ASSEMBLY

3 March 2021

Title: Treasury Management Strategy Statement 2021/22	
Report of the Cabinet Member for Finance, Performance and Core Services	
Open Report	**For Decision**
Wards Affected: None	**Key Decision:** Yes
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Summary

This report deals with the Treasury Management Annual Strategy Statement, Treasury and Prudential Indicators, Annual Investment Strategy and borrowing limits, in compliance with Section 15(1)(a) of the Local Government Act 2003.

The production and approval each year of a Treasury Management Strategy Statement and Annual Investment Strategy are requirements of the Council under Section 15(1) of the Local Government Act 2003. It is also a requirement of the Act to set an authorised borrowing limit for the forthcoming financial year.

The Local Government Act 2003 also requires the Council to have regard to the Prudential Code, and to set prudential indicators which consider the Council's capital investment plans for the next three years.

The Prudential Code was revised in 2017 with the main changes being the inclusion of the Capital Strategy 2021-22 requirements. The Capital Strategy is largely driven by the Council's Investment and Acquisition Strategy, which will be revised in March 2021 and will be based on the Be First Business Plan, which is due to come to Cabinet in March 2021.

This report was considered and endorsed by the Cabinet at its meeting on 15 February 2021.

Recommendation(s)

The Assembly is recommended to adopt the Treasury Management Strategy Statement for 2021/22 and, in doing so, to:

(i) Note the current treasury position for 2021/22 and prospects for interest rates, as referred to in sections 4 and 8 of the report;

(ii) Approve the Annual Investment Strategy 2021/22 outlining the investments that the Council may use for the prudent management of its investment balances, as set out in Appendix 1 to the report;

(iii) Approve the Council's Borrowing Strategy 2021/22 to 2023/24, as set out in Appendix 2 to the report;

(iv) Note that the Capital Strategy 2021/22, incorporating the Investment and Acquisitions Strategy, shall be updated and presented for approval in April 2021;

(v) Approve the Capital Prudential and Treasury Indicators 2021/22 to 2023/24, as set out in Appendix 3 to the report;

(vi) Approve the Minimum Revenue Provision Policy Statement for 2021/22, representing the Council's policy on repayment of debt, as set out in Appendix 4 to the report;

(vii) Approve the Operational Boundary Limit of £1.70bn and the Authorised Borrowing Limit of £1.80bn for 2021-22, representing the statutory limit determined by the Council pursuant to section 3(1) of the Local Government Act 2003, as referred to in Appendix 4 to the report; and

(viii) Delegate authority to the Finance Director, in consultation with the Cabinet Member for Finance, Performance and Core Services, to proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement to consider the increase in short-term cash held from borrowing.

Reason(s)

To enable the Council to accord with the requirements of the Local Government Act 2003.

1. Introduction and Background

1.1 The Council is required to operate a balanced budget, with cash raised during the year sufficient to meet the Council's cash expenditure. Treasury management supports the Council by seeking to ensure its cash flow is adequately planned, with cash being available when it is needed. Surplus cash is invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate security and liquidity while also considering the investment return.

1.2 A second function of treasury management is funding 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.

1.3 The Council is responsible for its treasury decisions, activity and risk appetite. The successful identification, monitoring and control of risk are integral elements of treasury management, including credit and counterparty risk, liquidity risk, market risk, interest risk, refinancing risk and legal and regulatory risk. The Council is statutorily required to approve the Treasury Management Strategy Statement (TMSS) prior to the new financial year.

2. Treasury Management Reporting Requirements

2.1 The Council is required to receive and approve at least three main treasury reports each year. These reports are required to be adequately scrutinised by Cabinet before being recommended to the Council. The three main treasury reports are:

i. **The TMSS** is the most important report and considers the impact of the Council's proposed Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position, the Prudential Indicators (PIs) and the outlook for interest rates. In addition, the current market conditions are factored into any decision-making process.

ii. **A Mid-Year Treasury Management Report** to update Members on the progress of the capital position, amending PIs and investment strategy as necessary.

iii. **An Annual Treasury Report** which outlines the actual PIs, treasury indicators and treasury operations compared to the estimates within the strategy.

2.2 As the Council is responsible for housing, PIs relating to capital expenditure, financing costs and the Capital Financing Requirement (CFR) are split between the Housing Revenue Account (HRA) and the General Fund (GF). The impact of new capital investment decisions on housing rents will also need to be considered.

2.3 This report provides an explanation of the key elements of the Council's TMSS, its Minimum Revenue Provision (MRP) Strategy, the Annual Investment Strategy (AIS) for 2021-22 and the Borrowing Strategy, which are set out in detail in the appendices attached to this report.

3. Treasury Management Strategy Statement for 2021-22

3.1 The strategy for 2021-22 covers two main areas, including Treasury Management and Capital Strategy Reporting issues. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Ministry of Housing, Communities and Local Government's (MHCLG) MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

3.2 Treasury Management Issues

- Current Portfolio Position at 31 December 2020 (section 4);
- Medium Term Capital Finance Budget (section 5);
- Treasury Position at 31 December 2020; forward projections 2023-24 (section 6);
- Economic Update (section 7);
- Interest rate forecast (section 8);
- Investment and Borrowing Rates (section 9);
- The Capital Expenditure Plans 2021/22 to 2023/24 (section 10);
- Treasury Management Advisors (section 11);
- Minimum Revenue Provision Policy Statement (section 12);
- Appendix 1 – Annual Investment Strategy 2021/22;
- Appendix 2 - Borrowing Strategy 2021/22 to 2023/24;
- Appendix 3 – The Capital Prudential and Treasury Indicators 2021/22 to 2023/24;
- Appendix 4 – Minimum Revenue Provision Policy Statement 2021/22; and

- Appendix 5 – Scheme of Delegation and Section 151 Officer Responsibilities

3.3 **Capital Strategy Reporting Requirements**

3.3.1 The CIPFA revised 2017 Prudential and Treasury Management Codes require all local authorities to prepare an additional report, a Capital Strategy Report (CSR), 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; and
- the implications for future financial sustainability.

3.3.2 The aim of this CSR is to ensure that Members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

3.3.3 The Council already has an Investment and Acquisitions Strategy (IAS), which forms the basis of the CSR. In addition to the IAS, the Council's Capital Strategy includes a Borrowing Strategy (appendix 2) and an MRP Policy (appendix 4), that include additional details on the borrowing and debt repayment for the Council's Capital Strategy. These documents combined provide details of the Council's Capital Strategy and includes:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

3.3.4 Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

3.3.5 Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

3.3.6 If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

3.3.7 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

3.3.8 The IAS was agreed at the October 2020 Cabinet meeting. This will be updated to reflect the updated Be First Business Plan and presented to the April 2021 Cabinet.

4. Current Portfolio Position at 31 December 2020

4.1 The Council holds cash balances from its operational activities, which are offset by expenditure to run services. The timing of these cash flows can result in surplus cash which is then invested. Cash balances are also affected by working capital.

4.2 These balances are made up of the following sources of cash:

- Capital grants and Section 106 funds received in advance of expenditure;
- General Fund, HRA and School cash balances;
- Earmarked Reserves, provisions, Capital Receipts and Working Capital;
- Borrowing (Financial Institutions and PWLB)

4.3 Table 1 shows the Council's investments, loans and borrowing balances at 31 December 2020, including the Average Life and the Average Rate of Return.

Table 1: Council's Treasury Position at 31 December 2020

	Principal £000s	Return %	Average Life (yrs.)
General Fund Fixed Rate Long Term Borrowing			
PWLB	512,490	2.06	25.83
European Investment Bank	79,363	2.21	23.30
DEXIA BANK LOBO	10,000	3.98	56.50
L1 RENEWABLES	6,803	3.44	25.76
Total General Fund Debt	**608,656**	**2.13**	**26.00**
General Fund Fixed Rate Short Term Borrowing			
Local Authority Short Term	92,000	0.2	0.11
Total GF Debt	**700,656**	**1.87**	**22.6**
HRA Fixed Rate Borrowing			
PWLB	265,912	3.5	35.10
Market Loans	30,000	4.03	44.96
Total HRA Debt	**295,912**	**3.55**	**36.06**
Total Council Borrowing	**996,568**	**2.37**	**26.60**
MMF / Cash	76,490	0.10	-
Local Authority Deposits	163,250	1.65	1.07
Bank Deposit	15,500	1.52	0.89
Loans	132,379	4.20	Various
Total Council Investments	**387,619**	**2.21**	**Various**

4.4 The debt is split between HRA and GF borrowing to match the two pool approach the Council has adopted for borrowing. The Council invests all cash in one investment pool, with interest distributed between the HRA, schools and GF. The elevated short-term cash position is due to £60m borrowed towards the end of December 2020, which will reduce as short-term borrowing is repaid.

5. Medium Term Capital Finance Budget

5.1 A key part of the Council's budget strategy is the medium-term capital finance budget shown in Table 2. It is a statutory requirement that the level of borrowing is kept under review and is affordable. Due to the Council's IAS, it is likely that the Council's cash position will significantly reduce over the next few years as a result of utilising the Council's reserves and using cash balances to fund property investments. Table 2 also includes the MRP budget, Investment and Acquisitions target and HRA interest costs.

5.2 The significant increase in GF Interest Payable is due to the borrowing required to fund the Council's IAS. The medium-term capital financing budget to 2023/24 is shown in table 2.

Table 2: Medium Term Capital and Treasury Budget

£'000s	2020-21 Budget £000	2021-22 Budget £000	2022-23 Budget £000	2023-24 Budget £000
General Fund				
MRP	7,398	8,352	8,502	8,652
Net Interest Budget	7,733	7,041	8,491	8,391
Investment Income	-5,725	-5,725	-5,725	-5,725
Net General Fund Cost	**9,406**	**9,668**	**11,268**	**11,318**
HRA Interest Payable	**10,059**	**10,059**	**10,059**	**10,059**

6. Treasury Position at 31 December 2020; Forward Projections 2023/24

6.1 The Council's treasury position at 31 December 2020, with forward projections, are summarised in table 3. The table shows the estimated external debt against the underlying CFR, highlighting any over or under borrowing. The CFR and the gross debt includes a significant increase in borrowing to fund the IAS. To ensure borrowing is only for a capital purpose Gross Debt should, except in the short term, be below the CFR over the period.

Table 3: Treasury Position at 31 December 2020, with Forward Projections

£'000s	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s
External Debt				
Debt at 1 April	981,688	1,140,465	1,616,825	2,090,630
Expected change in Debt	30,000	350,000	350,000	250,000
Finance Lease Liability	82,906	82,441	81,952	81,470
PFI Liability	45,871	43,919	41,853	39,617
Gross Debt at 31 March	**1,140,465**	**1,616,825**	**2,090,630**	**2,461,717**
CFR	**1,147,096**	**1,707,653**	**2,204,687**	**2,519,566**
Under/(over) borrowing	**6,631**	**90,828**	**114,058**	**57,850**

6.2 The £950m increase in expected debt from 2021-22 to 2023-24 largely relates to Be First portfolio schemes within the IAS that have been agreed or which are in the development pipeline within the Be First Business Plan. The schemes which have been approved so far are expected to deliver 4,396 new homes, delivering a positive financial return to the Council. Business cases for each scheme have been approved by Investment Panel and Cabinet.

6.3 Within the development pipeline there is potential to deliver a total of 9,000 homes by 2032 although this will require further funding to be approved which may include additional borrowing by the Council.

6.4 The Borrowing Strategy for the Council is set out in Appendix 2. This documents the treasury management considerations when undertaking borrowing and shows both the debt repayment profile and expected interest rates for the duration of the debt.

6.5 Further detail on the CFR, affordability, and limits to borrowing activity can be found in Appendix 3.

7. Economic Update by Link Asset Management

7.1.1 United Kingdom

The Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 5th November. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd 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".

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

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

7.1.3 Significantly, there was no mention of negative interest rates in the minutes, 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.

7.1.4 One key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. The Bank Rate forecast currently shows no increase through to Q1 2024 but there could 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.

7.1.5 However, the minutes did contain several references to downside risks. The MPC reiterated that the "recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside". It also said "the risk of a more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. 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.

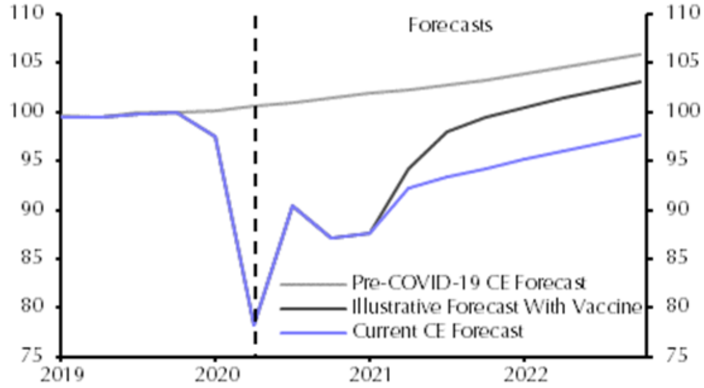
7.1.6 Upside risks include news that various COVID19 vaccines would be cleared as being safe and effective for administering to the public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which 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.

7.1.7 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 noted that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.

7.1.8 Public borrowing is 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 the total interest bill paid by the Government is manageable despite the increase in the total amount of debt. The OBR was also forecasting that the government will 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.

7.1.9 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)



7.1.10 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.

7.2 World growth

7.2.1 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 crisis.

7.2.2 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.

7.2.3 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 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.

7.3 Summary

7.3.1 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.

7.3.2 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.

7.3.3 **Inflation** has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

7.3.4 **Central bank monetary policy measures -** Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

8. Interest rate forecast

8.1 The interest rate forecasts provided by Link Asset Services in table 4 are predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31st December 2020.

8.2 Downside risks to current forecasts for UK gilt yields & PWLB rates include:

- **UK** - further national lockdowns or severe regional restrictions during 2021.
- **UK / EU trade negotiations** – may cause economic disruption and downturn in the rate of growth.
- **UK - Bank of England** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- 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.
- 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, because of the rise in popularity of the anti-immigration AfD party. 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 the major guiding hand and driver of EU unity will be when she steps down.

- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, could lead to increasing safe haven flows.

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

- **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.

9. Investment and borrowing rates

9.1 Borrowing: the interest rate forecast is provided in table 4 below:

Table 4: Interest Rate Forecast for the BOE Base Rate and PWLB

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

9.1.1 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.

9.1.2 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 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.

9.1.3 On 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The new margins over gilt yields are as follows:

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

9.2 Alternative Borrowing

During 2020 a number of alternative borrowing options were looked at, including:

- private placements;
- income strips; and
- bonds.

Bonds and private placements proved to be competitive against a PWLB rate when it included a 180-basis point (bps) margin, with bonds generally around 100 to 120 bps (including all costs) and private placements at around 120 to 130 bps. Income strips were competitive if duration was 35 years and the net initial yield rate of 2.70% but this was generally only in the first ten years and their competitiveness relied on the index linkage being at around the historical average. All alternative borrowing included a number of additional costs and resource requirements, with income strips also having additional risks as the borrowing is index linked.

Subsequently, with the reduction in PWLB rate to a margin over gilts of 80 bps, other funding options are much more expensive, with the exception of bonds. Bonds remain competitive but do require a significant amount of additional work and incur additional costs both around issuing the bond and managing the reporting requirements once the bind has been issued.

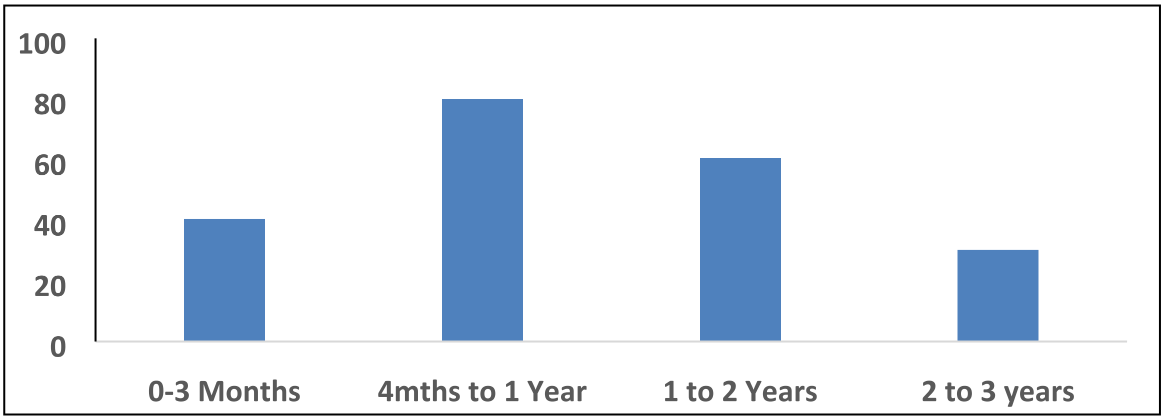
As the Council’s IAS is focused on regeneration of the borough and the provision of social housing, the PWLB is available to fund these projects. The reduction in

PWLB borrowing rates has made some schemes that were marginally viable, predominantly due to the high level of social housing being provided, now viable.

9.3 Treasury Investment Returns

Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following two years. Due to the very low reinvestment rates for the majority of 2020/21 and the relatively high costs of PWLB borrowing prior until its rate reduction, cash has been used to fund capital spend. At the start of the year the Council had elevated cash levels of £354.5m and this has reduced to £251.2m.

Overall, the Council's cash holding will likely reduce to approximately £90m over the next couple of years, with treasury investments being replaced with loans and long leases to Reside. The maturity profile of the Council's current treasury investments is provided below:



9.4 **Return Target 2021/22 to 2023/24**

9.4.1 To achieve the interest target, the following average returns need to be achieved:

2021/22	1.60 on an average cash balance of £150m (£2.4m)
2022/23	1.70 on an average cash balance of £120m £2.04m)
2023/24	1.50 on an average cash balance of £90m (£1.80m)

9.4.2 The return reflects the current investment positions (i.e. most of the return has already been secured) but if opportunities are available to secure competitive rates then further investments will be made.

9.5 **HRA Investments and abolition of HRA debt cap**

9.5.1 Cash balances held by the HRA will be invested as part of the Council's overall treasury strategy. Cash balances will generally earn the average short-term rate of the Council's investments, which will be calculated at the financial year end.

9.5.2 Where there is agreement by the S151 Officer, individual investments can be ring-fenced for the HRA, with the allocations made within the Council's overall treasury strategy requirements. For further details please refer to the HRA Business Plan.

10. The Capital Expenditure Plans 2021-22 – 2023-24

10.1 The Council's Housing (HRA) and General Fund (GF) capital expenditure plans, together with Balances and Reserves, are the key drivers of treasury management activity. The estimates for Capital expenditure, and its funding based on current proposed Revenue Budget and Capital Programmes, are reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans. The Prudential Indicators are included in Appendix 3.

10.2 Table 6 below shows the proposed Capital Financing Requirement over the coming four financial years. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and to consider the impact on Council Tax and, in the case of the HRA, housing rent levels.

Table 6: Proposed Capital Expenditure 2020-21 to 2023-24

Capital Expenditure	2020-21 Estimate £000s	2021-22 Estimate £000s	2022-23 Estimate £000s	2023-24 Estimate £000s
Capital Financing Requirement				
Opening CFR - General Fund	553,199	832,362	1,392,919	1,889,953
Net financing need for the year	289,765	572,428	509,202	325,742
MRP & Financing	-10,602	-11,871	-12,168	-10,863
Total General Fund CFR	**832,362**	**1,392,919**	**1,889,953**	**2,204,832**
CFR - Housing	314,734	314,734	314,734	314,734
Net financing need for the year	-	-	-	-
Total HRA CFR	**314,734**	**314,734**	**314,734**	**314,734**
Total CFR	**1,147,096**	**1,707,653**	**2,204,687**	**2,519,566**
Movement in CFR	**279,163**	**560,557**	**497,034**	**314,879**

10.3 A portion of the net financing need has already been borrowed as this relates to properties held by Reside, which was borrowed from the European Investment Bank. The increase financing need reflects the Investment and Acquisitions strategy borrowing requirement.

10.4 Sufficient headroom has been provided within the Authorised Limit on external borrowing to ensure that any major capital investment projects resulting from the IAS are not restricted by this statutory limit. The limit also covers any short-term borrowing for cash flow purposes as well as long term borrowing for capital projects, finance leases PFI initiatives as well as any unforeseen incidences where expected capital receipts are not forthcoming due to unexpected economic factors.

11. Treasury Management Advisors

11.1 The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

11.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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

12. Minimum Revenue Provision Policy Statement

12.1 In accordance with Statutory Instrument 2008 number 414 and new guidance issued by the Government under section 21 (1A) of the Local Government Act 2003 a statement on the Council's policy for its annual Minimum Revenue Provision (MRP) needs to be approved before the start of the financial year.

12.2 The Council are asked to approve the Minimum Revenue Provision Statement set out in Appendix 4.

13. Financial Implications

Implications completed by: Philip Gregory, Finance Director

13.1 The financial implications are discussed in detail in this report.

14. Legal Implications

Implications completed by: Dr. Paul Field, Senior Governance Solicitor

14.1 It is a statutory requirement under the Local Government Finance Act 1992 for the Council to set out what the Council has to base its budget calculations upon. Furthermore, it is a legal requirement for the Council to set a balanced budget with regard to the advice of its Chief Finance Officer. However, what is meant by 'balanced' is not defined in law and this has means that the Council must rely upon the professional judgement of its finance team to ensure that the local authority's budget is robust and sustainable.

14.2 The Local Government Act 2003 requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The Council must 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.

14.3 Part 1 of the Local Government Act 2003 (the "Act") requires ELWA as a joint local authority body to each year set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

15. Other Implications

15.1 **Risk Management:** This report has risk management issues for the Council, primarily that a counterparty could cease trading or risk that interest rates would rise adversely. The mitigation of these is contained in this report.

15.2 **Corporate Policy and Equality Impact -** The TMSS seeks to support the Council's investment aims to unlock regeneration and economic growth opportunities within the borough. There are no equality or diversity implications arising from this report.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- Appendix 1 – Annual Investment Strategy 2021/22
- Appendix 2 - Borrowing Strategy 2021/22 to 2023/24
- Appendix 3 – The Capital Prudential and Treasury Indicators 2021/22 – 2023/24
- Appendix 4 – Minimum Revenue Provision Policy Statement 2021/22
- Appendix 5 – Scheme of Delegation and Section 151 Officer Responsibilities