ARUN DISTRICT COUNCIL

REPORT TO AUDIT AND GOVERNANCE COMMITTEE
ON 25 February 2021

PART A: REPORT

SUBJECT: Treasury Management Strategy Statement and Annual Investment Strategy 2021/22

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EXTN: 37861
PORTFOLIO AREA: Corporate Support

EXECUTIVE SUMMARY:

The purpose of this report is to present the Treasury Management Strategy Statement and Annual Investment Strategy 2021/2022 and to enable the Audit and Governance Committee to scrutinise the report prior to making comment to Full Council (17 March 2021).

RECOMMENDATIONS:

The Committee is requested to recommend Full Council to:

(i) approve the Treasury Management Strategy for 2021/22;
(ii) approve the Annual Investment Strategy for 2021/22; and
(iii) approve the Prudential Indicators for 2021/22, 2022/2023 and 2023/24 as contained in appendix 1 and the body of the report.

BACKGROUND:

1 Introduction

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

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

CIPFA defines treasury management as:

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

1.2 Reporting Requirements

1.2.1 Capital Strategy

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

- a high-level long-term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

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

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

1.2.2 Treasury Management reporting

The Council is currently required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.

- **Prudential and Treasury Indicators and Treasury Strategy** (this report) - The first and most important report is forward looking and covers:
  - the capital plans (including prudential indicators) (2.0);
  - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time) (2.4);
  - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators (3.0); and
  - an investment strategy (the parameters on how investments are to be managed) (4.0).

- **A Mid-Year Treasury Management Report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. The Audit and Governance Committee will receive a mid-year report at its November meeting prior to approval by Full Council.

- **An Annual Treasury Report** – This is a backward looking review document providing details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy which the Audit and Governance Committee will receive at its July meeting prior to approval by Full Council.

1.3 Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

Capital issues

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

Treasury management Issues

- the current treasury position;

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

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

A Voluntary Repayment Provision (VRP) is sufficient as Arun's debt is all HRA. However, there is a possibility that the Council may wish to borrow for General Fund purposes at some point in the future.

1.4 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. Accordingly, all members were invited to attended a workshop presented by Link Asset Services (Treasury advisors) explaining the roles and responsibilities of elected members and giving them an economic update. The last session was held on 21st November 2019 and the next one is planned for 29th July 2021).

The training needs of treasury management officers are reviewed periodically and senior officers attend seminars at least once a year. Since Covid 19 there have been more bite size webinars from various organisations, which are attended by Treasury officers regularly.

1.5 Treasury management consultants

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

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

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions) and 1 commercial type investment (East Preston Depot). Any further commercial type investments will require specialist advisers in relation to this activity.

2 The Capital Prudential Indicators 2021/22 to 2023/24 (Appendix 1)

The Council's capital expenditure 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.

2.1 Capital Expenditure.

This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The Council's capital expenditure is considered as part of the budget setting process and a report for approval is going to Full Council on 17th February 2021.

Currently Arun's only borrowing relates to the HRA self-financing settlement. However, the Council has a significant capital programme including HRA acquisition/new builds and smaller projects such as work to carparks, public convenience's, cemeteries, and some infrastructure projects. Much of this programme will be funded from capital receipts and revenue resources but it is possible that additional borrowing will be required at some point in the future, however the source has not yet been identified.

The need to borrow is reviewed annually as part of the Treasury Management Strategy and budget setting process and will be dependent on the HRA Business Plan and the Capital programme.

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

Capital Expenditure	Actual 2019/20 £'000	Current Estimate outturn 2020/21 £'000	Estimate 2021/22 £'000	Estimate 2022/23 £'000	Estimate 2023/24 £'000
Non HRA	2,676	2,793	3,228	3,203	3,199
HRA	5,045	7,211	4,732	6,624	6,624
HRA settlement	-	-	-	-	-
Total	**7,721**	**10,004**	**7,960**	**9,827**	**9,823**
Financed by:					
Capital receipts (1-4-1)	1,261	1,726	117	200	100
Capital grants	2,308	1,544	1,400	1,400	1,400
Capital reserves	1,649	1,500	4,602	4,494	4,494
Revenue	188	1,251	1,841	1,983	2,079
	5,406	**6,021**	**7,960**	**8,077**	**8,073**
Net financing need for the year	**2,315**	**3,983**	**0**	**1,750**	**1,750**

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, 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 asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes.

The Council is asked to approve the CFR projections in Appendix 1 also shown below:

CFR at 31 March	Actual 2019/20 £,000	Current Estimate 2020/21 £,000	Estimate 2021/22 £,000	Estimate 2022/23 £,000	Estimate 2023/24 £,000
Capital Financing Requirement					
General Fund	(4,009)	(4,223)	(4,442)	(4,642)	(4,729)
HRA	52,365	50,865	49,914	53,024	51,390
Total CFR	**48,356**	**46,642**	**45,472**	**48,382**	**46,661**
Movement in CFR	**(3,362)**	**(1,714)**	**(1,169)**	**2,910**	**(1,721)**

Movement in CFR represented by					
Leasing arrangements (GF)	0	0	0	0	0
HRA unfinanced / Internally financed	2,315	2,044	2,727	4,870	246
Repayments	(1,923)	0	0	0	0
Less MRP/VRP	(3,754)	(3,758)	(3,896)	(1,960)	(1,967)
Movement in CFR	**(3,362)**	**(1,714)**	**(1,169)**	**2,910**	**(1,721)**

2.3 Core funds and expected investment balances

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

Year End Resources £m	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Fund balance	16.03	14.22	13.11	10.22	10.47
Earmarked Reserves	15.77	19.84	11.53	11.09	10.65
Capital Receipts	2.81	1.61	1.46	1.49	1.62
Other	1.68	1.73	2.25	2.25	2.25
Total core funds	**36.29**	**37.40**	**28.35**	**25.05**	**24.99**
(Under)/Over borrowing	22.41	23.30	17.61	14.53	7.01
Expected investments	**58.70**	**60.7**	**45.96**	**39.58**	**32.00**

2.4 Minimum revenue provision (MRP) policy statement

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

MHCLG regulations have been issued which require the Full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the MRP Statement in Appendix 2, written in previous years with no revisions at this time. The policy will need to be reviewed at such time as the need to borrow has been agreed. There may also be further HRA borrowing relating to the current acquisition/new build programme.

The Council does not currently have any General Fund external debt and therefore is not statutorily required to make Minimum Revenue Provision (MRP) in respect of its CFR, but there is a requirement for a charge for depreciation to be made.

It is considered prudent to make VRP in respect of the PWLB maturity loans funding the HRA self-financing settlement payment. The table shows the VRP reducing the CFR. The VRP is incorporated in the HRA Business Plan and in the 2021/22 HRA budget. If borrowing is taken out for general fund in 2021/22, the MRP policy will need to be reviewed.

MRP Overpayments

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2020 there were no VRP overpayments.

2.5 Affordability Prudential Indicators

This report covers the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicator contained in Appendix 1.

Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

	Actual 2019/20 %	Current Estimate 2020/21 %	Estimate 2021/22 %	Estimate 2022/23 %	Estimate 2023/24 %
Non-HRA	-3.08%	-2.17%	-1.90%	-1.90%	-1.90%
HRA	32.87%	32.84%	32.32%	20.05%	20.58%

3 Borrowing

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 **Current Portfolio Position**

The Council's Treasury Investment and debt portfolio position at 31 March 2020 and 31 December 2020 summarised below;

TREASURY PORTFOLIO				
	actual	actual	current	current
	31.3.20	**31.3.20**	**31.12.20**	**31.12.20**
Treasury investments	£000	%	£000	%
banks	35,000	60%	59,000	79%
building societies – unrated	2,000	3%	2,000	3%
building societies – rated	0	0%	0	0%
local authorities	7,000	12%	2,000	3%
DMADF (H.M.Treasury)	0	0%	0	0%
money market funds	9,700	16%	4,000	5%
certificates of deposit	0	0%	0	0%
Total managed in house	**53,700**	**91%**	**67,000**	**90%**
diversified funds	0	0%	2,000	3%
property funds	5,000	9%	5,000	7%
Total managed externally	**5,000**	**9%**	**7,000**	**10%**
Total treasury investments	**58,700**	**100%**	**74,000**	**100%**
Treasury external borrowing				
local authorities	0	0%	0	0%
PWLB	44,320	100%	44,320	100%
LOBOs	0	0%	0	0%
Total external borrowing	**44,320**	**100%**	**44,320**	**100%**
Net treasury investments / (borrowing)	**14,380**	**0**	**29,680**	**0**

The investments held at 31st December 2020 are shown in Appendix 3.

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

£m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
External Debt					
Debt at 1 April (HRA)	**53.18**	**44.32**	**44.32**	**38.19**	**50.67**
Expected change in Debt	0.00	0.00	2.73	12.49	0.25
Re-payments (HRA debt)	0.00	0.00	(8.86)	0.00	0.00
Other long-term liabilities (OLTL)	0.00	0.75	0.53	0.33	0.25
Actual gross debt at 31 March	**44.32**	**45.07**	**38.72**	**51.01**	**51.17**
Capital Financing requirement – HRA	53.59	50.86	49.91	53.02	51.39
Capital Financing requirement - GF	(1.87)	(4.22)	(4.44)	(4.64)	(4.37)
The Capital Financing Requirement	**51.72**	**46.64**	**45.47**	**48.38**	**46.66**
Under / (over) borrowing	1.46	1.57	6.75	(2.63)	(4.51)

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

The Council's only borrowing relates to the HRA Self-Financing settlement (initially £70.9m on 28/3/2012 now £44.32m). Prior to this borrowing being undertaken, the Council had a negative CFR of £2.6m which has arisen over a number of years and was due more to changes in the capital accounting regulations rather than to any specific policy decision. As a result, in 22/23 and 23/24 Arun's gross debt is expected to exceed its CFR.

The Group Head of Corporate Support reports that the Council complied with the prudential indicators 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 the budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

3.2.1 The Operational Boundary.

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

The Council is requested to approve an operational boundary of £50M in Appendix 1 (2021/22).

3.2.2 **The Authorised Limit for external debt.**

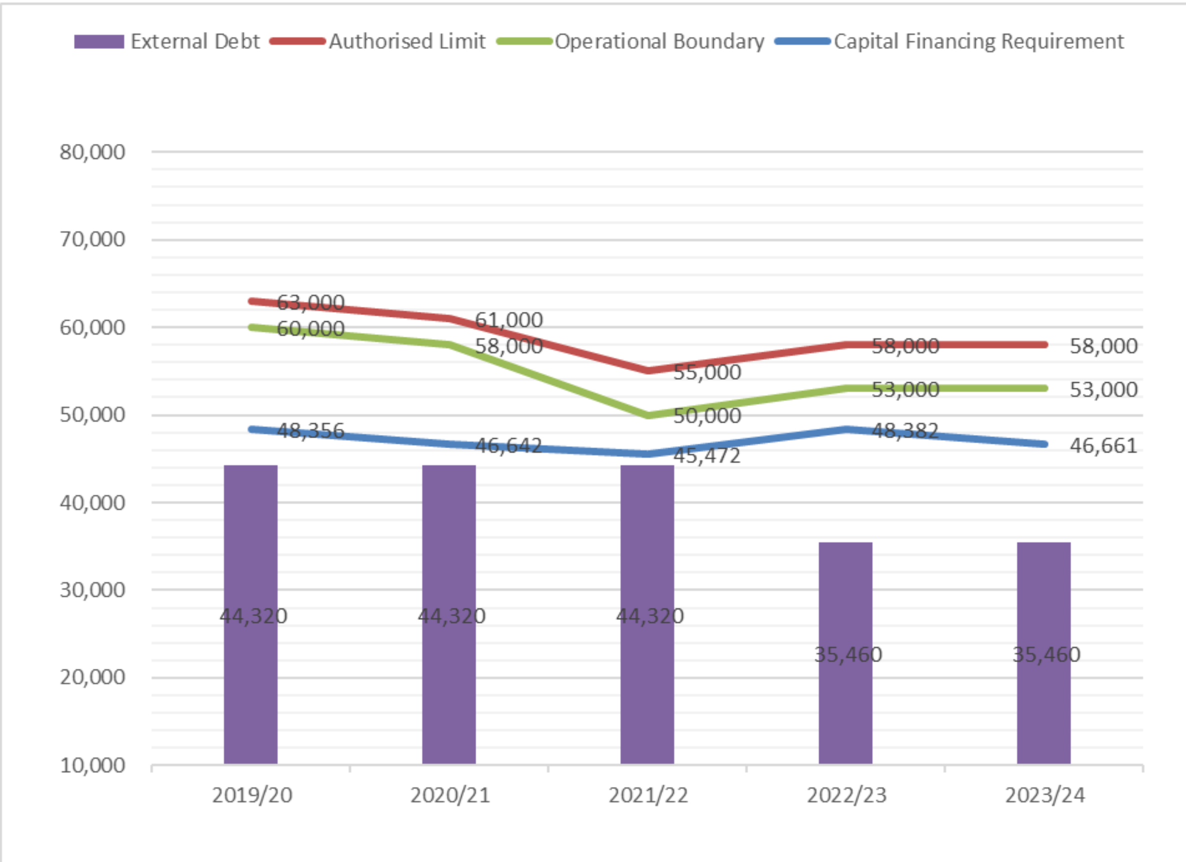
This is a key prudential indicator represents a control on the maximum level of borrowing.

This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

i. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

ii. The Council is asked to approve an Authorised Limit of £55M appendix 1 (2021/22).

3.2.3 The chart below shows the Councils projection of CFR and borrowing.



The bars in the chart above show the actual external debt (£44M-35M) and does not include any potential future borrowing. The Authorised limit and operational boundary factor in up to £15m potential borrowing (by 2022/23) for new acquisitions, garages and financing of unfinanced expenditure. The debt repayment on 28 March 2022 is shown in 2022/23 (reducing the borrowing from £44M to £35M at this date).

3.3 Prospects for Interest Rates

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

Link Group Interest Rate View 9.11.20														
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20														
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

3.3.2 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 16th December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20: as this has now occurred, these forecasts do not need to be revised.

Investment and borrowing rates

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

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

    - **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
    - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
    - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
    - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

- As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.

    - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
    - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
    - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

- **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows.

3.4 Borrowing Strategy

3.4.1 The Council has a significant capital programme including HRA acquisition/new build. The level of expenditure within the HRA will almost certainly require additional borrowing. which will be reflected in the HRA 30 year financial model which will form an integral part of the Business Plan. The HRA business plan will include a programme of new build/stock acquisition, in addition to ongoing maintenance and decent homes programme.

The source of any of this potential borrowing has not been identified at the time of writing. There may also be a requirement to borrow for other new projects / opportunities, but this would need to be dependent on a viable business case which fully justifies the investment.

The Council's borrowing strategy will give consideration to new borrowing in the following order or priority;

- Internal borrowing;

  By running down cash balances and foregoing interest earned at historically low rates, as this is the cheapest form of borrowing, however, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years;

- External borrowing;

  - the PWLB Certainty Rate is available to the Council at 0.2% below the normal terms (the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing) or;

  - borrowing from the money markets, most probably other local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate, depending on market conditions at the time.

The degree which any options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing, but our advisors will keep us informed.

There may be an occasional need to borrow for liquidity purposes especially as the Council no longer has an overdraft facility. The facility was removed as banking costs made it very expensive and rather than incurring any costs for the facility, the treasury team now maintain an approximate £200k balance in the account daily. Since the coronavirus outbreak this balance has not been earning any interest but is needed to cover any urgent requirements.

The borrowing activity is constrained by prudential indicators for borrowing and the CFR, and by the authorised limit.

3.4.2 Maturity structure of borrowing

These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits.

The Council is asked to approve the treasury indicators and limits in Appendix 1 also shown below:

Maturity structure of fixed interest rate borrowing 2021/22			
	Actual at 31/03/21	**Lower**	**Upper**
Under 12 months	20%	0%	40%
12 months and within 24 months	0%	0%	40%
24 months and within 5 years	0%	0%	50%
5 years and within 10 years	20%	0%	60%
10 years and above	60%	0%	100%

The Council currently has no variable rate borrowing.

3.5 Policy of Borrowing in Advance of Need

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

3.6 Debt Rescheduling

The only loans that the Council currently hold are those taken to fund the housing reform payment.

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of PWLB rates over gilt yields was reduced by 100 bps in November 2020.

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

4 Annual Investment Strategy

4.1 Investment Policy – management of risk

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

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

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, where the rates are exceptionally low and, in some cases, negative, it is considered appropriate to keep investments short to cover cash flow needs, which are not always clear with the current pandemic. 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 for diversification.

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

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

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

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

4. This Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 6 under the categories of 'specified' and 'non-specified' investments.

- **Specified investments;** (these are considered low risk assets where the possibility of loss of principal or investment income is small) are those with a high level of credit quality and subject to a maturity limit of one year.

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require

  greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18month deposit would still be non-specified even if it has only 11 months left until maturity.

5. **Lending limits**, (amounts and maturity), for each counterparty category will be set. (Appendix 6).

6. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (Appendix 1).

7. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (Appendix 8).

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

9. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

10. The Council may invest in investments that are termed **"alternative investments".** These include, but are not limited to, things such as renewable energy bonds (Solar farms). These are asset backed bonds, offering good returns, and will enable the Council to enter new markets, thus furthering the diversification of our investment portfolio with secured investments and enhancing yield. Any investments entered into of this type will be subject to a full due diligence review prior to investment. (Category 8, Appendix 6)

11. The Council may invest in **Open Ended Investment Companies (OEICs)** such as diversified funds (currently the CCLA property fund and diversified fund) subject to due diligence. These funds diversify the risk and offer a return of approximately 4% & 3% respectively. (Category 11 & 12, Appendix 6)

12. As a result of the change in accounting standards for 2019/20 under **IFRS 9,** this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing,

Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.

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

The Council does not strictly adhere to the advisor's suggested lending list and durations, but does take account of the advice offered before making any investment decisions. The Council will take advantage of any attractive rates available from counterparties of high creditworthiness for longer periods while interest rates remain extremely low. Our advisors forecast for a rate hike is not till after March 2024.

4.2 Creditworthiness policy

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

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

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

The Council achieves a high credit quality by using a minimum rating criteria (where rated). It does not use the approach suggested by CIPFA of using the lowest common denominator method of selecting counterparties as some rating agencies are more aggressive in giving low ratings than others. The Council applies a majority rule where a counterparty would be removed immediately from the lending list if 2 or more rating agencies downgrade the counterparty below the minimum criteria. The Council's minimum criteria can be seen in Appendix 7.

Additional requirements under the Code require the Council to supplement credit rating information, which the Council achieves using the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's.

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

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

All credit ratings are monitored weekly and the Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services 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 spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

The current list of approved counterparties is included in Appendix 7. Lloyds being the incumbent bank, has no limit however the Council will only invest up to £11M in term deposits with them.

4.3 Other limits

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

Non-specified investment limit. The Council has determined that it will limit the maximum total exposure to non-specified investments as being £18M (21/22) of the total investment portfolio.

The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent) as per the creditworthiness policy. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 7. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

No more than 25% will be placed with any individual non-UK country or 50% total non-UK at any time.

The exception to this policy is the UK, which is currently rated AA- by 2 of the rating agencies. If the UK's credit rating should fall below the minimum criteria set above, investment will continue to be made in UK financial institutions if after careful consideration it is deemed appropriate to do so.

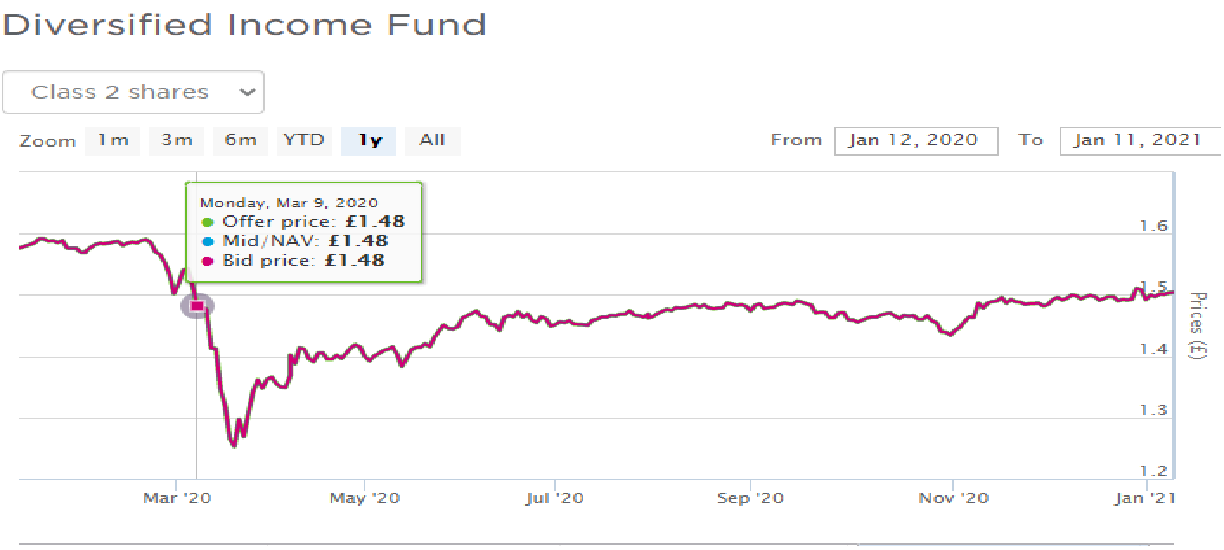
The Council does not currently use sector limits e.g. banks v. building societies due to the limited number of quality counterparties available. The Council has a limit of between £4M and £12M (see Appendix 6 and 7 for investment categories) which can be invested with a single counterparty (or group) depending on the credit quality of the counterparty.

Every effort will be made to spread the maturity profile of investments to compensate for the lack of sector or country spreads (due to limited counterparties).

4.4 Investment Strategy

The Council does not utilise external fund managers, but reserves the option to do so in the future should this be deemed to be appropriate, although it does invest in pooled funds. Should consideration be given to exercising the option of external fund managers in the future, the relevant Committee will be advised of the reason for doing so.

The Council's funds are therefore all managed in-house although £7m is invested in pooled funds - £5m in a property fund and £2m in a diversified fund run by CCLA (Churches, Charities and Local Authorities). As agreed on 13 Feb 20 and approved by Full Council on 15 July 20, diversified funds were added to the investment strategy to enhance diversification of the Council's investments. As a result, £1m was invested on 21 August and a further £1m investment was made on 22 December 2020 into the CCLA Diversified Income Fund. Anticipated returns are around 3% with the added advantage of much higher liquidity than the property fund (as below). At 31 December 2020 the market value of the £2m put into the diversified fund was £2,001,399.49.



	End of	Dec-20	Nov-20	Oct-20	Sep-20	Aug-20	Jul-20	Jun-20	May-20	Apr-20	Mar-20	Feb-20
Diversified Income Fund												
	Fund Size £m	177.80	175.87	169.91	173.40	176.03	173.04	171.16	170.72	164.66	156.90	172.02
Class 1	Price £	1.5501	1.5418	1.4896	1.5157	1.5387	1.5212	1.5047	1.5007	1.4694	1.4180	1.5600
	Dividend on XD Date £	0.0115			0.0128			0.0153			0.0122	
	Dividend - Last 12 Months £	0.0518	0.0522	0.0522	0.0522	0.0513	0.0513	0.0513	0.0508	0.0508	0.0508	0.0508
	Dividend Yield on Price %	3.34	3.38	3.50	3.44	3.34	3.38	3.41	3.38	3.45	3.58	3.26
Class 2	Price £	1.4924	1.4846	1.4343	1.4594	1.4816	1.4648	1.4488	1.4451	1.4149	1.3655	1.5023
	Dividend on XD Date £	0.0111			0.0124			0.0149			0.0118	
	Dividend - Last 12 Months £	0.0501	0.0505	0.0505	0.0505	0.0497	0.0497	0.0497	0.0493	0.0493	0.0493	0.0494
	Dividend Yield on Price %	3.36	3.40	3.52	3.46	3.35	3.39	3.43	3.41	3.48	3.61	3.29
Class 3	Price £	1.5017	1.4936	1.4430	1.4684	1.4906	1.4737	1.4578	1.4538	1.4234	1.3738	1.5112
	Dividend on XD Date £	0.0109			0.0122			0.0147			0.0117	
	Dividend - Last 12 Months £	0.0494	0.0499	0.0499	0.0499	0.0492	0.0492	0.0492	0.0490	0.0490	0.0490	0.0491
	Dividend Yield on Price %*	3.29	3.34	3.46	3.40	3.30	3.34	3.37	3.37	3.44	3.57	3.25

The average level of funds available for investment purposes is currently £72M (as at 31 December 2020). These funds are partially cash-flow derived and there is a core balance of approximately £59M which is available for investments over a year (maximum 5 years or 25 years for property funds). The core balance is comprised of funds that are available due to a number of factors including the setting aside of funds to repay the HRA loans (£3.5M) for when they become repayable, the Earmarked Reserves, Capital Receipt, General Fund and HRA balances which were £15.77m, £2.81m, £8.76m and £8.95m at 31 March 2020 respectively.

Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

The Council has the following spanning the financial year and there are no forward commitments (deals) for the financial year 2021/22;

- £5m invested in the CCLA property fund
- £2m invested in the CCLA diversified fund

Investment returns expectations.
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 periods up to about three months during each financial year are as follows (the long-term forecast is for periods over 10 years in the future):

Average earnings in each year	Now	Previously
2020/21	0.10%	0.10%
2021/22	0.10%	0.10%
2022/23	0.10%	0.10%
2023/24	0.25%	0.25%
2024/25	0.75%	0.75%
Long term later years	2.00%	2.00%

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

Negative investment rates

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

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

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

The Council's budgeted rate of return for 2021/22 is 0.64% based on 0.70% of funds that are already invested; 4.0% for the property fund (£5M), 3.0% for the diversified fund (£1m but has now been increased to £2m); 0.21% for the remaining core balances; and 0.15% for short term cash flow derived balances. The total investment income budget for 2021/22 is £332,000 (compared to £550k in 2020/21) which highlights the severely reduced rates contributing to the returns.

For its cash flow generated balances, the Council will seek to utilise its instant access and notice accounts, money market funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest. Currently the Santander and Svenska Handelsbanken notice accounts are outperforming many short-term fixed deposit rates.

The Council currently uses three types of Pooled Funds; property Funds, diversified funds and MMFs. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns particulary in the case of the property and diversified funds.

MMFs are used for short term daily surpluses of cash as they provide instant liquidity with high quality counterparties, but due to the pandemic, like other institutions, the rates are extremely low (0.01% - 0.044%).

The MMFs are "triple A" rated, liquid, and are currently all LVNAV (Low Volatility net asset value). This is a change from the previous constant net asset value (CNAV) as a result of the MMF reform where typically for every pound of principal invested you got a pound back. It is not guaranteed, but LVNAV offers better protection than using the VNAV (Variable net asset value) MMFs.

LVNAV MMFs are permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the fund does not deviate from the dealing NAV by more than 20 basis points.

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

The Council is asked to approve the treasury indicator and limits in appendix 1 (shown below- top line):

Upper limit for principal sums invested for longer than 365 days			
£m	**2021/22**	**2022/23**	**2023/24**
Principal sums invested for longer than 365 days	£18m	£15m	£13m
Current investments as at 31/12/21 in excess of 1 year	£7m	£7m	£7m

4.5 Investment risk benchmarking

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

4.6 End of year investment report

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

4.7 Scheme of delegation

Please see Appendix 9.

4.8 Role of the section 151 officer

Please see Appendix 10.

Contact: Sian Southerton ext 37861 sian.southerton@arun.gov.uk

2. PROPOSAL(S):		
To approve all 3 recommendations.		
3. OPTIONS:		
The Treasury Management Strategy is legislative and under the Local Government act 2003 and therefore the only option is to follow the proposal.		
4. CONSULTATION:		
Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		√
Relevant District Ward Councillors		√
Other groups/persons (please specify)	√ Treasury Advisors	
5. ARE THERE ANY IMPLICATIONS IN RELATION TO THE FOLLOWING COUNCIL POLICIES: (Explain in more detail at 6 below)	**YES**	**NO**
Financial	√	
Legal		√
Human Rights/Equality Impact Assessment		√
Community Safety including Section 17 of Crime & Disorder Act		√
Sustainability		√
Asset Management/Property/Land		√
Technology		√
Other (please explain)		
6. IMPLICATIONS:		
Approval will enable the Council to comply with legislation and provide a Treasury Service		

7. REASON FOR THE DECISION:

Statutory and the limits set, safeguard the Council against financial losses.

8. BACKGROUND PAPERS:

- The Local Government Act 2003 (www.legislation.gov.uk/ukpga/2003/26/content)
- CIPFA'S Treasury Management in the Public Services: Code of Practice (2017)

(Link not available as copyright)

- The Prudential Code for Capital Finance in Local Authorities (2017)

Cipfa Treasury Management Guidance notes (2018) *(Link not available as copyright)*

- MHCLG's Guidance on Local Government Investments ("the Guidance")

Prudential and treasury indicators

APPENDIX 1

1. PRUDENTIAL INDICATORS	2019/20	2020/21	2021/22	2022/23	2023/24
Extract from budget and rent setting report	**Actual**	**Probable outturn**	**Original**	**Original**	**Original**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure					
Non – HRA	2,676	2,793	3,228	3,203	3,199
HRA	5,045	7,211	4,732	6,624	6,624
TOTAL	**7,721**	**10,004**	**7,960**	**9,827**	**9,823**
Ratio of financing costs to net revenue stream					
Non – HRA	-3.08%	-2.17%	-1.90%	-1.90%	-1.90%
HRA	32.87%	32.84%	32.32%	*20.05%	20.58%
Capital Financing Requirement as at 31 March					
Non – HRA	-4,009	-4,223	-4,442	-4,642	-4,729
HRA	52,365	52,865	49,914	53,024	51,390
TOTAL	**48,356**	**46,642**	**45,472**	**48,382**	**46,661**
Annual change in Cap. Financing Requirement					
Non – HRA	-2,133	-214	-218	200	-87
HRA	-1,229	-1,500	-951	3,110	-1,634
TOTAL	**-3,362**	**-1,714**	**-1,169**	**2,910**	**-1,721**

*The provision for debt repayment has been reduced

2. TREASURY MANAGEMENT INDICATORS	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Probable outturn	Original	Original	Original
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	63,000	60,000	54,000	57,000	57,000
Other long term liabilities	0	1,000	1,000	1,000	1,000
TOTAL	**63,000**	**61,000**	**55,000**	**58,000**	**58,000**
Operational Boundary for external debt					
Borrowing	60,000	57,000	49,000	52,000	52,000
other long term liabilities	0	1,000	1,000	1,000	1,000
TOTAL	**60,000**	**58,000**	**50,000**	**53,000**	**53,000**
Actual external debt	53,180	44,320	*44,320	35,460	35,460
Upper limit for total principal sums invested for over 365 days (£m)	**18**	**18**	**18**	**15**	**13**
-	- -	-	-		

2021/22 potentially up to £3m borrowing for New Acquisitions

2022/23 potentially up to £12m of borrowing for garages and financing of unfinanced expenditure

Therefore, Authorised limit and Operational boundary increased by the £15m to allow for this

* £8.86m of debt being repaid (28 March 2022)

Maturity structure of fixed rate borrowing - upper & Lower limits	Actual at 31/03/21	lower limit	upper limit
under 12 months	20%	0%	40%
12 months and within 24 months	0%	0%	40%
24 months and within 5 years	0%	0%	50%
5 years and within 10 years	20%	0%	60%
10 years and above	60%	0%	100%

APPENDIX 2

Minimum Revenue Provision Policy

1. Introduction

1.1 CLG's Guidance on Minimum Revenue Provision (issued in 2012 but currently out for consultation) places a duty on local authorities to make a prudent provision for debt redemption. Where the Council finances capital expenditure by debt it must set aside resources to repay that debt in later years. The amount charged to revenue for the repayment of this debt is known as the Minimum Revenue Provision (MRP). The MRP charge is the means by which capital expenditure which has been funded by borrowing is paid for by council tax payers.

1.2. From 2007/08 onwards there has been no statutory minimum and the requirement is simply for local authorities to make a prudent level of provision, and the government has instead issued statutory guidance, which local authorities are required to 'have regard to' when setting a prudent level of MRP. The guidance gives local authorities more freedom to determine what would be a prudent level of MRP.

1.3. The CLG guidance requires the authority to approve an annual MRP statement, and recommends 4 options for calculating a prudent amount of MRP, for approval by Full Council in advance of the year to which it applies. Any subsequent revisions to that policy should also be approved by Full Council.

2. Details of DCLG Guidance on MRP

2.1. The statutory guidance issued by DCLG sets out the broad aims of a prudent MRP Policy as being "to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of the grant." It then identifies four options for calculating MRP and recommends the circumstances in which each option should be used, but states that other approaches are not ruled out.

2.2. The four MRP options available are:

- **Option 1**: Regulatory Method - is the previous statutory method, which is calculated as 4% of the Council's General Fund Capital Financing Requirement, adjusted for smoothing factors from the transition to the prudential capital financing regime in 2003.

- **Option 2**: CFR Method - Option 2 differs from Option 1 only in that the smoothing factors are removed. Option 2 has been included by DCLG to provide a simpler calculation for those councils for whom it would have a minimal impact, but the draft guidance does not expect it to be used by councils for whom it would significantly increase MRP.

- **Option 3**: Asset Life Method – MRP is charged over the expected useful life of the asset either in equal instalments or using an annuity method whereby the MRP increases in later years.

- **Option 4**: Depreciation Method - MRP is charged over the expected life of the asset in accordance with depreciation accounting. This would mean that the rate at which the MRP is charged could increase (or, more rarely, decrease) from year to year.

  The guidance clearly states this does not preclude other prudent methods to provide for the repayment of debt principal.

2.3 Under the statutory guidance, it is recommended that local authorities use Options 3 or 4 for all prudential borrowing and for all borrowing to fund capitalised expenditure (such as capital grants to other bodies and capital expenditure on IT developments). Authorities may use any of the four options for MRP for their remaining borrowing to fund capital expenditure.

2.4. For balance sheet liabilities relating to finance leases and PFI schemes, the guidance recommends that one prudent approach would be for local authorities to make an MRP charge equal to the element of the annual rental which goes to write down the balance sheet liability. This would have the effect that the total impact on the bottom line would be equal to the actual rentals paid for the year. However the guidance also mentions that Option 3 could be used for this type of debt.

2.5 The guidance also allows authorities to take an MRP Holiday where assets do not become operational for perhaps 2 or 3 years or longer. It proposes that MRP would not be charged until the year following the one in which the asset became operational.

3. Details of Statute - Part 4 Section 23 b of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

3.1 In deciding on the appropriate level of MRP to charge and the most appropriate method of financing the capital programme, the Council needs to have regard to the wider legislation regarding the use of capital receipts.

3.2 Statute gives local authorities the option to apply capital receipts to fund the payment of any liabilities relating to finance leases and PFI schemes. This is a reflection of the fact that such schemes are being treated in accounting terms as the acquisition of fixed assets, and the liability represents the amount being paid towards the purchase of the asset itself, rather than interest or service charges payable.

3.3 Local authorities may also use capital receipts to repay any borrowing that was incurred to fund capital expenditure in previous years.

4. 2018/19 MRP Policy

For 2018/19 it is recommended the Council adopt the following MRP policy:

- MRP will be charged utilising **option 3** for assets which have been funded from prudential borrowing.
- MRP will only be charged in the year following the asset becoming operational.
- If capital receipts are utilised to repay debt in year, the value of MRP chargeable will be reduced by the value of the receipts utilised.
- Whether an annuity or equal instalment method is adopted for option 3 will be dependent on the most financially beneficial method as determined by the Chief Financial Officer
- For PFI and Finance lease liabilities an MRP charge will be made to match the value of any liabilities that have not been funded from capital receipts.
- The Chief Finance Officer will determine annually the most prudent use of Capital Receipts, taking into account forecasts for future expenditure and the generation of further receipts.
- There is no requirement for the HRA to make debt repayments but it has opted to make voluntary repayments relating to debt inherited due to HRA self-financing settlement and provision has been made within the business plan to show that it can pay down the remaining debt over the life of the business plan.
- Any major revisions to this policy will be presented to Full Council for approval.

INVESTMENTS at 31st December 2020

Appendix 3

Type of Investment/Deposit	Reference no.	Counterparty	Issue Date	Maturity Date	Nominal	Current Interest Rate
Fixed Term Deposit	730	Lloyds	16/08/2019	06/04/2021	£1,000,000.00	1.12
Fixed Term Deposit	753	Qatar National Bank	27/04/2020	27/04/2021	£1,000,000.00	1.18
Fixed Term Deposit	771	Close Brothers	27/10/2020	26/10/2021	£1,000,000.00	0.80
Fixed Term Deposit	769	Close Brothers	04/09/2020	03/09/2021	£1,000,000.00	0.80
Fixed Term Deposit	770	Qatar National Bank	01/09/2020	06/04/2021	£2,000,000.00	0.36
Fixed Term Deposit	755	Qatar National Bank	27/04/2020	26/04/2021	£2,000,000.00	1.13
Fixed Term Deposit	775	Close Brothers	10/11/2020	09/11/2021	£2,000,000.00	0.70
Fixed Term Deposit	776	Qatar National Bank	17/11/2020	09/11/2021	£2,000,000.00	0.53
Fixed Term Deposit	766	Barclays Bank	19/06/2020	21/06/2021	£3,000,000.00	0.40
Fixed Term Deposit	745	Lloyds	24/01/2020	25/01/2021	£2,000,000.00	1.10
Fixed Term Deposit	758	Qatar National Bank	04/05/2020	04/05/2021	£1,000,000.00	1.03
Fixed Term Deposit	765	Qatar National Bank	02/06/2020	06/02/2021	£1,000,000.00	0.84
Fixed Term Deposit	767	Qatar National Bank	04/08/2020	03/08/2021	£1,000,000.00	0.53
Fixed Term Deposit	760	Qatar National Bank	18/05/2020	31/03/2021	£1,000,000.00	0.97
Fixed Term Deposit	761	Goldman Sachs	20/05/2020	22/02/2021	£2,000,000.00	0.63
Fixed Term Deposit	762	Goldman Sachs	26/05/2020	26/02/2021	£3,000,000.00	0.56
Fixed Term Deposit	763	Goldman Sachs	28/05/2020	26/02/2021	£2,000,000.00	0.57
Fixed Term Deposit	768	Close Brothers	11/08/2020	10/08/2021	£1,000,000.00	0.80
Fixed Term Deposit	773	Close Brothers	27/10/2020	26/10/2021	£1,000,000.00	0.70
Fixed Term Deposit	774	Yorkshire BS	29/10/2020	06/04/2021	£2,000,000.00	0.11
Fixed Term Deposit	772	Slough BC	19/11/2020	18/11/2021	£2,000,000.00	0.30
Call	44447	Lloyds			£1,000,000.00	0.01
Call	327	Svenska Handlesbanken			£1,000,000.00	0.10
Notice Account	44444	Svenska Handlesbanken - 35DN			£11,000,000.00	0.15
Notice Account	44443	Santander - 95DN			£11,000,000.00	0.40
Notice Account	44445	Lloyds Bank PLC - 95DN			£5,000,000.00	0.10
Property Fund	140000	CCLA (Churches, Charities and LA's)			£5,000,000.00	*4.27
Diversified Fund	140500	CCLA (Churches, Charities and LA's)			£2,000,000.00	*3.36
Money Market Fund	100500	CCLA (Churches, Charities and LA's)			£4,000,000.00	0.05
					£74,000,000.00	

* Yield on Nav/price from CCLA at 31 December 2020

Interest Rate Forecast 2020- 2024

APPENDIX 4

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

Link Group Interest Rate View 9.11.20									(The Capital Economics forecasts were done 11.11.20)				
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Bank Rate													
Link	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Capital Economics	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
5yr PWLB Rate													
Link	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
Capital Economics	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	-	-	-	-	-
10yr PWLB Rate													
Link	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
Capital Economics	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	-	-	-	-	-
25yr PWLB Rate													
Link	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
Capital Economics	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	-	-	-	-	-
50yr PWLB Rate													
Link	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Capital Economics	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	-	-	-	-	-

APPENDIX 5

5.3 ECONOMIC BACKGROUND

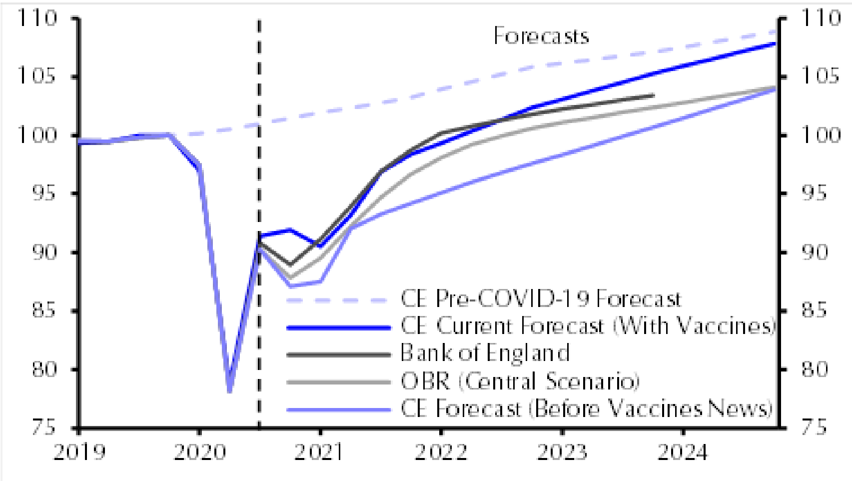
- **UK.** The key quarterly meeting of the Bank of England Monetary Policy Committee kept **Bank Rate** unchanged on 5.11.20. However, it revised its economic forecasts to take account of a second national lockdown from 5.11.20 to 2.12.20 which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE, announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".
- Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:
    - The economy would recover to reach its pre-pandemic level in Q1 2022
    - The Bank also expected there to be excess demand in the economy by Q4 2022.
    - CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- One key addition to **the Bank's forward guidance in August** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. **Inflation** is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor due to base effects from twelve months ago falling out of the calculation, and so is not a concern. Looking further ahead, it is also unlikely to be a problem for some years as it will take a prolonged time for spare capacity in the economy, created by this downturn, to be used up.

- **Public borrowing** was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.
- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. While the one month second national lockdown that started on 5th November caused a further contraction of 5.7% m/m in November, this was much better than had been feared and showed that the economy is adapting to new ways of working. This left the economy ‘only’ 8.6% below the pre-crisis level.

- **Vaccines – the game changer.** The Pfizer announcement on 9th November of a successful vaccine has been followed by approval of the Oxford University/AstraZeneca and Moderna vaccines. The Government has a set a target to vaccinate 14 million people in the most at risk sectors of the population by 15th February; as of mid-January, it has made good, and accelerating progress in hitting that target. The aim is to vaccinate all adults by September. This means that the national lockdown starting in early January, could be replaced by regional tiers of lighter restrictions, beginning possibly in Q2. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines have radically improved the economic outlook so that it may now be possible for GDP to recover to its pre-virus level as early as Q1 2022. These vaccines have enormously boosted confidence that **life could largely return to normal during the second half of 2021**. 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 when life returns to normal.

- 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 risk is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development, and vaccine production facilities are being ramped up around the world.

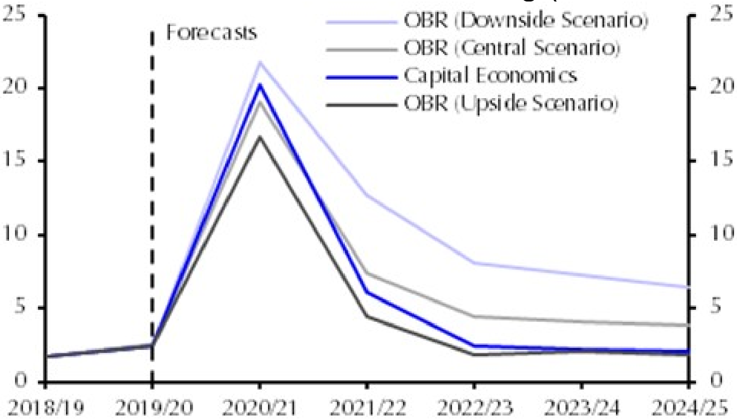
Chart: Level of real GDP (Q4 2019 = 100)



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

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

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



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

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

- **Brexit.** The final agreement of a trade deal on 24.12.20 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

- **Monetary Policy Committee meeting of 17 December.** All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy that it had highlighted in November. But this was caveated by it saying, "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." So, while vaccines are a positive development, in the eyes of the MPC at least, the economy is far from out of the woods in the shorter term. The MPC, therefore, voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for six months from 30.4.21 until 31.10.21. (The MPC had assumed that a Brexit deal would be agreed.)

- **Fiscal policy.** In the same week as the MPC meeting, the Chancellor made a series of announcements to provide further support to the economy: -
  - An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
  - The furlough scheme was lengthened from the end of March to the end of April.
  - The Budget on 3.3.21 will lay out the "next phase of the plan to tackle the virus and protect jobs". This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

- The **Financial Policy Committee** (FPC) report on 6.8.20 revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

- **US.** The Democrats gained the presidency and a majority in the House of Representatives in the November elections: after winning two key Senate seats in Georgia in elections in early January, they now also have a very slim majority in the Senate due to the vice president's casting vote. President Biden will consequently have a much easier path to implement his election manifesto. However, he will not have a completely free hand as more radical Democrat plans may not be supported by all Democrat senators. His initial radical plan for a fiscal stimulus of $1.9trn, (9% of GDP), is therefore likely to be toned down in order to get through both houses.

- **The economy** had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. 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, individual states might feel it necessary to return to more draconian lockdowns.

- The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and declining in December, and retail sales dropping back. The economy is set for further weakness into the spring. **GDP growth** is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

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

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

- **EU.** 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 seriously affected many countries. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the countries most affected by the first wave.

- With **inflation** expected to be unlikely to get much above 1% over the next two years, **the ECB** has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of TLTRO, (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022. The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before later in quarter 2 of 2021.

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

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

- **World growth.** World growth will has been in recession in 2020 and this is likely to continue into the first half of 2021 before recovery in the second half. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

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

Summary

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

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

INTEREST RATE FORECASTS

Brexit. The interest rate forecasts provided by Link in paragraph 3.3 were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. There is therefore no need to revise these forecasts now that a trade deal has been agreed. Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

The balance of risks to the UK

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

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

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

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

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

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

Specified and Non-Specified Investments **APPENDIX 6**

	specified	non-specified	Minimum Credit Criteria Fitch (and equivalent) / Minimum Criteria	Maximum Investment per Institution	Max. maturity period
Term deposits – Local Authorities **(category 1)**	✓	✓	--	£12M	5 years
Term deposits – banks and building societies **(category 1)**	✓	✓	Short-term F1+ Long-term AA-	£12M	5 years
Term deposits – banks and building societies **(category 2)**	✓	✓	Short-term F1 Long-term A+	£11M	3 years
Term deposits – banks and building societies **(category 3)**	✓	✓	Short-term F1 Long-term A-	£8M	2 years
Term deposits – building societies **(Category 4)**	✓	✓	Assets in Excess of £10 billion	£4M	1 year
Council's bank (for term deposits use appropriate category 1 to 3) **(category 5)**	✓	✓	n/a	No limit *Although category limit for term deposits*	As category 1 to 3
Term deposits – UK part nationalised banks **(category 6)**	✓	✓	Short-term F3 Long term BBB-	£11M	3 years
Callable deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Forward deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Alternative Investments – Asset Backed Bonds **(Category 8)**		✓	--	£4M	25 years
Debt Management Agency Deposit Facility **(category 9)**	✓	✓	--	No limit	Liquid

Bonds Issued by multilateral development banks **(category 10)**		✓	Long term AAA	£4M	5 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)					
Money Market Funds (CNAV, LVNAV & VNAV) Government Liquidity Fund **(Category 7)**	✓		AAA	£4M	liquid
Property funds **(Category 11)**		✓		£6M	25 years
Multi-Asset Funds **(Category 12 –** diversified funds**)**		✓	--	£6M	10 - 15 years

Part nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. In particular, as they are no longer separate institutions in their own right, however, these institutions have effectively taken on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. It is therefore proposed to continue to keep the category of UK part nationalised banks for both specified and unspecified investments (category 6).

APPENDIX 7

LIST OF AUTHORISED COUNTERPARTIES

Category 1 - Limit of £12 million for each institution - Maximum investment period - 5 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**AA-**	**F1+**
	Moody	**Aa3**	**P-1**
	S&P	**AA-**	**A-1+**

All Local Authorities

Bank of Nova Scotia (CAN)
DBS Bank Ltd (SING)
HSBC Bank plc (UK)
Oversea-Chinese Banking Corp Ltd (SING)
Svenska Handelsbanken (SW)
United Overseas Bank Ltd (SING)
First Abu Dhabi Bank (U.A.E)

Category 2 - Limit of £11 million for each institution - Maximum investment period - 3 Years

		Long Term	Short Term
Min Criteria			
	Fitch	**A+**	**F1**
	Moody	**A1**	**P-2**
	S&P	**A+**	**A-1**

Barclays Bank plc (RFB & NRFB) (UK)
Goldman Sachs International Bank (UK)
Standard Charted Bank (UK)
Qatar National Bank (Qatar)
National Westminster Bank PLC (RFB) (UK)
Royal Bank of Scotland PLC (RFB) (UK)
Santander (UK)

Category 3 - Limit of £8 million for each institution - Maximum investment period - 2 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**A-**	**F1**
	Moody	**A3**	**P-2**
	S&P	**A-**	**A-1**

Nationwide Building Society (UK)
Close Brothers (UK)

Category 4 - Limit of £4 million for each institution - Maximum Investment period - 1 year
Building Society with Assets greater than £10 billion

Coventry Building Society (UK)
Skipton Building Society (UK)
Yorkshire Building Society (UK)

Category 5 - Council's Bank

NO LIMIT - appropriate category 1 to 3 (Max of £11M term deposit)

Lloyds Bank Plc (RFB) (Cat 2)
Lloyds Bank Corporate Markets Plc (NRFB) (Cat 2)
Bank of Scotland PLC (RFB) (Cat2)

Category 6 - Limit of £11 million for each institution - Maximum investment period - 3 Years

banks effectively nationalised by UK government

		Long Term	Short Term
Min Criteria	**Fitch**	**BBB-**	**F3**
	Moody	**Baa3**	**P-3**
	S&P	**BBB-**	**A-3**

Category 7 - Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)

- Money Market Funds (MMF's), (CNAV, LVNAV, VNAV) & Enhanced MMF's
- Government Liquidity Funds

Limit of £4million for each institution

	Fitch	NAV
Aberdeen Standard (GBP)	AAA	LVNAV
CCLA Public sector deposit fund (PSDF)	AAA	LVNAV
Deutsche Banking Group	AAA	LVNAV
Federated Investors Ltd	AAA	LVNAV
Fidelity (GBP)	AAA	LVNAV
Northern Trust	AAA	

Category 8 - Alternative Investments (Asset Backed Bonds) - 25 Years

Maximum investment £4 million

Category 9 - Debt Management Office

Debt management Account - NO LIMIT (UK Govt)

Category 10 - Bonds issued by multilateral development banks - 5 Years

Maximum investment £4 million AAA

Category 11 – Property Funds - 25 Years

Maximum investment £6 million

CCLA

Category 12 - Multi-Asset Funds - 15 Years

Maximum investment £6 million

CCLA - Diversified Income Fund

Appendix 8

Approved countries for investments

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest of 2 or more rating agencies) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

Based on a majority rule of available ratings.

AAA

- Australia
- Canada (Fitch AA+)
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.S.A. (S&P AA+)

AA+

- Finland

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium (S&P AA)
- Hong Kong
- Qatar
- **U.K.** (S&P AA)

APPENDIX 9

Treasury management scheme of delegation

(i) Full Council

- approval of annual strategy
- budget consideration and approval approval of the division of responsibilities;
- approving the selection of external service providers and agreeing terms of appointment.
- receiving and reviewing monitoring and outturn reports on treasury management

(ii) Cabinet Member for Corporate Governance

- approval of amendments to the annual treasury management strategy once approved by Full Council between its review in consultation with the Group Head of Corporate Support.

(iii) Audit and Governance Committee (responsibility for scrutiny)

- reviewing the treasury management policy and procedures and making recommendations to Full Council (the responsible body).
- Scrutiny of annual strategy prior to adoption by Full Council
- Scrutiny of monitoring and outturn reports
- receiving and reviewing reports on treasury management policies, practices and activities

APPENDIX 10

The treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long-term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority