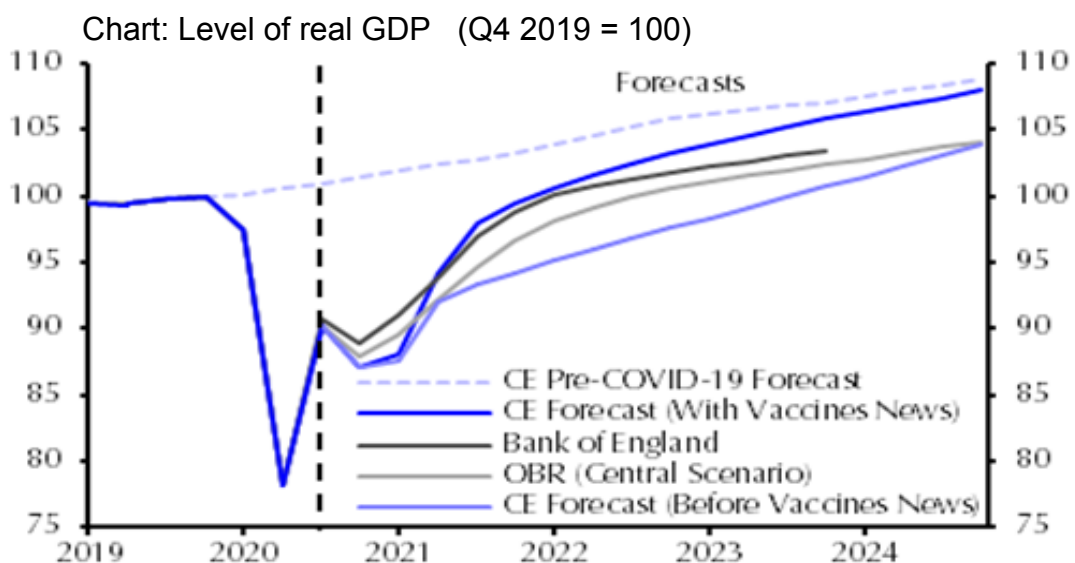
- C.1 The key quarterly meeting of the Bank of England Monetary Policy Committee kept **Bank Rate** unchanged on 5.11.20. However, it revised its economic forecasts to take account of a second national lockdown from 5.11.20 to 2.12.20 which is obviously going to put back economic recovery and do further 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”.
- C.2 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”.
- C.3 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.
- C.4 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.

- C.5 However, the minutes did contain several references to downside risks. The MPC reiterated that the “recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside”. It also said “the risk of a more persistent period of elevated unemployment remained material”. Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. Upside risks included the early roll out of effective vaccines.
- C.6 COVID-19 vaccines. We had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines 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).
- C.7 These announcements, plus expected further announcements that other vaccines could be approved soon, have enormously boosted confidence that life could largely return to normal during the second half of 2021, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels; this would help to bring the unemployment rate down. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could start to be eased, beginning possibly in Q2 2021 once vulnerable people and front-line workers have been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% in 2021 instead of 9%.
- C.8 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.

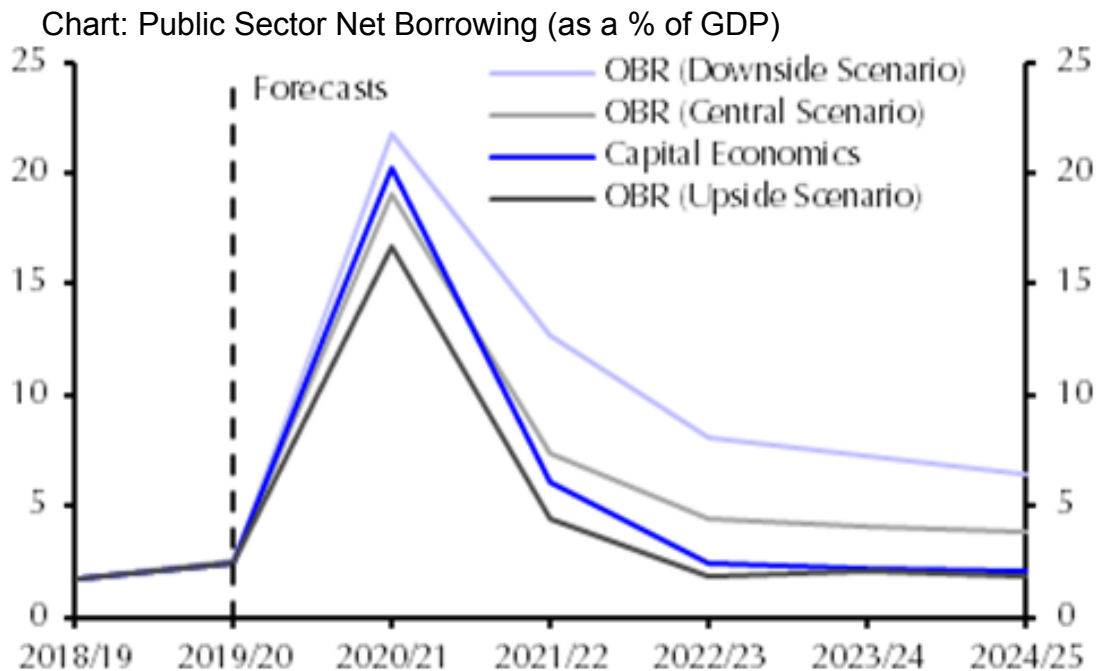
In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the 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.

C.9 Overall, the pace of recovery was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. It is likely that the one month national lockdown that started on 5th November, will have caused a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.

C.10 December 2020 / January 2021. Since then, there has been rapid back-tracking on easing restrictions due to the spread of a new mutation of the virus, and severe restrictions were imposed across all four nations. These restrictions were changed on 5.1.21 to national lockdowns of various initial lengths in each of the four nations as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under these new restrictions for some months; this means that the near-term outlook for the economy is grim. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow GDP to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022. Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant caveat is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development and vaccine production facilities are being ramped up around the world.



C.11 This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade would have major repercussions for public finances as it would be consistent with the government deficit falling to around 2.5% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assumed that there is a reasonable Brexit deal and also that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.



C.12 There will still be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

C.13 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.

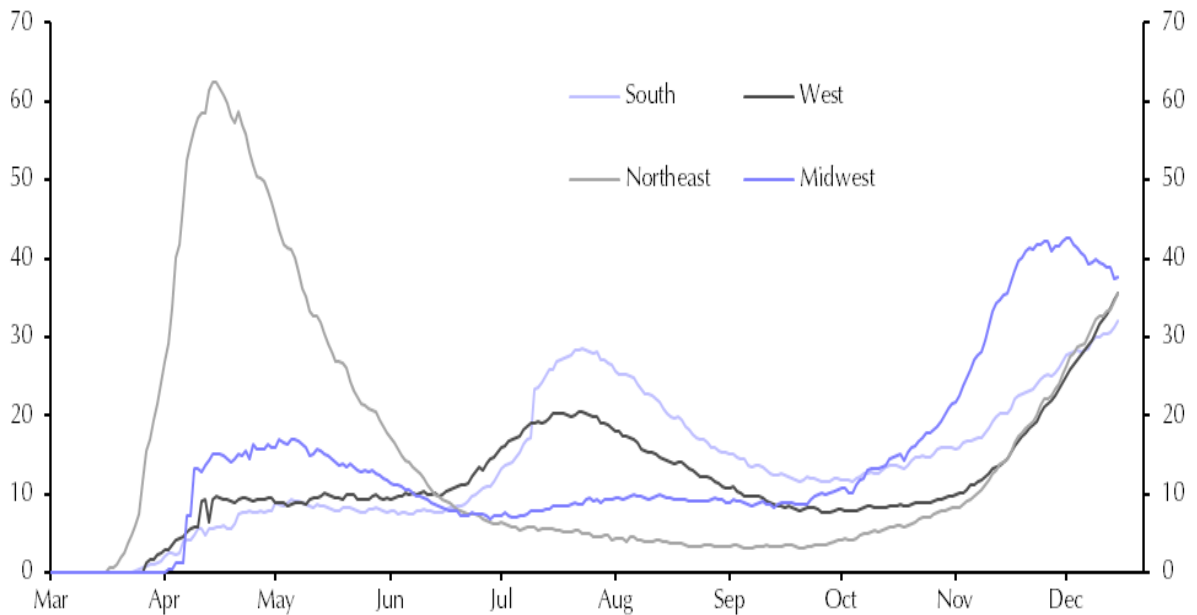
- C.14 Monetary Policy Committee meeting of 17 December. All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downside risks to the economy that it had highlighted 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.)
- C.15 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).
- C.16 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%.

USA

- C.17 The result of the November elections meant that while the Democrats gained the presidency and a majority in the House of Representatives, it looks as if the Republicans could retain their slim majority in the Senate provided they keep hold of two key seats in Georgia in elections in early January. If those two seats do swing to the Democrats, they will then control both Houses and President Biden will consequently have a free hand to determine policy and to implement his election manifesto.
- C.18 The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the third wave in the Midwest looks as if it now abating. However, it also looks as if the virus is rising again in the rest of the country.

The latest upturn poses a threat that the recovery in the economy could stall. This is the single biggest downside risk to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

COVID-19 hospitalisations per 100,000 population



C.19 The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and retail sales dropping back. The economy is set for further weakness in December and into the spring. However, a \$900bn fiscal stimulus deal passed by Congress in late December will limit the downside through measures which included a second round of direct payments to households worth \$600 per person and a three-month extension of enhanced unemployment insurance (including a \$300 weekly top-up payment for all claimants). GDP growth is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

C.20 After Chair Jerome Powell unveiled the Fed's adoption of a flexible average inflation target in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that "it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time." This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan.

It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

- C.21 The Fed's meeting on 5 November was unremarkable - but at a politically sensitive time around the elections. At its 16 December meeting the Fed tweaked the guidance for its monthly asset quantitative easing purchases with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that inflation will only get back to 2.0% in 2023, the vast majority expect the fed funds rate to be still at near-zero until 2024 or later. Furthermore, officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – which will also have an influence on gilt yields in this country.

EU

- C.22 In early December, the figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3 the economy grew by 12.5% q/q leaving GDP down by “only” 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Q4 and in Q1 of 2021, as a second wave of the virus has affected many countries: it is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the countries most affected by the first wave.
- C.23 With inflation expected to be unlikely to get much above 1% over the next two years, the ECB has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of TLTRO, (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022.

The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before later in quarter 2 of 2021.

CHINA

- C.24 After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

JAPAN

- C.25 A third round of fiscal stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That's huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal effort should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

WORLD GROWTH

- C.26 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.
- C.27 Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products.

It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

INTEREST RATE FORECASTS

- C.28 Brexit. The interest rate forecasts provided by Link were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. There is therefore no need to revise these forecasts now that a trade deal has been agreed. Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.
- C.29 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.
- C.30 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:
- UK government takes too much action too quickly to raise taxation or introduce austerity measures that depress demand in the economy.
 - UK - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

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

C.31 GILT yields / Public Works Loan Board (PWLB) rates. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc.

The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

- C.32 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.
- C.33 As the interest forecast table for PWLB certainty rates in paragraph 3.7 shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.
- C.34 **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.

- 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)
- While this authority will not be able to avoid borrowing to finance new capital expenditure in the medium term following the rundown of reserves there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Investment Strategy

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, 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 significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.
- **Negative investment rates:** While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

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

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