CONSULTATION REPORT 2021/22 TREASURY STRATEGY

Report of the Deputy Chief Executive (Section 151 Officer)

1. INTRODUCTION AND PURPOSE OF REPORT

1.1 This report seeks the views of the Corporate, Resource Management and Governance (CRMG) Scrutiny Committee on the development of the Council's Treasury Management Strategy Statement (TMSS), Annual Investment Strategy (AIS) and Minimum Revenue Provision (MRP) Policy for 2021/22, to be considered for approval at the Cabinet Meeting on 9 February 2021 and the Council Meeting on 25 February 2021.

2. BACKGROUND

2.1 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Management Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2.2 The Act requires the Council to set out its Treasury Management Strategy for borrowing and an Annual Investment Strategy which details the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments; these are submitted to Council for approval ahead of the financial year to which they relate.

2.3 An underlying requirement of the CIPFA Treasury Management in Public Services Code of Practice, among others, is the affirmation of effective management and control of risk as the prime objective of the Council's treasury management activities. The Code further advocates developing lending policies to counteract risk, i.e. use of market data in addition to credit ratings, greater consideration of diversification policy, having regard to country, sector and group limits. The Code places emphasis on regular reporting on treasury management strategy and performance and scrutiny of treasury management strategy and policy to a specific named body.

2.4 The Council has accordingly delegated the role of ensuring effective scrutiny of its Treasury Management Strategy to the CRMG Scrutiny Committee. In line with the Code, the Cabinet and CRMG have received annual training and updates since the 2009/10 financial year.

2.5 The TMSS and AIS is a comprehensive report that identifies specific expected treasury activities for the forthcoming financial year, which is constructed in full compliance with the CIPFA Code. The formulation of the Strategy is made in light of the anticipated movement in both fixed and short-term variable interest rates; the report therefore refers to detailed background information which informs the

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proposed policies, forward triggers and limits contained in each Strategy based on leading market forecasts.

2.6 The TMSS, AIS and MRP Policy is developed in conjunction with the Council's treasury management advisers and includes information on the Council's loan and investment portfolio position, forward borrowing requirement, interest rate forecasts and prudential indicators. The report cannot be finalised until February 2021 because it is partially dependent on Cabinet's budget proposals. In addition, the interest rate forecasts and economic outlook which also influence the strategy need to be as up to date as possible and therefore close to publication.

2.7 This consultation is based on the central borrowing and investment activities of the Council for the forthcoming financial year only and does not detail the Capital Plans or the Prudential and Treasury Management Indicators which are required by statute to be set under the CIPFA Code and will form part of the final strategy statement for 2021/22.

2.8 To assist the consultation process, Members may find it useful to refer to the current TMSS, AIS and MRP Policy for 2020/21 approved by the Council Meeting on 27 February 2020 which can be found at this link below:

Current TMSS, AIS and MRP Policy 2020/21

2.9 The Treasury Management Mid-Year Update Report for the current year elsewhere on this Agenda provides a further update against the original 2020/21 strategy.

2.10 Subject to the boundaries established by Statute, Regulation and the Code of Practice, this report seeks the views of CRMG on:

- The Council's approach to borrowing;
- The Council's approach to the investment of surplus funds and the management of risk; and
- The Council's MRP Policy and the Council's approach to providing for the repayment of debt.

2.11 Opinions expressed will be given due consideration prior to finalising the Strategy Statements to be considered by the Cabinet Meeting on 9 February 2021. Economic forecasts will be materially updated once we have further information regarding the impact of the second lockdown due to the Covid-19 pandemic on the economy and a deal or no deal Brexit agreement in the coming weeks.

3. LEGISLATIVE FRAMEWORK

3.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. The Act also requires the Council to set out specific strategies in relation to key aspects of its treasury management operations before the start of each financial year, specifically for borrowing and investments along with its policy for setting aside MRP to cover debt repayments associated with borrowing to fund capital investment.

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

3.3 In line with these various requirements this strategy includes:
- The Annual Borrowing Strategy, including the Council's Policy on Borrowing in Advance of Need (TMSS);
- The Annual Investment Strategy (AIS); and
- The Annual MRP statement.

3.4 In conjunction with the Treasury Management Policy Statement and the detailed Treasury Management Practices, these provide the policy framework for the engagement of the Council with the financial markets in order to fund its capital investment programme and maintain the security of its cash balances.

4. CIPFA TREASURY MANAGEMENT CODES AND GUIDANCE

4.1 The CIPFA 2017 Prudential and Treasury Management Codes introduced a requirement for local authorities to prepare a capital strategy report which provides:

- 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.

4.2 The aim of the capital strategy is to ensure that all elected members of the Council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. The first Capital Strategy report went to Cabinet in February 2019 and subsequently on 4 February 2020.

4.3 The Council will provide and update on its Capital Strategy separately from the Treasury Management Strategy and Annual Investment Strategy. The Capital Strategy will build on this year’s strategy and be a high level corporate document dealing with the key areas of strategic context, corporate priorities, capital investment ambition, available resources, affordability, capacity to deliver, risk appetite, risk management and determination of an appropriate split between non-financial and treasury management investments in the context of ensuring the long term financial sustainability of the Council.

4.4 The Capital Strategy will also focus on ‘commercial’ (non-treasury) investments, in appropriate detail so that Members can properly assess the particular risks in this area. Commercial non-financial investments for the purposes of the Code are identified as those focused on income generation, whereas the Council would argue none of its commercial type investments have been entered into solely for the purposes of income generation, but rather for the Council’s ambition to redevelop and improve the town centre. The Capital Strategy will be reported to Cabinet on 9 February 2021 alongside the budget reports for 2021/22.

4.5 Investment in commercial non-financial investments, especially in property, do not form part of treasury management activities carried out by the treasury management team of the Council. Accordingly, the TMSS and AIS for 2021/22 will not deal with expenditure on, or investing in, non-financial investments, but solely on treasury management investments. This will give Members the focus to provide for greater critical examination and understanding of the Council's treasury management strategies and policies for 2021/22.

4.6 ROLE OF SECTION 151 OFFICER – DEPUTY CHIEF EXECUTIVE

4.6.1 The specific roles of this officer (the Deputy Chief Executive (Section 151 Officer)) were extended in 2019/20 to include a series of new roles in respect of the Capital Strategy and also a specific role in respect of investment in non-financial assets. CIPFA has extended the definition of treasury management and investments to include non-financial assets, which, at the same time, it terms as being non-treasury investments.

5. TREASURY MANAGEMENT REPORTING 2021/22

5.1 The Council is currently required to receive and approve, as a minimum, three main reports each year;

- **The Treasury Management Strategy Statement (TMSS), Annual Investment Strategy (AIS) and MRP Statement**. A forward looking report which sets the scene for the forthcoming financial year;

- **The Mid-Year Review Report** on the current strategy which updates Members on the treasury and capital position;

- **The Annual report**. A retrospective review at the end of the financial year.

6. OBJECTIVES OF THE TREASURY MANAGEMENT STRATEGY

6.1 The Council's Treasury Management Strategy is designed to achieve the following objectives:

- To ensure the security of the principal sums invested which represent the Council's various reserves and balances;
- To ensure that the Council has access to cash resources as and when required;
- To minimise the cost of the borrowing required to finance the Council's Capital Investment programme; and
- To maximise investment returns commensurate with the Council's policy of minimising risks to the security of capital and its liquidity position.

7. SETTING THE TREASURY MANAGEMENT STRATEGY FOR 2021/22

7.1 In setting the treasury management strategy, the Council must have regard to the following factors which will have a strong influence over the strategy adopted:

- Economic forecasts;
- The level of the approved Capital Programme which generates the borrowing requirement;

- The current structure of the Council's investment and debt portfolio; and
- Prospects for interest rates and market liquidity.

8. UK ECONOMIC CONTEXT AND INTEREST RATES

8.1 To assist consideration of the Council's Borrowing Strategy, a detailed commentary outlining current expectations for the economy is included in the following paragraphs. The final strategy report will reflect the latest information available in January 2021.

8.1.1 Covid-19 and the actions to contain it have continued to have a dramatic and rapidly changing impact on the UK and countries around the world. Global activity fell sharply during the first half of 2020, reflecting the impact of the pandemic and the social distancing needed to contain its spread. As Covid-19 cases fell, global activity recovered materially in Q3 from low levels. Recently, however, cases have risen again in many countries.

8.1.2 The outlook for the UK economy remains unusually uncertain. It will depend on the evolution of the pandemic and measures taken to protect public health around the world, as well as the nature of, and transition to, the new trading arrangements between the European Union and the United Kingdom. It will also depend on the responses of households, businesses and financial markets to these developments.

8.1.3 The Bank of England's projections assume that developments related to Covid-19 will weigh on spending in the near term, although to a lesser extent than earlier in the year. UK activity in the first half of 2021 is also judged likely to be affected by lower trade as firms adjust to the UK and EU's new trading relationship. Over the forecast period, GDP is projected to recover as the direct impact of Covid-19 on the economy is assumed to wane. Activity is also supported by substantial fiscal and monetary policy actions. The recovery takes time, however, and the risks around the projection are judged to be skewed to the downside.

8.1.4 The fall in activity over 2020 has reflected a decline in both demand and supply. Overall, there is judged to be a material amount of spare capacity in the economy. Spare capacity is eroded as activity picks up and a small degree of excess demand is projected to emerge over the second half of the forecast period. The LFS unemployment rate rose to 4.5% in the three months to August, but it is likely that labour market slack has increased by more than implied by this measure. The extension of the Furlough Scheme will mitigate significantly the impact of weaker economic activity on the labour market. The unemployment rate is expected to peak at around 7.5% in Q2 2021/22. Beyond that point, spare capacity is expected to be eroded as activity picks up.

8.1.5 CPI inflation is below the MPC's 2% target, largely reflecting the direct and indirect effects of Covid-19 on the economy. These include the temporary impact of lower energy prices and the cut in VAT, as well as some downward pressure from spare capacity. As these effects wane, inflation rises. In the central projection, inflation is projected to be 2% in two years' time.

8.1.6 Recent Developments: Global and UK GDP picked up materially in Q3, although activity remains below levels in 2019 Q4. After falling sharply during the first half of 2020, global GDP rose materially in Q3, as the impact of Covid-19 on activity lessened. Some social distancing measures were relaxed, and consumers continued to adjust spending habits, for example spending more than previously on available goods and services, and by doing more shopping online. Activity remains below pre-Covid levels in most countries, however the Bank of England estimates that, in Q3, UK-weighted world GDP was around 4% lower than in 2019 Q4, somewhat stronger than had been expected in August; and that UK GDP was around 9% lower, broadly in line with the August projection.

8.1.7 During the Covid-19 pandemic, sharply reduced economic activity and substantial tax cuts and spending increases to support public services, businesses and households through the lockdown, mean that government borrowing will be increased enormously in 2020/21. Continued weakness in the economy will mean it is elevated for some years to come. This is the correct response: a sizeable one-off adverse shock to public finances should be associated with a large increase in government debt that is allowed to persist for many years. But as a result, the Debt Management Office (DMO) will need to sell many more gilts over coming years. This will make it even more important that the sale of these gilts is designed appropriately with respect to the costs and risks to the public purse, and the needs of the wider economy.

8.2 2021/22 PROSPECTS FOR INTEREST RATES

8.2.1 In planning the treasury management strategy, the Council will consider the prevailing and forecast interest rate situation. Regular forecasts of interest rates are provided by Link Asset Services, treasury management advisors to the Council, who assist the Council in formulating a view on interest rates. The following table provides the current central view for short term (Bank Rate), short-term investment rates and longer fixed interest rates.

		Bank Rate	Average Earnings Rates *			PWLB Borrowing Rates			
			3-Month	6-Month	1-Year	5-Year	10-Year	25-Year	50-Year
March	2021	0.10%	0.10%	0.10%	0.20%	0.80%	1.10%	1.50%	1.30%
June	2021	0.10%	0.10%	0.10%	0.20%	0.80%	1.10%	1.60%	1.40%
September	2021	0.10%	0.10%	0.10%	0.20%	0.80%	1.10%	1.60%	1.40%
December	2021	0.10%	0.10%	0.10%	0.20%	0.80%	1.10%	1.60%	1.40%
March	2022	0.10%	0.10%	0.10%	0.20%	0.90%	1.20%	1.60%	1.40%
June	2022	0.10%	0.10%	0.10%	0.20%	0.90%	1.20%	1.70%	1.50%
September	2022	0.10%	0.10%	0.10%	0.20%	0.90%	1.20%	1.70%	1.50%
December	2022	0.10%	0.10%	0.10%	0.20%	0.90%	1.20%	1.70%	1.50%
March	2023	0.10%	0.10%	0.10%	0.20%	0.90%	1.20%	1.70%	1.50%
June	2023	0.10%	0.10%	0.10%	0.20%	1.00%	1.30%	1.80%	1.60%
September	2023	0.10%	0.10%	0.10%	0.20%	1.00%	1.30%	1.80%	1.60%
December	2023	0.10%	0.10%	0.10%	0.20%	1.00%	1.30%	1.80%	1.60%
March	2024	0.10%	0.10%	0.10%	0.20%	1.00%	1.30%	1.80%	1.60%

* Please note LIBID London Interbank Bid Rates (indicative investment rates), have been replaced by indicative average earnings rates for the purpose of this report, as LIBOR[1]/LIBID is being discontinued after end 2021. These represent

[1] LIBOR one of the main interest rate benchmarks used in global financial markets, is a measure of the average rate at which banks are willing to borrow wholesale, unsecured funds. It underpins financial contracts worth trillions of pounds, including derivatives, bonds and loans. But the way banks fund themselves has changed, leaving very few transactions in the underlying market LIBOR measures. This means LIBOR is not a reliable benchmark for interest rates and is expected to be discontinued after end-2021.
Users of LIBOR need to prepare by transitioning to alternative, more robust benchmarks, such as overnight risk-free rates. In sterling markets, the primary alternative is SONIA, which is published by the Bank of England and based on an average of over £40 billion of transactions each day. This supports a well-

expected earnings by local authorities for 3 to 12 months.

** The rates shown reflect the introduction of the PWLB certainty rate discount on PWLB loans of 20 basis points[2] (from 1 November 2012).

8.2.2 The link in paragraph 2.8 to the current year borrowing strategy and the interest rate forecasts for short and longer-term borrowing therein reflect the original forecasts (from February 2020). These forecasts have changed dramatically in year as a result of the Coronavirus pandemic and are reflected in the mid-year treasury update for 2020/21.

8.2.3 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 9 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.

8.2.4 The Link 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.

8.2.5 GDP projections could be skewed to the downside. The risk of a more persistent period of elevated unemployment remains material. Downside risks could well include severe restrictions remaining in place for a prolonged period.

8.2.6 Upside risks to the above forecasts will relate mainly to news that various Covid-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9 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, 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.

8.2.7 What these vaccine results could mean is that life could largely return to normal during 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

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established and growing derivatives market, and has rapidly become the benchmark of choice for floating rate bonds over the last year.
LIBID is the London InterBank Bid rate. It is the rate a bank is prepared to pay on deposits from other AA-rated banks. LIBOR is greater than LIBID.
[2] Basis point (BP) refers to a common unit of measure for interest. One basis point is equal to 1/100th of 1%, or 0.01%, and is used to denote the percentage change in a financial instrument.

exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A large-scale roll-out of vaccines might take into late 2021 to fully complete; but if the vaccine really is that effective, then there is a possibility that restrictions could begin to be eased 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.

8.2.8 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 peak (forecast in HM Treasury's Spending Review 2020 to be 7.5% equating to approx. 2.6m people in Q2 2021/22) would be lower next year than is currently forecast. 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. Until there is clarity on these issues around the Pfizer vaccine, it would be premature to change the overall economic commentary and forecasting in this report. 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.

8.2.9 **Investment and borrowing rates 2021/22**

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

- **PWLB rates** fell to historically very low rates as a result of the Covid-19 crisis and the quantitative easing operations of the Bank of England; indeed, gilt yields up to 6 years were on negative yields during most of the first half of 2020/21. As illustrated in the table above, current forecasts show little movement in expected PWLB levels throughout the forecast period, although many factors could have a significant influence on them in 2021.

8.2.10 The above forecasts, (and MPC decisions), will be liable to further amendment. Central banks are 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.

8.2.11 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.

8.2.12 The interest rate forecasts provided by Link Asset Services in paragraph 8.2.1 are predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31 December 2020. 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.

8.2.13 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 2019. That is 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% 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.

8.2.14 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 2021. 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.

8.2.15 Relative to the slump in GDP endured during the Covid-19 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.

8.2.16 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-19 crisis.

8.2.17 In summary; there is not likely to be any change in Bank Rate in 2020/21 or 2021/22 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.

8.2.18 The balance of risks to the UK include:

- The overall balance of risks to economic growth in the UK is probably even 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[3],

[3] A safe haven is an investment that is expected to retain or increase in value during times of market turbulence

due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

9. BORROWING STRATEGY 2021/22

9.1 The Council has been maintaining an under-borrowed position for some time. 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.

9.2 With short-term interest rates having been lower than long-term rates for some time, it has been cost effective for the Council to either use internal resources, or to borrow short-term rather than take long-term borrowing to fully fund its Capital Financing Requirement (CFR). By doing so, the Council has been able to reduce net borrowing costs (and investment income forgone has been negligible due to enduring low short-term rates) and reduce overall treasury risk. This is called maintaining an 'internally borrowed position' and using the Council's cash reserves and balances to fund borrowing as a temporary measure. This strategy has been prudent as investment returns have been low and counterparty risk relatively high.

9.3 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

9.4 The Council has an extensive capital programme for 2021/22 to 2023/24. There is a total of £323.716m of planned expenditure on capital schemes over the three years from 2021/22 to 2023/24 and a significant proportion of this, £167.632m, is to be financed by prudential borrowing. There are some major schemes within the three year programme, including the highways schemes for the Highways Investment Programme (£22.623m) and Mayoral Walking and Cycling Challenge Fund (£19.059m). Other significant schemes in the three year programme include: HRA General Capital and New Build Schemes (£119.181m), loans to Stockport Homes for Affordable Homes (£10.852m) and the School Conditions Schemes and Special School Scheme (£36.590m). In addition, the Mayoral Development Corporation has approval for a recyclable equity and loan facility with an upper limit of £100m to support its objectives. This is not currently included in the capital programme and will be added when investment is required.

9.5 These are the latest spending profiles for schemes but it must be stressed that these are complex projects which are reviewed regularly to ensure that the programme reflects a realistic spending profile as they develop. Based on current forecasts there is clearly a significant amount of funding required to finance the Capital Programme in the next three years and the Council is unlikely to be able to do this without taking some longer-term borrowing.

9.6 It is however very unlikely that the Council will look to externalise its entire borrowing requirement during 2021/22 but will aim to maintain a balance between internal and external borrowing. The Bank Rate is currently forecast to remain at 0.10% for the entire forecast period; that being the case, the Council could opt for a continuation of its current policies and benefit from taking short-term borrowing from other authorities as a cheaper alternative to long-term borrowing rates. This will be somewhat dependent on continued liquidity in the short-term markets but looks to be the most beneficial approach given that long-term PWLB rates are not forecast to rise. If PWLB rates were expected to rise, the Council would benefit from taking long-term funding prior to that happening.

9.7 **Current Considerations:**

9.7.1 As already discussed, the policy of avoiding new borrowing by running down spare cash balances has served the Council well over the last few years. However, the unexpected increase of 100 bps in PWLB rates in October 2019, on top of the then current margin over gilt yields of 80 bps, gave reason for a rethink of the Council's treasury management strategy and risk management (the Council's reliance on PWLB lending) for the current financial year.

9.7.2 Following the outcome of the Government's consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure, which was announced on 25 November 2020, the Government reduced the following rates for borrowing for different types of capital expenditure:

- 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)

9.7.3 Please note that the Council has concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects.

9.7.4 As the PWLB Certainty Rate is now 80 basis points over the equivalent gilt, 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, or for flattening the profile of the maturity profile.

9.7.5 Now that the PWLB has reduced is lending levels by 1% the Council will again views these as the premise of its long-term borrowing strategy and as such will reference long-term 'trigger' borrowing rates from PWLB Certainty Rates.

9.7.6 Borrowing for alternative market lenders will also be considered where this can be demonstrated to be cheaper than equivalent PWLB lending rates for the same loan period.

9.7.7 While the Council 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 short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

9.8 The benefits of internal borrowing are being monitored regularly against the potential for incurring additional costs by postponing borrowing into future periods when long-term borrowing rates are forecast to rise (however gradually this is).

9.9 **Target PWLB Borrowing Rates for 2021/22**

9.9.1 Target PWLB Certainty rates for new borrowing in 2021/22 for 5 years out to 50 years are given in the table below. PWLB rates are given as the lowest forecast rates for the period under review, i.e. out to March 2022, currently based on the Link Asset Services latest forecasts.

PWLB Period	PWLB Certainty Rate
5 Year	0.80%
10 Year	1.10%
25 Year	1.50%
50 Year	1.30%

9.9.2 As we have a positive yield curve underpinning the interest rate forecasts at present, those target rates will roll forward in line with the interest rate forecast and will be subject to Link Asset Services 'Longer Interest Rate Strategy Group' meetings held once a quarter in line with the Bank of England Quarterly Inflation Reports (Feb, May, August, November), where forecasts will be reviewed.

9.9.3 This report has accentuated a number of upside and downside risks to interest rate predictions for 2021 (see paragraph 8.2), however being mindful that the Bank of England has commented that they anticipate the long-term neutral rate for Bank Rate to be circa 2.5%, the Council will avoid borrowing at an average rate over 2.5% unless additional funding certainty is required or there are liquidity shortages in the market that make this necessary.

9.10 All decisions on whether to undertake new or replacement borrowing to support previous or future capital investment plans will be subject to evaluation against the following criteria:

- **Overall need:** whether a borrowing requirement to fund the capital programme or previous capital investment exists;
- **Timing:** when such a borrowing requirement might exist given the overall strategy for financing capital investment and previous capital spending performance;
- **Market conditions:** to ensure borrowing that does need to be undertaken is achieved at minimum cost, including a comparison between internal and externally financed borrowing; and
- **Scale:** to ensure borrowing is undertaken on a scale commensurate with the agreed financing route.

All long term decisions will be documented reflecting the assessment of these criteria

9.11 Other sources of long term funding that may provide a cheaper alternative than PWLB loans will be considered as follows:

- Local authorities (primarily shorter dated maturities);
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates); and
- Municipal Bonds Agency.

9.12 Given the recent reductions in PWLB rates, the degree to which any of these options may prove cheaper than PWLB Certainty Rates is still evolving at the time of writing.

9.13 **Municipal Bond Agency**

9.13.1 The Municipal Bond Agency is now operational and allows local authorities to diversify funding sources and aims to offer borrowing at a lower cost than is available from Central Government via the Public Works Loan Board of the UK Debt Management Office, which is part of HM Treasury. The agency sells municipal bonds on the capital markets, raising funds that it will then lend to councils. The Council will consider making use of this new source of borrowing if it proves to be a cheaper source of long-term funding and the size of bond commanded does not prove to be an obstacle.

9.14 **Borrowing Ahead of Need**

9.14.1 The Council will not borrow more than or in advance of need with the objective of profiting from the investment of the additional sums borrowed. However, borrowing in advance of need can be justified in the following circumstances:

- Where there is a defined need to finance future capital investment that will materialise in a defined timescale of three years or less; and
- Where the most advantageous method of raising capital finance requires the Council to raise funds in a quantity greater than would be required in any one year; or
- Where in the view of the Deputy Chief Executive (Section 151 Officer), based on external advice, the achievement of value for money would be prejudiced by delaying borrowing to the year in which it falls.

9.14.2 Having satisfied these criteria any proposal to borrow in advance of need would also need to be reviewed against the following factors:

- Whether the on-going revenue liabilities created, and the implications for the future plans and budgets have been considered and reflected in those plans and budgets, and the value for money of the proposal has been fully evaluated;
- The merits and demerits of alternative forms of funding; and
- The alternative interest rate bases available, the most appropriate periods over which to fund and repayment profiles to use.

9.15 **Basis of Borrowing Strategy**

9.15.1 Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Deputy Chief Executive (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; and
- If 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.

9.16 **BORROWING STRATEGY: QUESTIONS FOR CONSIDERATION**

Making reference to the forecasts for borrowing rates, expectations for the economy going forward and the current year's borrowing strategy:

1. Does the borrowing strategy outlined in Section 9 above seem reasonable?

2. In the current economic climate do Members feel the policy of maintaining an internally borrowed position is correct?

3. Do Members agree with the view of short, medium and long-term interest rates which effectively will be the benchmark levels for borrowing?

4. Do Members have alternative views on the use of long-term and short-term borrowing and borrowing in advance of need (three year time frame under Prudential Code)?

5. Do Members have alternative views on the duration or type of future borrowing?

10. ANNUAL INVESTMENT STRATEGY (AIS)

10.1 Investment instruments identified for use in the financial year under the 'Specified' and 'Non-Specified' Investments categories, counterparty limits, creditworthiness policy etc. can be found in the current year's AIS in the link at paragraph 2.8.

10.2 **Investment Policy (management of risk)**

10.2.1 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'); and
- CIPFA Treasury Management Guidance Notes 2018.

10.2.2 In accordance with the Code, the Council's investment priorities are:

- The security of capital. The Council 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;
- 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; and

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

10.2.3 Treasury management investments represent the placement of cash in relation to the s12 Local Government Act 2003 Act investment powers, so the residual cash held in the bank resulting from the Council's day to day activities. These are invested under the SLY (Security, Liquidity and Yield) principles.

10.3 Link Asset Services suggested counterparty list is at the heart of the Council's creditworthiness policy and has always been conservatively constructed to protect the Council against credit risk whilst allowing for efficient and prudent investment activity. In accordance with the above guidance and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which enables diversification and thus avoidance of concentration risk.

10.4 **2021/22 INVESTMENT STRATEGY**

10.4.1 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 Bank Rate is likely to rise significantly within the time horizon being considered (unlikely), 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.

10.4.2 For its cash flow generated balances, the Council will utilise Money Market Funds (MMF) if rates continue to be positive to a degree that makes investing worthwhile, instant access and notice accounts and some short-dated deposits (up to twelve months).

10.4.3 **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 0.10% 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:

Year	Investment Return
2021/22	0.10%
2022/23	0.10%
2023/24	0.25%
2024/25	0.75%
Later years	2.00%

10.4.4 In the event that the Council is in a position to make investments for generally longer than 100 days or in notice accounts at enhanced levels, the budgeted return on investment earnings for 2021/22 and subsequent years will be amended to reflect this in line with average earnings forecasts (or replacement rate for LIBID) appropriate to the period (up to twelve months); indications of 3, 6 and 12 month average earnings rates are provided in paragraph 8.2.1.

- 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.

10.4.5 While the Bank of England has indicated 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. So far, however, the Council has been able to maintain balances in notice and deposit accounts still yielding a reasonable return in line with investment rate expectations. It is assumed the Council will be able to continue to do this into 2021/22, however the short-term markets are currently incredibly challenging and finding appropriate counterparties offering a reasonable return is not easy. Inter-local authority lending and borrowing is also presently more problematic due to the surge in the levels of cash seeking a short-term home as Council's have received significant Central Government grants in response to the pandemic.

10.4.6 Depending on the size of the investment portfolio, at times it is entirely appropriate to hold all investments as instant access, i.e. in liquid deposit accounts or MMFs. This is when investment balances are not particularly high relative to cashflow needs and are predominantly being used to supplement cashflow shortages. The Council has however seen its level of investment rise during 2020/21 whether this is a conscious decision to maintain a higher level of liquid resources to counteract liquidity issues should they arise; the result of temporary boosts to cash balances due to the receipt of Government grants for Covid-19 before they are passported through to the local community, or as a result of delays on spending on the Capital Programme. Where capacity allows, it may have significant benefit to the Council to invest longer term and in a wider variety of investment instruments. Simply by creating layers of the Councils investment portfolio in an optimal way based on spending needs.

10.4.7 UK money market rates have been on a downward trajectory since March when the coronavirus pandemic hit. Between market turmoil and falling bank rates worldwide, Money Market Funds (MMFs) have been grappling with how to best proceed in this prolonged low yield environment. Looking at data taken at the end of October, the 7-day yields offered by MMFs have fallen to below 0.10% which brings the return on these funds very close to zero or even negative in some cases. The response by fund managers has generally been to waive management fees to maintain a positive (or at least 0%) net return for those invested in the fund. However we have seen some funds close. It seems likely at this point that some funds may become unsustainable and will no longer be an investment option for the Council in 2020/21

10.4.8 There is a natural minimum balance that the Council requires to hold in shorter-term investments to supplement cashflow, however the Council may consider the use of Cash-Plus Funds which could be used to pick up additional returns versus usual Money Market Funds in 2021/22, whilst still providing a degree of liquidity should the Council's cash flow forecast not come to fruition as expected. Cash Plus Funds are similar to Money Market Funds however they are designed for investment over a longer duration (3+ months) at an enhanced return so are not as liquid. They are also Variable Net Asset Value funds (VNAV) rather than Constant Net Asset Value funds. The Council would need to fully understand the implications of this and any fund under consideration prior to making an investment.

10.4.9 What is clear for 2021/22 is that the Council needs to gauge what is the appropriate level of investments to hold, over what is required for cashflow needs. Money market rates are now so low that holding a higher level of investments than is actually required could be costly, but at the same time managing liquidity risk will also be fundamental.

10.5 UK Sovereign Rating

The UK sovereign rating could come under pressure from the impact of Covid-19 and/or a 'no deal' trade agreement on 31 December 2020. In October 2020, Moody's downgraded the rating to Aa3 (AA- equivalent), the same as Fitch, while Standard & Poor's has it rated at AA

The Council will amend the Counterparty criteria in the AIS 2021/22 for Country Limits to provide additional flexibility in this event if it were to result in the UK being downgraded below AA-.

10.6 Potential impact of Covid-19 and/or a 'no deal' Brexit on the credit ratings of financial institutions

10.6.1 In addition to the potential impact of Covid-19 on the UK economy there is, at the time of writing, continuing uncertainty over a potential Brexit deal. If the UK leaves the EU without a deal, then this could place further downside pressure on the sovereign rating, which may have a knock-on impact on UK financial institution ratings. The Council is mindful of this potential. The Link most recent 'stress test' on entities included within the 'Link suggested counterparty list' was to lower all long term ratings from all rating agencies by one notch. Under such a scenario, only Commerzbank, Norddeutsche Landesbank, NatWest Markets Plc (non-ring-fenced entity), Leeds, Skipton and Yorkshire Building Societies move from Green (three month investment) to No Colour (not suitable). While there are a further 17 drops in other entities' suggested durations, in these instances, these entities remained potentially available for use. Note that this scenario excludes any additional impact from relative movement in CDS pricing.

10.7 **Challenger Banks:** So far challenger banks[4] are not included in the Council's counterparty lists. This is because at present they do not have credit ratings and so would fall outside the Council's investment strategy criteria. However, we expect that some of these entities may get ratings in coming years and will therefore continue to keep this area under review.

10.8 **The Search for Higher Returns**

10.8.1 We remain in a very difficult investment environment. Whilst counterparty risk appears to have eased, market sentiment has still been subject to bouts of, sometimes, extreme volatility and economic forecasts abound with uncertainty. However, we also have a very accommodating monetary policy, reflected in a 0.10% Bank Rate. As a consequence, the Council is getting very little return from deposits. Against this backdrop it is, nevertheless, easy to forget recent history, ignore market warnings and search for that extra return to ease revenue budget pressures.

10.8.2 In this respect, we are seeing an increase in investment 'opportunities' being offered in the market or being discussed in the wider press within the area of sterling deposits developed by financial institutions. Most of these appear to afford similar security of capital to basic sterling deposits but they also offer the possibility, although never of course the certainty, of increased returns. The Deputy Chief Executive (Section 151 Officer), will, in liaison with the Council's external advisers, consider the benefits and drawbacks of these instruments and whether any of them are appropriate for the Council. Due to their relative complexity compared to straightforward term deposits and length, most of them would fall within the definition of non-specified investments. Decisions on whether to utilise such instruments will be taken after an assessment of whether their use achieves the Council's objectives in terms of reduction in overall risk exposure as part of a balanced portfolio

10.8.3 The Council will not solely look at return but more importantly the product, particularly when considering pooled investment vehicles. This will apply to any investment opportunity. It is not enough to rely on the fact that other councils may be investing in such schemes already. The Council is tasked through market rules to understand the product and appreciate the risks before investing.

10.8.4 There are varying degrees of risks associated with different investments or asset classes and these need comprehensive appreciation. It is not just credit risk that needs to be understood, but liquidity and interest rate/market risk as well, although these can often be intertwined. Any option in which an investor hopes to generate an elevated rate of return will almost always introduce a greater level of risk. By carefully considering and understanding the nature of these risks, an informed decision can be taken.

10.8.5 The particular asset classes the Council may consider include Ultra Short Dated Bond Funds, Corporate Bonds, Property Funds, Equity Funds and Multi Asset Funds. However given the longer-term nature of some of these funds, it is highly unlikely the Council will have the capacity to commit funds for investment over the number of years these type of investments require, i.e. property funds.

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[4] A relatively small retail bank set up with the intention of competing for business with large, long-established national banks, specifically designed to compete with the Big Four (HSBC, Lloyds, Barclays and RBS). These newer banks have an online presence rather than a physical one

10.9 The Council may consider extending their list of approved counterparties to include housing associations which have credit ratings that meet their minimum credit rating requirements.

10.10 **Ethical Investments**

10.10.1 The Council may consider Ethical Investments as part of its investment portfolio going forward. However, investment guidance, both statutory and from CIPFA, makes clear that all investing must adopt SLY principles; Security, Liquidity and Yield. As such, ethical issues, i.e. the green agenda, must play a subordinate role to those priorities. The Council will set out more fully its approach to such investments in the Treasury Management Strategy Statement for 2021/22 for Environmental, Social and Governance (ESG) issues. Nevertheless, there are already touchpoints with local authority investing, including the incorporation of ESG metrics into credit rating agency assessments and a small, but growing number of financial institutions and fund managers promoting ESG products.

10.10.2 Link Asset Services are looking at ways in which to incorporate these factors into their creditworthiness assessment service, but with a lack of consistency, as well as coverage, this is not straightforward. At the present time this is still under consideration. Members will be updated on the progress of this and the feasibility of including these investments as part of the Council's investment portfolio later in the 2021/22 financial year.

10.11 **INVESTMENT STRATGY: QUESTIONS FOR CONSIDERATION**

Making reference to the current year's Investment Strategy and supporting schedules, current expectations for the economy and likely investment rates available in 2021/22 given above:

1. Is the Council's current lending criteria too strict, too lax or about right? Does it have due regard to risk, but also practical operational considerations and access to counterparties of appropriate financial standing?

2. Do you consider that the Council is adequately controlling credit risk? Is the Council's risk appetite reasonable?

3. Do you think that the approach to the selection of approved counterparties is suitable to both manage risk and optimise returns, but with priority on the former? Is the pool of available investment instruments appropriate?

4. Do you think that the Council should or should not use non-specified investments, e.g. investments in excess of one year?

5. Have limits, i.e. individual and Group, Country and Sovereign been given due consideration?

6. Does the overall Investment Strategy appear sound?

11. MINIMUM REVENUE PROVISION (MRP) POLICY

11.1 The Council is required to settle an element of its non-HRA Capital Financing Requirement (CFR) each year by way of a revenue charge (the Minimum Revenue Provision, 'MRP'). Local Authorities may also provide additional 'Voluntary Revenue Provision' if they wish to do so.

11.2 CLG guidance recommends the preparation of an annual statement of policy on making MRP for submission to the Council Meeting for approval. The terms of the original statement may be revised during the year subject to the revised statement being approved by the Council Meeting at that time. The guidance presents four 'ready-made' options for calculating MRP but other options are not ruled out provided they are consistent with the statutory duty to make prudent provision.

11.3 The Council's MRP Policy was updated in the 2015/16 financial year so that provision for General Fund Borrowing previously supported through the RSG system would be in equal instalments over a 50 year period starting 1 April 2015, as opposed to the 4% on the outstanding balance previously provided.

11.4 The current MRP Policy for 2020/21 explains how the Council currently sets aside revenue budget provision for the repayment of debt which has been used to fund capital expenditure.

11.5 MRP POLICY: QUESTIONS FOR CONSIDERATION

Making reference to the current year's MRP Policy in paragraph 2.8 above:

1. Does the Committee believe that the Council's current MRP policy is sufficiently prudent?

12. CONCLUSIONS AND RECOMMENDATIONS

12.1 To assist the consultation process and the underlying requirements of the CIPFA Treasury Management in Public Services Code of Practice, which places emphasis on effective scrutiny of the Council's treasury management strategy and policy to a specific named body; this report provides a comprehensive picture of the economic and political factors that are likely to influence short and longer term interest rates and therefore the Council's strategies for borrowing and investing during the 2021/22 financial year.

12.2 It is recommended that CRMG give due consideration to the above questions so that their views can be taken into account in the development of the Council's 2021/22 Treasury Management Strategy Statement.

BACKGROUND PAPERS

There are none

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian on telephone number Tel: 0161 474 4026 or alternatively email lorna.soufian@stockport.gov.uk