

APPENDIX E

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2021/22

1. INTRODUCTION

1.1 Background

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

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

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

CIPFA defines treasury management as:

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

1.2 Reporting Requirements

Capital Strategy

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

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

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

The capital strategy is included as a separate document within the budget report.

Treasury Management Reporting

The council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals:

- a. Prudential and treasury indicators and treasury strategy (this report)** – This will provide members with an outline of how investments and borrowings are to be organised in coming years, including an Investment Strategy and relevant indicators.
- b. A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- c. An annual treasury report** – This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

The above report is required to be adequately scrutinised before being recommended to the council. This role is undertaken by the Budget and Corporate Scrutiny Management Board.

1.3 Treasury Management Strategy for 2021/22

The strategy for 2021/22 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 will limit the treasury risk and activities of the council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

1.4 Training

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. An overview of treasury management training was undertaken by the Budget and Corporate Scrutiny Management Board in December 2018 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury Management Consultants

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

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

2 THE CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2024/25

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 member's overview and confirm capital expenditure plans.

2.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
Capital Expenditure						
General Fund	71.612	81.766	94.804	12.714	12.414	12.414
HRA	50.768	63.972	70.808	45.612	45.612	45.612
Total	122.380	145.738	165.612	58.326	58.026	58.026

Other long-term liabilities - The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.

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.

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
Resourced by:						
Capital Receipts	8.506	9.992	32.836	6.234	6.299	10.351
Capital Grants & Contributions	66.727	70.847	44.591	8.394	8.394	8.394
Revenue	20.312	21.979	18.536	13.979	13.979	13.979
Capital Expenditure Financed from Borrowing	26.835	42.920	69.649	29.719	29.354	25.302

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

The second prudential indicator is the council's Capital Financing Requirement (CFR). The CFR is 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, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities such as PFI schemes and finance leases. Whilst these increase the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. The council currently has £74.308m of such schemes within the CFR as at 31 March 2020.

The council is asked to approve the CFR projections below:

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
Capital Financing Requirement (CFR)						
General Fund	308.242	296.864	298.367	281.946	264.327	242.204
HRA	429.112	457.089	499.487	519.765	540.010	560.220
Total CFR @ 31 March	737.354	753.953	797.854	801.711	804.337	802.424
Movement in CFR		16.599	43.901	3.857	2.626	-1.913
Movement Represented by:						
Capital expenditure to be financed from borrowing		42.920	69.649	29.719	29.354	25.302
Less MRP/VRP and other financing movements *		-26.321	-25.748	-25.862	-26.728	-27.215
Movement in CFR		16.599	43.901	3.857	2.626	-1.913

* Includes PFI annual principal repayments

2.3 Core funds and expected investment balances

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

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
Balances	106.147	100.000	90.000	90.000	90.000	90.000
Specific reserves	46.014	20.000	20.000	20.000	20.000	20.000
Capital Receipts Unapplied	23.383	25.000	15.000	10.000	5.000	5.000
Capital Grants Unapplied	12.749	15.000	15.000	15.000	15.000	15.000
Con Adv & Borrowing	17.389	15.000	15.000	15.000	15.000	15.000
Collection Fund	-4.097	-5.067	-1.903	-1.903	0.000	0.000
Total Core Funds	201.585	169.933	153.097	148.097	145.000	145.000
Net Working capital *	12.125	25.000	25.000	25.000	25.000	25.000
Expected investments	48.040	40.000	23.000	23.000	23.000	23.000

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

2.4 Minimum Revenue Provision (MRP) Policy Statement

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

MHCLG Regulations have been issued which require the full council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

Average Asset Life method - MRP will be based on the total average estimated life of assets held by the authority.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

Individual Asset Life Method - MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This provides for a reduction in the borrowing need over the assets' life.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement to make a charge for depreciation.

Annual principal repayments included in PFI schemes or finance leases are applied as MRP.

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. For this sum to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2020 the total VRP overpayments made by the General Fund account was £5.423m.

2.5 West Midlands Combined Authority: Collective Investment Fund

The agreed Combined Authority Devolution Deal proposes the establishment of a Collective Investment Fund to support investment in the region. It is possible that some of this investment may be delivered by individual districts and funded from prudential borrowing.

MRP on capitalised loan advances to other organisations or individuals will not be required. Instead, the capital receipts arising from the capitalised loan repayments will be used as provision to repay debt. However, revenue MRP contributions would still be required equal to the amount of any impairment of the loan advanced.

MRP on investments in Equities will be made on an annuity profile over 20 years, as recommended by Government guidance.

3 Borrowing

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

3.1 Current Portfolio Position

The overall treasury management portfolio as at 31 March 2020 and for the position as 31 December 2020 are shown below for both borrowing and investments:

Treasury Portfolio				
	Actual 31/03/2020 £'000	Actual 31/03/2020 %	Current 31/12/2020 £'000	Current 31/12/2020 %
Treasury Investments				
Banks	3,244	7%	7,398	12%
Temporary Deposits	2,633	5%	0	0%
Money Market Funds	41,900	87%	56,500	88%
Local Authorities	0	0%	0	0%
6 Towns Credit Union	250	1%	250	0%
Total Managed In House	48,027	100%	64,148	100%
Total Treasury Investments	48,027	100%	64,148	100%
Treasury External Borrowing				
Local Authorities	0	0%	0	0%
PWLB	342,601	71%	333,444	69%
LOBO's	82,000	17%	82,000	17%
Market Fixed Loan	10,000	2%	10,000	2%
Temporary Loans	49,132	10%	57,900	12%
Soft Loans	1,067	0%	2,264	0%
Total External Borrowing	484,800	100%	485,608	100%
Net Treasury Investments/(Borrowing)	(436,773)		(421,461)	

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.

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
External Debt as at 1 April	496.341	476.409	493.008	536.908	540.765	543.391
Expected change in Debt	0.176	16.599	43.901	3.857	2.626	0.000
Other Long Term Liabilities (OLTL)*	77.365	74.308	69.688	66.034	62.752	58.697
Expected change in OLTL	-3.057	-4.620	-3.654	-3.282	-4.055	-4.325
External Debt as at 31 March	570.825	562.696	602.943	603.517	602.088	597.763
Capital Financing Requirement	737.354	753.953	797.854	801.711	804.337	802.424
Under / (Over) Borrowing	166.529	191.257	194.911	198.194	202.249	204.661

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

Director of Resources (Section 151 Officer) confirms that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view considers current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary

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

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
External Debt	496.517	493.008	536.909	540.765	543.391	543.391
Other Long Term Liabilities*	74.308	69.688	66.034	62.752	58.697	54.372
Operational Boundary	570.825	562.696	602.943	603.517	602.088	597.763

The Authorised Limit

The Authorised Limit for external debt is a further key prudential indicator, which represents control over the maximum level of debt. 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.

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.

The council is recommended to approve the following Authorised Limit:

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
External Debt	663.046	684.265	731.820	738.959	745.640	748.052
Other Long Term Liabilities*	74.308	69.688	66.034	62.752	58.697	54.372
Authorised Limit	737.354	753.953	797.854	801.711	804.337	802.424

The HRA CFR is built into the total reported Authorised Limit, this revised limit is currently £753.953m; the UK Government announced that there would be a policy change which led, in October 2018, to the HRA debt cap being abolished. The HRA therefore, are no longer restricted to a debt ceiling however, although the debt cap has now been lifted, the HRA will still follow the principals of the Prudential Code; (as a result will still use the CFR as their ultimate debt ceiling).

3.3 Prospects for Interest Rates

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. The following table gives their central view on interest rates over the next few years.

	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec-20	0.10	0.80	1.50	1.30
Mar-21	0.10	0.80	1.50	1.30
Jun-21	0.10	0.80	1.60	1.40
Sep-21	0.10	0.80	1.60	1.40
Dec-21	0.10	0.80	1.60	1.40
Mar-22	0.10	0.90	1.60	1.40
Jun-22	0.10	0.90	1.70	1.50
Sep-22	0.10	0.90	1.70	1.50
Dec-22	0.10	0.90	1.70	1.50
Mar-23	0.10	0.90	1.70	1.50
Jun-23	0.10	1.00	1.80	1.60
Sep-23	0.10	1.00	1.80	1.60
Dec-23	0.10	1.00	1.80	1.60
Mar-24	0.10	1.00	1.80	1.60

A more comprehensive list of these rates is detailed in Appendix 1.

Link Group have also provided a detailed analysis of the economic background for the UK and the rest of the world which is given as Appendix 2 to this report. However, their general comments are as follows:

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.
- Borrowing interest fell to historically very low rate as a result of the COVID crisis and the quantitative easing operations of the Bank of England: Indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure.
- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and any rundown on reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4 Borrowing Strategy

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. Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Director

of Resources (Section 151 Officer) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- If it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.
- If it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.5 Policy on Borrowing In Advance of Need

The council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Finance 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.

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 20% of the expected increase in borrowing need (CFR) over a three-year planning period

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.

3.6 Debt Rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

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

3.7 New Financial Institutions (as a source of borrowing or types of borrowing)

Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100bps to 180 basis points on all certainty rate

loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency (no insurance at present but there is potential)

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

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

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

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

The council's investment priorities will be security first, portfolio liquidity second and then yield (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate 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, as well as wider range fund options.

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

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
 2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this
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consideration the council will engage with its advisors to maintain a monitor on market pricing such as “**credit default swaps**” and overlay that information on top of the credit ratings.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
 4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Appendix 3 under the categories of ‘specified’ and ‘non-specified’ investments.
 - **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 more than one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18-month deposit would still be non-specified even if it has only 11 months left until maturity.
 5. **Non-specified investments limit.** The council has determined that it will limit the maximum total exposure to non-specified investments as being 30% of the total investment portfolio.
 6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in section 4.2.
 7. **Transaction limits** are set for each type of investment in section 4.2.
 8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.4).
 9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).
 10. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
 11. All investments will be denominated in **sterling**.
 12. As a result of the change in accounting standards for 2020/21 under IFRS 9, this authority will consider the implications of investment
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instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.

13. If considering 'Property Funds' or other 'Diversified Income Funds' in the future, the council may look to use externally appointed fund managers.

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, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.

The above criteria are unchanged from last year.

4.2 Creditworthiness policy

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

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the council's prudential indicators covering the maximum principal sums invested.

The Director of Resources (Section 151 Officer) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either Specified or Non-Specified as it provides an overall pool of counterparties considered high quality which the council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible long-term change) are provided to officers almost immediately after they occur, and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum council criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- Banks 1 - good credit quality – the council will only use banks which:
 - i. are UK banks and/or
 - ii. are non-UK and domiciled in a country which has a minimum sovereign long-term rating of AA-

and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

- i. Short term - F1, P-1, A-1 respectively
 - ii. Long term – A-, A1 and A- respectively
 - Banks 2 – Part nationalised UK banks – Royal Bank of Scotland ringfenced operations. These banks can be included provided they continue to be part nationalised or meet the ratings in Banks 1 above.
 - Banks 3 – The council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
 - Bank subsidiary and treasury operation. The council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
 - Building societies - The council will use all societies which meet the above criteria.
 - Money Market Funds (MMFs) CNAV – AAA rated money market funds.
 - Money Market Funds (MMFs) LVNAV – AAA rated money market funds.
 - Money Market Funds (MMFs) VNAV – AAA rated money market funds.
 - Ultra-Short Dated Bond Funds with a credit rating of at least 1.25 – AAA
-

- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions
- Property Funds.
- Building Schools for the Future Local Education Partnership
- Sandwell Inspired Partnership Services
- Sandwell Children’s Trust
- West Midlands Fire & Rescue Authority

A limit will be applied to the use of Non-Specified investments, further details can be found at Appendix 3.

Use of additional information other than credit ratings

Additional requirements under the Code require the council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments

The time and monetary limits for institutions on the council’s counterparty list are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 category high quality	AA-	£30m	3yrs
Banks 1 category medium quality	A-	£10m	364 days
Limit 3 category – council’s banker (not meeting Banks 1)	-	£15m	1 day
Other institutions limit	-	£10m	364 days
DMADF	AAA	unlimited	6 months

Money market Funds (CNAV, LVNAV & VNAV)	AAA	£20m	Liquid
Ultra-Short Dated Bond Funds	-	£10m	6 months
Local authorities	-	£10m	364 days
Property Funds	-	£10m	10yrs plus

The proposed criteria for Specified and Non-Specified investments are shown in Appendix 3 for approval.

UK banks – Creditworthiness

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on actual levels of credit losses.

(Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6 August revised down their expected credit losses for the UK banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

4.3 Other limits

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

- a) **Non-specified investment limit.** The council has determined that it will limit the maximum total exposure of treasury management investments to non-specified investments as being 30% of the total investment portfolio.
-

- b) **Country limit.** The council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch or equivalent. The list of countries that qualify using this credit criteria, will be added to or deducted from, by officers should ratings change in accordance with this policy.
- c) **Other limits.** In addition:
- no more than 20% will be placed with any non-UK country at any time;
 - limits in place above will apply to a group of companies;

4.4 Investment Strategy

In-house funds

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 the 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.

Investment returns expectations

Bank rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

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

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

The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus. It may also be affected by what, if any, deal the UK agrees as part of Brexit.

There is relatively little UK domestic risk of increases or decreases in Bank Rate and shorter term PWLB rates until 2023/24 at the earliest.

WM Combined Authority

The council will be prepared to lend to the Combined Authority. Such lending may be as part of arrangements agreed with the Combined Authority and other constituent authorities.

Negative investment rates

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

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

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

Investment treasury indicator and limit

These are the 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 > 364 days			
	2021/22	2022/23	2023/24
Principal sums invested > 365 days	£30m	£30m	£30m

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

4.5 Investment Risk Benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

Security - The council's maximum-security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.00% historic risk of default when compared to the whole portfolio.

Liquidity – the council seeks to maintain:

- Bank overdraft - £2m
- Liquid short-term deposits of at least £21m available with a week's notice.

Yield - Local measures of yield benchmarks are:

- Investments – internal returns above the 7-day LIBID rate

The current LIBID benchmarks are reported below; please note that these rates are variable and change daily. They are linked to current market conditions and may go up or down as those conditions change.

% Benchmarks	7 Day	1 Month	3 Month	6 Month	12 Month
Benchmark Return (LIBID Uncompounded)	-0.06%	-0.04%	0.04%	0.12%	0.23%

Note: This benchmark is an average risk of default measure and would not constitute an expectation of loss against a particular investment.

The Council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors in determining suitable replacement investment benchmark(s) ahead of this cessation and will report back to members accordingly.

4.6 End of year investment report

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

5 TREASURY INDICATORS 2021/22 – 2024/25

5.1 Affordability Prudential Indicators

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 indicator:

Ratio of Financing Costs to Net Revenue Stream

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

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
General Fund	6.08%	5.59%	6.03%	4.79%	4.49%	4.21%
HRA	22.70%	23.33%	22.31%	22.47%	22.20%	22.19%

The estimates of financing costs include current commitments and the proposals in this budget report.

HRA Ratios

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
HRA Debt (£m)	370.218	360.970	338.594	334.738	324.737	316.311
HRA Revenues (£m)	131.646	128.597	134.185	135.351	136.538	136.538
Ratio of Debt to Revenues (%)	2.81%	2.81%	2.52%	2.47%	2.38%	2.32%
	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
HRA Debt (£m)	370.218	360.970	338.594	334.738	324.737	316.311
Number of HRA Dwellings	28,442	28,292	28,142	27,992	27,842	27,692
Debt Per Dwelling (£m)	13.017	12.759	12.032	11.958	11.664	11.422

5.2 Maturity Structure of Borrowing

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

The council is asked to approve the following treasury indicators and limits:

Maturity Structure of Fixed Interest Rate Borrowing 2021/22		
	Lower %	Upper %
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	20%
5 years to 10 years	0%	20%
10 years to 20 years	0%	20%
20 years to 30 years	0%	30%
30 years to 40 years	0%	40%
40 years to 50 years	0%	50%
50 years plus	0%	90%

Maturity Structure of Variable Interest Rate Borrowing 2021/22		
	Lower %	Upper %
Under 12 months	0%	5%
12 months to 2 years	0%	5%
2 years to 5 years	0%	5%
5 years to 10 years	0%	5%
10 years to 20 years	0%	5%
20 years to 30 years	0%	10%
30 years to 40 years	0%	10%
40 years to 50 years	0%	10%
50 years plus	0%	10%

APPENDIX 1: Interest Rate Forecasts

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 11 August.20. However, following the conclusion of the review of PWLB margins over gilt yields on 25 November.20, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps:

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

Brexit. The interest rate forecasts provided by Link are predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31 December.20. However, as the differences between a Brexit deal and a no deal are not as big as they once were, the economic costs of a no deal have diminished. The bigger risk is that relations between the UK and the EU deteriorate to such an extent that both sides start to unravel the agreements already put in place. So what really matters now is not whether there is a deal or a no deal, but what type of no deal it could be.

The differences between a deal and a no deal were much greater immediately after the EU Referendum in June 2016, and also just before the original Brexit deadline of 29 March 19. That's partly because leaving the EU's Single Market and Customs Union makes this Brexit a relatively "hard" one. But it's mostly because a lot of arrangements have already been put in place. Indeed, since the Withdrawal Agreement laid down the terms of the break-up, both the UK and the EU have made substantial progress in granting financial services equivalence and the UK has replicated the bulk of the trade deals it had with non-EU countries via the EU. In a no deal in these circumstances (a "cooperative no deal"), GDP in 2021 as a whole may be only 1.0% lower than if there were a deal. In this situation, financial services equivalence would probably be granted during 2021 and, if necessary, the UK and the EU would probably rollover any temporary arrangements in the future.

The real risk is if the UK and the EU completely fall out. The UK could override part or all of the Withdrawal Agreement while the EU could respond by starting legal proceedings and few measures could be implemented to mitigate the disruption on 1 January.21. In such an "uncooperative no deal", GDP could be 2.5% lower in 2021 as a whole than if there was a deal. The acrimony would

probably continue beyond 2021 too, which may lead to fewer agreements in the future and the expiry of any temporary measures.

Relative to the slump in GDP endured during the COVID crisis, any hit from a no deal would be small. But the pandemic does mean there is less scope for policy to respond. Even so, the Chancellor could loosen fiscal policy by about £10bn (0.5% of GDP) and target it at those sectors hit hardest. The Bank of England could also prop up demand, most likely through more gilt and corporate bond purchases rather than negative interest rates.

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.

So in summary there is not likely to be any change in Bank Rate in 20/21 – 21/22 due to whatever outcome there is from the trade negotiations and while there will probably be some movement in gilt yields / PWLB rates after the deadline date, there will probably be minimal enduring impact beyond the initial reaction.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal the UK agrees as part of Brexit.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, 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** - further national lockdowns or severe regional restrictions in major conurbations during 2021.
- **UK / EU trade negotiations** – if they were to cause significant economic disruption and downturn in the rate of growth.
- **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 year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between

northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued 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 intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. In November, Hungary and Poland threatened to veto the 7-year EU budget due to the inclusion of a rule of law requirement that poses major challenges to both countries. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks**, for example 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** - stronger than currently expected recovery in UK economy, especially if effective vaccines are administered quickly to the UK population and lead to a resumption of normal life and a return to full economic activity across all sectors of the economy.
- **Post-Brexit** – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.

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 later rapid series of increases in Bank Rate faster than we currently expect.

Gilt yields / PWLB rates

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to

very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

- **Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.
- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of

20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. It also introduced the following rates for borrowing for different types of capital expenditure:

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
 - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
 - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
 - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
 - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
-
- As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.
 - On 25 November 20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The new margins over gilt yields are as follows:
 - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
 - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
 - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
 - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
 - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
 - **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable.
 - While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

APPENDIX 2: Economic Background

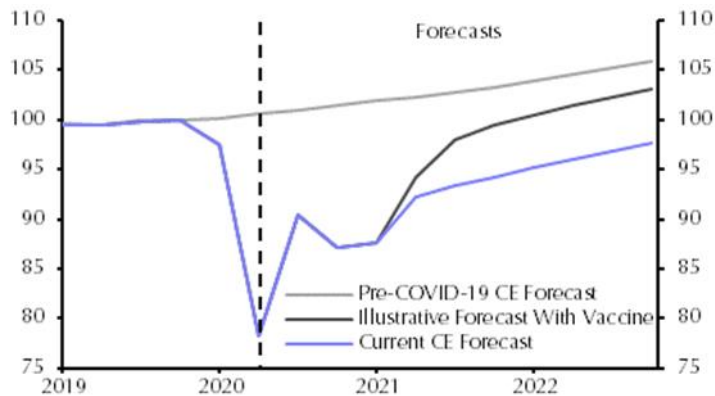
- **UK.** The Bank of England's Monetary Policy Committee kept **Bank Rate** unchanged on 5 November. However, it revised its economic forecasts to take account of a second national lockdown from 5 November to 2 December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do 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 the time, to be rather optimistic in terms of three areas:
 - The economy would recover to reach its pre-pandemic level in Q1 2022
 - The Bank also expects there to be excess demand in the economy by Q4 2022.
 - CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".
- 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 through to quarter 1 2024 but there could well be no increase during the next five years due to the slow rate of recovery of the economy and the need for the Government to see the burden of the elevated debt to GDP ratio falling significantly. **Inflation** is unlikely to pose a threat requiring increases in Bank Rate during this period as there is likely to be spare capacity in the economy for a considerable time. It is expected to briefly peak at around 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. That could involve some or all of the lockdown being extended beyond 2nd December, a temporary relaxation of restrictions over Christmas, a resumption of the lockdown in January and lots of regions being subject to Tier 3 restrictions when the lockdown ends. Hopefully, restrictions should progressively ease during the spring. It is only to be expected that some businesses that have barely survived the first lockdown, will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to the end of 31st March will limit the degree of damage done.
- As for **upside risks**, we have been waiting expectantly for news that various **COVID19 vaccines** would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9 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, their phase three trials are still only two-thirds complete. More data needs to be collected to make sure there are no serious side effects. We don't know exactly how long immunity will last or whether it is effective across all age groups. The Pfizer vaccine specifically also has demanding cold storage requirements of minus 70C that might make it more difficult to roll out. However, the logistics of production and deployment can surely be worked out over the next few months.
- However, there has been even further encouraging news since then with another two vaccines announcing high success rates. Together, these three announcements 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, which would help to bring the unemployment rate down. With the household saving rate currently being exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could begin to be eased, possibly in Q2 2021, once vulnerable people and front-line workers had 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% next year instead of 9%. But while this would reduce the need for more QE and/or negative interest

rates, increases in Bank Rate would still remain some years away. There is also a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.

- **Public borrowing** is now forecast 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 but after a disappointing increase in GDP of only 2.1% in August, this left the economy still 9.2% smaller than in February; this suggested that the economic recovery was running out of steam after recovering 64% of its total fall during the crisis. The last three months of 2020 were originally expected to show zero growth due to the impact of widespread local lockdowns, consumers probably remaining cautious in spending, and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year also being a headwind. However, the second national lockdown starting on 5th November for one month is expected to depress GDP by 8% in November while the rebound in December is likely to be muted and vulnerable to the previously mentioned downside risks. It was expected that the second national lockdown would push back recovery of GDP to pre pandemic levels by six months and into sometime during 2023. However, the graph below shows what Capital Economics forecast could happen if successful vaccines were widely administered in the UK in the first half of 2021; this would cause a much quicker recovery.

Level of real GDP (Q4 2019 = 100)



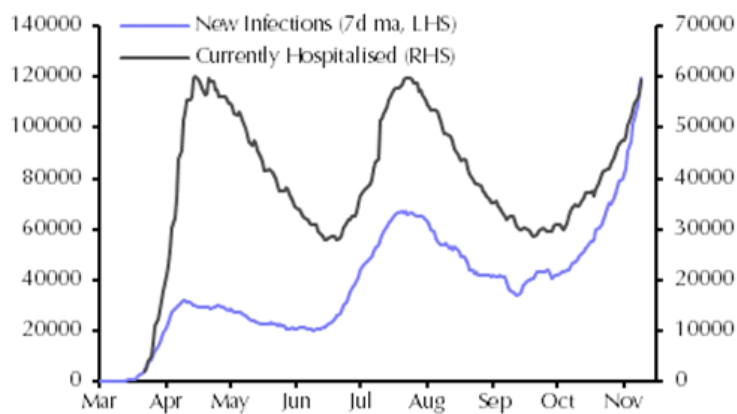
- There will be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a 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.
- The **Financial Policy Committee** (FPC) report on 6 August revised down their expected credit losses for the banking sector to “somewhat less than £80bn”. It stated that in its assessment “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.

US. The result of the **November elections** means that while the Democrats have gained the presidency and a majority in the House of Representatives, it looks as if the Republicans will retain their slim majority in the Senate. This means that the Democrats will not be able to do a massive fiscal stimulus, as they will have to get agreement from the Republicans. That would have resulted in another surge of debt issuance and could have put particular upward pressure on debt yields – which could then have also put upward pressure on gilt yields. On the other hand, equity prices leapt up on 9th November on the first news of a successful vaccine and have risen further during November as more vaccines announced successful results. This could cause a big shift in investor sentiment i.e. a swing to sell out of government debt to buy into equities which would normally be expected to cause debt prices to fall and yields to rise. However, the rise in yields has been quite muted so far and it is too early to say whether the Fed would feel it necessary to take action to suppress any further rise in debt yields. It is likely that the next two years, and possibly four years in the US, could be a political stalemate where neither party can do anything radical.

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 third wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the latest wave has been driven by a growing outbreak in the Midwest. 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 New infections & hospitalisations



After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation 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 Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. 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.

EU. The economy was recovering well towards the end of Q2 and into Q3 after a sharp drop in GDP caused by the virus, (e.g. France 18.9%, Italy 17.6%). However, growth is likely to stagnate during Q4, and Q1 of 2021, as a second wave of the virus has affected many countries and is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected countries. 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. It is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support from governments. The current PEPP scheme of €1,350bn 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, the PEPP scheme is regarded as being a temporary measure during this crisis so it may need to be increased once the first PEPP runs out during early 2021. It could also decide to focus on using the Asset Purchase Programme to make more monthly purchases, rather than the PEPP scheme, and it does have other monetary policy options.

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. Japan's success in containing the virus without imposing draconian restrictions on activity should enable a faster return to pre-virus levels of output than in many major economies. While the second wave of the virus has been abating, the economy has been continuing to recover at a reasonable pace from its earlier total contraction of 8.5% in GDP. However, there now appears to be the early stages of the start of a third wave. It has also been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. There has also been little progress on fundamental reform of the economy. The change of Prime Minister is not expected to result in any significant change in economic policy.

World growth. While Latin America and India have, until recently, been hotspots for virus infections, infection rates have begun to stabilise. World growth will be in recession this year. 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 come under more pressure to support growth by looser monetary policy measures and this is likely to result in more quantitative easing and keeping rates very low for longer. It will also put pressure on governments to provide more fiscal support for 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.

The graph below as at 10 November, shows how the 10 and 30-year gilt yields in the UK spiked up after the Pfizer vaccine announcement on the previous day, (though they have levelled off during late November at around the same elevated levels):



APPENDIX 3: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The MHCLG issued Investment Guidance in 2018 and this forms the structure of the council’s policy below. These guidelines do not apply to either trust funds or pension funds that operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently and that priority is given to security and liquidity before yield. To facilitate this objective, the guidance requires this council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. In accordance with the Code, the Section 151 Officer has produced its Treasury Management Practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the council will use. These are high security (i.e. high credit rating, although this is defined by the council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality such as a bank or building society. This covers bodies with a minimum short-term rating of A (or equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the council has set additional criteria to set the time and amount of monies which will be invested in these bodies; this criteria is as per the Investment Counter Party and Liquidity Framework.

Non-Specified Investments – are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any sterling investments with:

	Non-Specified Investment Category	Limit (£ or %)
a.	<p>Supranational Bonds greater than 1 year to maturity</p> <p>(a) Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.).</p> <p>(b) A financial institution that is guaranteed by the United Kingdom Government (e.g. National Rail, the Guaranteed Export Finance Company {GEFCO})</p> <p>The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt-edged securities. However, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p>	30%

b.	Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	30%
c.	The council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£15m
d.	Any bank or building society that has a minimum long-term credit rating of AA-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	3 Years and £30m
e.	Building Schools for the Future Local Education Partnership. Whilst this is not a usual investment counter party, the council is likely to invest a small amount as part of the wider Building Schools for the Future project. As this institution is not credit rated it falls under the Non-specified criteria.	£1m
f.	Sandwell Inspired Partnership Services. Whilst this is not a usual investment counter party, the council is likely to invest a small amount for the organisation to be use as working capital in its infancy. As this institution is not credit rated it falls under the Non-specified criteria.	£1.2m
g.	Bond funds this Authority will seek further advice on the appropriateness and associated risks with investments in these categories.	£10.0m
h.	Property funds the use of these instruments can be deemed to be capital expenditure and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using.	£10.0m (10 years plus)

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Section 151 Officer and if required new counterparties which meet the criteria will be added to the list.