Agenda Item

WARRINGTON BOROUGH COUNCIL

FULL COUNCIL

1 March 2021

Report of	Lynton Green, Director of Corporate Services (Section 151 Officer)/Deputy Chief Executive	
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Ward Members:	All	

2021/22 TREASURY MANAGEMENT STRATEGY

1. PURPOSE OF THE REPORT

1.1 This report sets out the Council's proposed Treasury Management Strategy for 2021/22. The report was reported to the Audit and Corporate Governance Committee on 4 February 20221 and scrutinised by them. It is now presented to Council for approval.

2. BACKGROUND

2.1 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 activities is to ensure that cash flow is adequately planned, with sufficient cash being available when it is required to meet payment obligations. Surplus monies are invested, in reliance upon the statutory investment power, in counterparties or instruments approved by the Council as being commensurate with their risk appetite, with a view to ensuring that adequate liquidity takes precedence over investment return.

2.2 Treasury Management activity also incorporates financing the Council's capital activity that flows from its approved capital and non-treasury management investment plans, whether through the use of available resources, or through external borrowing. This element of activity seeks to balance aggregate borrowing needs over the longer term with the Council's Capital and Investment Strategy through arranging long and short term borrowing within a balanced risk portfolio approach. It may also be appropriate for certain loans taken out to be restructured in the future where variations in interest rate levels cause this to represent an appropriate risk balancing measure.

2.3 The contribution the treasury management function makes to the authority is critical, as balancing the borrowing and investment operation ensures liquidity and the ability to meet spending commitments as they fall due, either for day-to-day revenue requirements or for larger capital transactions. The treasury operation seeks to optimise the effect of borrowing costs and investment income on the Council's resources, whilst having careful regard to inherent risks. 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.

2.4 Whilst any commercial initiatives or loans to third parties may impact on the treasury management function, these activities are referred to by CIPFA as "non-treasury management activities" and thereby considered separately from the more normal form of day to day treasury management activities.

2.5 CIPFA defines treasury management as:

> "*The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.*"

2.6 Alongside, for the Council, responsible investment is a key added lens that needs to be integrated with the Treasury Management Strategy. The Council has declared a Climate Emergency previously but beyond this, there is a growing appreciation that financial markets and investments cannot be removed from the wider environment and society within which they sit. This means articulating and clarifying the Council's approach towards responsible investment, sustainability, its impact on society and the environment, as well as other ethical and good governance considerations. These factors can collectively be termed ESG (Environmental, Social and Governance). Integrating ESG into the Treasury Management Strategy will allow the Council to deliver on key goals and also improve the long-term resilience of the treasury portfolio, particularly as it is now increasingly clear that there are financial benefits to be gained in the long-term from recognising the impact of climate change, efficient energy consumption, sustainable resources, inclusion, diversity, equality and strong corporate governance.

2.7 Revised reporting is recommended for the 2021/22 reporting cycle following revisions by the Ministry for Housing, Communities and Local Government (MHCLG) to the Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and CIPFA Treasury Management Code. The primary reporting changes recommended include the inclusion within the Prudential Code of the need for a capital strategy, with the objective of providing a longer-term focus on the Council's capital and investment plans. This wider approach will incorporate the Councils approved commercial activity. The Capital Strategy is reported to the Council separately.

2.8 The Treasury Management Strategy is drawn from the Council's Treasury Policy Statement and covers investments, borrowing, the outlook for interest rates, the management of associated risks, prudential indicators and the policy to be adopted on the Minimum Revenue Provision (MRP).

2.9 The Council's 2021/22 Treasury Management Strategy is attached at Appendix 1. Whilst endeavours are made to limit the technical content of the Strategy, it is by its nature necessary to include technical aspects. Additional explanations are therefore contained within the glossary of terms in Annexe A with a view to helping Members' understanding of certain technical terms contained in the Strategy.

3 CONFIDENTIAL OR EXEMPT

Not confidential.

4 FINANCIAL CONSIDERATIONS

N/A

5. RISK ASSESSMENT

5.1 The Council would be putting its financial standing at risk, as well as failing to meet the requirements of the Local Government Act 2003, should it not have regard to the recommended procedures.

5.2 The Treasury Management Strategy and Prudential and Treasury Indicators reflect various assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy.

6. EQUALITY AND DIVERSITY/EQUALITY IMPACT ASSESSMENT

6.1 The Finance Service undertakes an Equality Impact Assessment (EIA) in its wider functions. Service changes that emerge from proposals contained in the treasury management strategy are subject to EI Assessments.

7. CONSULTATION

Not applicable.

8. REASONS FOR RECOMMENDATIONS

8.1 To ensure the Council's Treasury Management Strategy reflects the manner in which it has had regard to the revised 2017 CIPFA Treasury Management Code of Practice and MHCLG Investment Guidance.

9. RECOMMENDATIONS

9.1 Council approves the 2021/22 Treasury Management Strategy.

10. BACKGROUND PAPER

10.1 Treasury Management working papers.

Contacts for Background Papers:

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11. CLEARANCE DETAILS

	Name	Consulted		Date Consulted
		Yes	No	
SLT			✓	
Director of Corporate Services (Section 151 Officer) / Deputy Chief Executive	**Lynton Green**	✓		22.1.2021
Director of Legal Services	**Matthew Cumberbatch**	✓		22.1.2021

APPENDIX 1

2021/22 COUNCIL'S TREASURY MANAGEMENT STRATEGY

1. INTRODUCTION

1.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code (for "affordability" purposes) and the CIPFA Treasury Management Code of Practice when it is setting prudential indicators for the next three years to ensure that its capital investment plans are affordable, prudent and sustainable.

1.2 The Council is recommended therefore to set out its Treasury Management Strategy and an Annual Investment Strategy (as recommended by Investment Guidance). The Treasury Management Strategy contains the Council's policies for managing their cash flows and investments and for giving priority to the security and liquidity of those investments. The Investment Strategy also includes the Council's Strategy in respect of its non-treasury management investments. All investments are made in accordance with the requirements of S.12, Local Government Act 2003 (LGA).

1.3 Each of these Strategies has had regard to the Ministry for Housing, Communities and Local Government (MHCLG) Guidance on Local Government Investments ("the Guidance"), the latest form of which became operative from 1 April 2018.

1.4 The combined Strategy also includes the Council's 2021/22 Minimum Revenue Provision Strategy, which is compiled after having regard to Guidance issued under S.21 (1)(A) of LGA 2003.

1.5 The CIPFA Code of Practice on Treasury Management (revised in December 2017) has been adopted by the Council. The Investment Guidance has been amended and is detailed in section 9 of this report.

1.6 The primary recommendations of the Treasury Management Code are as follows:

(i) Creation and maintenance of an annual Treasury Management Policy Statement, which set out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives:

- Reporting Requirements – the Council is recommended to receive and approve, as a minimum, three associated reports each year, which should incorporate appropriate Policies, together with estimates and actuals of associated activities.
    - **Prudential and Treasury Indicators and Treasury Strategy** – the first, and most important report covers:

1. The capital plans (including prudential indictors);
2. A Minimum Revenue Provision (MRP) Policy (how residual capital debt liability is charged to revenue over time);
3. The Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
4. An Investment Strategy (the parameters on how investments are to be managed).

- **A mid-year treasury management report** – this will update members with the progress of treasury management activity, amending prudential indicators as necessary, and whether any policies require revision. In addition, the Council will receive quarterly update reports.

- **An annual treasury report** – this provides details of a selection of actual prudential and treasury indicators and treasury operations compared with the estimates previously included within the strategy.

(iii) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(iv) Delegation by the Council of the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. For this Council, the delegated body is the Audit and Corporate Governance Committee.

1.7 The CIPFA revised 2017 Prudential and Treasury Management Codes recommend that all local authorities prepare a Capital Strategy, to include the following:

- A high-level long-term overview of how priorities for capital investment are to be determined, together with how much additional borrowing may be required
- An overview of how the associated risks are to be managed
- The implications for future financial sustainability

The aim of this Capital Strategy is to ensure that all elected members of the Council fully understand the Council's overall long-term policy objectives, and the associated implications arising from these.

1.8 The Council's Capital Strategy for 2021/22 is due to be approved on 1 March 2021.

1.9 The climate emergency and ESG more generally have moved up the policy agenda for both the Council as well as the government. CIPFA has indicated that it intends to integrate aspects of this into future iterations of the Prudential Code. This is most likely to take the form of monitoring and disclosure requirements, coupled with having regard to considering these factors as part of the Council's prudent approach to investment.

1.10 The suggested Strategy for 2021/22 in respect of the following aspects of the Treasury Management function is based upon the views of treasury officers regarding interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor (Link Asset Services). The Strategy covers two main areas:

Capital Issues
- The capital investment 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 arising from activities of the Council
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- Debt rescheduling opportunities
- The investment strategy
- ESG Policy
- Creditworthiness policy
- Policy on use of external service providers
- Future developments.

These elements reflect the Council having had regard to the requirements and recommendations of the Local Government Act 2003, the CIPFA Prudential Code, the MHCLG MRP Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

1.11 Separately, Section 32 of the Local Government Finance Act 1992 requires the Chief Finance Officer of the Authority to calculate and report upon its budget requirement for each financial year, and the adequacy of proposed financial reserves, to include the revenue costs which flow from capital financing decisions.

1.12 Section 3 of the Local Government Act 2003 requires that the Council must determine and keep under review how much money it can afford to borrow. In order to do this, it must have regard to the Prudential Code in order to determine an Affordable Borrowing Limit.

1.13 In general, the Prudential Code recommendations provide for close scrutiny and monitoring of capital investment plans in order to achieve a balance between investment needs and associated revenue consequences.

1.14 **Training**:

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training. This especially applies to members responsible for scrutiny. Both internal and external training courses are provided to Members. Member training is a key theme from CIPFA and the MHCLG. During 2021/22 a comprehensive training programme will be offered to all members.

2. TREASURY LIMITS FOR 2021/22

2.1 It is a statutory duty, under Section 3 of LGA 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. The Authorised Limit arising under the Prudential Code is intended to enable the statutory affordability requirement to be complied with.

2.2 The Council must have regard to the Prudential Code when setting its Affordable Borrowing Limit (ABL). This essentially requires it to ensure that total capital investment remains within sustainable limits and in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

2.3 Whilst termed an "Affordable Borrowing Limit", its extent represents mainly the Council's underlying capital investment "debt" liability, whether or not this is fully financed from external borrowing at any moment in time (e.g. the Council may on occasion use its own resources to finance new capital investment liabilities, rather than investing the monies externally). This underlying capital investment liability may also include any "credit arrangements" entered into by the Council, such as arise from leases. The ABL is determined at least annually, on a rolling basis, for the forthcoming financial year and two successive financial years.

2.4 Prudential and Treasury Indicators identified at Annexe 2 are relevant for the purposes of setting an integrated Treasury Management Strategy.

2.5 The Council is also recommended to indicate whether it has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management in Local Authorities (the Treasury Management Code). The original Treasury Management Code was adopted in 2004 at a full meeting of the Council, and the 2009 revised Treasury Management Code was adopted at a full meeting of the Council on 1 March 2010. The latest Amendments to the Code amended in 2017 are set out in section 9 of this report. Subject to any amendments by the Committee it will be forwarded to the Council for approval at its meeting of 1 March 2021.

3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position as at 31st December 2020 comprised of:

Current Portfolio Position	Principal £m	Total £m	Average Interest Rate %
Fixed Rate Funding			
- Public Works Loans Board	1,112.466		2.179
- Money Market	154.112		2.198
- Temporary Borrowing	185.210	1,451.788	1.432
Variable Rate Funding			
- Public Works Loans Board			
- Money Market	150.000	150.000	0.871
TOTAL BORROWING		**1,601.788**	2.155
Council Investments			
- Externally Managed	(107.808)		4.344
- Internally Managed	(51.080)		0.821
- Call Accounts	(170.037)	(328.926)	0.140
TOTAL INVESTMENTS		**(328.926)**	**1.377**
NET BORROWING		**1,272.862**	
Non-Treasury Investments			
- Group Entities	(324.698)		
- Loans to Housing Assoc. & Commercial	(237.792)		
- Investment Properties	(303.717)	**(866.207)**	
NET BORROWING (less Non-Treasury)		**406.655**	

BORROWING REQUIREMENT

3.2 The capital investment plans provide details of the service and non-treasury management investment 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 these activities arising under the Council's Capital Strategy. This will involve both the organisation of the cash flow and, where capital plans require, and organisation of appropriate borrowing facilities. The Strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual Investment Strategy. The Council's capital investment plans are the key driver of treasury management activity.

3.3 The output of the capital investment plans is reflected in prudential indicators, which are designed to assist member's overview of performance.

3.4 The table below sets out the Council's future borrowing requirement (current and previous year are shown for comparison) based on current commitments and plans.

2019/20 Actual £m	2020/21 Estimate £m	Capital Investment	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	TOTAL 3 Years £m
521.355	378.985	Capital Expenditure	404.064	308.906	83.378	**796.348**
		Financed By:				
24.667	22.614	Capital Grants & Reserves	12.658	0.508	0	**13.166**
4.820	3.859	Capital Receipts	4.861	2.125	1.553	**8.539**
0.000	0.213	Council Revenue Funding	0	0	0	**0**
3.116	13.000	External Funding	13.747	4.585	0	**18.332**
185.834	**339.299**	**Financing need for year**	**372.798**	**301.688**	**81.825**	**756.311**

4. PROSPECTS FOR INTEREST RATES

4.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

4.2 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 no solely, the treasury advisers.

4.3 The Council 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.

4.4 The Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future. The suggested budgeted investment earnings rates for returns on investments placed for period 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):

- 2020/21 0.10%
- 2021/22 0.10%
- 2022/23 0.10%
- 2023/24 0.10%
- 2024/25 0.10%
- Longer term later years 2.00%

Link Asset Services' interest rate forecast

The following table gives their view:

	Bank Rate	PWLB Borrowing Rates			
		5 year	**10 year**	**25 year**	**50 year**
Mar-21	0.10%	0.80%	1.10%	1.50%	1.30%
Jun-21	0.10%	0.80%	1.10%	1.60%	1.40%
Sep-21	0.10%	0.80%	1.10%	1.60%	1.40%
Dec-21	0.10%	0.80%	1.10%	1.60%	1.40%
Mar-22	0.10%	0.90%	1.20%	1.60%	1.40%
Jun-22	0.10%	0.90%	1.20%	1.70%	1.50%
Sep-22	0.10%	0.90%	1.20%	1.70%	1.50%
Dec-22	0.10%	0.90%	1.20%	1.70%	1.50%
Mar-23	0.10%	0.90%	1.20%	1.70%	1.50%
Jun-23	0.10%	1.00%	1.30%	1.80%	1.60%
Sep-23	0.10%	1.00%	1.30%	1.80%	1.60%
Dec-23	0.10%	1.00%	1.30%	1.80%	1.60%
Mar-24	0.10%	1.00%	1.30%	1.80%	1.60%

4.5 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 5 November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that 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 as economic recovery is expected to be only gradual and, therefore, prolonged.

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

4.7 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, yields have fallen 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 yield to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

4.8 As the interest forecast table for PWLB certainty rates 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 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.

4.9 **Investment returns** – are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

4.10 **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 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. 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)
- Local Infrastructure Rates is gilt plus 60bps (G+60bps)

4.11 As a consequence of these increases in margins, some 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.

4.12 On 25 November 2020, 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 80 basis points (G+80bps)
- Local Infrastructure Rates is gilt plus 60bps (G+60bps)

4.13 **Borrowing for capital financing** – 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 capital financing 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.

4.14 While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and 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.

5. ECONOMIC BACKGROUND

5.1 **UK** – the key quarterly meeting of the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 5 November 2020. However, it revised its economic forecasts to take account of a second national lockdown from 5 November to 2 December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do 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".

5.2 Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:

- The economy would recover to reach its pre-pandemic level in Q1 2022
- The Bank also expects there to be excess demand in the economy by Q4 2022
- CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".

5.3 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.

5.4 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 the level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. The 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 factors and so not a concern.

5.5 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

5.6 As for upside risks – news that various COVID19 vaccines have been cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9 November 2020 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).

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

5.8 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 Q1 saw growth at -3.0% followed by -18.8% in Q2 and then an upswing of +16.0% in Q3; 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 November, will have cause a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.

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

5.10 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 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 depress economic growth and recovery.

5.11 There will still be some painful longer term adjustments as for example office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possible 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.

5.12 **Brexit** – while the UK has been gripped by the long running saga of whether or not a deal would be made by 31 December the final agreement on 24 December, 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 were 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 not amendment to these forecasts.

5.13 **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 it had highlighted in November. But this was caveated by it saying “Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case”. So, while the vaccine is a positive development, in the eyes of the MPC at least, the economy is far from out of the woods. As a result of these continued concerns, the MPC voted to extend the availability of the Term Funding Scheme with additional incentives for small and medium size enterprises for six months from 30 April until 31 October 2021. (The MPC had assumed that a Brexit deal would be agreed).

5.14 **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 March 2021 will lay out the “next phase of the plan to tackle the virus and protect jobs”. This does not sound like tax rises are imminent (which could hold back the speed of economic recover)
- The Financial Policy Committee (FPC) report on 6 August revised down their expected credit losses for the banking sector to “somewhat less than £80bn”. It stated that in its assessment “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.

5.15 **USA** – the result of the November elections means that while the Democrats have gained the presidency, a majority in the House of Representatives and now the senate due to the change in the two key seats in Georgia elections. The Democrats will then control both Houses and President Biden will consequently have a free hand to determine policy and to implement his election manifesto.

5.16 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 Q4, 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, 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.

5.17 The restrictions imposed to control its spread are once again weighting 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.

5.18 After Chair Jerome Powell unveiled the Fed's adoption of a flexible average inflation target in his Jackson Hole speech in late August, 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 and 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 Federal Open Market Committee (FOMC) updated economic and rate projections in mid-September showed that official 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 on trade deal.

5.19 The Fed's meeting on 5 November was unremarkable – but at a politically sensitive time around the elections. At its 16 December meeting the Fed tweaked the guidance for its asset purchases in the statement issued after the conclusion of today's FOMC meeting, with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that inflation will only get back to 2% in 2023, the vast majority expect the Fed funds rate to be still at near zero until 2024 or later. Furthermore, the new rate forecast tables reveal that officials think the balance of risks surrounding the 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.

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

5.21 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 Pandemic Emergency Purchase Programme (PEPP) (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities until December 2023. Three additional tranches of targeted longer-term refinancing operations (TLTROs) (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.

5.22 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.

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

5.24 **China** - after a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implanted 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 it comparative outperformance compared to western economies.

5.25 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 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.

5.26 **Japan** – a third round of stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That'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 arrow should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

5.27 **World growth** - world growth will be 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.

5.28 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 Chinse 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 to 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 likely that there will be 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.

5.29 **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.

5.30 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.

5.31 **Interest Rate Forecasts** – Brexit – the interest rate forecasts are predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20.

5.32 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.

5.33 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 subject to major 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, (an so PWLB rates), in the UK.

5.34 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 currently anticipated.
- **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 year or so. 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 Eurobond to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- **European banks** – weak capitalisation of some European banks, which could be undermined further depending on the extent of credit losses resultant of the pandemic.

- **German minority government and 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 intends to 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. In November, Hungary and Poland threatened to veto the 7 year EU budget due to the inclusion of a rule of law requirement that poses major challenges to both countries. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks** – for example China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

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

- **UK** – a significant rise in inflationary pressures, e.g. caused by a stronger than currently expected recovery in the UK economy after effective vaccines are administered quickly to the UK population, leading to a rapid resumption of normal life and return to full economic activity across all sectors of the economy. . These could be caused by an uncooperative Brexit deal or by stronger than currently expected recovery in the UK economy after effective vaccines are administered quickly to the UK population which leads to a resumption of normal life and a return to full economic activity across all sectors of the economy.
- **The Bank of England** – is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a rapid series of increases in Bank Rate to stifle inflation.

5.36 Outside of financial risks, there are also key non-financial risks with financial consequences over the longer-term:

- **Environmental risks –** Climate change has continued to become an increasingly evident problem, with extreme weather events rising and temperatures increasingly on a global basis. Coupled with the depletion of natural resources and the negative feedback loop created by hydrocarbon pollution, there are growing concerns about the environment and the potential financial impact on societies, economies and businesses.
- **Social risks** – Inequality, diversity and inclusion are becoming more important considerations. The unequal recovery since the last financial crisis coupled with financial pressures on public sector balance sheets has led to a growing divergence of outcomes and concerns about parts of society being systematically left behind. There is also increased

scrutiny from a range of stakeholders and society at large regarding entrenched biases. This has been evidenced most recently through the Black Lives Matter and #Me-too movements as well as the Uighurs controversy in China, to name just a few examples. Beyond a moral imperative, it is also clear that this is emerging as a reputational and legal risk for companies, which could cause long-term damage in the absence of change. For the Council, there is also a vested interest in protecting and minimising the most vulnerable in society.

- **Governance risks** – Governance covers the rights and responsibilities of the senior management of companies, institutions and counterparties, in particular its structures, corporate values and accountability processes. The proper treatment of employees, ensuring an ethical approach to supply chains, paying living wages, how counterparties ensure that management is acting in the best interests of all stakeholders – these are all clear areas of focus that if poorly managed, can lead to reputational and financial consequences for the Council's portfolio in the long-term. Properly done, they improve its resilience.

5.37 More recently, the Covid-19 pandemic has exacerbated many of these risks and exposed many longer-term frailties in society. The profile of cases and deaths have been unequal, while the economic fallout has led to significant lockdowns for large parts of the economy, increased job insecurity and elevated business risk for SMEs. The Council has seen the immediate impact of the pandemic in its own finances as well, making it critical to having a longer-term approach to tackling these risks.

5.38 On the positive side, the pandemic has also led to renewed momentum in tackling climate change. It is increasingly a consensus that any economic recovery will be led by significant fiscal stimulus. Much of this is focused on the environment, notably areas such as renewables and electric vehicles.

5.39 The UK will host the 26th UN Climate Change Conference of the Parties (COP26) in Glasgow in November 2021. COP26 will be biggest summit the UK has ever hosted and has been described as the most significant climate event since the 2015 Paris Agreement. The current government has pledged to reduce the UK's carbon emissions to "net zero" by 2050 – an ambitious target. Meeting this means that emissions from transport, farming, industry and other parts of the economy will have to be voided or offset. That requires significant investment and creates opportunities for the Council to support its policy objectives and to ensure its portfolio is aligned with these.

6. BORROWING STRATEGY

6.1 The capital investment plans provide details of the anticipated spending and non-treasury investment 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 facilitate this joint nature of activity. This will involve both the organisation of the cash flow and, where capital investment 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.

6.2 In general, the Council will borrow for one of two purposes – to finance cash flow in the short-term or to fund capital investment over the longer term. The Council is currently maintaining an under-borrowed position, in that it is investing some of its own resources internally. This means that the underlying capital debt liability (primarily signified by the Capital Financing Requirement), has not been fully funded through external borrowing. This strategy is considered to be prudent, as investment returns are low, whilst counterparty risk is also limited under this approach.

6.3 The Council's treasury portfolio position at 31 March 2020, with forward projections is summarised below and detailed in table 3.3. The actual external borrowing (under treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlights an underlying need to borrow £339.299m in 2020/2021, £372.798m in 2021/22, £301.688m in 2022/23 and £81.825m 2023/24. There is a large requirement in the early years. This is due to the impact of new capital investment schemes in the programme and the need to replace some existing short term loans which were taken to benefit from the then existing market conditions.

6.4 A key aim of the Treasury Management Strategy is to minimise the cost of the Council's external borrowing (portfolio), through seeking to spread the period for which loans are raised so as to avoid any undue fluctuation on interest costs arising from the future need to replace earlier amounts borrowed.

6.5 Currently the average rate of interest on the Council's loan portfolio is 2.16%, which is considered to be a beneficially low rate. The achievement of such low average rate demonstrates how the Council benefits from the best value for money in terms of its borrowing. This is the result of a number of years proactively managing the portfolio on loans through restructuring and taking advantage of the best possible interest rates available. The proposed treasury management strategy aims to continue this successful approach.

6.6 The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- UK Local Authorities
- Municipal Bond Agency
- Any institution approved for investments including high quality supranational banks
- European Banks Green Sustainable Bond Issuances
- World Wide Banks Green Sustainable Bond Issuances

- UK public and private sector pension funds
- Any other financial institution approved by the Prudential Regulation Authority, which is part of the Bank of England and is responsible for the regulation and supervision of banks, building societies, credit unions, insurers and major investment firms
- Capital market bond investors either over the counter or through electronic trading platforms
- Community Municipal Bonds

6.7 New financial institutions as a source of borrowing and / or types of borrowing – currently the PWLB Certainty Rate is set at gilts+80bps. However, consideration may still need to be given to sourcing funding from the follow:

- 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.

The PWLB rate forecasts are given in the table below.

	PWLB Borrowing Rates			
	5 year	**10 year**	**25 year**	**50 year**
Mar-21	0.80%	1.10%	1.50%	1.30%
Jun-21	0.80%	1.10%	1.60%	1.40%
Sep-21	0.80%	1.10%	1.60%	1.40%
Dec-21	0.80%	1.10%	1.60%	1.40%
Mar-22	0.90%	1.20%	1.60%	1.40%
Jun-22	0.90%	1.20%	1.70%	1.50%
Sep-22	0.90%	1.20%	1.70%	1.50%
Dec-22	0.90%	1.20%	1.70%	1.50%
Mar-23	0.90%	1.20%	1.70%	1.50%
Jun-23	1.00%	1.30%	1.80%	1.60%
Sep-23	1.00%	1.30%	1.80%	1.60%
Dec-23	1.00%	1.30%	1.80%	1.60%

6.8 These forecasts are based around an expectation that there will normally be variations of +/-25bp during each quarter around these average forecasts in the normal economic and political circumstances. However, greater variations can occur should there be any unexpected shocks to financial and/or political systems.

6.9 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration was given to sourcing funding at cheaper rates. The Council will also evaluate the option of borrowing further from the bond markets during 2021/22. Borrowing from the bond market will take place if it offers greater value for money than borrowing from the PWLB. The degree to which any option proves cheaper than PWLB Certainty Rate and the changes to criteria is still evolving at the time of writing and further updates will be provided.

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

- If it was felt that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- If it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and 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 still lower than they are projected to be in the next few years.

6.11 There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns. The Council's policy for 2021/22 will be to balance investments to obtain returns within the council's risk appetite. However, an assessment of the opportunity for borrowing will be made on the cost of borrowing long-term, within forward approved Capital Financing Requirement estimates, and will be consider carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

6.12 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 in respect of known needs, having regard to the Capital Strategy, after having regard also to the need to ensure value for money and the security of such funds.

6.13 All transactions will be reported to the Audit and Corporate Governance Committee at the next available opportunity.

7. DEBT RESCHEDULING

7.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt (which has now been compounded, since 20 October 2010 and 9 October 2019 (new borrowing rates), by a considerable further widening of the difference between new borrowing and repayment rates) has generally meant that PWLB to PWLB debt restructuring is now much less attractive than before these events. In particular, consideration would have to be given to the balance to be struck between premiums incurred and benefits arising from replacement borrowing. Interest savings may also be achievable through using other local authority loans and market loans in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

7.2 As short-term borrowing rates are generally likely to be cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term to short term borrowing. However, such savings will need to be considered in the light of the current treasury position, the cost of loan repayment (premiums incurred), and potential future fluctuation in interest rates.

7.3 The reasons for any rescheduling to take place will include:

(a) The generation of cash savings and / or discounted cash flow savings;

(b) Help fulfil the borrowing strategy outlined above;

(c) Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

7.4 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

7.5 All rescheduling will be reported to the Audit and Corporate Governance Committee at the earliest meeting following this action.

7.6 It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

8. TREASURY POLICY STATEMENT

8.1 Treasury management within this Council is undertaken having regard to the CIPFA Code of Practice for Treasury Management in the Public Services ("the TM Code"). This Code has been reviewed and updated following recent developments in the marketplace and the introduction of the Localism Act 2011 for English local authorities.

8.2 The Council has complied with the recommendations of the TM Code and has formally adopted the key recommendations as described within Section 4.

8.3 In accordance with the TM Code, the Council defines treasury management activities as:

"The management of the council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

8.4 'Investments' are described within the latest Investment Guidance as covering all of the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily or partially for financial returns, such as investment property portfolios. To the extent that this recommendation includes investments which are not managed as part of normal treasury management activity, the relevant Council Policy detail is contained within their Investment Strategy.

8.5 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Further, the Council considers both financial risks, such as credit risk, as well as non-financial risks, such as climate risk. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

8.6 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

8.7 The Council will create and maintain, as the cornerstone for effective treasury management:

- A Treasury Policy Statement, setting out the policies, objectives and approach to risk management of its treasury management activities
- Suitable Treasury Management Practices (TMPs) setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities (reported to the Audit & Corporate Governance Committee annually)
- Treasury management Prudential Indicators as determined by the recommendations of the CIPFA Prudential Code;

- The content of the Policy Statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the TM Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the TM Code's key principles.
- The Council will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, an annual report after its close and an half year review report.
- The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Audit & Corporate Governance Committee, and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the Council's Treasury Management Strategy and the TM Code, who is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

2021/22 COUNCIL'S ANNUAL INVESTMENT STRATEGY

9. INTRODUCTION

9.1 The aim of the Council's Investment strategy is to:

- Maintain the principal amount of sums invested;
- Maintain policy flexibility.

9.2 The Council's Section 151 Officer, under delegated powers, will undertake the most appropriate form of investments made in reliance upon S.12, Local Government Act 2003 (LGA) depending on the prevailing interest rates at the time, and taking into account the risks shown in the forecast above.

9.3 The Council invests surplus cash balances only with certain approved organisations, as security of funds is of primary importance. All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

10. INVESTMENT POLICY – Management of Risk

10.1 The MHCLG and CIPFA have suggested an extension of the meaning of 'investments' to include both financial and non-financial investments. The Council is mindful, however, that only those non-financial investments made in reliance upon S.12 are subject to the having regard to the Guidance. Certain non-financial investments can be made in reliance upon other powers where achievement of profit or financial return is not the primary motive.

10.2 When making a S.12 investment, the Council will have regard to:

- The requirements and extent of the statutory power
- 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 CIPFA TM Code")
- CIPFA Treasury Management Guidance Notes 2018.

10.3 The Council's investment priorities are:

(a) The security of capital
(b) The liquidity of its "specified" treasury management investments (funds, reserves and cash balances)
(c) Yield
(d) Social Impact
(e) ESG Impact (covering environmental, social and governance)

10.4 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity and in line with the Council's risk appetite. In the current economic climate it is consider 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 longer periods with high credit rated financial institutions, as well as wider range fund options.

10.5 Council has reviewed its classification with financial institutions under MIFID II requirements. A schedule has been included with the Treasury Management Practices document of those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client.

10.6 In accordance with guidance from MHCLG and CIPFA, which places a high priority on the management of risk, the Council has stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list, which also enable diversification and thus avoidance of concentration risk.

10.7 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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 this end the Council will engage with its advisors to maintain and monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is integrated into the credit methodology provided by the advisors, Link Asset Services in producing its colour coding which show the varying degrees of suggested creditworthiness.

10.8 The Council's officers also recognise that there are other risks of material importance to the treasury portfolio from an environmental, social and governance perspective. It is important, therefore, to assess these risks as well and to understand if these create potential longer-term financial and reputational risks for the Council, and if there are any commonalities with the Council's key objectives in this regard. To this end, the Council will use information sources and its advisors as appropriate to assist it in scrutinising and understanding if these might affect the suitability of potential counterparties.

10.9 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.

10.10 The aim of the strategy is to generate a list of highly creditworthy counterparties, which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment, minimisation of all risks and alignment where possible with the Council's policy objectives.

10.11 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices Statement.

11. SPECIFIED INVESTMENTS (MATURITIES UP TO ONE YEAR) AND COUNTERPARTY LIMITS

11.1 All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable. The maximum limit will be applied to each account (i.e. bank, local authority, bond, etc.)

1. Specified Investments (limit per counterparty)	**Maximum Group Limit**
UK Government	Unlimited
Local Authorities	Unlimited
Money Market Funds CNAV	£75.0m
Money Market Funds LVNAV	£75.0m
Money Market Funds VNAV	£75.0m
Pooled Fund Institution with a min rating of AAA/A1	£75.0m
Institutions with a minimum rating of AAA/A1	£75.0m
Institutions with a minimum rating of AA-/A2	£30.0m
Institutions with a minimum rating of A-/A3	£20.0m
Institutions with a minimum rating of BBB/A3	£15.0m
Building Societies – assets greater than £5,000 million	£5.0m
Building Societies – assets greater than £1,000 million	£2.5m
Building Societies – assets greater than £ 250 million	£1.0m

All investments with maturities up to maximum 1 year, high credit criteria:			
	Minimum 'High' Credit Criteria	**Maximum Limit**	**Maximum Maturity Period**
Debt Management Agency Deposit Facility	UK sovereign rating	£50m	1 year
Term deposits – local authorities and other public institutions	UK sovereign rating	£20m	1 year
Term deposits – banks and building societies*	UK sovereign rating	£20m	1 year

11.2 Term deposits with nationalised banks, banks and building societies

	Minimum 'High' Credit Criteria	**Maximum Limit**	**Maximum Maturity Period**
UK part nationalised banks	UK sovereign rating	£20m	1 year
Banks part nationalised by high credit rated (sovereign rating) countries	Sovereign rating A	£20m	1 year

*The countries approved for investing with their banks: Australia, Canada, Denmark, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland, Finland, USA, Abu Dhabi (UAE), Hong Kong, France, UK, Belgium, and Qatar.

11.3 Other instruments

	Minimum 'High' Credit Criteria	Max Individual Investment	Maximum Total Investment	Max Maturity Period
Collateralised deposit	UK sovereign rating	£5m	£5m	1 year
Certificates of deposits issued by banks and building societies	UK sovereign rating	£5m	£20m	1 year
UK Government Gilts	UK sovereign rating	£10m	£50m	1 year
Bonds issued by multilateral development banks	Long term AA	£10m	£20m	1 year
Treasury Bills	UK sovereign rating	£5m	£20m	1 year

Collective Investment Schemes structures as Open Ended Investment Companies (OEICs)			
Government Liquidity Funds	Long term AA	£10m	1 year
Money Market Funds	Variable CNAV Long Term AAA	£50m per fund	1 year
Money Market Funds	Stable LNNAV Long Term AAA	£50m per fund	1 year
Money Market Funds	Stable VNAV Long Term AAA	£20m per fund	1 year
Enhanced Cash Funds	Long Term AA	£5m	1 year
Bonds Funds	Long Term AA	£5m	1 year / rolling
Gilt Funds	Long Term AA	£5m	1 year
Bond Funds	B- and unrated debt issuers	£20m per fund	1 year / rolling
Managed Account Bond Funds	B- and unrated	£30m per fund	1 year / rolling

12. NON-SPECIFIED INVESTMENTS (MATURITIES OVER ONE YEAR)

12.1 These are any investments which do not meet the specified investment criteria. The investments may be for periods in excess of one year, and/or more complex instruments which require greater consideration by members and officers before being authorised. Non-financial investments are also likely to fall within this category, such as loans made solely the purpose of financial gain, or acquisitions of commercial property. Separate detailed consideration is given by the Council in respect of every proposal which represents these activities. Whilst these activities carried out solely for profit must necessarily rely upon the S.12 investment power, they may also have the effect of causing the Council's aggregate outstanding amount of borrowing to increase. The Investment Guidance recommends that where this is the case, appropriate quantitative indicators should be established which will allow Councillors and the general public to assess the risks and opportunities over both its payback period and period of borrowing taken out.
The Council undertakes to comply in general with these suggestions when considering each proposed transaction, but also comments that it would be inappropriate to seek to link any particular amount borrowed with any new investment.

12.2 A maximum of 95% may be held in aggregate in non-specified investments. A variety of investment instruments will be used both debt and equity subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Term deposits with nationalised banks and building societies:			
	Minimum 'High' Credit Criteria	**Maximum Limit**	**Maximum Maturity Period**
UK part nationalised banks	UK sovereign rating	£20m	5 year
Banks part nationalised by high credit rated (sovereign rating) countries UK and non UK*	Sovereign rating A	£20m	5 year

12.3 Maturities of any period:

	Minimum 'High' Credit Criteria	**Maximum Individual Investment**	**Maximum Group Limit**	**Maximum Maturity Period**
Structured deposits	In accordance with Link's Credit Worthiness Criteria	£5m	£20m	5 years
Banks and Building Societies term deposits with unrated counterparties : any maturity	The top twenty building societies by total assets with a minimum asset size of £1bn and the following credit rating Fitch (or its equivalent):			
	Long term rating AA-, short term rating F2	£1m	£5m	5 years
	Non rated	£0.5m	£1m	1 year
Challenger Banks term deposits with unrated counterparties : any maturity	The non-rated bank must have a minimum asset level of £200m,	£5m	£20m	1 year
Municipal Bonds	UK sovereign rating	£10m	£10m	10 years
Commercial paper	Short-term F2, Long term A	£5m	£5m	5 years
Corporate Bonds Corporate Bond Funds / Gilt Funds	Short-term F2, Long term A	£20m	£20m	10 years
Floating Rate Notes	Long term A	£1m	£5m	5 years
Covered Bonds	Long term AA-	£20m	£50m	10 years
Un-rated bonds	Long term	£50m	£75m	10 years
Churches, Charities and Local Authorities (CCLA) Property Fund		£20m	£20m	10 years

12.4 Maturities in excess of 1 year

	Minimum 'High' Credit Criteria	**Maximum Individual Limit**	**Maximum Group Limit**	**Maximum Maturity Period**
Term deposits – local authorities and other public institutions		£5m	£50m	5 years
Term deposits – banks and building societies		£1m	£5m	5 years
Certificates of deposits issued by banks and building societies	UK sovereign rating	£5m	£20m	5 years
UK Government Gilts	UK sovereign rating	£5m	£50m	5 years
Bonds issued by multilateral development banks	AA	£5m	£20m	5 years
Corporate bonds	Short term F2 Long Term A-	£10m	£20m	10 years
Green Energy Bonds	Internal and External Due Diligence	£100m	£100m	5 years
Collateralised Term Deposit	Local Authority	£5m	£20m	5 years
Sovereign bond issues (i.e. other than the UK government)	AA	£5m	£20m	5 years
Property Bonds	External Due Diligence	£20m	£50m	5 years
Property Pooled Funds	External Due Diligence	£50m	£150m	10 Years
LiveWire Community Energy	Internal Due Diligence	£1m	£1m	20 years
Funding Circle	Internal and External Due Diligence	£10m	£10m	5 years
Asset Backed Securities	Internal and External Due Diligence	£20m	£100m	10 years
Asset Backed Pooled Funds	Internal and External Due Diligence	£150m	£150m	10 years

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Bond Funds	AA	£5m	£10m	10 years
Gilt Funds	AA	£5m	£10m	5 years
Forest Financial Instrument	Internal and External Due Diligence	£20m	£50m	30 years
Special Purpose Acquisition Company Funds (SPAC)	Internal and External Due Diligence	£1m	£1m	2 years
Public Sector Social Impact Fund	Unrated	£100m	£100m	10 years
Real Estate Investment Trusts (REITS)	Internal & External Due Diligence	£20m	£50m	5 years
Bond Funds	B- and unrated debt issuers	£75m	£100m	5 years
Managed Account Bond Funds	B- and unrated	£50m	£50m	5 years
Bank Tier 2 Capital both upper & lower levels	Rated & Un rated – Internal & External Due Diligence	£25m	£50m	10 years
Loan Rates	Unrated	£50m	£50m	10 years
Debentures	Internal DD	£50m	£100m	10 years
Technology Enhanced Oil	Internal and External Due Diligence	£20m	£20m	5 years

12.5 As a result of the change in accounting standards for 2019/20 under IFRS 9, the Council 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 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, ending 31.3.23. The IFRS 9 provisions are unlikely to apply to any of the Council's non-financial investments where these are separately treated as capital expenditure or for other reasons do not fall within the definition of a financial instrument. Items of capital expenditure are not considered to satisfy the asset/liability criteria that is required in order for a financial instrument to be subject to IFRS9.

12.6 **OTHER TYPES OF NON-SPECIFIED INVESTMENTS**

- Fixed term deposits with variable rate and variable maturities
- Limited Liability Partnerships
- Limited Partnerships

- Loans made for solely financial gain
- Commercial property acquisitions

12.7 **INVESTMENTS TARGETTING HIGHER RETURNS**

The Council, over the last few years due to uncertainty in the world financial markets and the low returns on offer from traditional instruments and inflation eroding these returns together with a desire to invest in Environmental Social and Governance Investments (ESG), has successfully been investing in secured diversified higher yield investments. This policy will be continued into 2021/2022.

12.8 Without this allocation the weighted average return of the Council's cash investments based on investments held at 31 December 2020 would have been 0.14%; whereas the allocation to higher yielding investments has a weighted average return of bringing the overall average return for the portfolio to 1.182%.

12.9 The latest estimated value of investment income is circa £3.5m for 2020/21. However, as these balances and returns do not remain constant over the course of a year the figures are indicative, and the actual returns will form part of the outturn report at the conclusion of the financial year.

12.10 Higher yields can be accessed through long-term cash investments (although this is currently less the case as yields have declined) and investments in other assets than cash, such as pooled property, equities and bonds. Non-cash pooled investments must be viewed as medium-term investments in order that monies are not withdrawn in the event of a fall in capital values to avoid crystallising a capital loss.

12.11 Bond, equity and property funds offer enhanced returns. These allow the Council to diversify into asset classes other than cash without the need to manage the underlying investments. Depending on the type of pooled fund invested in, it may have to be classified as capital expenditure.

12.12 When the Council began to specifically target higher returns from a proportion of its investments, it also established a Treasury Management Reserve to mitigate the risk of an irrecoverable fall in the value of these investments. This reserve currently stands at £5m and has never been drawn upon.

12.13 At the current time, given the medium term nature of the investments, it is unlikely that a capital loss would ever be realised, since the Council would avoid selling investments that realised a capital loss.

12.14 Going forward however, changes to IFRSs mean that capital gains and losses on investments which represent financial instruments need to be reflected in the revenue account on an annual basis. There is currently a statutory override in place for local authorities that exempts them from complying with this requirement for the next three years. However, given the greater future risk in this area it is proposed to continue to contribute towards the Treasury Management Reserve on an on-going basis. The amount contributed each year will be determined by the Section 151 Officer when the Outturn is known each year.

13 CREDITWORTHINESS POLICY

13.1 This Council uses the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

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

13.2 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments on some occasions.

13.3 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link Asset Services weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:

Colour	**Suggested Duration**
Yellow	5 years *
Dark Pink	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
Light Pink	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised or semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	Not to be used

**The yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.*

13.4 The Link Asset Services' 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.

13.5 Typically the minimum credit ratings criteria the Council 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.

13.6 All credit ratings will be monitored weekly. The Council 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 Council's minimum criteria, its further use as a new investment will be withdrawn immediately;
- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap (CDS) against the iTraxx (CDS product brand name) benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

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

13.8 **UK banks:** 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. In future quarters, more information will emerge on actual levels of credit losses. 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 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 projections, with unemployment rising to above 15%.

13.9 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.

13.10 **CDS prices** – although bank CDS prices (these are market indicators of credit risk) spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. Nevertheless, prices are still elevated compared to end of February 2020. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstance. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information.

14. COUNTRY LIMITS

14.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide them). The list will be added to, or deducted from by officers should ratings change in accordance with this policy.

15. INVESTMENT CRITERIA

15.1 Prudence will drive the Council's approach to its treasury management investments in 2021/22 due to the volatility and uncertainty that exists in the world's financial markets. It is anticipated that these investments will generally be of a short- term nature, which may be represented by a combination of short-term loans and internal borrowing (i.e. use of the Councils own balances and reserves until required for an approved purpose). In order to minimise risk, the Council will look to diversify its investment portfolio by investing in other longer term investment vehicles such as money market funds and property funds. The driving force of the Council's strategy in this respect will be maintaining the security of capital and maintaining appropriate liquidity. The Council will use a combination of credit ratings, sovereign ratings, internal and external due diligence and guarantees to assess the credit quality of financial institutions before placing investments.

16. INTEREST RATE OUTLOOK

16.1 It is considered by the Council's treasury advisors that the present low level of Bank Rate is unlikely to rise for the foreseeable future. This will have implications for all types of interest returns available from treasury investments.

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

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

16.3 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 the deal agreed for Brexit.

16.4 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.

16.5 **Negative investment rates** – while the Bank of England said in August/September 2020 that it is unlikely to introduce a negative Bank Rates, 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.

16.6 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.

16.7 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.

16.8 For 2021/22 the Council will budget for an investment return of 0.10% on investments placed during the financial year.

17. LIQUIDITY OF INVESTMENTS-

17.1 The maximum period of investment of treasury balance will be ten years.

17.2 There will be no more than £150m of core treasury funds committed for a period over 5 years.

18. FINANCIAL DERIVATIVES

18.1 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The GPOC arising from Section 1 of the *Localism Act 2011* May have removed some uncertainty as to whether, and to what extent, local authorities are able to enter into "stand-alone" forms of derivative contract (i.e. those that are not embedded into a loan or investment). Should any such opportunity arise, the individual conditions/circumstances would be carefully considered.

18.2 The Council will as a general rule only consider standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

18.3 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

19. ESG POLICY

19.1 The Council is committed to being a responsible investor at all times. Responsible investment means to recognise the importance of the long-term health and stability of the financial markets, and to understand that this depends on key external non-financial factors, such as the environment, social stability and strong governance. Collectively, these factors are often referred to under the umbrella of ESG (Environmental, Social and Governance).

19.2 The Council's objective is to recognise all these risks, to mitigate them where possible and thereby improve the security of its portfolio in the long-term.

19.3 Within these risks, the Council has identified climate change as a long-term, material and systemic financial risk with the potential to significantly impact the treasury portfolio and the Council's financial resilience over time. Therefore, the Council seeks to:

- Minimise exposure to counterparties and investments heavily impacted by climate change risk
- Increase exposure to sectors, counterparties and investments, such as renewables, whose activities aid the transition to a lower carbon world and economy.

- Contribute meaningfully to an improved economically sustainable future locally and nationally, without sacrificing security.

19.4 This is not to downplay other non-financial risks. The Council sees positive social impact also as key to aid long-term financial stability, and as a meaningful contribution to the local, regional and national economy. Good governance meanwhile is also critical to safeguarding the Council's reputational risk.

19.5 The Council's core ESG principles are set out below in full:

- The Council recognises the potential impact of its counterparties and investments on the environment, workers, communities and society, as well as the potential impact of climate change on the counterparties, businesses into which the Council invests, the Council itself and its local economy and community.
- The Council will, and seek to ensure where possible its investment counterparties will, act responsibly with respect to the environment, aiming for a sustainable approach to the use of resources, avoiding irresponsible disposal of hazardous products and unnecessary waste.
- The Council and its counterparties will be non-discriminatory (whether on grounds of gender, race or disability), and adopt equality and diversity in their employment practices
- The Council seeks to ensure it and its counterparties always respect human rights and ensure no exploitation of child labour.
- The Council and its counterparties will seek to act with integrity at all times in their dealings.
- The Council will seek to encourage positive ESG behaviour, engaging with counterparties and investments where appropriate to encourage best practice and drive change.
- The Council will comply with any industry standard ESG guidelines that may arise and otherwise, always seek to ensure best practices, actively managing ESG considerations and risks alongside its financial considerations and risks.

19.6 The Council will Incorporate ESG issues into its analysis and decision making processes when considering the treasury portfolio and investments. The Council will seek to use data and analysis to determine the type and materiality of relevant issues for counterparties, and their alignment with the Council's core principles.

19.7 It is important to note that the Council shall invest on the collective basis of its investment priorities – Security, Liquidity, Yield and ESG impact – having considered all factors contributing to the risk of its counterparties and investments, including ESG factors to the extent these indirectly or directly impact on financial risk and return as well as the Council's broader policy objectives.

19.8 The Council will also seek to report progress, providing transparency on the ESG profile and impact of its portfolio investments. These will be through supporting investments and counterparties aligned with the Council's objectives, reviewing the ESG policies of funds and counterparties where appropriate, and the sourcing of suitable metrics where relevant such as for example, social impact metrics, external ratings and quantifying the investments in assets and businesses contributing to climate change reduction.

20. POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS

20.1 The Council uses Link Asset Services (previously named Capita Asset Services) as its external treasury management advisers.

20.2 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 our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

20.3 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 Council tendered for the service in 2019 for a three year period.

20.4 The Council fully appreciates the importance of monitoring the activity and resultant performance of its appointed external fund manager. The Council's external fund managers will comply with the Annual Investment Strategy. In order to aid this assessment, the Council is provided with a suite of regular reporting from its manager. This includes quarterly/semi-annual and annual reports, statements, access to online fund reporting sites, etc.

20.5 In addition to formal reports, the Council also meets with representatives of the fund manager on (quarterly, semi-annual, annual) basis. These meetings allow for additional scrutiny of the manager's activity as well as discussions on the outlook for the fund as well as wider markets.

20.6 Markets in Financial Instruments Directive – the Council has opted up to professional client status with its providers of financial services, including advisers, brokers, and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

21. TREASURY MANAGEMENT SCHEME OF DELEGATION

21.1 The scheme of delegation is in the Council's Treasury Management Practices statement which will be reported to the Audit and Corporate Governance Committee on an annual basis.

21.2 The Council considers it essential, for the purposes of the effective control and monitoring of its Treasury Management activities, the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that the responsibilities of Treasury Management is always clear.

21.3 **Full Council**

- Receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual treasury management and investment strategies
- approval of the Mid-Year Review Report of Treasury Management
- approval of capital strategy
- monitoring of yearly Treasury Outturn Report

21.4 **Audit and Corporate Governance Committee**

- the body appointed by Council for the scrutiny of Treasury Management
- recommend the Council's Annual Treasury Management Strategy to Council
- approval of/amendments to the organisation's adopted clauses, treasury management policy and treasury management practices to Council
- receiving and reviewing regular monitoring reports and acting on recommendations
- recommending the yearly Mid-Year Review and Treasury Outturn Report to Council
- approving the selection of external service providers and agreeing terms of appointment

21.5 **Section 151 Officer**

The Section 151 Officer (Deputy Chief Executive & Director of Corporate Services) and in their absence their appointed deputies is the delegated responsible officer by Full Council for the operation of the Council's overall borrowing and investment activities. The Section 151 Officer will implement and monitor the Treasury Management Strategy and make recommendations to the responsible body.

22. MINIMUM REVENUE PROVISION (MRP) STRATEGY

22.1 The Council is required to make a minimum revenue provision (MRP) to a revenue account for each financial year. An earlier statutory provision contained within Regulation 28 of the 2003 Capital Finance and Accounting Regulations was replaced in 2008 by a requirement for the Council to calculate an amount of MRP each year which they consider to be prudent. In order to arrive at an annual prudent provision, the Council is required to have regard to statutory Guidance.

22.2 The statutory change in the method for assessing a prudent provision reflected in general an intention to vary the earlier annual 4% charge in respect of outstanding capital debt liability to an annual charge, assessed in equal instalments, which spread future debt liability over a period bearing some relation to that which an "associated" asset is anticipated to provide a service for the Council (the asset life method).

22.3 The amount of capital debt liability that was outstanding at the time the statutory change was introduced was not subject to this revised beneficial life consideration. The MRP Guidance provided that this historic liability could either continue in accordance with the previous statutory method of assessment (referred to in the Guidance as Option 1), or subject to local variation. The Council has approved a local variation which will result in this proportion of outstanding debt liability being charged more prudently over a 50- year period. Further consideration of still more prudent or appropriate options should also be considered.

22.4 The Guidance suggests four options for charging amounts of outstanding capital debt liability. As indicated, the Council has adopted a local determined option in respect of the historical element of debt liability. For most of its future capital debt liability arising from capital expenditure, the Council has determined to adopt Option 3. This reflects the asset "useful-life" approach. The Council has separately determined different approaches where considered appropriate, such as in the case of loans treated as capital expenditure, and certain larger schemes or transactions which warrant a more locally determined prudent approach.

22.5 The determination of which expenditure should be charged under Option 3, and the life periods considered to be applicable to these, will be carried out under delegated powers by the Section 151 Officer. For certain types of debt liability, such as loans or land acquisitions, Option 3 and associated suggested life periods may not accord with the Council's views regarding the likely period of benefit. Any variation from Guidance suggestions will be specifically considered by full Council.

22.6 A prudent provision will not be considered for new amounts of debt liability until the year following that in which the scheme or asset giving rise to the debt liability has commenced providing the level of service or similar benefit for the Council that formed a significant element of the reason(s) for entering into the scheme. For example, in cases where future levels of anticipated income are either known to be subject to an introductory development period, or delayed due to unforeseeable events, such as have arisen as a consequence of Covid 19 restrictions.

22.7 Items of capital debt liability will only be considered for division into separate amount(s) in cases where two or more major components have substantially different useful economic lives. Assets will not be transferred into the asset register and fixed assets account until complete, in accordance with proper practices.

22.8 In the case of long -term debtors arising from loans or other similar types of transaction treated as capital expenditure which give rise to a capital debt liability, the Council has determined that, in general, it will reflect a prudent approach if no amount of MRP is charged where there is reasonable or actual expectation of principal repayment(s) being made either during the currency of the maximum loan period (e.g. through tranches of principal repayment) or where the maturity date offers sufficient expectation of full principal repayment within a reasonable period. In approving this approach, the Council has had regard to the fact that such loans have similar characteristics to any other loans made for treasury management purposes, whereby careful consideration is first given to security and avoidance of risk. The nature of security and likelihood of repayment of principal under the agreed loan terms for each individual loan will however be kept under review during its currency so that appropriate alternative approaches may be considered, either in respect of the introduction of a prudent provision, or through application of specific reserves set aside to guard against any such possibility. This form of regular reappraisal of the likelihood of loan principal repayment is considered necessary as the similar provisions that apply under IFRS9 are not relevant in the case of loans treated as capital expenditure. The Council acknowledge and agree this approach as being a variance with the approach outlined within the MRP Guidance, which suggests assuming an equal annual charge spread over the life period that reflects the useful asset life of the third party which can be linked with the purpose for which the loan was granted. In general, it is considered unlikely that there could be any reasonable correlation between loan periods and underlying asset life periods.

22.9 A similar type of policy will apply in the case of the Golden Square Shopping Centre. However, instead of relying solely upon principal element of repayments to satisfy the MRP liability, the annual MRP charge that will in effect be made will equate to the principal amount that has been assessed by the Council's advisers, Price Waterhouse Coopers, to be included each year within the repayments received by the Authority under the lease. Rather than resulting in a fixed annual MRP charge over the period of the lease, the nominal amount of MRP charge each year will be regarded as met by the element of the lease rental which serves to write down the outstanding long term debtor created as a consequence of the lease having been granted. The deferred capital receipt created under this arrangement will be earmarked on a yearly basis to pay off the debt liability over 200 years and will equate to the MRP charge. This approach mirrors that which is recommended within paragraph 20 of the MRP Guidance with regard to leases where the authority is a lessee.

22.10 Other finance leases and Private Finance Initiative (PFI) assets will have their MRP liability determined according to the life of the financial instrument, acting as a a proxy for asset life, or in accordance with the useful life of the asset to which the PFI arrangement relates, should this be considered more appropriate to prudent provision principles. MRP on these instruments may separately be considered under IFRS accounting principles where these do not conflict with capitalisation and statutory principles.

22.11 The Council, if it considers it prudent for a particular financial year, will set aside capital receipts, either to reduce outstanding aggregate capital debt liability (such as in the case of loan principal repayments), or to reduce the aggregate level of outstanding capital debt liability by an amount up to the level of reduction that would otherwise arise from setting aside an annual amount of MRP. In such circumstances, the Council will be acknowledging that present taxpayers are most likely to have contributed to the cost of assets disposed of that are giving rise to the capital receipt thereby allowing associated benefit to flow back to them more immediately. The present manner in which annual amounts of MRP must be assessed does not otherwise provide for any proportion of the benefit arising from present capital receipts to be passed back to these more historic taxpayers. This alternative approach, where adopted, will in any event maintain the relationship between useful asset lives and amounts by which the outstanding capital debt liability is reduced, and reflect situations where its application has been formally acknowledged to represent a prudent approach.

22.12 For those types of capital expenditure incurred by the Council which are not capable of being related to an individual asset (e.g. revenue expenditures treated as capital expenditure), 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.

22.13 Certain loans made solely or primarily for profit will be made in reliance upon the S.12 investment power. These loans do not represent capital expenditure. They will not therefore be subject to MRP. Any such loans are subject to separate consideration under the Council's Investment Strategy, and also statutory Investment Guidance.

22.14 The policy will be reviewed on an annual basis. If it is proposed to vary the terms of the original Policy Statement during any year, a revised statement should be put to members at that time.

22.15 The separate Guidance Options Option 2 & 4 may be considered in the case of economic regeneration schemes should this be considered to be prudent.

22.16 The Council has determined that it will be prudent to not charge MRP on its investment in Redwood Bank for a period of 5 years. This is in recognition by the Council of the principle that assets should not be subject to a prudent provision until they have commenced providing a service, which in this case, in line with relevant Guidance, will reflect when the Council anticipate they will receive envisaged amounts of income. Whilst the Redwood bank is operational during its initial 5 years, its specialist nature in relation to other service providing assets means that its envisaged benefit to the Warrington community will not reasonably be viewed as having been realised until this period has elapsed. The Council has also noted that the likely life period of their equity holding in Redwood Bank will be considerably longer than might apply to more common forms of share capital acquisitions, for which the MRP Guidance suggests a 20-year life period. The Council has had regard to the Guidance, following which they have determined that the anticipated life period for this equity acquisition should be 50 years.

22.17 The Council acknowledge any perception this may create with regard to a variation from suggested Guidance principles. They have made their decision having had full regard to these. They have accordingly adopted the principle in the light of the business case agreed by the Executive Board on 12th January 2017, which agreed that the Council should receive no dividends during this initial 5-year period. Thereafter, a prudent provision is likely to be made over an anticipated life period of 50 years, to reflect the period over which it is anticipated that the Council's taxpayers will continue to receive benefits from this acquisition.

22.18 Strategic Asset Investment Programme - this relates mainly to commercial property acquisitions made solely or primarily for the achievement of a profit. To the extent that this is the case, the properties are required by statute to be treated as investments, subject to the power granted by S.12, LGA 2003. The acquisitions do not represent capital expenditure, and are not therefore subject to MRP. The Council has previously sought to consider these acquisitions under both the MRP Guidance and the Investment Guidance, which has reflected the confusion that appears to be evident within each form of Guidance with regard to the legal nature of this type of transaction. For the avoidance of doubt, therefore, the Council has now reconsidered the MRP Guidance, in particular its reference to investment properties, and resolved that this cannot reasonably be viewed as having relevance to the nature of transactions they have or are likely to enter into when exercising the S.12 investment power. The Council considers that the MRP Guidance reference to investment properties can only reasonably be taken to be referring to properties capitalised under Accountancy Code of Practice (ACOP) criteria which must provide a wider economic benefit, as distinct from a purely financial benefit. The Council has therefore resolved that the MRP Guidance in this respect is not applicable to their circumstances.

22.19 The purchase of certain income earning properties may primarily be for service related or regeneration purposes. Any associated expenditure that may reasonably be viewed as having caused an increase in the Council's capital debt liability for such properties will be treated as capital expenditure, subject to consideration of a prudent provision. Any surplus of income over expenditure for such properties will be treated as being ancillary to the primary service or regeneration purpose. It may also be properly taken into account when determining whether annual revenue provision should be made through MRP or by way of setting aside annually a proportion of ancillary income received. The consideration of the appropriateness of a prudent provision under the normal Option 3 approach will be exercised in the case of each acquisition. Such consideration will take into account the capability or likelihood of the asset being disposed of during a foreseeable whilst uncertain time period, thereby recognising the key difference between assets acquired for service-related reasons, which can be anticipated to be held throughout their useful life, and assets where the life expectancy, whilst not known, can reasonably be anticipated to have much shorter duration. By sale or raising capital through an alternative route, this can be used to repay any outstanding debt liabilities related to the original acquisition cost.

22.20 The asset values of these properties will be reviewed annually. Should their value vary, they will be subject to the revaluation procedures set out in proper practices for capitalised expenditure. Consideration will also be given to commencing a prudent provision should amounts set aside from surplus income be considered to require enhancement to take account of the extent of any change in valuation.

22.21 The nature of more locally determined approach provided for in paragraph 21.4, as adopted for example in the case of the Redwood Bank, will also be applied in the case of the Times Square Town Centre redevelopment scheme. Whilst actual development works have now been completed, many of the associated occupation and income earning provisions taken into account when approving the scheme will not be received for a number of years, caused to a significant extent by the Covid restrictions. Accordingly, a prudent MRP will not be determined until the year after the envisaged service and income benefits are received. It is envisaged that this could be up to 5 years after the initial year of MRP that might otherwise have been made following completion of development works. The period of MRP deferment will however be kept under regular review.

22.22 New Bailey **-** the Council is making a loan in respect of the development of new office and associated facilities which, when complete, will be owned by the Council under a long-term lease, which will in turn be the subject of sub-lease arrangements. This loan will be made in reliance upon the S.12 investment power, subject to MRP consideration when treated as capital expenditure. Under a locally determined approach for determining a prudent provision, the Council will not charge MRP during the development period, as the loan will be of very limited duration, following which the long-term lease accounting provisions will apply. At the appropriate time, the Council will consider the annual prudent provision in accordance with the principles outlined in paragraph 21.10 above.

22.23 Together Energy - the Council has acquired a 50% stake in this company, which has been treated as capital expenditure in view of the security obtained through ownership of share capital. The Council has noted that the MRP Guidance suggests that share capital acquisitions should be spread over 20 years. However, it is mindful that this recommendation, which has been evident within Investment Guidance from its outset, was intended to relate to acquisitions of negotiable share capital carried out for an investment return purpose which could reasonable be considered to have a relatively limited life period. In the case of Together Energy, the Council considers that the substance of the acquisition is once more properly related to the asset’s life, whereby they anticipate this investment will be for a much longer duration than 20 years. They are therefore adopting a local variation to the determination of a prudent provision, under which the costs of the share acquisition will be spread over 50 years.

ANNEXE A

GLOSSARY OF TERMS

Basis Point (BP)	1/100th of 1%, i.e. 0.01% (or 0.0001 decimal form)
Base Rate	Minimum lending rate of a bank or financial institution in the UK
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Constant Net Asset Value CNAV)	Constant Net Asset Value refers to funds which use amortised cost accounting to value all of their assets. They aim to maintain a Net Asset Value (NAV), or value of a share of the fund, at £1 and calculate their price to 2 decimal places.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement
CIPFA	Chartered Institute of Public Finance and Accountancy
CLG	Department for Communities and Local Government
CPI	Consumer Price Index – calculated by collecting and comparing prices of a set basket of goods and services as bought by a typical consumer, at regular intervals over time. The CPI covers some items that are not in the

	RPI, such as unit trust and stockbrokers fees, university accommodation fees and foreign students' university tuition fees.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.
ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
EMU	European Monetary Union
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
EU	European Union
Fed.	Federal Reserve Bank of America – sets the central rates in the USA
Floating Rate Notes (FRN)	Bonds on which the rate of interest is established periodically with reference to short-term interest rates
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
Forward Deposits	Same as forward dealing (above).
FCA	Financial Conduct Authority – one of the main UK regulatory bodies with three main objectives – to protect consumers, to protect and enhance the integrity of financial markets and to promote effective competition.
Fiscal Policy	The Government policy on taxation and welfare payments.
GDP	Gross Domestic Product
GF	General Fund
Gilt	Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Gilt Funds	Pooled fund investing in bonds guaranteed by the UK government.
Government MMF	MMFs that invest solely in government securities, or reverse repurchase agreements backed by Government Securities.
HM Treasury	Her Majesty's Treasury
HRA	Housing Revenue Account
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
iTraxx	The brand name for the group of credit default swaps index products.
LOBO's	Lenders Option Borrowers Option loans
MHCLG	Ministry of Housing, Communities and Local Government
MiFID	Markets in Financial Instruments Directive is a regulation that increases the transparency across the European Union's financial markets and standardises the regulatory disclosures required for particular markets.

	The directive has been in force across the European Union (EU) since 2008
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments. It is very similar to a unit trust, however in a MMF.
Monetary Policy committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2% in two years' time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and employment.
MRP	Minimum Revenue Provision – the annual charge to the revenue account of the prudent provision for the repayment of debt, incurred in respect of capital expenditure financed from borrowing or other long-term credit arrangements.
MTFP	Medium Term Financial Plan
Open Ended Investment Companies	A diversified pooled investment vehicle, with a single purchase price, rather than a bid/offer spread.
OIS	Overnight Indexed Swap – an interest rate swap where the periodic floating payment is generally based on a return calculated from a daily compound interest investment.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PFI	Private Finance Initiative
PWLB	Public Works Loan Board
QE	Quantitative Easing
Reverse Gilt Repo	This is a transaction as seen from the point of view of the party which is buying the gilts. In this case, one party buys gilts from the other and, at the same time and as part of the same transaction, commits to resell equivalent gilts on a specified future date, or at call, at a specified price.
Retail Price Index (RPI)	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
RPIX	As RPI but excluding mortgage interest rate movements.
RPIY	As RPI but excluding mortgage interest rate movements and changes in prices caused by changes in taxation.
SONIA	Sterling Overnight Index Average – SONIA is the effective reference overnight rate for unsecured transactions in the Sterling market
Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.
Supranational Bonds	Bonds issued by supranational bodies, e.g. European investment bank. These bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.
SORP	Statement of Recommended Practice
S151	Section 151 Officer

Term Deposit	A deposit held in a financial institution for a fixed term at a fixed rate.
Treasury Bill	Treasury bills are short term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.
UBS	Union Bank of Switzerland
US	United States
Ultra-Short Dated Bond Fund (USDBF)	Fund designed to produce an enhance return over the above Money Market Fund (MMF). The manager may use a wide range of alternative options to try and generate excess performance.
VNAV	Variable Net Asset Value – refers to funds which use mark-to-market accounting to value some of the assets.
WARoR	Weighted Average Rate of Return is the average annualised rate of return weighted by the principal amount in each rate.
WAM	Weighted Average Time to Maturity is the average time, in days, till the portfolio matures, weighted by principal amount.
WATT	Weighted Average Total Time is the average time, in days, that deposits are lent out for, weighted by principal amount.
WA Risk	Weighted Average Credit Risk Number. Each institution is assigned a colour corresponding to a suggested duration using Sector's Suggested Credit Methodology.
Model WARoR	Model Weighted Average Rate of Return is the WARoR that the model produces by taking into account the risks inherent in the portfolio.

PRUDENTIAL INDICATORS

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits.

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

A Capital Investments

For capital programme purposes, the Council makes a reasonable estimate of the capital debt liability that that it plans to incur envisages will arise in the following three years and after each year-end it will account for the actual capital expenditure incurred for each year.

The Council's capital programme informs the requirements of these indicators. In terms of the capital expenditure element of aggregate capital activity (which includes non- financial investments), the amounts incurred by the Council in 2019/20, the revised estimate for the current year and estimates for the future years are as follows:

2019/20 Actual £m	**2020/21 Forecast £m**	**Capital Expenditure**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
8.031	10.941	Families & Wellbeing	4.028	0.414	0
5.886	4.702	Corporate Services	2.940	2.000	1.588
46.966	46.363	Environment & Transport	44.511	15.913	6.196
11.631	5.688	Growth	17.127	0.127	0
		Leases			
145.922	311.290	Invest to Save Programme	335.458	290.452	75.594
521.355	**378.985**	**Total Capital Expenditure**	**404.064**	**308.906**	**83.378**

Invest to Save programme relates to areas such as capital expenditure on investment properties, loans to third parties, etc.

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

2019/20 Actual £m	2020/21 Forecast £m	Capital Financing	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
185.834	339.299	Unsupported Borrowing	372.798	301.688	81.825
24.667	22.614	Capital Grants and Reserves	12.658	0.508	0
4.820	3.859	Capital Receipts	4.861	2.125	1.553
0	0.213	Revenue Funding	0	0	0
3.116	13.000	External Funding	13.747	4.585	0
218.437	**378.985**	**Total Capital Financing**	**404.064**	**308.906**	**83.378**

B Capital financing cost indicators

One of the indicators of affordability is the estimated ratio of the Council's general fund capital financing costs to its net revenue stream in percentage terms. This indicator shows the proportion of the revenue budget spent on capital financing costs; if the ratio is increasing rapidly over time then a larger proportion of revenue resources is being taken up by capital financing costs, which could be used for other elements of the authority's budget.

For 2020/21, net revenue streams are based on the MTFP draft general fund (GF). For future years, the GF net revenue stream is projected in the Council's MTFP.

2019/20 Actual %	2020/21 Forecast %	Ratio of financing costs to net revenue stream	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %
4.93	8.21	Services	8.21	9.67	9.23

C Capital Financing Requirement – the Council's borrowing need

Another prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR represents the total historic outstanding capital investment debt liability which has not yet been paid charged to revenue for otherwise financed. It is essentially a measure of the Council's indebtedness and in turn their underlying borrowing need. Any capital financing liability 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 borrowing need in line with each assets' life, and so charges the economic consumption of capital assets as they are used. It may also be reduced by the setting aside of monies achieved from asset disposals.

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.

2020/21 Forecast £m	**Capital Financing Requirement (CFR)**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
1592.169	CFR	**1945.762**	**2227.056**	**2287.842**
320.412	**Movement in CFR**	**353.592**	**281.294**	**60.786**
Movement in CFR represented by:				
63.086	Financing need for the year	352.237	301.688	81.825
276.213	Over borrowed from previous year	20.561		
(18.887)	Less MRP, other financing movements	(19.206)	(20.394)	(21.039)
320.412	**Net Movement in CFR**	**353.592**	**281.294**	**60.786**

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown above demonstrate the scope of this activity and proportionality to the Council's remaining activity.

D Gross Borrowing Requirement

There is a clear linkage between the authority's capital financing requirement indicators and its gross external borrowing. Within the code there is a key indicator of prudence that ensures that, over the medium term, gross borrowing is only for a capital purpose. This can be demonstrated by comparing gross external borrowing shown in the table below to the total CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. Gross external borrowing should not exceed this limit except in the short term. There is some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council's treasury portfolio position at 31 March 2020, with forward projections are summarised below. The table shows the actual external debt (the treasury management operation), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlighting any over or under borrowing:

2019/20 Actual £m	**2020/21 Forecast £m**	**Current Portfolio Position**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
870.679	1568.531	Debt at 1 April	1612.730	1945.762	2227.056
697.852	44.199	Expected change in Debt	333.031	281.294	60.786
1568.531	1612.730	External Debt at 31 March	1945.762	2227.056	2287.842
1271.757	1592.169	Capital Financing Requirement	1945.762	2227.056	2287.842
(296.774)	**(20.561)**	**Under / (Over) borrowing**	**0**	**0**	**0**

The Section 151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

E Impact of Capital Investment Decisions on Council Tax

The other indicator of affordability is the estimate of the incremental impact on Council Tax, over and above capital investment decisions that have previously been taken by the Council. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period. The indicator is intended to show the effect on Council Tax of approving new capital expenditure in the capital programme.

2019/20 Actual £	2020/21 Forecast £	Impact of Council capital programme for band D Council Tax	2021/22 Estimate £	2022/23 Estimate £	2023/24 Estimate £
12.25	8.18	Unsupported Borrowing	10.82	20.98	1.81

F Authorised Limit for External Debt

This is a 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 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.

The authority has to set an Authorised Limit, which is the statutory maximum borrowing permitted, and an Operational Boundary, which is the normal level of borrowing expected, for external debt. This is a 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.

The Authorised Limits set out below are consistent with the authority's current commitments, existing plans and the proposals set out in this report for the capital expenditure and financing, and with its approved treasury policy statement and practices. They are based on the most likely, prudent, but not worst case scenario, with sufficient headroom over and above this to allow for operational management recognising that during the year it may be necessary to exceed the operational boundary in order to take advantage of interest rate movements or to accommodate unusual cash flow movements.

2019/20 Actual £m	2020/21 Forecast £m	Authorised Limit for External finance	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
1725.384	1774.003	Borrowing	2140.338	2449.761	2516.626
3.773	3.647	Other Long Term Liabilities	3.512	3.367	3.212
1729.157	**1777.650**	**Total Authorised Limit**	**2143.8750**	**2453.128**	**2519.838**

This indicator being the maximum limit the Council may borrow at any point in time in the year. If borrowing above this level were needed a report would go to Executive Board for authorisation to increase the limit.

G Operational Boundary for External borrowing and other financing

The operational boundary is a key management tool for in-year monitoring. Temporary breach of the operational boundary will not in itself be a cause for concern, although a sustained breach might indicate an underlying issue that would need investigation and action.

The Operational Boundaries below are based on the Authorised Limit, estimating the authority's most likely level of borrowing and leasing each year. It includes long term borrowing to fund capital and short term borrowing to meet day to day variations in cash flow but without the additional headroom.

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.

2019/20 Actual £m	**2020/21 Forecast £m**	**Operational Boundary**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
1578.531	1622.730	Borrowing	1955.762	2237.056	2297.842
3.773	3.647	Other long term liabilities	3.512	3.367	3.212
1582.304	**1626.377**	**Total**	**1959.274**	**2240.423**	**2301.054**

Treasury management indicators for debt

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

H Maturity structure of borrowing

It is recommended that the Council sets upper and lower limits for the maturity structure of its debt for the forthcoming year as follows:

Maturity Structure	Lower Limit		Upper Limit	
	Fixed	Variable	Fixed	Variable
Under 12 months	0%	0%	30%	40%
12 months to 2 years	0%	0%	30%	0%
2 years to 5 years	0%	0%	35%	0%
5 years to 10 years	0%	0%	30%	0%
10 years to 20 years	40%	0%	100%	0%
20 years to 30 years	40%	0%	100%	0%
30 years to 40 years	40%	0%	100%	0%
40 years and above	40%	0%	100%	0%

The above percentages are the ranges for the projected borrowing maturing in each year out of the total projected borrowing. The indicator is designed to be a control over the Council having large concentrations of fixed interest rate debt needing to be replaced at any one time and thus being at risk of having to borrow large amounts when interest rates may be unfavourable.

Please note that the maturity structure guidance for lobo loans deems the maturity date to be the next call date which would account for £68.5m and 5.21% of the current loan portfolio. The loans have remained as the expected maturity date, however, these loans could potentially be called by the lender within the next six month period but they are unlikely to do so due to the current low interest rate environment.

I Fixed interest rate exposure

The table below shows the Council's upper limit for fixed interest rate exposure for the next three years. This indicator shows the percentage of borrowing that can be undertaken at fixed interest rates. Up to 100% of borrowing can be at fixed interest rates. Again, this indicator is set at levels to reduce the risk from interest rate movements.

Upper Limit – Fixed Interest Rate Exposure	2021/22 %	2022/23 %	2023/24 %
Fixed Interest Rates	100	100	100

J Variable interest rate exposure

The following indicator shows the percentage of borrowing that can be undertaken at variable interest rates. The purpose of the indicator is to restrict variable rate borrowing in order to reduce the risk from sudden movements in interest rates. The Council sets its upper limit for borrowing, reflecting variable interest rates less investments that are variable rate investments at 40%.

Upper Limit – Variable Interest Rate Exposure	**2021/22 %**	**2022/23 %**	**2023/24 %**
Variable Interest Rates	40	40	40

K Investment periods

It is recommended that the Council sets a limit on the amount invested for periods longer than one year of £200m in total for 2021/22, with the maximum period for any one investment being ten years. 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.

Upper Limit for Total Principal Sums Invested for over 365 days	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
Investment	200	200	200
Non Treasury Investments	1500	1500	1500