

<b>Report of:</b>	<b>Head of Finance</b>
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<b>Contact Number:</b>	<b>01543 464 412</b>
<b>Portfolio Leader:</b>	<b>Leader of the Council</b>
<b>Key Decision:</b>	<b>No</b>
<b>Report Track:</b>	<b>Cabinet: 02/02/22 Council: 16/02/22</b>

<p><b>Cabinet</b></p> <p><b>2 February 2022</b></p> <p><b>Treasury Management Strategy, Minimum Revenue Provision Policy, Annual Investment Strategy and Capital Strategy 2022/23</b></p>
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<p><b>1 Purpose of Report</b></p>
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- 1.1 This report is presented to obtain the Council's approval to:-
- Prudential and Treasury indicators - setting of indicators to ensure that the capital investment plans of the Council are affordable, prudent and sustainable;
  - The Minimum Revenue Provision (MRP) Policy;
  - Treasury Management Strategy Statement for 2022/23 - to set treasury limits for 2022/23 to 2023/24 and to provide a background to the latest economic forecasts of interest rates;
  - Annual Investment Strategy 2022/23 - to set out the strategy of investment of surplus funds.

<p><b>2 Recommendation(s)</b></p>
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- 2.1 That Council, at its meeting to be held on 16 February 2022, be recommended to approve:-
- (a) The Prudential and Treasury indicators;
  - (b) The MRP Policy Statement;
  - (c) The Treasury Management Policy;
  - (d) The Annual Investment Strategy for 2022/23,
- 2.2 To note that indicators may change in accordance with the final recommendations from Cabinet to Council in relation to both the General Fund / Housing Revenue Account Revenue Budgets and Capital Programmes.

### 3 Key Issues and Reasons for Recommendations

#### Key Issues

- 3.1 The Treasury Management Function essentially consists of:
- In the short-term ensuring that the cash flow of a Balanced Revenue Budget is adequately planned with surplus monies invested in accordance with the risk appetite of the Council.
  - In the long-term funding the capital plans of the authority and in particular managing the debt of the Council and any new borrowing requirement.
- 3.2 The Governance arrangements are detailed in the various policies and strategies as detailed in the report together with the setting of Indicators in accordance with the Capital Financing Prudential Code.

#### Reasons for Recommendations

- 3.3 The Council is required to approve its treasury management, investment and capital strategies to ensure that cash flow is adequately planned and that surplus monies are invested appropriately.

### 4 Relationship to Corporate Priorities

- 4.1 Treasury management and investment activity links in with all of the Council's priorities and their spending plans.

### 5 Report Detail

#### Background

- 5.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 5.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 5.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance

of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

5.4 CIPFA defines treasury management as:

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

5.5 This authority has not engaged in any commercial investments and has no non-treasury investments.

### **Reporting Requirements**

5.6 **Capital Strategy** - The CIPFA 2017 Prudential and Treasury Management Codes required all local authorities to prepare a capital strategy report which will provide the following:

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

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

5.8 The capital strategy approved on the 7 February 2019 covers the period 2018/22 but has been extended a further year.

5.9 **Treasury Management reporting** - The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

5.10 **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:-

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an Investment Strategy (the parameters on how investments are to be managed).

- 5.11 **A mid year treasury management report** - This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- 5.12 **An annual treasury report** - This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.
- 5.13 **Scrutiny** - The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.
- 5.14 The Council has adopted the following reporting arrangements in accordance with the requirements of the CIPFA Code of Practice:-

<b>Area of Responsibility</b>	<b>Council/Committee</b>	<b>Frequency</b>
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy	Full council	Annually in January/February each year
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy/Monitoring of Prudential Indicators	Full council	Mid-year
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy – updates or revisions at other times	Full council	As required
Annual Treasury Outturn Report	Audit & Governance Committee and Council	Annually by 30 September after the end of the year
Scrutiny of treasury management strategy	Cabinet	Annually in January / February before the start of the year

**Treasury Management Strategy for 2022/23**

- 5.15 The strategy for 2022/23 covers two main areas:-

**Capital issues**

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

**Treasury management issues**

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;

- debt rescheduling;
  - the investment strategy;
  - creditworthiness policy; and
  - policy on use of external service providers.
- 5.16 These elements cover the requirements of the Local Government Act 2003, DLUHC Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

### **Training**

- 5.17 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training for members is currently being reviewed and will be arranged as required.
- 5.18 The training needs of treasury management officers are periodically reviewed.

### **Treasury Management Consultants**

- 5.19 The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.
- 5.20 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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

### **The Capital Prudential Indicators 2022/23 - 2024/25**

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

### **Capital expenditure**

- 5.22 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts, which include a review of current schemes, but to note these may change as part of the scrutiny process and finalisation of the Budget.
- 5.23 Any change to the forecast and any new growth bids will be separately identified in future Budget Reports and reflected in this indicator as reported to full Council.

**Item No. 11.6**

<b>Capital expenditure</b>	<b>2020/21 Actual £'000</b>	<b>2021/22 Estimate £'000</b>	<b>2022/23 Estimate £'000</b>	<b>2023/24 Estimate £'000</b>	<b>2024/25 Estimate £'000</b>	<b>Earmarked £'000</b>
Leader	303	47	-	-	-	-
Environment & Climate Change	231	234	90	80	80	255
Neighbourhood Safety & Partnerships	-	-	-	-	-	67
Housing, Heritage & Leisure	1,855	3,413	2,431	1,101	1,051	1,242
District Development	219	257	90	-	-	45,095
Innovation & High Street	195	9	-	-	-	-
<b>Non –HRA</b>	<b>2,803</b>	<b>3,960</b>	<b>2,611</b>	<b>1,181</b>	<b>1,131</b>	<b>46,659</b>
<b>Non – HRA programme estimate</b>	<b>-</b>	<b>-</b>	<b>10,779</b>	<b>18,267</b>	<b>17,613</b>	<b>(46,659)</b>
<b>HRA</b>	<b>3,010</b>	<b>6,561</b>	<b>8,790</b>	<b>6,825</b>	<b>7,026</b>	<b>11,740</b>
<b>HRA programme estimate</b>	<b>-</b>	<b>-</b>	<b>1,500</b>	<b>5,800</b>	<b>4,440</b>	<b>(11,740)</b>
<b>Total</b>	<b>5,813</b>	<b>10,521</b>	<b>23,680</b>	<b>32,073</b>	<b>30,210</b>	<b>-</b>

5.24 **Other long-term liabilities.** The financing need excludes other long-term liabilities, such as leasing arrangements which already include borrowing instruments.

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

<b>Capital expenditure</b>	<b>2020/21 Actual £'000</b>	<b>2021/22 Estimate £'000</b>	<b>2022/23 Estimate £'000</b>	<b>2023/24 Estimate £'000</b>	<b>2024/25 Estimate £'000</b>	<b>Unallocated £'000</b>
<b>Total Spend</b>	<b>5,813</b>	<b>10,521</b>	<b>23,680</b>	<b>32,073</b>	<b>30,210</b>	
<b>Financed by:</b>						
Capital Receipts	1,448	1,731	2,346	9,116	3,459	
Capital grants/ contributions	1,637	3,255	12,878	12,161	8,219	
Major Repairs	2,299	5,335	8,328	4,255	6,997	
Revenue	429	200	128	3,519	3,935	
<b>Total Financing</b>	<b>5,813</b>	<b>10,521</b>	<b>23,680</b>	<b>29,051</b>	<b>22,610</b>	
<b>Net financing need for the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,022</b>	<b>7,600</b>	

- 5.26 The capital financing of the programme will similarly be reviewed as part of the Budget process and any change will be separately identified in future Budget Reports and reflected in this indicator.

**The Council’s borrowing need (the Capital Financing Requirement)**

- 5.27 The second prudential indicator is the Council’s Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council’s indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.
- 5.28 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life and so charges the economic consumption of capital assets as they are used.
- 5.29 The CFR includes any other long-term liabilities (e.g finance leases). Whilst these increase the CFR, and therefore the Council’s borrowing requirement, these types of scheme include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £0.451 million of finance leases within the CFR.
- 5.30 The Council is asked to approve the following CFR projections, subject to any changes arising from the budget process:-

	2020/21 Actual £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
<b>Capital Financing Requirement</b>					
CFR - non-housing	9,119	8,650	8,194	7,972	15,358
CFR - housing	82,486	82,477	82,468	85,481	85,473
<b>Total CFR</b>	<b>91,605</b>	<b>91,127</b>	<b>90,662</b>	<b>93,453</b>	<b>100,831</b>
Movement in CFR	(485)	(478)	(465)	2,791	7,378
<b>Movement in CFR represented by</b>					
Net financing need for the year	-	-	-	3,022	7,600
Less MRP and other financing movements	(485)	(478)	(465)	(231)	(222)
Movement in CFR	(485)	(478)	(465)	2,791	7,378

**Core funds and expected investment balances**

- 5.31 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed on the following page are

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

<b>Year End Resources £m</b>	<b>2020/21 Actual £'000</b>	<b>2021/22 Estimate £'000</b>	<b>2022/23 Estimate £'000</b>	<b>2023/24 Estimate £'000</b>	<b>2024/25 Estimate £'000</b>
<b>Earmarked Fund balances / reserves</b>					
General Fund	24,098	16,969	15,131	14,806	14,529
General Fund working balance	1,144	1,144	1,056	(1,749)	(4,889)
HRA	11,029	12,376	13,592	11,411	8,653
HRA working balance	1,713	1,842	1,929	1,975	2,076
<b>Sub Total</b>	<b>37,984</b>	<b>32,331</b>	<b>31,708</b>	<b>26,443</b>	<b>20,369</b>
<b>Capital receipts</b>					
GF	6,873	6,422	6,288	3,156	231
HRA	3,295	2,806	1,450	-	-
<b>Sub Total</b>	<b>10,168</b>	<b>9,228</b>	<b>7,738</b>	<b>3,156</b>	<b>231</b>
<b>Provisions</b>	<b>2,220</b>	<b>2,220</b>	<b>2,220</b>	<b>200</b>	<b>200</b>
<b>Major Repairs Reserve</b>	<b>6,459</b>	<b>5,437</b>	<b>1,587</b>	<b>2,087</b>	<b>52</b>
<b>Capital Grants Unapplied</b>	<b>2,571</b>	<b>2,097</b>	<b>930</b>	<b>727</b>	<b>378</b>
<b>Other - grants receipts in advance</b>	<b>1,589</b>	<b>2,026</b>	<b>1,982</b>	<b>1,982</b>	<b>2,158</b>
<b>Total core funds</b>	<b>60,991</b>	<b>53,339</b>	<b>46,165</b>	<b>34,595</b>	<b>23,388</b>
Working Cashflow requirement	11,940	5,000	5,000	5,000	5,000
Under/over borrowing	9,549	9,299	9,057	8,826	8,604
Expected investments	39,502	39,040	32,108	20,769	9,784

\*Working cashflow requirement shown are estimated year-end.

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

- 5.32 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP).
- 5.33 DLUHC Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:-
- 5.34 The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09, and will assess MRP for 2009/10 onwards in accordance with the recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

- 5.35 Under powers delegated to the Section 151 Officer, the Council's annual MRP provision for expenditure incurred after 1 April 2008 and before 31 March 2017 will be based on the uniform rate of 4% of the Capital Financing Requirement. The Council's annual MRP provision for expenditure incurred on or after 1 April 2017 will be based on the asset life method i.e. the provision will be calculated with reference to the estimated life of the assets acquired, in accordance with the regulations.
- 5.36 MRP will be applicable from the year following that in which the asset is brought into operation.
- 5.37 Repayments included in finance leases are applied as MRP.
- 5.38 The Council is satisfied that the policy for calculating MRP set out in this policy statement will result in the Council continuing to make prudent provision for the repayment of debt, over a period that is on average reasonably commensurate with that over which the expenditure provides benefit.
- 5.39 The Section 151 Officer will, where it is prudent to do so, use discretion to review the overall financing of the Capital Programme and the opportunities afforded by the regulations, to maximise the benefit to the Council whilst ensuring the Council meets its duty to charge a prudent provision.
- 5.40 **MRP Overpayments** - A change introduced by the revised DLUHMC MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. The Council has previously not made any MRP overpayments.

**Affordability prudential indicators**

- 5.41 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:-

**Ratio of financing costs to net revenue stream**

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

%	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
<b>Non HRA</b>	3.2	3.1	2.6	0.1	2.1
<b>HRA</b>	16.77	16.72	16.09	16.16	15.7

## HRA ratios

	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
<b>HRA debt £'000</b>	81,605	81,605	81,605	84,627	84,627
<b>HRA revenues £'000</b>	9,341	19,433	20,190	20,488	21,085
<b>Ratio of debt to revenues</b>	4.2	4.2	4.0	4.1	4.0
<b>Number of HRA dwellings</b>	5,086	5,086	5,060	5,034	5,008
<b>Debt per dwelling £</b>	16.05	16.05	16.13	16.81	16.90

## Borrowing

- 5.43 The capital expenditure plans provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

## Current portfolio position

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

	2020/21 Actual £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
<b>External Debt</b>					
PWLB debt at 1 April	81,605	81,605	81,605	81,605	84,627
Expected change in Debt	-	-	-	3,022	7,600
<b>Other long-term liabilities (OLTL)</b>	674	451	223	-	-
<b>Expected change in OLTL</b>	(223)	(228)	(223)	-	-
<b>Actual gross debt at 31 March</b>	82,056	81,828	81,605	84,627	92,227
<b>The Capital Financing Requirement</b>	91,605	91,127	90,662	93,453	100,831
<b>Under / (over) borrowing</b>	9,549	9,299	9,057	8,826	8,604

- 5.45 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in

the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

- 5.46 The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals contained in the General Fund and HRA Budgets.

#### Treasury Indicators: limits to borrowing activity

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

Operational boundary	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Debt	91,670	91,214	94,014	101,401
Other long-term liabilities	223	1,000	1,000	1,000
Total	91,893	92,214	95,014	102,401

- 5.48 **The authorised limit for external debt.** This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

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

Authorised limit	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Debt	103,170	102,714	105,514	112,901
Other long-term liabilities	223	1,000	1,000	1,000
Total	103,393	103,714	106,514	113,901

## Prospects for interest rates

- 5.49 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 8th November 2021. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View		8.11.21													
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	
3 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.10	1.10	1.10	1.10	1.10	1.10	
12 month ave earnings	0.50	0.60	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20	1.20	
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.80	1.90	1.90	2.00	2.00	
10 yr PWLB	1.80	1.90	1.90	2.00	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.40	
25 yr PWLB	2.10	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70	
50 yr PWLB	1.90	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	

- 5.50 The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings. As shown in the forecast table above, the forecast for Bank Rate now includes five increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%. Following on from this forecast, the Bank of England raised interest rates to 0.25% from 16 December 2021.

### Significant risks to the forecasts

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.
- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, resulting in further national lockdowns or severe regional restrictions.
- **The Monetary Policy Committee** acts 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.
- **The Monetary Policy Committee** tightens monetary policy too late to ward off building inflationary pressures.
- **The Government** acts too quickly to cut expenditure to balance the national budget.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **German general election** in September 2021. Germany faces months of uncertainty while a new coalition government is cobbled together after the

indecisive result of the election. Once that coalition is formed, Angela Merkel's tenure as Chancellor will end and will leave a hole in overall EU leadership.

- **Longer term US treasury yields** rise strongly and pull gilt yields up higher than forecast.
- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- **Geopolitical risks**, for example in Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

**The balance of risks to the UK economy: -**

- The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

**5.51 Forecasts for Bank Rate**

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes five increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- It is estimated that there were around 1 million people who came off furlough at the end of September; how many of those would not have had jobs on 1<sup>st</sup>

October and would therefore be available to fill labour shortages which are creating a major headache in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate one of the MPC's key current concerns.

- We also recognise there could be further nasty surprises on the Covid front, on top of the flu season this winter, and even the possibility of another lockdown, which could all depress economic activity.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no deal Brexit.

5.52 In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will be revised again over the next few months - in line with what the new news is. It should also be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. Since this forecast, the Bank of England has reversed the emergency measure by raising interest rates to 0.25% on 16 December 2021. It should be noted however, that any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

### 5.53 **Forecasts for PWLB rates and gilt and treasury yields**

As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

There is likely to be **exceptional volatility and unpredictability in respect of gilt yields and PWLB rates** due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields (see below). Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures actually turn out to be in both the US and the UK and so put upward pressure on treasury and gilt yields?

- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the “taper tantrums” in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

5.54 The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

#### 5.55 **Gilt and treasury yields**

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden’s, and the Democratic party’s, determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package already passed in December 2020. This was then followed by additional Democratic ambition to spend \$1trn on infrastructure, which has just been passed by both houses, and an even larger sum on an American families plan over the next decade; this is still caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy has been growing strongly during 2021.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing stimulus through monthly QE purchases.

5.56 These factors could cause an excess of demand in the economy which could then unleash strong inflationary pressures. This could then force the Fed to take much earlier action to start increasing the Fed rate from near zero, despite their stated policy being to target average inflation.

5.57 **At its 3rd November Fed meeting**, the Fed decided to make a start on tapering QE purchases with the current \$80bn per month of Treasury securities to be trimmed by \$10bn in November and a further \$10bn in December. The \$40bn of MBS purchases per month will be trimmed by \$5bn in each month. If the run-down continued at that pace, the purchases would cease entirely next June but the Fed has reserved the ability to adjust purchases up or down. This met market expectations. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that Treasury yields would rise as a consequence over the taper period, all other things being equal.

However, on the inflation front it was still insisting that the surge in inflation was "largely" transitory. In his post-meeting press conference, Chair Jerome Powell claimed that "the drivers of higher inflation have been predominantly connected to the dislocations caused by the pandemic" and argued that the Fed's tools cannot address supply constraints. However, with the Fed now placing major emphasis on its mandate for ensuring full employment, (besides containing inflation), at a time when employment has fallen by 5 million and 3 million have left the work force, resignations have surged due to the ease of getting better paid jobs and so wage pressures have built rapidly.

With wage growth at its strongest since the early 1980s, inflation expectations rising and signs of a breakout in cyclical price inflation, particularly rents, the FOMC's insistence that this is still just a temporary shock "related to the pandemic and the reopening of the economy", does raise doubts which could undermine market confidence in the Fed and lead to higher treasury yields.

- 5.58 As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases eventually needed to suppress inflation, are likely to be faster and stronger than Bank Rate increases in the UK. This is likely to put upward pressure on treasury yields which could then spill over into putting upward pressure on UK gilt yields.

**The balance of risks to medium to long term PWLB rates: -**

- There is a balance of upside risks to forecasts for medium to long term PWLB rates.

**5.59 A new era – a fundamental shift in central bank monetary policy**

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US, before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.
- **For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the**

**recovery eventually runs out of spare capacity to fuel continuing expansion.**

- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

**Investment and borrowing rates**

- **Investment returns** are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.
- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The current margins over gilt yields are as follows: -
  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- **Borrowing for capital expenditure.** Our long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing if an authority is seeking to avoid a “cost of carry” but also wishes to mitigate future re-financing risk.

**Borrowing strategy**

- 5.60 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.
- 5.61 Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.
- 5.62 Any decisions will be reported to members appropriately at the next available opportunity.

**Treasury management limits on activity**

- 5.63 Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large, fixed-rate sums falling due for refinancing, and are required for upper and lower limits.
- 5.64 The Council is asked to approve the following treasury indicators and limits:-

**Maturity structure of fixed interest rate borrowing 2022/23**

	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	100%

**Maturity structure of variable interest rate borrowing 2022/23**

	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	75%
12 months to 2 years	0%	75%
2 years to 5 years	0%	75%
5 years to 10 years	0%	75%
10 years and above	0%	75%

**Policy on borrowing in advance of need**

- 5.65 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
- 5.66 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### **Debt rescheduling**

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

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

- 5.68 Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:
- Local authorities (primarily shorter dated maturities)
  - Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
- 5.69 Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

### **Annual Investment Strategy**

#### **Investment policy – management of risk**

- 5.70 The Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).
- 5.71 The Council’s investment policy has regard to the following:-
- DLUHC’s Guidance on Local Government Investments (“the Guidance”)
  - CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
  - CIPFA Treasury Management Guidance Notes 2018
- 5.72 The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council’s risk appetite. The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious damage or whose activities are inconsistent with the councils’ mission and values. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions.

- 5.73 The above guidance from the DLUHC and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -
- (a) Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
  - (b) Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.
  - (c) Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- 5.74 This authority has defined the list of types of investment instruments that the treasury management team are authorised to use, as per **APPENDIX 2**.
- Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
  - Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.
- 5.75 **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio.
- 5.76 **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in the **APPENDIX 2**.
- 5.77 **Transaction limits** are set for each type of investment in **APPENDIX 2**.
- 5.78 This authority will set a limit for the amount of its investments which are invested for longer than 365 days.
- 5.79 Investments will only be placed with counterparties from countries with a specified minimum sovereign rating.
- 5.80 This authority has engaged external consultants, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

- 5.81 All investments will be denominated in sterling.
- 5.82 As a result of the change in accounting standards for 2022/23 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23.
- 5.83 However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

### **Creditworthiness policy**

- 5.84 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 and Poor's. The credit ratings of counterparties are supplemented with the following overlays:-
- credit watches and credit outlooks from credit rating agencies;
  - CDS spreads to give early warning of likely changes in credit ratings;
  - sovereign ratings to select counterparties from only the most creditworthy countries.
- 5.85 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:-
- Yellow                      5 years
  - Dark pink                      5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
  - Light pink                      5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
  - Purple                      2 years
  - Blue                      1 year (only applies to nationalised or semi nationalised UK Banks)
  - Orange                      1 year
  - Red                      6 months
  - Green                      100 days
  - No colour                      not to be used

- 5.86 The Link creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.
- 5.87 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalent) of short term rating F1 and a long term rating of A- or equivalent. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
- 5.88 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of our creditworthiness service.
- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
  - in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
- 5.89 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 any external support for banks to help support its decision making process.
- 5.90 The Council has determined that it will only use approved counterparties from the UK and countries with a minimum sovereign credit rating of AA- from Fitch or equivalent. The list of countries that qualify using this credit criteria as at the date of this report are shown in **APPENDIX 3**. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

### **Creditworthiness**

- 5.91 Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

### **CDS Prices**

- 5.92 Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

## Investment Strategy

5.93 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

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

5.94 **Investment returns expectations.** The Bank Rate increased to 0.25% in December 2021.

5.95 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows.

Average earnings in each year	%
2022/23	0.50%
2023/24	0.75%
2024/25	1.00%
2025/26	1.25%
Long term later years	2.00%

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

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

### Maximum principal sums invested > 365 days

	2022/23	2023/24	2024/25
Principal sums invested > 365 days	£10m	£10m	£10m

5.97 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

### **Investment risk benchmarking**

- 5.98 This Council will use an investment benchmark to assess the investment performance of its investment portfolio of overnight, 7 day, 1, 3, 6 or 12 month compounded / SONIA

### **End of year investment report**

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

<b>6 Implications</b>
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#### **6.1 Financial**

Included in the report.

#### **6.2 Legal**

None.

#### **6.3 Human Resources**

None.

#### **6.4 Risk Management**

The Council regards security of the sums it invests to be the key objective of its treasury management activity. Close management of counterparty risk is therefore a key element of day to day management of treasury activity. The practices designed to ensure that risks are managed effectively are set out in the Treasury Management Practices available on the Council's website.

#### **6.5 Equality & Diversity**

The Council considers the effect of its actions on all sections of our community and has addressed all of the following Equality Strands in the production of this report, as appropriate:-

Age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, sexual orientation.

#### **6.6 Climate Change**

The Councils investment policy now includes a criteria that the Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious damage or whose activities are inconsistent with the councils' mission and values.

<b>7 Appendices to the Report</b>
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Appendix 1: Economic Background

Appendix 2: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

Appendix 3: Approved Countries for Investment

Appendix 4: Treasury Management Scheme of Delegation

Appendix 5: The Treasury Management Role of the Section 151 Officer.

**Previous Consideration**

None.

**Background Papers**

None.

## Economic Background

### MPC meeting 4<sup>th</sup> November 2021

- The Monetary Policy Committee (MPC) voted 7-2 to leave Bank Rate unchanged at 0.10% with two members voting for an increase to 0.25% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn by a vote of 6-3.
- After the Governor and other MPC members had made speeches prior to the MPC meeting in which they stressed concerns over inflation, (the Bank is now forecasting inflation to reach 5% in April when the next round of capped gas prices will go up), thus reinforcing the strong message from the September MPC meeting, financial markets had confidently built in an expectation that Bank Rate would go up from 0.10% to 0.25% at this meeting. However, these were not messages that the MPC would definitely increase Bank Rate at the first upcoming MPC meeting as no MPC member can commit the MPC to make that decision ahead of their discussions at the time. The MPC did comment, however, that Bank Rate would have to go up in the short term. It is, therefore, relatively evenly balanced as to whether Bank rate will be increased in December, February or May. Much will depend on how the statistical releases for the labour market after the end of furlough on 30<sup>th</sup> September 2021 turn out.
- Information available at the December MPC meeting will be helpful in forming a picture but not conclusive, so this could cause a delay until the February meeting. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would, therefore, need to wait until the May meeting (although it also meets in March) when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation expected around that time. If the statistics show the labour market coping well during the next six months, then it is likely there will be two increases in these three meetings.
- Over the next year the MPC will be doing a delicate balancing act of weighing combating inflation being higher for longer against growth being held back by significant headwinds. Those headwinds are due to supply shortages (pushing prices up and holding back production directly), labour shortages, surging fuel prices and tax increases. However, those headwinds could potentially be offset – at least partially - by consumers spending at least part of the £160bn+ of “excess savings” accumulated during the pandemic. However, it is also possible that more affluent people may be content to hold onto elevated savings and investments and, therefore, not support the economic recovery to the extent that the MPC may forecast.
- The latest forecasts by the Bank showed inflation under-shooting the 3 years ahead 2% target (1.95%), based on market expectations of Bank Rate hitting 1% in 2022. This implies that rates don't need to rise to market expectations of 1.0% by the end of next year.
- It is worth recalling that the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement after the MPC meeting in September yet at its

August meeting it had emphasised a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. On balance, once this winter is over and world demand for gas reduces - so that gas prices and electricity prices fall back - and once supply shortages of other goods are addressed, the MPC is forecasting that inflation would return to just under the 2% target.

- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
  1. Raising Bank Rate as "the active instrument in most circumstances".
  2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
  3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
  4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.
- **COVID-19 vaccines.** These have been the game changer which have enormously boosted confidence that **life in the UK could largely return to normal during the summer** after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread. There is also a potential for the winter flu season combined with Covid to overwhelm NHS hospitals so the UK is not entirely in the clear yet.
- **Since the September MPC meeting**, the economy has been impacted by rising gas and electricity prices which are now threatening to close down some energy intensive sectors of industry – which would then further impact the supply chain to the rest of the economy. Ports are also becoming increasingly clogged up with containers due to a shortage of lorry drivers to take them away. The labour market statistics for August released in mid-October showed a sharp rise in employment but also a continuing steep rise in vacancies. The combination of all these factors is a considerable headwind to a recovery of economic growth in the months ahead.

**US.** Shortages of goods and intermediate goods like semi-conductors, are fuelling increases in prices and reducing economic growth potential. It now also appears that there has been a sustained drop in the labour force which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023 while core inflation is likely to remain elevated at around 3% in both years instead of declining back to the Fed's 2% central target. This could well cause the Fed to focus on supporting economic growth by delaying interest rate rises, rather than combating elevated inflation i.e., there may be no rate rises until 2023.

*See also comments in paragraph 3.3 under PWLB rates and gilt yields.*

**EU.** The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery is nearly complete although countries dependent on tourism are lagging. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

German general election. With the CDU/CSU and SPD both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SPD-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.

**China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. Supply shortages, especially of coal for power generation, which is causing widespread power cuts to industry, are also having a sharp disruptive impact on the economy. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

**Japan.** 2021 has been a patchy year in combating Covid. However, recent business surveys indicate that the economy is rebounding rapidly now that the bulk of the population is fully vaccinated and new virus cases have plunged. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was actually negative in July. New Prime Minister Kishida had promised a large fiscal stimulus package after the November general election which his party has now won.

**World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is 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, and vice versa. This is likely to reduce world growth rates from those in prior decades.

**Supply shortages.** The pandemic and extreme weather events, followed by a major surge in demand after lockdowns ended, have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable

**Item No. 11.29**

to unload their goods at ports in New York, California and China. Such issues have led to a misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. The latest additional disruption has been a shortage of coal in China leading to power cuts focused primarily on producers (rather than consumers), i.e., this will further aggravate shortages in meeting demand for goods. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

### Treasury Management Practice (TMP1) - Credit and Counterparty Risk Management

**SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable. (Non-specified investments which would be specified investments apart from originally being for a period longer than 12 months, will be classified as being specified once the remaining period to maturity falls to under twelve months.)

**NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the specified investment criteria. A maximum of 50% will be held in aggregate in non-specified investments.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:-

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	100%	6 months
UK Government gilts	UK sovereign rating	£6 million	5 years
UK Government Treasury bills	UK sovereign rating	£6 million	12 months
Bonds issued by multilateral development banks	AAA	£6 million	5 years
Money Market Funds CNAV	AAA	100%	Liquid
Money Market Funds LNAV	AAA	100%	Liquid
Money Market Funds VNAV	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	Liquid

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
Local authorities	N/A	100%	12 months
Call Accounts	N/A	£6 million	Liquid
Term deposits with housing associations	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
Term deposits with banks and building societies	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	£6 million	12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating	£6 million	12 months

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

### Approved Countries for Investment

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

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

##### AAA

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

##### AA+

- Canada
- Finland
- U.S.A.

##### AA

- Abu Dhabi (UAE)
- France

##### AA-

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

## **Treasury Management Scheme of Delegation**

### **Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

### **Committees/Council**

- 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.

### **Body/person(s) with responsibility for scrutiny**

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

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

### **The S151 (responsible) officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- preparation of a capital strategy to include capital expenditure, capital financing, and treasury management, with a long term timeframe.