

**Manchester City Council**  
**Report for Resolution**

**Report to:** Executive – 17 February 2021  
Resources and Governance Scrutiny – 1 March 2021  
Council – 5 March 2021

**Subject:** Treasury Management Strategy Statement 2021/22, including  
Borrowing Limits and Annual Investment Strategy

**Report of:** Deputy Chief Executive and City Treasurer

---

**Summary**

To set out the proposed Treasury Management Strategy Statement and Borrowing Limits for 2021/22 and Prudential Indicators for 2021/22 to 2023/24.

**Recommendations**

The Executive is requested to:

1. Recommend the report to Council.
2. Delegate authority to the Deputy Chief Executive and City Treasurer, in consultation with the Executive Member for Finance and Human Resources, to:
  - approve changes to the borrowing figures as a result of changes to the Council's Capital or Revenue budget; and
  - submit these changes to Council.

The Resource and Governance Scrutiny Committee is requested to commend the report to Council.

The Council is recommended to:

1. Approve the proposed Treasury Management Strategy Statement, in particular the:
  - Borrowing Requirement listed in Section 7 of this report;
  - Borrowing Strategy outlined in Section 10;
  - Annual Investment Strategy detailed in Section 11;
  - Prudential and Treasury Indicators listed in Appendix A;
  - MRP Strategy outlined in Appendix B;
  - Treasury Management Policy Statement at Appendix C; and
  - Treasury Management Scheme of Delegation at Appendix D
2. Delegate to the Deputy Chief Executive and City Treasurer, in consultation with the Executive Member for Finance and Human Resources, the power to pursue any restructuring, rescheduling or redemption opportunities available, including amendments to the Treasury Management Strategy if the changes

require it. Any changes required to the Strategy will be reported to members at the earliest opportunity.

---

## Wards Affected - All

<b>Environmental Impact Assessment</b> - the impact of the decisions proposed in this report on achieving the zero-carbon target for the city
---

Treasury Management activity underpins the Council's finances, and therefore supports projects and initiatives which seek to achieve the Council's zero carbon target.
--

Our Manchester Strategy outcomes	Contribution to the strategy
A thriving and sustainable city: supporting a diverse and distinctive economy that creates jobs and opportunities	The Treasury Management function supports the whole Council by seeking to ensure that funding is available when required, to fund all of the work that the Council undertakes. Therefore, whilst not directly contributing to the strategic aims, the Council's treasury management activity underpins the work taking place elsewhere to achieve the outcomes.
A highly skilled city: world class and home grown talent sustaining the city's economic success	
A progressive and equitable city: making a positive contribution by unlocking the potential of our communities	
A liveable and low carbon city: a destination of choice to live, visit, work	
A connected city: world class infrastructure and connectivity to drive growth	

**Full details are in the body of the report, along with any implications for**

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

---

## Financial Consequences – Revenue

The capital financing budget forms a key part of the Council's revenue budget. The activity forecast in this report is affordable within the existing and future capital financing budget, including use of the capital financing reserve.

## Financial Consequences – Capital

None – the Council's treasury management activity is by definition not capital expenditure.

---

---

**Contact Officers:**

Name: Carol Culley  
Position: Deputy Chief Executive and City Treasurer  
Telephone: 0161 234 3406  
E-mail: carol.culley@manchester.gov.uk

Name: Helen Seechurn  
Position: Deputy City Treasurer  
Telephone: 07814 087850  
E-mail: helen.seechurn@manchester.gov.uk

Name: Tim Seagrave  
Position: Group Finance Lead – Capital and Treasury Management  
Telephone: 0161 234 3445  
E-mail: timothy.seagrave@manchester.gov.uk

Name: Matus Majer  
Position: Treasury Manager  
Telephone: 0161 600 8490  
E-mail: matus.majer@manchester.gov.uk

**Background documents (available for public inspection):**

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report.

- Capital Strategy and Budget 2020/21 to 2024/25 report to Executive 17 February 2021
- CIPFA Prudential Code 2017
- CIPFA Treasury Management Code of Practice 2018

Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy please contact one of the contact officers above.

## 1. Introduction

- 1.1 The Treasury Management Strategy Statement sets out the risk framework under which the Council's treasury management function will operate. By detailing the investment and debt instruments to be used during the year the Strategy details the risk appetite of the Authority and how those risks will be managed.
- 1.2 The Treasury Management Strategy Statement is linked to the Capital Strategy, in that both documents detail the risks that the Council face, but critically the Treasury Management Strategy Statement is focussed on the risks associated with the management of the Council's cash flow and debt, whereas the Capital Strategy looks at capital investment and expenditure decisions.
- 1.3 The capital budget contains significant priorities for the Council, such as the refurbishment of the Town Hall, which are to be funded from borrowing. This strategy details how decisions will be taken regarding new borrowing and that the over-arching principle is that the borrowing provides value for money for the Council in whatever form it takes. Capital investment decisions are made in line with the economic and regeneration objectives for the city and to support delivery of the agreed capital strategy.
- 1.4 For treasury management investments the Council holds security and liquidity as paramount. This strategy proposes the use of investment types aimed at ensuring that funds are kept secure and that the Council has access to funds when they are required.
- 1.5 The work of the Council's treasury management function is impacted by market conditions and there are significant economic changes, such as the end to the transition period and COVID-19 Pandemic, which create uncertainty in the market. The strategy has been drafted to provide flexibility to manage the risks associated with uncertainties such as interest rate or liquidity challenges.

### **Treasury Management Strategy for 2021/22**

- 1.6 The suggested strategy for 2021/22 is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury advisor, Link Asset Services. The strategy covers:
  - Section 1: Introduction
  - Section 2: CIPFA Definition of Treasury Management
  - Section 3: Statutory and other Requirements
  - Section 4: Prudential and Treasury Indicators for 2021/22 to 2023/24
  - Section 5: Impact of 2012 HRA reform
  - Section 6: Current Portfolio Position
  - Section 7: Prospects for Interest Rates
  - Section 8: Borrowing Requirement
  - Section 9: Borrowing Strategy
  - Section 10: Annual Investment Strategy

Section 11: Scheme of Delegation  
Section 12: Role of the Section 151 Officer  
Section 13: Minimum Revenue Provision (MRP) Strategy  
Section 14: Recommendations

Appendix A: Prudential and Treasury Indicators for approval  
Appendix B: MRP Strategy  
Appendix C: Treasury Management Policy Statement  
Appendix D: Treasury Management Scheme of Delegation  
Appendix E: The Treasury Management Role of the Section 151 Officer  
Appendix F: Economic Background – Link Asset Services  
Appendix G: Prospects for Interest Rates  
Appendix H: Glossary of Terms  
Appendix I: Treasury Management Implications of HRA Reform

## **2 CIPFA Definition of Treasury Management**

- 2.1 Treasury management is defined by CIPFA as:  
'The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

## **3 Statutory and other requirements**

### **Statutory requirements**

- 3.1 The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
- 3.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as section 11 of this report); the Strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 3.3 The Department for Housing, Communities and Local Government (DHCLG) issued revised investment guidance which came into effect from the 1 April 2010. In 2017 the Department, now the Ministry of Housing Communities and Local Government (MHCLG) further updated its guidance on local government investments. CIPFA responded to these revisions by issuing an updated Code of Practice on Treasury Management and the Prudential Code in 2017. CIPFA also issued Public Services Guidance Notes in 2018 to support the changes made to the Codes.

## **CIPFA requirements**

- 3.4 The CIPFA Code of Practice on Treasury Management has been adopted by the Council. This strategy has been prepared in accordance with the revised December 2017 Code.
- 3.5 The primary requirements of the Code are as follows:
- a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
  - b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
  - c) Receipt by the full Council of an annual Treasury Management Strategy Statement, including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year;
  - d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions;
  - e) Delegation by the Council of the role of responsible body for treasury management strategy and practices, budget consideration and approval, monitoring and selection of external service providers to a specific named body. For this Council the delegated body is the Audit Committee.
  - f) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Resource and Governance Scrutiny Committee.
- 3.6 The Council's adherence to the Prudential Code is monitored through the series of Prudential Indicators defined by CIPFA. Adherence to the CIPFA Prudential Code is a factor which informs the Council's investment policy. The legal status of the Treasury Management Code is derived in England and Wales from regulations issued under the Local Government Act 2003. This includes statutory guidance on Local Government investments issued under section 15(1) (a) of the Act.

## **Balanced Budget Requirement**

- 3.7 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, revised under Section 31 of the Localism Bill 2011, for the Council to produce a balanced budget. In particular, Section 31 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:
- increases in interest charges caused by increased borrowing to finance additional capital expenditure;
  - increases to the minimum revenue provision; and
  - increases in running costs from new capital projects

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

#### **4 Prudential and Treasury Indicators for 2021/22 to 2023/24**

- 4.1 It is a statutory duty under Section 3 of the Act and supporting regulations that the Council determines and keeps under review how much it can afford to borrow. This amount is termed the 'Affordable Borrowing Limit'. In England this Authorised Limit represents the legislative limit specified in the Act and is one of the key Prudential Indicators identified by the CIPFA Code.
- 4.2 The Council must have regard to the Prudential Code when setting the Authorised Limit which requires it to ensure that total capital investment remains within sustainable limits.
- 4.3 Whilst termed an Affordable Borrowing Limit, the capital plans incorporate financing by both external borrowing and other forms of liability such as credit arrangements. The Authorised Limit is to be set on a rolling basis for the forthcoming financial year and two successive financial years.
- 4.4 The full set of Treasury limits and Prudential Indicators recommended by the Code and used by the Council, together with their suggested levels for 2021/22 is noted in Appendix A of this report.
- 4.5 It should be noted that the Prudential and Treasury Indicators in this report may be subject to change dependent on decisions taken on the Capital and Revenue budgets which are reported elsewhere on this agenda.

#### **5 The Housing Revenue Account – Impact of 2012 HRA Reform**

- 5.1 The Local Government Finance and Housing Act 1989 requires Councils who own housing they rent out to tenants to separate all of the financial activities relating to the Council acting as landlord into a ring-fenced account known as the Housing Revenue Account (HRA). Due to the ring-fence it is illegal for the Council to subsidise any General Fund (GF) activity from its HRA and vice versa.
- 5.2 The Treasury Management Strategy for 2013/14 was the first to incorporate the split of the Council's debt portfolio following the HRA debt settlement of March 2012 which ended the subsidy arrangement. Details of how the split was calculated and the corresponding effect on treasury management activities are at Appendix I.
- 5.3 The treasury position of the Council will continue to be monitored at a Council level alongside the separate positions for the GF and the HRA. The HRA is also limited in terms of the treasury activity it can undertake as any temporary borrowing or investing it requires or long-term borrowing will be through the GF. This ensures that the overall Council position is managed as effectively and efficiently as possible.

5.4 To reflect the fact that the HRA now has its own treasury position this report will mention where the HRA treasury strategy may be different to that of the GF. Where the Council strategy is mentioned this applies to both the GF and the HRA.

## 6 Current Portfolio Position

6.1 The forecast portfolio position for the end of the current financial year is shown below. Short term borrowing relates to temporary borrowing from other Local Authorities which was required to ensure cash liquidity during the COVID-19 pandemic that put significant strain on the availability of cash due to reduced income from business rates, council tax, and other forms of income, as reported in the Interim Report 2020/21 which went to Audit Committee on 10<sup>th</sup> of November 2020.

6.2 The Council's forecast treasury portfolio position at 31<sup>st</sup> March 2021 is:

Table 1	Principal			Av Rate
	GF £'m	HRA £'m	Total £'m	%
<b>Long Term Borrowing</b>				
PWLB	150.0	0.0	<b>150.0</b>	2.45
Market	336.8	61.9	<b>398.7</b>	4.48
Stock	0.9	0.0	<b>0.9</b>	4.00
SALIX	15.0	0.0	<b>15.0</b>	0.00
HCA	8.4	0.0	<b>8.4</b>	0.00
	511.1	61.9	<b>573.0</b>	
<b>Short Term Borrowing</b>				
Local Authorities	165.0	0.0	<b>165.0</b>	0.68
Other	11.1	0.0	<b>11.1</b>	0.60
	176.1	0.0	<b>176.1</b>	
<b>Forecast Additional Borrowing<sup>1</sup></b>	20.0	0.0	<b>20.0</b>	
<b>Gross Debt</b>	707.2	61.9	<b>769.1</b>	2.96
External Investments	(12.0)	0.0	<b>(12.0)</b>	0.00
Internal Balances (GF/HRA)	51.1	(51.1)	<b>0</b>	0.00
<b>Net Debt</b>	<b>746.3</b>	<b>10.8</b>	<b>757.1</b>	
Capital Financing Requirement			1,700.6	
Gross Debt			769.1	
Internal Borrowing			<b>931.5</b>	

6.3 The Capital Financing Requirement measures an Authority's underlying need to borrow or finance by other long-term liabilities for a capital purpose. It

<sup>1</sup> Forecast additional borrowing is based on current forecasts at the end of December 2020 and is subject to change depending on changes in expenditure, income, and working capital.



represents the amount of capital expenditure that has not yet been resourced absolutely, whether at the point of spend (by capital receipts, capital grants/contributions or from revenue income), or over the longer term by prudent Minimum Revenue Provision (MRP) or voluntary application of capital receipts for debt repayment etc. Alternatively, it provides a figure for the capital expenditure incurred by the Council but not yet provided for.

- 6.4 The Capital Financing Requirement of the City Council as at 31<sup>st</sup> March 2021 is forecast to be c. £1,700.6m. The difference between this and the actual gross debt of the Council is c. £931.5m which is the amount of funding that the Council has internally borrowed or has been funded through credit arrangements. This is a reflection of the Council's ongoing treasury strategy of using internal cash to reduce the amount of borrowing required rather than holding this cash as investments.
- 6.5 In the current environment where the rate of interest on investments is significantly lower than that on borrowing and there are substantial counterparty risks, this has been a prudent approach and has provided value for money for the Council. Internal cash refers to cash surpluses which arise from the timing of receipts and payments.
- 6.6 As part of the reform of the HRA, on the 28<sup>th</sup> March 2012 the then DHCLG repaid all of the Council's Public Works Loan Board (PWLB) debt which had been gradually reduced over recent years by various housing stock transfers. Subsequently the HRA debt portfolio consists almost exclusively of market debt, the majority of which are Lender Option Borrower Option (LOBO) loans which have long-term maturity dates. Whilst this provides some stability for the Council as LOBOs are unlikely to be called in the near future due to the current and forecast market environment, it does mean that when seeking to take new debt the Council should consider diversifying the portfolio, not least to ensure a wider range of maturity dates.
- 6.7 The portfolio at 31<sup>st</sup> March 2021 includes Council Stock with a value of £0.9m. This Stock debt is attributable to the irredeemable class of stock where stockholders have not taken up the Council's redemption offer made in 2017/18.

## **7 Prospects for Interest Rates**

- 7.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Appendix G draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following gives Link's central view for interest rates at financial year ends (March):
- 2021: 0.10%
  - 2022: 0.10%
  - 2023: 0.10%

- 7.2 There is no certainty to these forecasts. A detailed view of the current economic background prepared by Link Asset Services is at Appendix F to this report.
- 7.3 The Council seeks to maintain a portfolio of debt and investments that is a mix of fixed and variable interest rates. Whilst fixed interest rates give the Council certainty, there is also a risk that prevailing market rates change and there are then opportunities to either increase the rate of return on investments or reduce the rate of interest on debt which could not be taken if the whole portfolio was fixed.
- 7.4 The Council's treasury management investments are classed as variable as the Council invests short term to enable the cash flow to be managed. In terms of debt, the Council has a significant portfolio of fixed rate debt, but as noted above a significant element of this is LOBO debt which means that there are risks that the interest rate on that debt could change. The Council monitors this position, including the likely use of the Lender Options, and will make future borrowing decisions with a view to keeping the debt portfolio balanced between fixed and variable debt.

## 8 Borrowing Requirement

- 8.1 The potential long-term borrowing requirements over the next three years are:

<b>Table 2</b>	<b>2021/22 £'m estimate</b>	<b>2022/23 £'m estimate</b>	<b>2023/24 £'m estimate</b>
Planned Capital Expenditure funded by Borrowing	258.5	205.9	100.4
Change in Grants & Contributions	45.7	48.4	0.0
Change in Capital Receipts	1.3	(24.3)	(34.8)
Change in Reserves	97.9	109.9	15.9
MRP Provision	(31.1)	(36.1)	(38.8)
Refinancing of maturing debt (GF)	196.0	7.7	3.1
Refinancing of maturing debt (HRA)	1.1	1.4	0.6
<b>Estimated Borrowing Requirement</b>	<b>569.4</b>	<b>312.9</b>	<b>46.4</b>
Funded by:			
GF	568.3	311.5	45.8
HRA	1.1	1.4	0.6

## 9 Borrowing Strategy

### General Fund

- 9.1 Following the HRA debt settlement in 2012 the Council's debt position is one of significant internal borrowing meaning cash backed reserves and provisions are being used in lieu of external debt. The external debt held is predominantly long term in nature.

- 9.2 The proposed Capital Budget, submitted to Executive in February and Council in March, contains significant capital investment across the city. The scale of the investment suggests that the Council will need to undertake external borrowing in the future and will not be able on to rely on internal borrowing alone. Where possible, internal borrowing will remain the first option due to the interest savings generated.
- 9.3 To this aim, the Council's borrowing strategy will utilise the annual provision it is required to make to reduce debt, in the form of its Minimum Revenue Provision (MRP). If MRP is not used to reduce external debt it is held as cash so the most efficient arrangement is for MRP to be used to reduce the new long term debt expected to be required. This ensures that MRP is utilised and does not accumulate as cash on the Balance Sheet. Alternatively MRP could be used to repay existing debt but this would be at considerable cost in the current interest rate environment.
- 9.4 Beyond the forecast period for capital investment and matching to the same principles as above, a prudent strategy is to seek to borrow in the medium term with maturities to match the estimated MRP that is generated in the same period. This avoids an accumulation of cash on the Balance Sheet that would need to be invested at a potential net cost and investment risk to the Council.
- 9.5 The overall strategy is therefore for the Council to continue to use reserves and provisions to maximise internal borrowing whilst seeking to rebalance the portfolio with more medium term debt when there is a need to externally borrow. This must be done with a strong focus on achieving value for money on interest costs and balancing the risks to the overall debt portfolio.

## **HRA**

- 9.6 The Council's proposed capital budget for 2020/21 and beyond does not contain any requirement for the HRA to borrow. It is expected that proposals will be brought forward that require funding via borrowing so it is likely the HRA will have a borrowing requirement in 2020/21. The level of borrowing affordable is restrained by the statutory requirement for the HRA Business Plan to avoid going into a deficit.
- 9.7 The impact of any required further long term borrowing on the Business Plan will be reviewed which will inform the borrowing options pursued. Any temporary borrowing required will be sought from the General Fund. This is discussed further in Appendix I.
- 9.8 Note, in the event that some of the current debt is required to be repaid, for example if one of the LOBO loans was called, the refinancing arrangements would need to be considered.

## **Borrowing Options**

- 9.9 The overall forecast for the long term borrowing rates are to remain relatively stable in year 2021/22, increasing slightly over the next 3 years. In terms of the Council's borrowing strategy there are three options:
- i. Internal borrowing
  - ii. Short to medium term borrowing
  - iii. Long term borrowing

Treasury Management will continue to monitor and manage the risk of each of the above borrowing options. At such time the Council will need to borrow, the debt market will be actively monitored and the borrowing strategy which delivers the optimum value for money will be chosen. The short-term advantage of internal and short-term borrowing will be weighed against the potential cost if long term borrowing is delayed.

- 9.10 New borrowing will be considered in the forms noted below. All options will be evaluated alongside their availability and which provides best value for money. The options below are not presented in a hierarchical order.

- **Public Works Loan Board (PWLB)**

In February 2020 Parliament reformed the statutory basis of the PWLB, transferring lending powers to HM Treasury. In March 2020 the government consulted on revising the PWLB's lending terms to reflect the new governance arrangements as well as to end the situation in which a minority of local authorities used PWLB loans to fund debt for yield activity via commercial investments. The government published its response to this consultation and implemented these reforms in November 2020.

Additional requirements to borrow from PWLB were introduced. Each local authority that wishes to borrow from the PWLB will need to submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. Any investment assets bought primarily for yield will not be supported by PWLB.

Local Authorities will be asked to:

- i. Categorise Capital Spending into: Service Spending, Housing, Regeneration, Preventative Action, Treasury Management, and Debt for Yield activity.
- ii. Provide a short description covering at least 75% of the spending in each category.
- iii. Provide assurance from the section 151 officer or equivalent that the local authority is not borrowing in advance of need and does not intend to buy investment assets primarily for yield.

PWLB borrowing is available between 1 and 50 year maturities on various bases. This offers a range of options for new borrowing which could spread debt maturities away from a concentration in longer dated debt and allow the Council to align maturities to MRP.

The Link forecast for the PWLB Certainty Rate is as follows:

<b>Table 3</b>	<b>Mar 21</b>	<b>Jun 21</b>	<b>Sep 21</b>	<b>Dec 21</b>	<b>Mar 22</b>	<b>Mar 23</b>	<b>Mar 24</b>
Bank Rate %	0.10	0.10	0.10	0.10	0.10	0.10	0.10
5 yr PWLB rate %	0.80	0.80	0.80	0.80	0.90	0.90	1.00
10 yr PWLB rate %	1.10	1.10	1.10	1.10	1.20	1.20	1.30
25 yr PWLB rate %	1.50	1.60	1.60	1.60	1.60	1.70	1.80
50 yr PWLB rate %	1.30	1.40	1.40	1.40	1.40	1.50	1.60

A more detailed Link forecast is included in Appendix G to this report.

- **European Investment Bank (EIB)**

Historically, the EIB rates for borrowing were generally favourable compared to PWLB although the margin of benefit has now reduced as a result of the U.K. withdrawing from the EU and the reversal of PWLB rates as described above. The Council still has access to EIB along with the option to forward fix rates for borrowing and this option will be considered if the conditions can be met and it offers better value for money.

The EIB appraises its funding plans against individual schemes, particularly around growth and employment and energy efficiency, and any monies borrowed are part of the Council's overall pooled borrowing.

- **Third Party Loans**

These are loans from third parties that are offered at lower than market rates, for example Salix Finance Ltd is offering loans to the public sector at 0% to be used specifically to improve their energy efficiency and reduce carbon emissions.

- **Inter-Local Authority advances**

Both short and medium term loans are often available in the inter Local Authority market.

- **Market Loans**

Following the reversal of the PWLB rates noted above, there has been a decrease in market activity relating to local authority debt as the debt pricing and structure offer less value for money compared to PWLB.

Market loans offer forward fixing which is not an option with PWLB, however as rates are forecast to remain relatively low over the next few years forward fixing brings marginal advantage.

- **Local Authority Bond Agency**

The UK Municipal Bonds Agency was established in June 2014 with the primary purpose of reducing local authority financing costs by:

- Issuing bonds in the capital markets and on-lending to councils.
- Lending between councils.
- Sourcing funding from 3rd party sources, and on-lending to councils.

The Agency's aim is to raise finance for Local Authorities by issuing municipal bonds to capital markets. At the time of writing the third bond issue for Warrington Council has been cancelled following the drop in PWLB rate as

mentioned above. Only two other bonds of £350m and £250m for Lancashire County Council were issued. The Council will continue to monitor the Agency's development and whether it can offer a competitive option for future borrowing.

- 9.11 These types of borrowing will need to be evaluated alongside their availability, particularly whilst there is a very limited availability of traditional market loans. The traditional market loans available tend to be Lender Option Borrower Option (LOBO) loans and they are not currently offered at competitive rates of interest. LOBOs provide the lender with future options to increase the interest rate whilst the local authority has the option to repay if the increase in the rate is unacceptable to them.
- 9.12 Following HRA reform the vast majority of the Council's existing debt portfolio consists of LOBOs and the Authority needs to consider diversifying its loan book to reduce the impact of any volatility that may cause these loans to be called. It should be noted that the Council's current LOBO loans are unlikely to be called in the medium term at current interest rates.

### **Sensitivity of the forecast**

- 9.13 In normal circumstances the main sensitivities are likely to be the two scenarios noted below. Council officers in conjunction with the treasury advisors will continually monitor the prevailing interest rates and the market forecast, adopting the following responses to a change of sentiment:
- **If it were felt that there was a significant risk of a sharp FALL in long and short term rates**, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation then long term borrowings will be postponed.
  - **If it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that current forecast**, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, the portfolio position will be re-appraised. The likely action will be that fixed rate funding will be drawn whilst interest rates remain relatively cheap.

### **External v. Internal borrowing**

- 9.14 The current borrowing position reflects the historic strong Balance Sheet of the Council as highlighted in Section 6. The policy remains to keep cash as low as possible and minimise temporary investments.
- 9.15 The next financial year is again expected to be one of historically low Bank Rate. This provides a continuation of the opportunity for local authorities to review their strategy of undertaking new external borrowing. At Appendix F there is an in depth analysis of economic conditions provided by Link Asset Services, the Council's independent treasury advisors.

- 9.16 Over the next three years, investment rates are expected to be significantly below long term borrowing rates. This would indicate that value could best be obtained by limiting new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt.
- 9.17 This will be weighed against the potential for incurring additional long term costs by delaying new external borrowing until later years when longer term rates are forecast to be marginally higher. Consideration will also be given to forward fixing rates whilst rates are favourable.
- 9.18 Against this background caution will be adopted within 2021/22 treasury operations. The Deputy Chief Executive and City Treasurer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision-making body at the next available opportunity.

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

- 9.19 From a statutory point of view a Local Authority has the power to invest for 'any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs.' The MHCLG takes an informal view that local authorities should not borrow purely to invest at a profit. This does not prevent the Council temporarily investing funds borrowed for the purpose of expenditure in the reasonable near future.
- 9.20 This Council will not borrow in advance of need to on lend and profit from the difference in interest rate. Any decision to borrow in advance in support of strategic and service delivery objectives will be in the context of achieving the best overall value for money, for example to minimise the risk of borrowing costs increasing in the future and that the Council can ensure the security of such funds. In determining whether borrowing is undertaken in advance of need the Council will:
- ensure that there is a clear link between the capital programme and maturity profile of the existing debt profile which supports the need to take funding in advance of need;
  - ensure the ongoing revenue liabilities created and implications for future plans and budget have been considered;
  - evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
  - consider the merits and demerits of alternative forms of funding;
  - consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use; and
  - consider the impact of borrowing in advance temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

### **Forward Fixing**

9.21 As noted above, the Council will give consideration to forward fixing debt, whereby the Council agrees to borrow at a point in the future at a rate based on current implied market interest rate forecasts. There is a risk that the interest rates proposed would be higher than current rates; however, it can be beneficial as it avoids the need to borrow in advance of need and suffer cost of carry. It may also represent a saving if rates were to rise in the future. Any decision to forward fix will be reviewed for value for money and will be reported to Members as part of the standard treasury management reporting.

### **Debt Rescheduling**

9.22 It is likely that opportunities to reschedule debt in the 2021/22 financial year will be limited due to prevailing debt interest rates being relatively low.

9.23 As short term borrowing rates will be considerably cheaper than longer term rates, there may be some opportunity to generate savings by switching from long term debt to short term debt. These savings will need to be considered in the light of the premiums incurred and the likely cost of refinancing those short term loans once they mature compared to the current rates of longer term debt in the existing portfolio.

9.24 The debt portfolio following HRA reform consists mainly of LOBOs, and the premia for rescheduling these make it unlikely there will be a cost effective opportunity to reschedule. The premia relates to the future interest payments associated with the loan and compensation for the lender for the buy-back of the interest rate options the loan has embedded in it.

9.25 The Council will continue to monitor the LOBO market and opportunities to reschedule, redeem or alter the profile of existing LOBO debt. The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the strategy outlined above in this section;
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility)

9.26 Any restructuring of LOBOs will only be progressed if it provides value for money and reduces the overall treasury risk the Council faces. The Council's Constitution delegates to the Deputy Chief Executive and City Treasurer the authority to pursue any restructuring, rescheduling or redemption opportunities available.

9.27 Consideration will also be given to the potential for making savings by running down investment balances to repay debt prematurely. It is likely short term rates on investments will be lower than rates paid on current debt.

9.28 All rescheduling will be reported to the Executive as part of the normal treasury management activity. If rescheduling requires amendments to the Treasury Management Strategy the Deputy Chief Executive and City



Treasurer will be asked to approve them in accordance with the delegated powers accorded to the position and the changes will be reported to Members.

## **10 Annual Investment Strategy**

### **HRA**

- 10.1 In order to maintain efficient, effective and economic treasury management for the Council as a whole, the HRA will only be able to invest with the General Fund. This is discussed further in Appendix I.

### **General Fund**

#### **Introduction**

- 10.2 The Council will have regard to the MHCLG's Guidance on Local Government Investments (the Guidance) and the 2011 and 2017 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA TM Code). The Council's investment priorities are:

- The security of capital; and
- The liquidity of its investments.

- 10.3 The risk appetite of the Council is low in order to give priority to the security of its investments. The Council will aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity.

- 10.4 The borrowing of monies by an Authority purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. However the Council may provide loan finance funded from borrowing if this supports the achievement of the Council's strategies and service objectives.

- 10.5 The Council's TMSS focusses solely on treasury management investments. The Council does not hold any commercial investments and details of strategic capital investments can be found in the Capital Strategy and Budget Report to the Executive.

#### **Negative Investment Rates**

- 10.6 In September 2020, the Bank of England said it is unlikely to introduce a negative Bank Rate in the next 6-12months, but recognises it as one of the tools available.

- 10.7 Negative rates have already been seen in the market specifically when placing cash with the Debt Management Office and the Money Market Funds. At the time of writing, the Treasury Management team managed to avoid investments with a negative rate of return.

- 10.8 Investing short term at a negative rate will remain to be the option of last resort. At such time this is no longer possible, alternative longer-term

investments no greater than 364 days will be considered to ensure the delivery of value for money.

### **Investment Policy**

- 10.9 The Council's investment policy is to manage the Council's cash flow through investments in high credit quality.
- 10.10 As in previous years, the Council will not just utilise ratings as 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. The Council will engage with its advisors to maintain a monitor on market pricing such as 'credit default swaps'<sup>2</sup> and overlay that information on top of the credit ratings.
- 10.11 Investment in banks and building societies are now exposed to bail-in risk following the introduction of the EU's Banking Recovery and Resolution Directive, which means depositor's funds over £85,000 are at risk of "bail-in" if the bank fails. In response to this, the Council adopted lower operational limits for such investments in 2016/17 and these remain.
- 10.12 The exception is the limit with Barclays bank; Barclays is the Council's main banker and is the investment destination of last resort for the close of daily trading. These revised limits are operational changes and to preserve flexibility should circumstances change the overall investment limits approved for banks and building societies for 2020/21 will be maintained in 2021/22.
- 10.13 In line with the policy adopted in this strategy in previous years, options to diversify the investment portfolio have been reviewed and adopted. The Council now actively uses money market funds alongside deposits with banks, other local authorities and the Debt Management Agency.
- 10.14 For 2021/22 the Council will continue to consider investing in Treasury Bills, Certificates of Deposit and Covered Bonds albeit at the time of writing the rates are not favourable. In addition to diversification each of these options offer the Council benefits which are noted in more detail below. These instruments require the Council to have specific custodian and broker facilities which have been opened. Officers are working to monitor these markets to prompt participation in the instruments when rates are favourable, and to identify and resolve any governance challenges arising from investing in instruments which have an active secondary market. Work is continuing to open further access points to markets and to identify opportunities for benefit which are new to the Council.

---

<sup>2</sup> A credit default swap is a financial instrument that effectively provides the holder insurance against a loan defaulting. The CDS spread is the difference between the price at which providers are willing to sell the swap, and the price at which buyers are willing to buy. A relatively high spread may suggest that the loan is more likely to default.

10.15 It should be noted that, whilst seeking to broaden the investment base officers will seek to limit the level of risk taken. It is not expected that the measures considered above will have a significant impact on the rates of return the Council currently achieves.

### **Specified and Non-Specified Investments**

10.16 Investment instruments identified for use in the financial year are listed below and are all specified investments. Any proposals to use other non-specified investments will be reported to Members for approval.

10.17 Specified investments are sterling denominated, with maturities up to a maximum of one year and meet the minimum 'high' rating criteria where applicable. Further details about some of the specified investments below can be found in later paragraphs in this Section.

<b>Table 4</b>	<b>Minimum 'High' Credit Criteria</b>	<b>Use</b>
Term deposits – banks and building societies <sup>3</sup>	See Creditworthiness Policy.	In-house
Term deposits – other Local Authorities	High security. Only few local authorities credit-rated	In-house
Debt Management Agency Deposit Facility	UK Government backed	In-house
Certificates of deposit issued by banks and building societies covered by UK Government guarantees	UK Government explicit guarantee	In-house
Money Market Funds (MMFs)	AAA	In-house
Treasury Bills	UK Government backed	In-house
Covered Bonds	AAA	In-house

### **Creditworthiness Policy**

10.18 The Council applies 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. Link supplement the credit ratings of counterparties with the following overlays:

---

<sup>3</sup> Banks & Building Societies

The Council will keep the investment balance below or at the maximum limit based on the institutions credit rating as detailed in paragraph 10.21-10.22. If this limit is breached, for example due to significant late receipts, the Deputy Chief Executive and City Treasurer will be notified as soon as possible after the breach, along with the reasons for it. Please note this relates to specific investments and not balances held within the Council's bank accounts, including the general bank account.

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

10.19 The above are combined in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties.

10.20 The Council has regard to Link's approach to assessing creditworthiness when selecting counterparties as it uses a wider array of information than just primary ratings and by using a risk weighted scoring system does not give undue prominence to just one agency's ratings.

10.21 In summary the Council will approach assessment of creditworthiness by using the Link counterparty list and then applying its own counterparty limits and durations. All credit ratings will be monitored on a daily basis and re-assessed weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of Credit Ratings, the Council will be advised of information in Credit Default Swap against the iTraxx benchmark<sup>4</sup> and other market data on a weekly basis. Extreme market movements may result in the downgrade of an institution or removal from the Council's lending list.

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

### **Investment Limits**

10.23 In applying the creditworthiness policy the Council holds the security of investments as the key consideration and will only seek to make treasury investments with counterparties of high credit quality.

10.24 The financial investment limits of financial institutions will be linked to their short and long-term ratings (Fitch or equivalent) as follows:

---

<sup>4</sup> The Markit iTraxx Senior Financials Index is a composite of the 25 most liquid financial entities in Europe. The index is calculated through an averaging process by the Markit Group and is used as the benchmark level of CDS spreads on Link Asset Services' Credit List.

<u>Long Term</u>	<u>Amount</u>
Fitch AA+ and above	£20 million
Fitch AA/AA-	£15 million
Fitch A+/A	£15 million
Fitch A-	£10 million
Fitch BBB+	£10 million

The Council will only utilise those institutions that have a short term rating of F2 or higher, (Fitch or equivalent).

UK Government (including the Debt Management Office)	£200 million
Greater Manchester Combined Authority	£200 million
Other Local Authorities	£20 million

10.25 In seeking to diversify the Council will utilise other investment types which are described in more detail below and ensure that the investment portfolio is mixed to help mitigate credit risk. The following limits will apply to each asset type:

<b>Total Deposit</b>	<b>Amount</b>
Local Authorities	£250 million
UK Government	£200 million
- Debt Management Office	
- Treasury Bills	
Money Market Funds	£75 million
Certificates of Deposit	£25 million
Covered Bonds	£25 million

10.26 It may be prudent to temporarily increase the limits shown above, as in the current economic environment it is increasingly difficult for officers to place funds. If this is the case officers will seek approval from the Deputy Chief Executive and City Treasurer and any increase in the limits will be reported to Members through the normal treasury management reporting process.

#### **Durational Limits**

10.27 Operationally the Council has in recent years not invested cash for more than three months, which was a product of security concerns following the financial crisis of 2008/09 and the relatively volatile nature of the Council's cash flow.

10.28 The financial markets have changed significantly since 2008/09, and the transparency of creditworthiness has improved. It is therefore proposed that the Council formally states, as part of the Investment Strategy, that it will invest for up to 364 days provided that such investments form part of the management of the cash flow and not for increased yield. On this basis, such investments will only be made if the cash flow forecast at the time indicates a level of "core" cash which will not be required for the investment period.

10.29 As noted in the latest Treasury Management Interim Report 2020/21, negative rates are already being seen in the markets. At such time these negative rates

will impact the Council's short-term investments, alternative longer-term deposits will be necessary in order to protect the overall value for money.

### **Money Market Funds**

- 10.30 The removal of the implied levels of sovereign support that were built into ratings throughout the financial crisis has impacted on bank and building society ratings across the world. Rating downgrades can limit the number of counterparties available and to provide flexibility the Council will use MMFs when appropriate as an alternative specified investment.
- 10.31 MMFs are investment instruments that invest in a variety of institutions therefore diversifying the investment risk. The funds are managed by a fund manager and have objectives to preserve capital, provide daily liquidity and a competitive yield. The majority of money market funds invest both inside and outside the UK. MMFs also provide flexibility as investments and withdrawals can be made on a daily basis.
- 10.32 MMFs are rated through a separate process to bank deposits. This looks at the average maturity of the underlying investments in the Fund as well as the credit quality of those investments. The Council will only use MMFs where the institutions hold the highest AAA credit rating and those which are UK or European based.
- 10.33 As with all investments there is some risk with MMFs in terms of the capital value of the investment. European legislation has required existing and new Constant Net Asset Value MMFs to convert to a Low Volatility Net Asset Value (LVNAV) basis by January 2019. This basis allows movements in capital value, but there is a restriction that the deviation cannot be more than 20 basis points, e.g. on a deposit of £100 the Fund must ensure withdrawal proceeds are no greater than +/- 20p.
- 10.34 There is ever growing pressure the MMFs will generate negative returns. Partly because the markets are oversaturated with cash and partly because there is a lack of demand for cash as a result of uncertainties around how the world economies will continue to deal with the COVID-19 Pandemic as well as how the economies will manage post the end of the transition period. At the time of writing this report, negative rates have already been seen in MMFs, however Treasury Management has agreed with fund managers to waive administration fees for as long as possible in order to maintain a positive return. At such time, the waiving of fees is not possible alternative longer-term investments will be chosen.

### **Treasury Bills**

- 10.35 Treasury Bills are marketable securities issued by the UK Government and counterparty and liquidity risk is relatively low although there is potential risk to value arising from an adverse movement in interest rates unless they are held to maturity.

- 10.36 At the time of writing this report, Treasury Bills were yielding a negative return. Efforts to use Treasury Bills have been put on hold until the securities are once again yielding a higher than market average return.

### **Certificates of Deposit**

- 10.37 Certificates of Deposit are short dated marketable securities issued by financial institutions so the counterparty risk is low. The instruments have flexible maturity dates so it is possible to trade them in early although there is a potential risk to capital if they are traded ahead of maturity and there is an adverse movement in interest rates. Certificates of Deposit are subject to bail-in risk as they are given the same priority as fixed deposits if a bank was to default. The Council will only deal with Certificates of Deposit that are issued by banks and meet the credit criteria.

### **Covered Bonds**

- 10.38 Covered Bonds are debt instruments secured by assets such as mortgage loans. They are issued by banks and other non-financial institutions. The loans remain on the issuing institutions' Balance Sheet and investors have a preferential claim in the event of the issuing institution defaulting. All issuing institutions are required to hold sufficient assets to cover the claims of all covered bondholders. The Council would only deal with bonds that are issued by banks which meet the credit criteria, or AAA rated institutions, (e.g. insurance companies).

### **Liquidity**

- 10.39 Based on cash flow forecasts, the level of cash balances in 2021/22 is estimated to range between £0m and £230m. The higher level can arise where for instance large Government grants are received or long term borrowing has recently been undertaken.

### **Investment Strategy to be followed in-house**

- 10.40 Link's view of the forecast Bank Rate is noted at Section 9. The current economic outlook is that the structure of market interest rates and government debt yields have several key treasury management implications.
- 10.41 At the time of writing this report a trade deal has been agreed between the UK and the EU. Following the COVID-19 Pandemic, the Bank Rate is forecast to remain constant over the next few years. Link's view is that the Bank Rate will remain at 0.10% by March 2021. This suggests that investment returns are likely to remain low during 2021/22, and beyond given the global economic outlook.
- 10.42 There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.
- 10.43 The Council will avoid locking into longer term deals while investment rates are at historically low levels unless attractive rates are available with

counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the Council.

- 10.44 For 2021/22 it is suggested the Council should target an investment return of 0% to 0.05% on investments placed during the financial year. For cash flow generated balances the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to six months) in order to benefit from the compounding of interest.
- 10.45 The Bank of England and the Financial Conduct Authority (FCA) are committed to phasing out LIBOR before the end of 2021. To date the Council has used LIBOR as a benchmark rate for investments and temporary borrowing. The Bank of England formed the Risk Free Rate Working Group which recommended a reformed Sterling Overnight Index Average (SONIA) as the alternative unsecured risk - free rate for the Pound Sterling (GBP) LIBOR Market. SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other investors. Treasury Management will therefore adopt the use of SONIA as a benchmark rate moving forward.
- 10.46 The SONIA rate will also be applied to any transfer rates between the General Fund and the HRA, further details are outlined in Appendix I. Treasury Management will apply mitigating changes to the transfer rates if the benchmark rates were to go into negative territory.

#### **End of year Investment Report**

- 10.47 At the end of the financial year, the Council will receive a report on investment activity as part of the Annual Treasury Management Report.

#### **Policy on the use of External Service Providers**

- 10.48 The Council uses Link Asset Services as external treasury management advisors and has access to another provider who is an approved supplier should a second opinion or additional work be required. 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 its external service providers.
- 10.49 The Council recognises there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. It will ensure the terms of the Advisor's appointment and the methods by which their value is assessed are properly agreed and documented, and subjected to regular review.

### **11 Scheme of Delegation**

- 11.1 Appendix D describes the responsibilities of Member groups and officers in relation to treasury management.

### **12 Role of the Section 151 Officer**



12.1 Appendix E notes the definition of the role of the Deputy Chief Executive and City Treasurer in relation to treasury management.

### **13 Minimum Revenue Provision (MRP) Strategy**

13.1 Appendix B contains the Council's policy for spreading capital expenditure charges to revenue through the annual MRP charge.

### **14 Recommendations**

14.1 Please see the start of the report for the list of recommendations.

### **15 Contributing to a Zero-Carbon City**

15.1 Treasury Management activity underpins the Council's finances, and therefore supports projects and initiatives which seek to achieve the Council's zero carbon target.

### **16 Contributing to the Our Manchester Strategy**

16.1 The Treasury Management function supports the whole Council by seeking to ensure that funding is available when required, to fund all of the work that the Council undertakes. Therefore, whilst not directly contributing to the strategic aims, the Council's treasury management activity underpins the work taking place elsewhere to achieve the outcomes.

### **17 Key Policies and Considerations**

#### **(a) Equal Opportunities**

17.1 None.

#### **(b) Risk Management**

17.2 CIPFA's Prudential and Treasury Management Codes provide the risk management framework within which the treasury management activities of the Council operate. The Strategy should be seen as the Council's approach to this framework.

#### **(c) Legal Considerations**

17.3 None.

**Appendix A**  
**Prudential and Treasury Indicators for approval**

Please note last years approved figures are shown in brackets.

Treasury Management Indicators	2021-22	2022-23	2023-24
	%	%	%
<b>Estimated Financing Costs to Net Revenue Stream<sup>5</sup></b>	6.2%	6.4%	6.2%
	£m	£m	£m
<b>Authorised Limit - external debt</b>			
Borrowing	1,711.6 (1,384.5)	1,737.3 (1,396.2)	1,737.3
Other long term liabilities	190.0 (190.0)	190.0 (190.0)	190.0
TOTAL	1,901.6 (1,574.5)	1,927.3 (1,586.2)	1,927.3
<b>Operational Boundary - external debt</b>			
Borrowing	1,350.3 (1,006.2)	1,591.5 (1,176.9)	1,626.3
Other long term liabilities	190.0 (190)	190.0 (190.0)	190.0
TOTAL	1,540.3 (1,196.2)	1,781.5 (1,366.9)	1,816.3
<b>Estimated external debt</b>	1,142.4 (792.8)	1,454.3 (1,016.4)	1,501.8
<b>Upper limit for total principal sums invested for over 364 days</b>	0 (0)	0 (0)	0
<b>Estimated Capital Expenditure</b>			
Non - HRA	439.4 (339.6)	286.3 (260.2)	131.9
HRA	40.2 (38.8)	45.5 (28.6)	3.2
TOTAL	479.6 (378.4)	331.8 (288.8)	135.1
<b>Estimated Capital Financing Requirement (as at 31 March)</b>			
Non – HRA	1,626.3 (1,543.1)	1,792.1 (1,706.5)	1,849.6
HRA	300.0 (299.2)	301.0 (300.0)	301.8
TOTAL	1,926.3 (1,842.3)	2,093.1 (2,006.5)	2,151.4

<sup>5</sup> Note that for 2021-22 onward these are based on estimated net revenue budgets.

<b>Maturity structure of borrowing during 2021-22</b>	<b>Upper Limit</b>		<b>Lower limit</b>	
	under 12 months	80%	(80%)	0%
12 months and within 24 months	80%	(70%)	0%	(0%)
24 months and within 5 years	70%	(60%)	0%	(0%)
5 years and within 10 years	70%	(50%)	0%	(0%)
10 years and above	90%	(80%)	20%	(40%)
<b>Has the Authority adopted the CIPFA Treasury Management Code?</b>				Yes

The status of the indicators will be included in Treasury Management reporting during 2021/22. They will also be included in the Council's Capital Budget monitoring reports during 2021/22.

**Definitions and Purpose of the Treasury Management Indicators noted above (Indicators are as recommended by the CIPFA Prudential Code last revised in 2017)**

**Estimated Financing Costs to Net Revenue Stream**

The authority will set for the forthcoming year and the following financial years an estimate of financing costs to net revenue stream. The indicator recognises that ultimately all debts of a local authority fall on the taxpayer, and that therefore when considering affordability it is important to review the scale of financing costs to net revenue.

**Estimated Capital Expenditure**

The authority sets a capital budget for each financial year, which includes an estimate of the capital expenditure which might be incurred. The figures here also include changes to other long term liabilities.

**Estimates Capital Financing Requirement**

The capital financing requirement reflects the authority's underlying need to finance capital expenditure, and is based on all capital expenditure including that incurred in previous years.

**Authorised Limit - external debt**

The local authority will set for the forthcoming financial year and the following two financial years an authorised limit for its total external debt, excluding investments, separately identifying borrowing from other long-term liabilities. Other long term liabilities include PFI's, service concessions and finance leases. Due to the introduction of IFRS16 (Leasing) on the 1<sup>st</sup> of April 2020, more of the Council's lessee leases will be classed as finance leases and will therefore fall under the

categorisation, therefore the value has increased from previous years. Work is underway to determine the value of this change in accounting standards, but £20.0m has been added to the indicator at this stage, and will be reviewed once this work is complete. This prudential indicator is referred to as the Authorised Limit.

### **Operational Boundary - external debt**

The local authority will also set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt, excluding investments, separately identifying borrowing from other long-term liabilities. This prudential indicator is referred to as the Operational Boundary.

Both the Authorised Limit and the Operational Boundary need to be consistent with the authority's plans for capital expenditure and financing; and with its treasury management policy statement and practices. The Operational Boundary should be based on the authority's estimate of most likely, i.e. prudent, but not worst case scenario. Risk analysis and risk management strategies should be taken into account.

The Operational Boundary should equate to the maximum level of external debt projected by this estimate. Thus, the Operational Boundary links directly to the Authority's plans for capital expenditure; its estimates of capital financing requirement; and its estimate of cash flow requirements for the year for all purposes. The Operational Boundary is a key management tool for in-year monitoring.

It will probably not be significant if the Operational Boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the Operational Boundary would be significant and should lead to further investigation and action as appropriate. Thus, both the Operational Boundary and the Authorised Limit will be based on the authority's plans. The authority will need to assure itself that these plans are affordable and prudent. The Authorised Limit will in addition need to provide headroom over and above the Operational Boundary sufficient for example for unusual cash movements.

### **Estimated external debt**

After the year end, the closing balance for actual gross borrowing plus (separately), other long-term liabilities is obtained directly from the local authority's Balance Sheet.

The prudential indicator for Estimated External Debt considers a single point in time and hence is only directly comparable to the Authorised Limit and Operational Boundary at that point in time. Actual external debt during the year can be compared.

### **Upper limit for total principal sums invested for over 364 days**

The authority will set an upper limit for each forward financial year period for the maturing of investments made for a period longer than 364 days. This indicator is referred to as the prudential limit for Principal Sums Invested for periods longer than 364 days.

The purpose of this indicator is so the authority can contain its exposure to the possibility of loss that might arise as a result of its having to seek early repayment or redemption of principal sums invested.

### **Maturity structure of new borrowing**

The authority will set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of its borrowing. These indicators are referred to as the Upper and Lower limits respectively for the Maturity Structure of Borrowing.

### **Local Prudential Indicators**

The Council has not yet introduced Local Prudential Indicators to reflect local circumstances, but will review on a regular basis the need for these in the future.

## **Appendix B**

### **Minimum Revenue Provision Strategy**

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2011/12 and has assessed its MRP for 2021/22 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The Council is required to make provision for repayment of an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP).

MHCLG Regulations require full Council to approve an MRP Statement, in advance of each year. If the Council wishes to amend its policy during the year this would need to be approved by full Council. A variety of options are available to councils to replace the previous Regulations, so long as there is a prudent provision. The options are:

- **Option 1:** Regulatory Method – can only be applied to capital expenditure incurred prior to April 2008 or Supported Capital Expenditure. This is calculated as 4% of the non-housing CFR at the end of the preceding financial year, less some transitional factors relating to the movement to the new Prudential Code in 2003.
- **Option 2:** CFR Method – a provision equal to 4% of the non-housing CFR at the end of the preceding financial year.
- **Option 3:** Asset Life Method – MRP is calculated based on the life of the asset, on either an equal instalment or an annuity basis.
- **Option 4:** Depreciation Method – MRP is calculated in accordance with the depreciation accounting required for the asset.

Options 1 and 2 may be used only for supported expenditure, which is capital expenditure for which the Council has been notified by Government that the costs of that expenditure will be taken into account in the calculation of Government funding due to the Council.

It is important to note that the Council can deviate from these options provided that the approach taken ensures that there is a prudent provision. The Council has historically followed option 1 for supported expenditure based on the level of support provided by Government through Revenue Support Grant (RSG).

The assets created or acquired under Supported Capital Expenditure predominantly had long asset lives of c. 50 years, such as land or buildings, and an MRP of 4% suggests a significantly shorter asset life. As the level of notional RSG the Council receives has reduced in recent years, it was considered prudent to review the approach to MRP on supported borrowing to reflect the Government support received.

It was therefore agreed that from 2017/18 a provision of 2% of the non-housing CFR as at the end of the preceding financial year is to be made. This is in line with many other local authorities who have reviewed the basis for their MRP and have applied similarly revised policies.

It is the Council’s policy that MRP relating to an asset will start to be incurred in the year after the capital expenditure on the asset is incurred or, in the case of new assets, in the year following the asset coming into use, in accordance with MHCLG’s guidance.

The Council recognises that there are different categories of capital expenditure, for which it will incur MRP as follows:

- For non HRA Supported Capital Expenditure: MRP policy will be charged at a rate of 2% on a similar basis to option 1 of the guidance (the regulatory method) but at a lower rate, better reflecting the asset lives of the assets funded through Supported Borrowing.
- For non HRA unsupported capital expenditure incurred the MRP policy will be:
  - Asset Life Method – MRP will be based on a straight line basis or annuity method so linking the MRP to the future flow of benefits from the asset, dependant on the nature of the capital expenditure, in accordance with option 3 of the guidance.
  - If the expenditure is capital by virtue of a Ministerial direction, has been capitalised under a Capitalisation Directive, or does not create a council asset, MRP will be provided in accordance with option 3 of the guidance with asset lives calculated as per the table below:

<b>Expenditure type</b>	<b>Maximum period over which MRP to be made</b>
Expenditure capitalised by virtue of a direction under s16 (2) (b).	20 years.
Regulation 25(1) (a). Expenditure on computer programs.	Same period as for computer hardware.
Regulation 25(1) (b). Loans and grants towards capital expenditure by third parties.	The estimated life of the assets in relation to which the third party expenditure is incurred.
Regulation 25(1) (c). Repayment of grants and loans for capital expenditure.	25 years or the period of the loan if longer.
Regulation 25(1) (d). Acquisition of share or loan capital.	20 years, or the estimated life of the asset acquired.
Regulation 25(1) (e). Expenditure on works to assets not owned by the authority.	The estimated life of the assets.
Regulation 25(1) (ea). Expenditure on assets for use by others.	The estimated life of the assets.

Regulation 25(1) (f). Payment of levy on Large Scale Voluntary Transfers (LSVTs) of dwellings.	25 years.
--	-----------

- For PFI service concessions and some lessee interests: Following the move to International Accounting Standards arrangements under private finance initiatives (PFIs) service concessions and some lessee interests (including embedded leases) are accounted for on the Council's Balance Sheet, and with the introduction of IFRS16 (Leasing) from the 1<sup>st</sup> of April 2021 more lessee leases will be classified in a similar way. Where this occurs, a part of the contract charge or rent payable will be taken to reduce the Balance Sheet liability rather than being charged as revenue expenditure. The MRP element of these schemes will be the amount of contract charge or rental payment charged against the Balance Sheet liability. This approach will produce an MRP charge comparable to that under option 3 in that it will run over the life of the lease or PFI scheme.

In some exceptional cases, the Council will deviate from the policy laid out above provided such exceptions remain prudent. Any exceptions are listed below:

- Where capital expenditure is incurred through providing loans to organisations, and where those loans are indemnified or have financial guarantees protecting against loss from a third party of high credit quality, no MRP will be charged in relation to the capital expenditure. Similarly, loans given by the Council where any losses incurred on the investment will impact solely on a third party, such as those provided under the City Deal arrangement with the HCA, will not require an MRP charge.



## **Appendix C**

### **Treasury Management Policy Statement**

1. This organisation defines its treasury management activities as:  
The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.
2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The Council will invest its monies prudently, considering security first, liquidity second, and yield last, carefully considering its investment counterparties. It will similarly borrow monies prudently and consistent with the Council's service objectives.

## Appendix D

### Treasury Management Scheme of Delegation

- i **Full Council**
  - receiving and reviewing reports on treasury management policies, practices and activities
  - approval of annual strategy
  
- ii **Responsible body – Audit Committee**
  - approval of/amendments to the organisation’s adopted clauses, treasury management policy statement and treasury management practices
  - budget consideration and approval
  - approval of the division of responsibilities
  - receiving and reviewing regular monitoring reports and acting on recommendations
  - approving the selection of external service providers and agreeing terms of appointment
  
- iii **Body with responsibility for scrutiny - Resource and Governance Scrutiny Committee**
  - reviewing the treasury management policy and procedures and making recommendations to the responsible body
  
- iv **Deputy Chief Executive and City Treasurer**
  - delivery of the function

## Appendix E

### **The Treasury Management role of the Section 151 Officer**

#### **The S151 (responsible) Officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers

The points noted above reflect the specific responsibilities of the S151 Officer prior to the 2017 CIPFA Treasury Management Code revisions. The CIPFA Prudential Code revision which followed the MHCLG revised guidance on local government investments represents a major extension of the functions of the S151 Officer role, especially in respect of non-financial investments which CIPFA define as being part of treasury management.

The additional functions of the S151 Officer role are:

- preparation of a capital strategy with a long term timeframe to include capital expenditure, capital financing, non-financial investments and treasury management
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensuring that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following:

- Risk management including investment and risk management criteria for any material non-treasury investment portfolios;
- Performance measurement and management including methodology and criteria for assessing the performance and success of non-treasury investments;
- Decision making, governance and organisation including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
- Reporting and management information including where and how often monitoring reports are taken;
- Training and qualifications including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

## Appendix F

### **Economic Background December 2020 – Link Asset Services**

This section has been prepared by the Council's Treasury Advisors, Link Asset Services, for the Treasury Management Strategy Statement 2021/22.

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

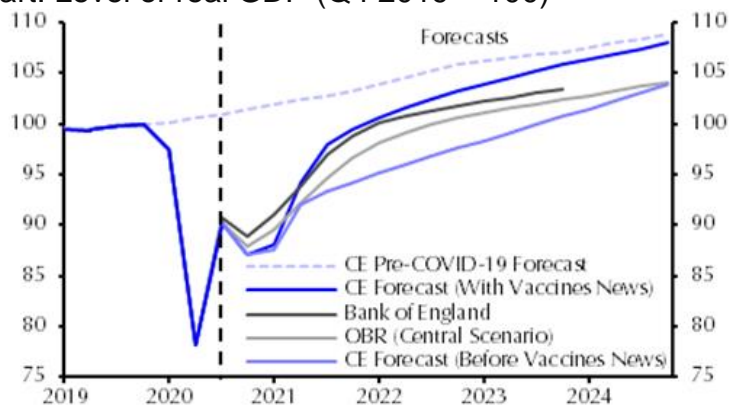
more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. **Upside risks** included the early roll out of effective vaccines.

- **COVID-19 vaccines.** We had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9<sup>th</sup> November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, this vaccine has demanding cold storage requirements of minus 70c that impairs the speed of application to the general population. It has therefore been particularly welcome that the Oxford University/AstraZeneca vaccine has now also been approved which is much cheaper and only requires fridge temperatures for storage. The Government has 60m doses on order and is aiming to vaccinate at a rate of 2m people per week starting in January, though this rate is currently restricted by a bottleneck on vaccine production; (a new UK production facility is due to be completed in June).
- These announcements, plus expected further announcements that other vaccines could be approved soon, have enormously boosted confidence that **life could largely return to normal during the second half of 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels; this would help to bring the unemployment rate down. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could start to be eased, beginning possibly in Q2 2021 once vulnerable people and front-line workers have been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% in 2021 instead of 9%.
- **Public borrowing** was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by

2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. It is likely that the one month national lockdown that started on 5<sup>th</sup> November, will have caused a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.
- **December 2020 / January 2021.** Since then, there has been rapid back-tracking on easing restrictions due to the spread of a new mutation of the virus, and severe restrictions were imposed across all four nations. These restrictions were changed on 5.1.21 to national lockdowns of various initial lengths in each of the four nations as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under these new restrictions for some months; this means that the near-term outlook for the economy is grim. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow GDP to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022. Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant caveat is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development and vaccine production facilities are being ramped up around the world.

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

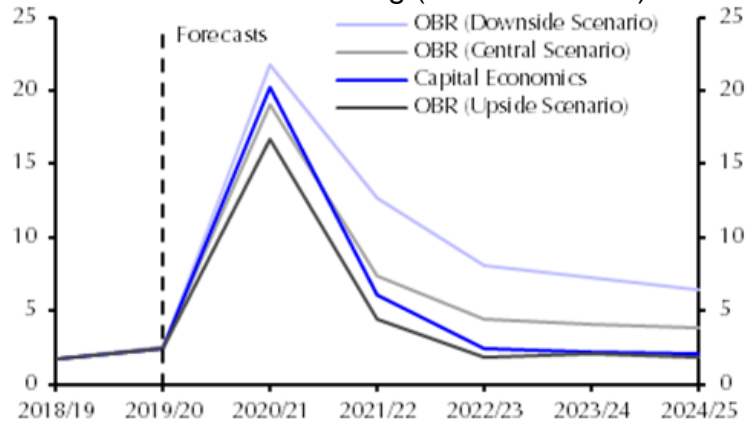


*(if unable to print in colour..... the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.*

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 there is a reasonable Brexit deal and also that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.

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.)*

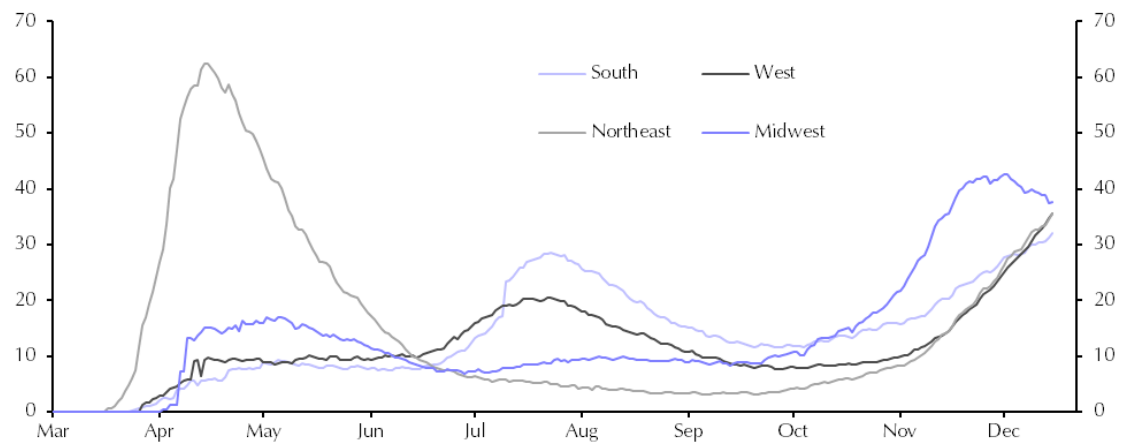
- There will still be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to 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.** While the UK has been gripped by the long running saga of whether or not a deal would be made by 31.12.20, the final agreement on 24.12.20, followed by ratification by Parliament and all 27 EU countries in the following week, has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.
- **Monetary Policy Committee meeting of 17 December.** All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy that it had highlighted in November. But this was caveated by it saying, “Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case.” So, while the vaccine is a positive development, in the eyes of the MPC at least, the economy is far from out of the woods. As a result of these continued concerns, the MPC voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size



enterprises for six months from 30.4.21 until 31.10.21. (The MPC had assumed that a Brexit deal would be agreed.)

- **Fiscal policy.** In the same week as the MPC meeting, the Chancellor made a series of announcements to provide further support to the economy: -
  - An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
  - The furlough scheme was lengthened from the end of March to the end of April.
  - The Budget on 3.3.21 will lay out the “next phase of the plan to tackle the virus and protect jobs”. This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).
- The **Financial Policy Committee** (FPC) report on 6.8.20 revised down their expected credit losses for the banking sector to “somewhat less than £80bn”. It stated that in its assessment, “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.
- **US.** The result of **the November elections** meant that while the Democrats gained the presidency and a majority in the House of Representatives, it looks as if the Republicans could retain their slim majority in the Senate provided they keep hold of two key seats in Georgia in elections in early January. If those two seats do swing to the Democrats, they will then control both Houses and President Biden will consequently have a free hand to determine policy and to implement his election manifesto.
- **The economy** had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the third wave in the Midwest looks as if it now abating. However, it also looks as if the virus is rising again in the rest of the country. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

COVID-19 hospitalisations per 100,000 population



- The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and retail sales dropping back. The economy is set for further weakness in December and into the spring. However, a \$900bn fiscal stimulus deal passed by Congress in late December will limit the downside through measures which included a second round of direct payments to households worth \$600 per person and a three-month extension of enhanced unemployment insurance (including a \$300 weekly top-up payment for all claimants). GDP growth is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.
- 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 affected many countries: it is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the countries most affected by the first wave.
- 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 have been in recession in 2020. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.
- 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 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 in the economy.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**. The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next two or three years. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between

northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.

- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she will remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU, and they had threatened to derail the 7 year EU budget until a compromise was thrashed out in late 2020. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks**, for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

#### **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.

## Appendix G

### Prospects for Interest Rates

The data below shows the latest interest rate forecast from the Council's treasury management advisors, Link Asset Services, dated 9<sup>th</sup> November 2020.

Link Group Interest Rate View 9/11/20													
<i>These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26/11/20</i>													
	<b>Mar 21</b>	<b>Jun 21</b>	<b>Sep 21</b>	<b>Dec 21</b>	<b>Mar 22</b>	<b>Jun 22</b>	<b>Sep 22</b>	<b>Dec 22</b>	<b>Mar 23</b>	<b>Jun 23</b>	<b>Sep 23</b>	<b>Dec 23</b>	<b>Mar 24</b>
<b>BANK RATE</b>	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
<b>3 month ave earnings</b>	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
<b>6 month ave earnings</b>	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
<b>12 month ave earnings</b>	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
<b>5 yr PWLB</b>	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
<b>10 yr PWLB</b>	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
<b>25 yr PWLB</b>	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
<b>50 yr PWLB</b>	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

Please Note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

## Appendix H

### **Glossary of Terms**

**Authorised Limit** - This Prudential Indicator represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

**Bank Rate** - the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

**Counterparty** - one of the opposing parties involved in a borrowing or investment transaction.

**Covered Bonds** - Debt instruments secured by assets such as mortgage loans. These loans remain on the issuer's balance sheet and investors have a preferential claim in the event of the issuing institution defaulting.

**Credit Rating** - A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

**Discount** - Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.

**Fixed Rate Funding** - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

**Gilts** - The loan instruments by which the Government borrows. Interest rates will reflect the level of demand shown by investors when the Government auctions Gilts.

**High/Low Coupon** - High/Low interest rate

**LIBID (London Interbank Bid Rate)** - This is an average rate, calculated from the rates at which individual major banks in London are willing to borrow from other banks for a particular time period. For example, 6 month LIBID is the average rate at which banks are willing to pay to borrow for 6 months.

**LIBOR (London Interbank Offer Rate)** - This is an average rate, calculated from the rates which major banks in London estimate they would be charged if they borrowed



from other banks for a particular time period. For example, 6 month LIBOR is the average rate which banks believe they will be charged for borrowing for 6 months.

**Liquidity** - The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

**LOBO (Lender Option Borrower Option)** - This is a type of loan where, at various periods known as call dates, the lender has the option to alter the interest rate on the loan. Should the lender exercise this option, the borrower has a corresponding option to repay the loan in full without penalty.

**Market** - The private sector institutions - Banks, Building Societies etc.

**Maturity Profile/Structure** - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Council vulnerable to current interest rates in that year.

**Monetary Policy Committee** - the independent body that determines Bank Rate.

**Money Market Funds** - Investment instruments that invest in a variety of institutions, therefore diversifying the investment risk.

**Operational Boundary** – This Prudential Indicator is based on the probable external debt during the course of the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

**Premium** - Where the prevailing current interest rate is lower than the fixed rate of a long-term loan, which is being repaid early, the lender can charge the borrower a premium, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.

**Prudential Code** - The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

**PWLB** - Public Works Loan Board. Part of the Government's Debt Management Office, which provides loans to public bodies at rates reflecting those at which the Government is able to sell Gilts.

**SONIA** – Sterling Overnight Index Average (SONIA) is an interest rate benchmark which is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

**Specified Investments** - Sterling investments of not more than one-year maturity. These are considered low risk assets, where the possibility of loss of principal or investment income is very low.

**Non-specified investments** - Investments not in the above, specified category, e.g., foreign currency, exceeding one year or outside our minimum credit rating criteria.

**Treasury Bills** - These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low.

**Variable Rate Funding** - The rate of interest either continually moves reflecting interest rates of the day, or can be tied to specific dates during the loan period. Rates may be updated on a monthly, quarterly or annual basis.

**Volatility** - The degree to which the debt portfolio is affected by current interest rate movements. The more debt maturing within the coming year and needing replacement, and the more debt subject to variable interest rates, the greater the volatility.

**Yield Curve** - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short-term loans compared to long-term loans. An inverted Yield Curve is the opposite of this.

## Appendix I

### Treasury Management Implications of HRA Reform

As discussed in Section 5 of the report, the reform of the HRA finance system has consequences for the treasury management of the Council. As part of the reform, the HRA's debt portfolio needs to be separately identifiable to that of the General Fund, and the HRA will hold some autonomy over the management of its debt portfolio. However, in order to ensure that the treasury management function of the Council remains effective and provides value for money, and given that the Section 151 officer for both the General Fund and the HRA is the Deputy Chief Executive and City Treasurer, the HRA's treasury portfolio must be run in the context of the overall Council portfolio.

This appendix seeks to explain how the debt portfolio of the Council has been split between the General Fund and the HRA, and how the HRA treasury position will be managed going forward.

#### **The Portfolio Split**

One of the principles behind the reform of HRA finance was to provide some level of treasury autonomy for the HRA, separating its debt from the Council's so that its treasury position could be managed separately. To achieve this, the debt portfolio was to be split at the point that the debt settlement was made.

On the 28 March 2012, the Council received c. £294m which was to be used to reduce the debt held by the Council. The table below shows the Council's treasury portfolio before and after the settlement:

	Pre reform		Post reform
	£'000		£'000
PWLB	199,966		0
Market	549,640		480,215
Stock	8,159		8,159
<b>Gross Debt</b>	<b>757,765</b>		<b>488,374</b>
Deposits	-17,954		-42,839
<b>Net Debt</b>	<b>739,811</b>		<b>445,535</b>

At this point, the debt was to be split according to the relative capital financing requirements (CFRs) of both the General Fund and the HRA. The cash remainder of the settlement could not be used to redeem further market debt so, to ensure that the HRA CFR fell by the full level of the settlement, a notional transaction took place. An amount of debt equivalent to the cash remainder was transferred from the HRA to the General Fund, alongside the cash. This had a neutral effect on the General Fund's net debt.

The table below shows the CFRs before and after the debt settlement, with the HRA CFR falling by the settlement:

<b>CFRs</b>	Pre reform		Post reform	% of total
	<i>£'000</i>		<i>£'000</i>	
General Fund	675,454		675,454	84.47%
HRA	418,463		124,187	15.53%
<b>Total</b>	<b>1,093,917</b>		<b>799,641</b>	<b>100.00%</b>
<i>Of which financed:</i>			488,374	
<i>Of which unfinanced:</i>			311,267	

As can be seen from the tables below, the debt was to split in a ratio of 84.47:15.53 between the General Fund and the HRA, including the unfinanced CFR element. This is the level of internal borrowing undertaken in lieu of external borrowing, through the use of cash balances to fund expenditure rather than external borrowing. It was decided, for administrative reasons, that all of the Council's remaining stock debt should be held by the General Fund, which increased the relative level of unfinanced CFR held by the HRA.

The final split of the debt portfolio is shown in the table below:

	General Fund	HRA	Total
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Market	405,636	74,579	480,215
<i>% of total market</i>	<i>84.47%</i>	<i>15.53%</i>	
Stock	8,159	0	8,159
<i>% of stock</i>	<i>100.00%</i>	<i>0.00%</i>	
<b>Total Loans</b>	<b>413,795</b>	<b>74,579</b>	<b>488,374</b>
<i>% of total loans</i>	<i>84.73%</i>	<i>15.27%</i>	
Unfinanced CFR	261,659	49,608	311,267
<i>% of unfinanced CFR</i>	<i>84.06%</i>	<i>15.94%</i>	
<b>Total CFR</b>	<b>675,454</b>	<b>124,187</b>	<b>799,641</b>
<i>% of total CFR</i>	<i>84.47%</i>	<i>15.53%</i>	

### **Future HRA borrowing**

Following the split of the portfolio, the HRA can make borrowing decisions according to the needs of their business plan, provided those decisions are aligned with their treasury strategy and are agreed by the Section 151 officer. The amounts and maturity periods of any future loans will be determined by the HRA, in conjunction with the Treasury Management team and the Deputy Chief Executive and City Treasurer. Any future borrowing made by the Council will be for either the General Fund or the HRA and not for the Council in general.

### **Use of Temporary Cash Balances and Temporary Borrowing**

Although the HRA's treasury position is now independent of the General Fund, both are managed in the name of the Council as a whole. As such, the day to day treasury

position of the Council, whilst having regard to the impact on the HRA and the General Fund, will be run on a Council basis – this simplifies the risk management of the treasury position, and should help to ensure that the treasury function is providing value for money.

To achieve this, the General Fund will deposit and temporarily borrow externally, but the HRA will only be able to deposit with the General Fund and, should it be required, will only be able to access temporary borrowing through the General Fund. In order to ensure that this is fair, interest rates will be applied to any such internal transfers, as summarised below:

- If the General Fund has temporary investments, HRA investments with the General Fund will earn – ***average portfolio temporary investment rate***
- If the General Fund does not have temporary investments, HRA investments with the General Fund will earn – ***SONIA***
- If the General Fund has temporary borrowing, HRA temporary borrowing from the General Fund will be charged – ***average portfolio temporary borrowing rate***
- If the General fund does not have temporary borrowing, HRA temporary borrowing from the General Fund will be charged – ***SONIA***

The Bank of England and the Financial Conduct Authority (FCA) are committed to phasing out LIBOR before the end of 2021. Therefore, the market rates used are SONIA which the Council will use for benchmarking investments and temporary borrowing.

### **Future Reporting**

The intention is to continue to report to Members the overall treasury position of the Council, including both the General Fund and the HRA. Separate reports will be provided on the General Fund and the HRA, when required.