Revised Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Pendle Borough Council
2020/21
(November 2020)

INDEX

1.INTRODUCTION

1.1 Background

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

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

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

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

CIPFA defines treasury management as:

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

1.2 Reporting requirements

1.2.1 Capital Strategy

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

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

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

The Capital Strategy is reported separately from this Treasury Management Strategy Statement; Non-treasury investments will be reported through the former. This ensures the separation of the core treasury funder under security, liquidity and yield (SLY) principles, and the policy and commercialism investments usually driven by expenditure on an asset.

The Council's Capital Strategy was revised and approved in September 2019 and is still considered fit for purpose.

This authority has not engaged in any commercial investments to date and has non-treasury investments.

1.2.2 Treasury Management reporting

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

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
   - the capital plans, (including prudential indicators);
   - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
   - the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
   - an investment strategy, (the parameters on how investments are to be managed).

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, quarterly update reports are submitted for consideration to the Accounts and Audit Committee.

c. **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
As indicated above, the scrutiny role is fulfilled by the Accounts and Audit Committee to whom quarterly reports on treasury management activity are submitted.

1.3 Treasury Management Strategy for 2020/21

The strategy for 2020/21 covers two main areas:

Capital issues

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

Treasury management issues

- the current treasury position;

- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

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.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny (in the Council's case, this is the Accounts and Audit Committee). The training needs of Councillors is continually assessed during the year and training will be arranged as required.

The training needs of treasury management officers are periodically reviewed as part of the Council's annual Performance Management Review (appraisal) process.

1.5 Treasury management consultants

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

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 the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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

As the scope of the Council's investments will include conventional treasury investments (the placing of residual cash from the Council's functions) and more commercial type investments, such as commercial investment properties, there may be a requirement for the Council to retain the services of specialist advisors. Whilst no appointment has yet been made, any decision to do so will be reported to the Council's Policy and Resources Committee.

2 THE CAPITAL PRUDENTIAL INDICATORS 2020/21 – 2022/23

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

2.1 Capital expenditure (excluding Commercial Investment)

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

Capital expenditure	**2018/19 Actual £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
Housing Projects	**904**	**1,344**	**3,459**	**990**	**990**
Car Parks, Flooding etc	**262**	**415**	**210**	**-**	**-**
Other Miscellaneous Projects	**157**	**329**	**1,007**	**275**	**275**
Community Safety	**197**	**75**	**4**	**-**	**-**
Asset Renewal (excl. Parks)	**174**	**290**	**708**	**138**	**99**
Parks and Recreation Assets	**224**	**255**	**148**	**-**	**-**
Strategic Property Investment*	**-**	**-**	**-**	**-**	**-**
Resource Procurement	**641**	**155**	**4,537**	**258**	**292**
Area Committees	**153**	**200**	**493**	**170**	**170**
Total	**2,712**	**3,063**	**10,566**	**1,831**	**1,826**

*Commercial Investment is considered unlikely during the year (although still approved) but excluded from the above table.

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

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

Financing of capital expenditure	**2018/19 Actual £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
Total Expenditure	2,712	3,063	10,566	1,831	1,826
Financed by:					
Capital receipts	1,622	1,226	1,691	100	100
Capital grants	1,065	1,730	1,239	820	820
Revenue	25	53	58	-	-
Section 106		-	58	-	-
Net financing need for the year	**-**	**54**	**7,520**	**911**	**906**

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

The second prudential indicator is the Council’s Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council’s indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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

The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council’s borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes.

Similarly, accounting code changes applicable from 2020/21, will require current hire/operating lease costs to be shown on Balance Sheet (IFRS16). These sums will impact on the CFR but will also include a borrowing facility, as above. These sums are not currently included in the CFR projections below but will be calculated for inclusion and presented to Committee later in the year as part of an updated TMSS. **Update: in light of the Coronavirus outbreak, the introduction of this accounting standard for local government is anticipated to be effective from 2021/22.**

The Council is asked to approve the CFR projections below:

	2018/19 Actual £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Capital Financing Requirement					
CFR – services	20,404	19,884	26,840	26,791	26,682
CFR – Commercial Investments	**-**	**-**	-	**-**	**-**
Total CFR	**20,404**	**19,884**	**26,840**	**26,791**	**26,682**
Movement in CFR		**(520)**	**6,956**	**(49)**	**(109)**

Movement in CFR represented by					
Net financing need for the year (above)		54	7,520	911	906
Less MRP/VRP and other financing movements **–** Services		(574)	(564)	(746)	(795)
Less MRP/VRP and other financing movements– Commercial Investments		-	-	(214)	(220)
Movement in CFR		**(520)**	**6,956**	**(49)**	**(109)**

2.3 Core funds and expected investment balances

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

Year End Resources £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Fund balances / reserves	6,124	4,688	4,427	3,552	3,302
Capital receipts	1,622	1,226	1,691	100	100
Provisions	2,065	1,800	1,800	1,900	2,000
Total core funds	**9,811**	**7,714**	**7,918**	**5,552**	**5,402**
Working capital*	**1,000**	**1,000**	**1,000**	**1,000**	**1,000**
Under/over borrowing**	68	5,580	(1,385)	(344)	(245)
Expected investments	**10,879**	**14,294**	**7,533**	**6,208**	**6,157**

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

2.4 Minimum revenue provision (MRP) policy statement

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

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

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

- **Based on CFR** – MRP will be based on the CFR (option 2) but adopting a charge of 2.5% per annum (40 year asset life) on a straight line basis rather than 4% (25 year asset life) ass assumed in the guidance on a reducing balance; under the latter , the debt is never fully repaid unlike the former which results in debt being repaid within 40 years;

For capital expenditure **from 1 April 2008** for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (option 3 per MHCLG regulations) using the annuity method under which annual payments gradually increase during the life of the asset. Option 3 must be applied for any expenditure capitalised under Capitalisation Direction. ;

Repayments included in annual PFI or finance leases are applied as MRP.

MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year.

Exceptions to the MRP Policy – There are currently the following exceptions to the MRP policy stated above:

- In late 2016, the Council agreed to advance a loan of £1.1m to Pendle Leisure Trust to be repaid over a 12-year term. As part of the approved Budget for 2020/21, the loan term was re-profiled and extended by 5 years. The principal element of the repayments by the Trust constitute capital receipts. The intention is to set these receipts aside in lieu of MRP to provide for the loan repayment to the Council.
- Any borrowing to finance housing projects using the Brownfield Regeneration Fund will also be excluded from the requirement to for an MRP charge. If such borrowing is undertaken, the intention is to repay this borrowing from the capital receipts generated by the sale of properties over a period of up to 5 years.
- A similar approach may be taken on other ‘regeneration’ type schemes where it is the intention to repay any debt financing from the subsequent disposal proceeds over a ‘short’ period (usually limited to 5 years).

3 BORROWING

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

3.1 Current portfolio position

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

	2018/19 Actual £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
External Debt					
Debt at 1 April	19,359	20,359	25,359	24,359	23,359
Expected Debt Repayments	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Expected Replacement Debt	-	1,000	-	-	-
Expected New Debt					
• Non Commercial	2,000	5,000	-	-	-
• Commercial		-	-	-	-
Other long-term liabilities (OLTL)	120	112	104	96	87
Expected change in OLTL	(7)	(7)	(8)	(8)	(9)
Actual gross debt at 31 March	**20,472**	**25,465**	**24,455**	**23,447**	**22,359**
The Capital Financing Requirement	**20,404**	**19,884**	**26,840**	**26,791**	**26,682**
Under / (over) borrowing	**(68)**	**(5,580)**	**2,385**	**3,344**	**4,323**

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, **except in the short term**, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Chief Executive, as Chief Finance Officer, reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans (as approved in the indicative Capital Programme for 2020/23), and the proposals in this report.

3.2 Treasury Indicators: limits to borrowing activity

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

Operational boundary	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt				
• Non Commercial	28,000	28,000	29,000	29,000
• Commercial*	-	-	-	-
Other long term liabilities	500	500	500	500
Total	**28,500**	**28,500**	**29,500**	**29,500**

*Excluded to show non-Commercial only as unlikely to invest in Commercial activity in year.

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

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

2. The Council is asked to approve the following authorised limit:

Authorised limit	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt				
- Non Commercial	30,000	30,000	31,000	31,000
- Commercial*	-	-	-	-
Other long term liabilities	500	500	500	500
Total	**30,500**	**30,500**	**31,500**	**31,500**

*Excluded to show non-Commercial only as unlikely to invest in Commercial activity in year.

3.3 Prospects for interest rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The forecasts were produced before the coronavirus pandemic had a major impact on the UK, Europe, US and around the world, and are therefore considered out of date. Until some stability returns to financial markets and economies recover from this outbreak, any forecasts will have little credibility or durability.

Recent forecasts assumed an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a comprehensive trade deal within the short time to December 2020, as the prime minister has pledged. It is unclear what impact the coronavirus outbreak may have on Brexit negotiations.

2019 was a year of weak UK economic growth as political and Brexit uncertainty depressed confidence. It was therefore little surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% during the year. However, during January 2020, financial markets were predicting a 50:50 chance of a cut in Bank Rate at the time of the 30 January MPC meeting. Admittedly, there had been plenty of downbeat UK economic news in December and January which showed that all the political uncertainty leading up to the general election, together with uncertainty over where Brexit would be going after that election, had depressed economic growth in quarter 4 of 2019. However, that downbeat news was backward looking; economic statistics during January and February, prior to the coronavirus outbreak, pointed in the direction of a robust bounce in economic activity and a recovery of confidence after the decisive result of the general election removed political and Brexit uncertainty. The January MPC meeting clearly decided to focus on the more recent forward-looking news, rather than the earlier downbeat news, and so left Bank Rate unchanged.

Coronavirus. The Coronavirus outbreak caused major disruption to the economy of China in quarter 1 of 2020; it looks likely that the economy will have contracted by about 20% during the quarter and recovery looks like being slow. The outbreak is now beginning to do the same in the UK, Europe and the US with whole sections of the economy likely to close down as a result of policies of social isolation. This poses a major risk to employment, people earning incomes, and businesses going bust with insufficient cash flow to keep them going.

In March, the Bank of England has cut Bank Rate twice, first from 0.75% to 0.25% and then on 19 March, to 0.1%. It has also restarted quantitative easing with an increase of £200bn of purchases and introduced a series of measures to support bank lending and financing for small and medium enterprises. The Budget, on the same day as the first cut in Bank Rate, similarly included a raft of measures to stimulate economic growth and to support the cash flows of businesses.

While governments are beginning to put in place major support measures to try to stop businesses going bust and support workers who lose their incomes, it remains to be seen how effective these will prove both in terms of quantity of support and the practical speed of implementation. In addition, there is a major question mark over how the self-employed will manage, a key issue when the gig economy has taken off in the UK over the last ten years or so. Investor fears have resulted in a number of days of major crashes in share values during March. Whereas government bonds are normally the safe haven that investors move into, the size of government support programmes to be financed by additional borrowing, and fund managers being forced into selling holdings of their most liquid assets, i.e. government bonds, in order to meet investor demands for immediate cash, have caused bond yields to start rising from previously unheard of lows. All that can be said in summary at the time of writing (20.3.20) is that we are in uncharted waters and no one knows where this will all end. The only thing that is clear is that UK economic growth could well contract by something like 15% in quarter 2 and that recovery after then is unlikely to be sharp due to the extent of economic damage that is likely to have been done. One major risk is that a sharp economic downturn morphs into a financial crash; but that is why western governments are mounting major support programmes to avert that happening.

Bond yields / PWLB rates.
Once the coronavirus outbreak ends and the economy gets back to some sort of normality, then it would be expected that the overall longer run future trend would be for gilt yields, and consequently PWLB rates, to rise, albeit gently. 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. Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

- Investment returns are likely to remain exceptionally low during 2020/21 with little increase in the following two years.
- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps, 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 amending the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. (Please note that Link Asset Services 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.) It also introduced the following rates for borrowing for different types of capital expenditure: -

PWLB Standard Rate is still gilt plus 200 basis points (G+200bps)
PWLB Certainty Rate is still gilt plus 180 basis points (G+180bps)
PWLB HRA Standard Rate is now gilt plus 100 basis points (G+100bps)
PWLB HRA Certainty Rate is now gilt plus 80bps (G+80bps)
Local Infrastructure Rate is still gilt plus 60bps (G+60bps)

- In view of the consultation process ending on 4 June, local authorities may wish to exercise caution and delay any new long-term General Fund borrowing until new borrowing rates and regulations have been finalised unless there is a desire for certainty in respect of long-term funding rates from a budgetary perspective.
- Borrowing not for HRA or infrastructure capital expenditure. As Link Asset Services' long-term forecast for Bank Rate is 2.25%, and all PWLB non-HRA certainty rates (i.e. gilts plus 180bps), are close to or above 2.25%, there is little value in borrowing from the PWLB at present. Accordingly, the Council will reassess its risk appetite in terms of either seeking cheaper alternative sources of borrowing or switching to short term borrowing in the money markets until such time as the Government reconsiders the margins charged over gilt yields for non-HRA capital expenditure. Longer-term borrowing could also be undertaken for the purpose of

certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

• While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace 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.

3.4 Borrowing strategy

The Council is currently maintaining an over-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has been fully funded with loan debt.

Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Chief Finance 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,* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

The Council's original 2020/21 borrowing strategy comprised three core strands:

- External borrowing for the balance of sums approved as part of the 2019/20 Estimate (non-commercial activity);
- External borrowing to replace expected debt maturity (repayment);
- External borrowing to support the Council's Property Investment Strategy (commercial activity).

This revised 2020/21 Strategy now consists of the following:

- No external borrowing to be undertaken during 2020/21 to fund capital slippage brought forward from 2019/20;
- No re-financing of maturing debt (replacement borrowing);
- No investment in Commercial activity in 2020/21.

The Council will instead utilise surplus cash balances (internal borrowing) in lieu of external debt.

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred). The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
The decision whether to reschedule debt rest with the Chief Financial Officer who will, as required, seek the advice of Link Asset Services. All rescheduling will be reported to the Policy and Resources Committee and the Accounts and Audit Committee at the earliest meetings following its action.

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

Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Municipal Bonds Agency

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

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

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

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

Fundamentally, the Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

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

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 5.4 under the categories of 'specified' and 'non-specified' investments.

    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.

    - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. ***The Council will not use Non-Specified Investments***

5. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the creditworthiness policy outlined in paragraph 4.2.

6. **Transaction limits** are set for each type of investment in 4.2.

7. Investments will only be placed with counterparties from the UK in accordance with approved minimum lending criteria, (see paragraph 4.3).

8. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

9. All investments will be denominated in **sterling**.

10. As a result of the change in accounting standards for 2019/20 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.
The above criteria are broadly unchanged from the Treasury Management Strategy, as amended, for 2019/20.

4.2 Creditworthiness policy

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

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

The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings form the three main credit rating agencies – Fitch, Moody's and Standard and Poor's, The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

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

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Other limits

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

a) **Non-specified investment limit.** The Council has determined that it will not use non specified investments.

b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK. In 2016, the Council agreed to exclude the UK sovereign rating from its minimum sovereign rating criteria and this is still considered appropriate.

c) **Other limits.** In addition:

- Despite the exclusion of the UK rating the Council will only invest with UK institutions that meet the approved minimum lending criteria.

4.4 Investment strategy

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

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations.
Bank Rate is unlikely to rise from 0.1% (at 20.3.20) 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 will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (Link Asset Services has withdrawn all forecasts up to 2024):

2019/20	
2020/21	
2021/22	
2022/23	
2023/24	
2024/25	1.75%
Later years	2.25%

- The overall balance of risks to economic growth in the UK is probably to the downside.

- The balance of risks to increases or decreases in Bank Rate from 0.1% and shorter term PWLB rates are also broadly even.

4.5 Investment performance / risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID.

4.6 End of year investment report

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

5 APPENDICES

(These can be appended to the report or omitted as required)

1. Prudential and treasury indicators
2. Interest rate forecasts
3. Economic background
4. Treasury management practice 1 – credit and counterparty risk management (option 1)
5. Treasury management practice 1 – credit and counterparty risk management (option 2)
6. Approved countries for investments
7. Treasury management scheme of delegation
8. The treasury management role of the section 151 officer

5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2020/21 – 2022/23

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

5.1.1 Capital expenditure

Capital expenditure	2018/19 Actual £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Housing Projects	**904**	**1,344**	**3,459**	**990**	**990**
Car Parks, Flooding etc	**262**	**415**	**210**	**-**	**-**
Other Miscellaneous Projects	**157**	**329**	**1,007**	**275**	**275**
Community Safety	**197**	**75**	**4**	**-**	**-**
Asset Renewal (excl. Parks)	**174**	**290**	**708**	**138**	**99**
Parks and Recreation Assets	**224**	**255**	**148**	**-**	**-**
Strategic Property Investment*	**-**	**-**	**-**	**-**	**-**
Resource Procurement	**641**	**155**	**4,537**	**258**	**292**
Area Committees	**153**	**200**	**493**	**170**	**170**
Total	**2,712**	**3,063**	**10,566**	**1,831**	**1,826**

**Excluded as investment now considered unlikely in year, although still approved*

5.1.2 Affordability prudential indicators

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

a. Ratio of financing costs to net revenue stream

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

%	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Total	10.50	9.02	12.42	12.63

The estimates of financing costs include current commitments and the proposals in budget report of 27th February 2020.

5.1.3 Maturity structure of borrowing

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

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

Maturity structure of fixed interest rate borrowing 2020/21		
	Lower	**Upper**
Under 12 months	0%	20%
12 months to 2 years	0%	30%
2 years to 5 years	0%	40%
5 years to 10 years	0%	60%
10 years and above	0%	100%
Maturity structure of variable interest rate borrowing 2020/21		
	Lower	Upper
Under 12 months	0%	25%
12 months to 2 years	0%	25%
2 years to 5 years	0%	25%
5 years to 10 years	0%	0%
10 years and above	0%	0%

5.2 INTEREST RATE FORECASTS 2020-2023

At the time of writing, no commentary is offered due to market volatility as a consequence of the Coronavirus outbreak.

Link forecasts predate the coronavirus outbreak and are considered obsolete.

Link will not be updating their interest rate forecast until some sort of normality returns to economies and financial markets.

5.3 ECONOMIC BACKGROUND

Update: at the time of writing, the commentary below is now considered to be of little relevance given market volatility as a consequence of the Coronavirus outbreak.

UK. Brexit. 2019 was a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. The Conservative Government gained a large overall majority in the **general election** on 12 December; this ensured that the UK left the EU on 31 January. However, there will still be much uncertainty as the detail of a comprehensive trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open three possibilities; a partial agreement on many areas of agreement and then continuing negotiations to deal with the residual areas, the need for the target date to be put back, probably two years, or, a no deal Brexit in December 2020.

GDP growth took a big hit from both political and Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The forward-looking surveys in January have indicated that there could be a significant recovery of growth now that much uncertainty has gone. Nevertheless, economic growth may only come in at about 1% in 2020, pending the outcome of negotiations on a trade deal. Provided there is a satisfactory resolution of those negotiations, which are in both the EU's and UK's interest, then growth should strengthen further in 2021.

At its 30 January meeting, the Monetary Policy Committee held Bank Rate unchanged at 0.75%. The vote was again split 7-2, with two votes for a cut to 0.50%. The financial markets had been predicting a 50:50 chance of a rate cut at the time of the meeting. Admittedly, there had been plenty of downbeat UK economic news in December and January which showed that all the political uncertainty leading up to the general election, together with uncertainty over where Brexit would be going after the election, had depressed economic growth in quarter 4. In addition, three members of the MPC had made speeches in January which were distinctly on the dovish side, flagging up their concerns over weak growth and low inflation; as there were two other members of the MPC who voted for a rate cut in November, five would be a majority at the January MPC meeting if those three followed through on their concerns.
However, that downbeat news was backward looking; more recent economic statistics and forward-looking business surveys, have all pointed in the direction of a robust bounce in economic activity and a recovery of confidence after the decisive result of the general election removed political and immediate Brexit uncertainty. In addition, the September spending round increases in expenditure will start kicking in from April 2020, while the Budget in March is widely expected to include a substantial fiscal boost by further increases in expenditure, especially on infrastructure. The Bank of England cut its forecasts for growth from 1.2% to 0.8% for 2020, and from 1.8% to 1.4% for 2021. However, these forecasts could not include any allowance for the predicted fiscal boost in the March Budget. Overall, the MPC clearly decided to focus on the more recent forward-looking news than the earlier downbeat news.

The quarterly Monetary Policy Report did, though, flag up that there was still a risk of a Bank Rate cut; "Policy may need to reinforce the expected recovery in UK GDP growth should the more positive signals from recent indicators of global and domestic activity not be sustained or should indicators of domestic prices remain relatively weak." Obviously, if trade negotiations with the EU failed to make satisfactory progress, this could dampen confidence and growth. On the other hand, there was also a warning in the other direction, that if growth were to pick up strongly, as suggested by recent business surveys, then "some modest tightening" of policy might be needed further ahead. It was therefore notable that the Bank had dropped its phrase that tightening would be "limited and gradual", a long-standing piece of forward guidance; this gives the MPC more room to raise Bank Rate more quickly if growth was to surge and, in turn, lead to a surge in inflation above the 2% target rate.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5% and then even further to 1.3% in December. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market,** growth in numbers employed has been quite resilient through 2019 until the three months to September, where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000 and then a stunning increase of 208,000 in the three months to November. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.4% in November (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

Coronavirus. The recent Coronavirus outbreak could cause disruption to the economies of affected nations. The Chinese economy is now very much bigger than it was at the time of the SARS outbreak in 2003 and far more integrated into world supply chains. However, a temporary dip in Chinese growth could lead to a catch up of lost production in following quarters with minimal net overall effect over a period of a year. However, no one knows quite how big an impact this virus will have around the world; hopefully, the efforts of the WHO and the Chinese authorities will ensure that the current level of infection does not multiply greatly.

USA. After growth of 2.9% y/y in 2018 fuelled by President Trump's massive easing of fiscal policy, growth has weakened in 2019. After a strong start in quarter 1 at 3.1%, (annualised rate), it fell to 2.0% in quarter 2 and then 2.1% in quarters 3 and 4. This left the rate for 2019 as a whole at 2.3%, a slowdown from 2018 but not the precursor of a recession which financial markets had been fearing earlier in the year. Forward indicators are currently indicating that growth is likely to strengthen somewhat moving forward into 2020.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment'. It also ended its programme of quantitative tightening in August 2019, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. It left rates unchanged at its December meeting. Rates were again left unchanged at its end of January meeting although it had been thought that as the yield curve on Treasuries had been close to inverting again, (with 10 year yields nearly falling below 2 year yields - this is often viewed as being a potential indicator of impending recession), that the Fed could have cut rates, especially in view of the threat posed by the coronavirus. However, it acknowledged that coronavirus was a threat of economic disruption but was not serious at the current time for the USA. In addition, the phase 1 trade deal with China is supportive of growth. The Fed though, does have an issue that despite reasonably strong growth rates, its inflation rate has stubbornly refused to rise to its preferred core inflation target of 2%; it came in at 1.6% in December. It is therefore unlikely to be raising rates in the near term. It is also committed to reviewing its approach to monetary policy by midyear 2020; this may include a move to inflation targeting becoming an average figure of 2% so as to allow more flexibility for inflation to under and over shoot.

"The NEW NORMAL." The Fed chairman has given an overview of the current big picture of the economy by summing it up as **A NEW NORMAL OF LOW INTEREST RATES, LOW INFLATION AND PROBABLY LOWER GROWTH.** This is indeed an affliction that has mired Japan for the last two decades despite strenuous efforts to stimulate growth and inflation by copious amounts of fiscal stimulus and cutting rates to zero. China and the EU are currently facing the same difficulty to trying to get inflation and growth up. Our own MPC may well have growing concerns and one MPC member specifically warned on the potential for a low inflation trap in January.
It is also worth noting that no less than a quarter of total world sovereign debt is now yielding negative returns.

EUROZONE. Growth has been slowing from +1.8 % during 2018 to nearly half of that in 2019. Growth was +0.4% q/q in quarter 1, +0.2% q/q in quarters 2 and 3; it then fell to +0.1% in quarter 4 for a total overall growth rate of only 1.0% in 2019. Recovery from quarter 4 is expected to be slow and gradual. German GDP growth has been struggling to stay in positive territory in 2019 and grew by only 0.6% in 2019, with quarter 4 potentially being a negative number. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and in 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting, it said that it expected to leave interest rates at their present levels "at least through to the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they would have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period.** At its October meeting it said these purchases would start in

November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by 'growth friendly' fiscal policy. There have been no changes in rates or monetary policy since October. In January, the ECB warned that the economic outlook was 'tilted to the downside' and repeated previous requests for governments to do more to stimulate growth by increasing national spending. The new President of the ECB, Christine Lagarde who took over in December, also stated that a year long review of monetary policy, including the price stability target, would be conducted by the ECB
On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The most recent results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates**.

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU.** On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably relatively even due to the weight of all the uncertainties over post-Brexit trade arrangements and the impact of an expansionary government spending policy (as expected in the Budget on 11th March).
- The balance of risks to increases or decreases in Bank Rate and shorter term PWLB rates are also broadly even.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Post Brexit trade negotiations** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments.** Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but his time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some $19trn of corporate debt in major western economies,** if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is $15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.
- **Geopolitical risks,** for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

- **Brexit** – if a comprehensive agreement on a trade deal was reached that removed all threats of economic and political 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.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

5.4 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT SUMMARY

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 364 days**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: The Council will not invest in Non-Specified Investments.

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

	Minimum credit criteria / colour band	** Max % of total investments / £ limit per institution	Max. maturity period
DMADF – UK Government	yellow	Unlimited	6 months (max. is set by the DMO*)
UK Government Treasury bills	yellow		364 days (max. is set by the DMO*)
Money Market Funds (CCLA Public Sector Deposit Fund only)	AAA	£1m	Liquid
Principal Local authorities	N/A	£3m (£6m for Lancashire County Council)	364 days
Term deposits/Instant Access with non UK Banks meeting approved credit criteria	Blue Orange Red Green No Colour	Range between £2m and £10m (£10m is restricted to Lloyds Group as Banker to the Council)	Upto 364 days Upto 364 days 6 months 100 days Not for use
Certificate of Deposits (CDs) with designated UK Banks and Building Societies	Blue Orange Red Green No Colour	£1m	Upto 364 days Upto 364 days 6 months 100 days Not for use
Term deposits/Instant Access with non UK Banks meeting approved credit criteria	Red Green	£2.5m £1m	Upto 6 months Upto 100 days

The Council's minimum ratings criteria relating to the above, as per Fitch Rating Agency, are summarised below:

Long-term rating:	A-
Short-term rating:	F1
Viability:	BB+
Support:	5

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

5.5 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

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

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2017). In accordance with the Code, the Chief Finance Officer has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

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

- The strategy guidelines for choosing and placing investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than 364 days.

The investment policy proposed for the Council is:

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

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

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, housing association, parish council or community council.

4. Pooled investment vehicles (such as money market funds currently CCLA Public Sector Deposit Fund only) that have been awarded a high credit rating by a credit rating agency.
5. A body that is considered of a high credit quality (such as a bank or building society).

5.6 APPROVED COUNTRIES FOR INVESTMENTS

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

Based on lowest available rating

AAA

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

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- Hong Kong
- France
- U.K.

AA-

- Belgium
- Qatar

THIS LIST IS AS AT 20.3.20

5.7 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full Council

- Initial Approval and adoption of the Treasury Management Policy Statement and subsequent revisions (as and when required).
- Approval of the Annual Treasury Management Strategy/Annual Investment Strategy and Policy on the Minimum Revenue Provision and consideration and approval of any in year changes (in March each year for the forthcoming financial year);
- Approval of the Council's Capital Strategy and related Capital Programme.

(ii) Policy and Resources Committee

- Annual Treasury Management outturn Report (by October each year for the previous financial year);
- Mid-Year Treasury Management Report (by September of each year for the year in question);
- Strategic Monitoring Report (Quarterly).

(iii) Accounts and Audit Committee

- approval/amendments to the Council's adopted Treasury Management Practices (TMPs);
- Receiving and reviewing regular monitoring reports and acting on recommendations;
- Scrutiny of treasury management performance and strategy.

5.8 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe.
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and, where applicable, non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to Councillors of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that Councillors are adequately informed and understand the risk exposures taken on by the Council
- ensuring that the Council has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following:-
- Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
- Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
- Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;

- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.