Cabinet

25th November 2021

Treasury Management Monitoring Report

Recommendation

That the Cabinet notes and comments on Treasury Management activity and performance in respect of the first 6 months of the 21/22 financial year.

1 Executive Summary

1.1 The Treasury Management Strategy sets out that Council delegates to Cabinet responsibility for receiving and reviewing monitoring reports and acting on recommendations in respect of treasury management.

1.2 This report provides an update on treasury management activity and performance for the last six months of the year.

1.3 The following headlines are detailed in the report:

- Cash and Cash Equivalent balances have risen by £70.52m. The increase is attributed to reprofiled capital spending, due to delays in both the capital programme and non-treasury investments programme; unbudgeted covid grants; and timing differences in income and expenditure flows.

- Investment returns remain low due to the ongoing impact of Covid-19 on interest rates. There is a shortfall in investment returns of £508k compared to the half year budget. This will be covered by the interest rate volatility reserve.

- Security and liquidity continue to be the priority for investment balances. No credit defaults or liquidity issues have been experienced.

- No new debt has been taken out and borrowing has remained within prudential limits.

- Activity in respect of developing non-treasury investment has occurred with the first investment being a working capital loan to the Warwickshire Property Development Group.

2 Treasury Management

2.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet cash expenditure. Part of the purpose of treasury management operations is to ensure this cash flow is planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

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

2.3 Accordingly, Treasury Management is defined by the CIPFA Code of Practice 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."*

2.4 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- Creation and maintenance of Treasury Management Practices which set out the way the Council will seek to achieve those policies and objectives.

- Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Resources and Fire & Rescue Overview and Scrutiny Committee.

2.5 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and includes coverage of the following:

- An economic update for the first half of the 2021/22 financial year (Appendix E).
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (Section 3).
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators (Section 6 and Appendix H of this report, and capital spending is reported in more detail elsewhere on this meeting's agenda).
- A review of the Council's investment portfolio for 2021/22 (Section 4).
- A review of the Council's borrowing strategy for 2021/22 (Section 5).
- A review of any debt rescheduling undertaken during 2021/22 (Section 5).
- A review of compliance with Treasury and Prudential Limits for 2021/22 (Section 6).

3 Treasury Management Strategy and Annual Investment Strategy

3.1 The Treasury Management Strategy Statement, (TMSS), and Investment Strategy (IS) for 2021/22 were approved by Council on 17th June 2021. There are no recommended policy changes to the TMSS or IS.

4 Investments Review

4.1 The Council has an investment portfolio consisting of reserves and cash arising from daily receipts being more than payments on a short-term basis.

4.2 As directed by the Treasury Management Strategy, security and liquidity has been prioritised above the requirement to maximise returns. A cautious approach is taken to lending to financial institutions, and credit quality information regarding the institutions on the Council's approved Lending List is monitored.

4.3 The Council's investment portfolio as of 30 September 2021 was as follows:

Table 1

	31st March 2021	Additions (Withdrawals)	30th Sept 2021
In house deposits	178.20	38.74	216.94
Money Market/External Funds	192.43	26.18	218.61
Total Treasury Management Investments	**370.63**	**64.92**	**435.55**
Cash	24.80	5.60	30.40
Total Cash and Cash Equivalents and Short Term Investment	**395.43**	**70.52**	**465.95**

4.4 Balances at the end of September are higher with the following factors having impacted on cash balances:

- An underspend on the 2021/22 capital programme including some reprofiling to future years of £15m.
- The launch of the Warwickshire Recovery Investment Fund (WRIF) took place in July 2021. As at the 30th September 2021 £10m in capital and £1m in revenue had not been allocated in respect of this fund.
- £9m of covid grants received up to September 2021 that were not included in the original budget.
- There was an expected surplus of funds (£35m) from known income and expenditure flows. During the first 6 months of the financial year income is higher than expenditure due to operational cash receipts (such as council tax payments made over 10 months of the year).

4.5 During 2020/21 cash was held in short term investments, such as overnight funds, because of the economic volatility due to the Covid-19 pandemic. The Council has gradually invested small portions of funds back into longer term investments, up to 18 months duration, as the economic volatility reduces, without compromising on liquidity as and when required. The impact on the performance of investments as a result of these decisions is explained in 4.8.

4.6 Appendix A illustrates the deposits making up the £435.55 of assets held as of 30 September 2021. Investments with counterparties were kept within approved counterparty limits during the period from April to September 2021.

4.7 The performance of the Council's internally and external managed investments (weighted) versus the benchmark is set out in Table 2.

Table 2: Investment Performance to 30 September 2021

%	Average Interest rate year to date	Target rate: 30 day LIBID + 0.46%	Variance
In house deposits	0.06%	0.39%	-0.32%
Money Market/External Funds	0.29%	0.39%	-0.10%
Weighted Average	**0.18%**	**0.39%**	**-0.20%**

4.8 The weighted average performance on the Councils investments is 0.20% (20 basis points) below the benchmark. This variance can be explained by the mix of treasury investments in place during the first 6 months of 2021/22, following the “security, liquidity, yield” principle[1].

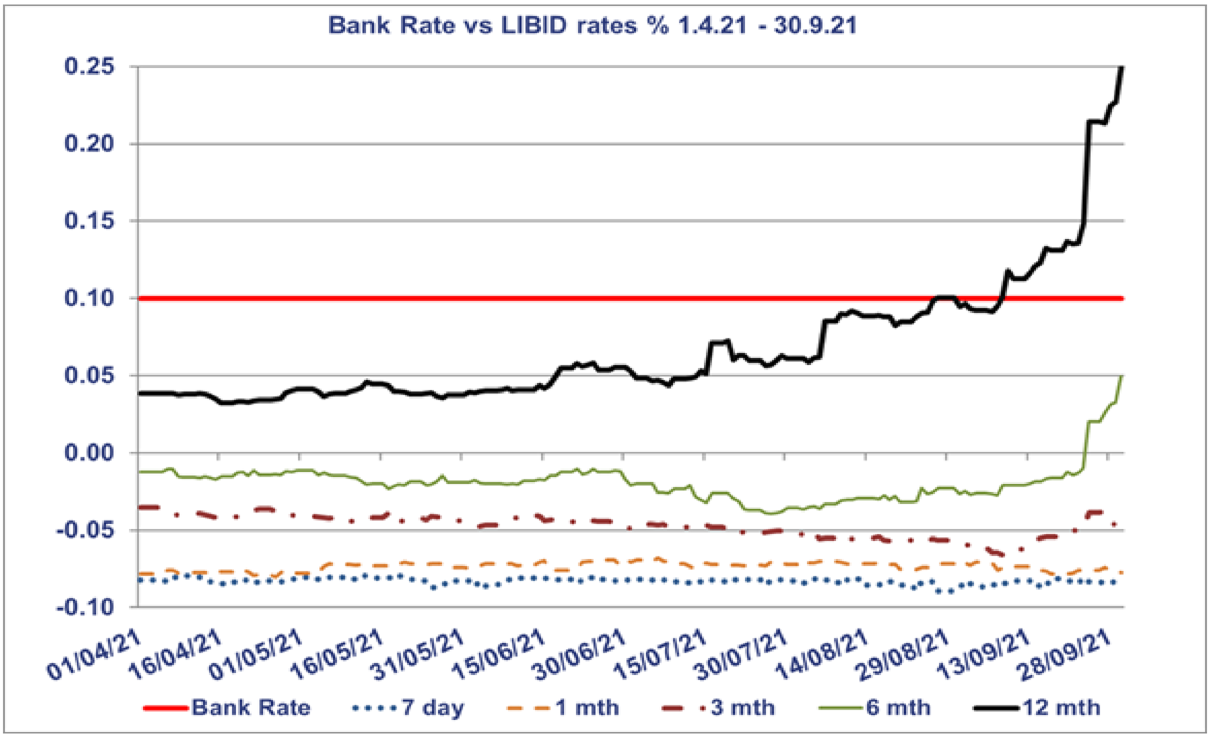
- The security of the cash held by the Council is first priority. The highest rated money market funds, banks and building societies were chosen and investments in lower rated funds or counterparties were limited. High rated funds carry lower levels or risk, and therefore return.
- The liquidity of the cash held by the Council is prioritised second. Due to the volatility of the economic marketplace since the Covid-19 pandemic, the investments chosen were short term to allow for fluctuations in cash need. Whilst some longer term investments were entered into, the majority of investments remained short term (under 1 year duration). Shorter duration funds and investments carry lower levels of return.
- Overall yield in the marketplace is extremely low due to the impact of Covid-19 on the economy.

4.9 The benchmark continues to reflect the 30 day London Inter Bank Bid Rate (LIBID) plus 0.46%. The ongoing impact of Covid is such that the average 30 day LIBID rate is negative for the first half of 2021/22 (-0.074%) and therefore the target rate is 0.39%

4.10 Following the reduction of the bank rate in March 2020 to 0.10%, the Bank of England have made no further changes to the bank rate within the year 2020/21, or in the first half of 2021/22.

[1] The CIPFA Treasury Management Code requires a local authority to prioritise Security, Liquidity and Yield, in that order of importance, with regard to treasury management activities.

Chart 1 – Bank of England Base Rate and Inter Bank Rates



4.11 The impact on rates of return on treasury investments has remained low during the first half of this year.

- Fixed term fixed rate loans to other institutions (mostly other Local Authorities) continued to pay at the agreed interest rates until the loans matured. Then as replacement loans have been issued the rates attained on those have remained at low levels.

- Money market fund returns have been minimal, and in most cases zero. Several fund managers reduced their management fees late in 2020, (fees are taken net of yield) to mitigate the impact of possible negative rates, which continued into 2021. However, during the first half of 2021/22, the Council has been able to avoid placing funds with negative rates and distribute cash into higher yielding funds, as the economy stabilised, and this risk subsided.

- The CCLA Property Fund and Threadneedle Social Bond Fund have continued to pay income at 4.5% and 2.5% respectively, these are similar levels to the start of the year.

4.12 In the current economic climate, it is still considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 18 months with high credit rated financial institutions and other Local Authorities.

4.13 Appendix B illustrates the mix of treasury management investment returns from the different deposits held at the end of September. Returns vary significantly however risk also varies with return. This analysis excludes cash balances which are not investments and investments that are not held for treasury management purposes.

4.14 The percentage interest earned on the Council’s investments is below the benchmark. The budget for interest income for the first half of 2021/22 is £1.313m. Actual interest income to September 2021 is £805k. The shortfall of £508k will be covered by the interest rate volatility reserve.

Table 3: Interest Earned to September 2021

£m	Budget	Returns	Variance	*Estimated Costs	Return net of fees
In house deposits	0.582	0.126	- 0.456	-	0.126
Money Market/External Funds	0.731	0.679	- 0.052	0.176	0.503
Total	**1.313**	**0.805**	**- 0.508**	**0.176**	**0.629**

*Costs are mid-year estimates – actual costs will be updated at the outturn.

4.15 Externally managed funds incur management fees which are noted in Table 3. Internally managed funds do not present fees in the same way, either county council cash is lent to other institutions (e.g., other local authorities) who pay fees as the borrower or are invested in deposit funds that present net returns rather than gross returns with costs.

4.16 Most of the deposits simply provide a return and the deposit value is static. However, some funds are of a nature where the deposit itself has a value which can rise or fall. The changes in the underlying asset value of these investments are not reflected in investment returns above but would be realised upon selling. This issue relates to the CCLA Property Fund and the Threadneedle Social Bond Fund whose values are illustrated in Appendix C. The value of both funds was impacted by Covid but have now returned to pre Covid levels. These funds are held for returns over significantly longer durations than most treasury investments and are not required for liquidity purposes at this time.

4.17 Further information about funds held is summarised in Appendix D. This information focuses on treasury management investment returns and so excludes cash balances which are not investments, and long-term investments which are not held for treasury management purposes.

4.18 Our consultant, Link Asset Services, provided the below forecasts (Public Works Loan Board “PWLB” rates are certainty rates, gilts yield plus 80bps). As shown in the forecast table below, one increase in bank rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.05% in quarter 2 of 23/24 and a third one to 0.75% in quarter 4 of 23/24. Further commentary on the wider economic environment and interest rate forecasts from our external advisers (Link) is provided in Appendix E.

Table 4: Interest Rate Forecast

Link Group Interest Rate View 29.9.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

Source: Link Asset Services 29th September 2021 -

4.19 There is likely to be a steady rise in interest rates over the forecast period, with some degree of uplift due to rising treasury yields in the US. There is likely to be exceptional volatility and unpredictability in respect of gilts yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will The Federal Reserve take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the Monetary Policy Committee act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds?

4.20 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are having difficulties over accurately forecasting when expenditure and income will occur or when further large receipts will be received from the Government. The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy. For local authorities, this means that investment interest rates and short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion

Creditworthiness

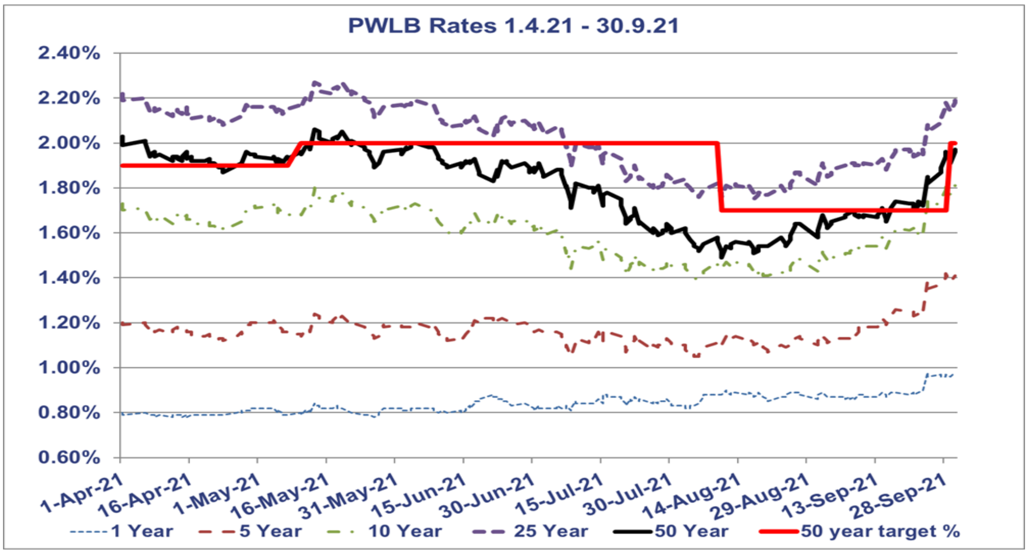
4.21 Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks (expected changes based on forecasts). However, as economies are beginning to reopen, there have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

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

5 Borrowing Strategy and Debt Financing

5.1 The Council did not undertake any new long-term borrowing during the first half of the year. The Council is currently in an over-borrowed position[2] and does not anticipate taking out any new external borrowing in the remainder of 2021/22 based on the current capital financing requirement. However, the current trends on PWLB borrowing rates are reproduced for information in the chart below.

Chart 2 – Trends in Available Borrowing Rates



5.3 Borrowing has remained within the defined prudential limits. The profile of when £321m of remaining debt is due to mature is set out in Appendix F.

5.4 No debt rescheduling (paying off more existing debt and replacing it with new debt) has been undertaken as PWLB loan repayments are subject to penalties for early redemption that make early repayments uneconomic.

5.5 No changes to the borrowing strategy are recommended.

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2 "over-borrowed position" refers to the level of Gross Debt compared to Capital Finance Requirement for the year. See Appendix G for calculation.

6 Compliance with Treasury Limits and Prudential Indicators

6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the first half year ended 30 September 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22.

6.2 Details of capital spending and Prudential Indicators are shown in Appendix G. Explanations of the terminology employed are set out in Appendix H**.**

6.2 A detailed report on capital spending is set out elsewhere on this Cabinet agenda.

7 Sensitivity Analysis

7.1 For the purposes of disclosure on Market Risk a sensitivity analysis has been carried out to show the impact of a change in interest rates of + 1% on the debt portfolio.

7.2 The following table shows the results of the sensitivity analysis:

Table 5 Interest Rate Sensitivity Analysis

	Actual	+1% increase in Base Rate	
	Fair Value at 31.03.2021 £m	Fair Value at 31.03.2021 £m	Difference £m
Debt (new borrowing)	520.549	434.563	-85.986
Debt (early repayment)	623.075	513.333	-109.742

7.3 The above table demonstrates how as interest rates rise the fair value of a given level of debt reduces, i.e. less cash would be required now to meet a given future series of cashflows if interest rates rise.

7.4 New borrowing illustrates the fair value of debt if taken out at a certain point in time. Early repayment illustrates the additional premium payable on the portfolio of loans to compensate for loss of interest for the Treasury.

8 Non-Treasury Management Investments

8.1 The Councils Investment Strategy was approved in July 2021. This detailed the Councils plans to launch the Warwickshire Property and Development Group (WPDG) and the Warwickshire Recovery Investment Fund (WRIF). Both of these investments are now in their early stages and reporting on these will be subject to a separate Outturn report on Investments at year end.

8.2 At the end of September 2021, the Council had agreed a loan facility with WPDG for working capital purposes. The facility is for a maximum of £404k, with £50k of this in use at the end of September 2021. The interest rate for this facility is 3.44%, with a commitment fee also in place.

8.3 The Council also holds longer term investments for service reasons rather than treasury management purposes, including for example the University of Warwick Science Park and Educaterers Ltd. These long-term investments are valued at £2m.

8.4 The Council has a loan facility with Educaterers Ltd, a wholly owned company. For the first half of the year interest earned was £50k.

9 Financial Implications

9.1 The financial implications of the Treasury Management outturn are set out in the body of the report.

10 Environmental Implications

10.1 None.

11 Supporting Information

11.1 Supporting information is set out in the body of the report and appendices.

12 Timescales Associated with Next Steps

12.1 A Treasury Management Outturn report and Investment Outturn report will be presented to Cabinet after the year end.

Appendices

Appendix A – Investment Balances as at 30/9/2021
Appendix B – Investment % Returns as at 30/9/2021
Appendix C – Asset Value Movements
Appendix D – Cash Funds Summary
Appendix E – Economics and Interest Rates Update
Appendix F – PWLB Maturity Profile
Appendix G – Prudential Indicators
Appendix H – Prudential Indicators Glossary

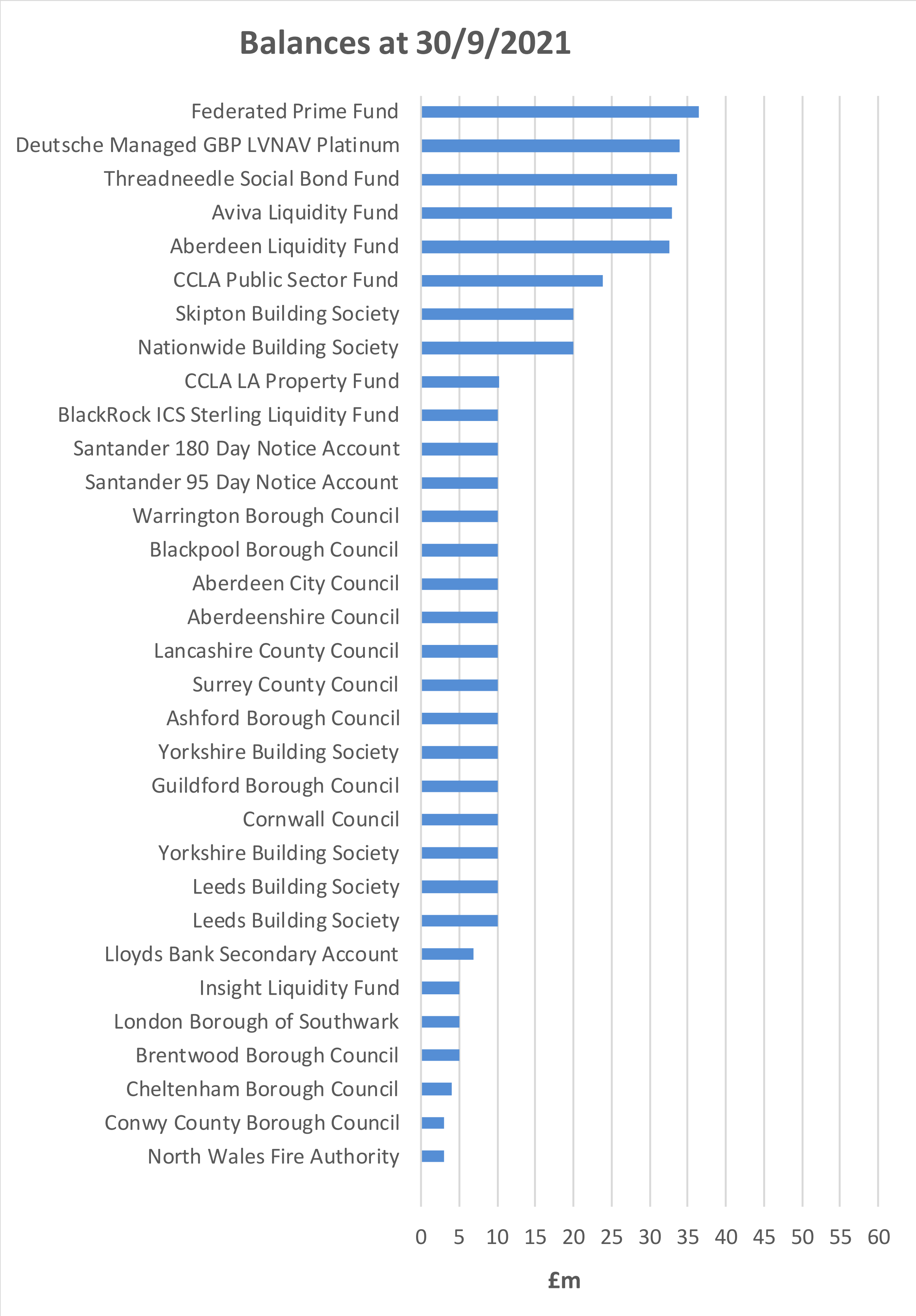
Background Papers

None

	Name	**Contact Information**
Report Author	Chris Norton, Emily Reaney	chrisnorton@warwickshire.gov.uk, emilyreaney@warwickshire.gov.uk
Assistant Director	Andy Felton	andrewfelton@warwickshire.gov.uk
Strategic Director	Rob Powell	robpowell@warwickshire.gov.uk
Portfolio Holder	Portfolio Holder for Finance and Property, Councillor Peter Butlin	cllrbutlin@warwickshire.gov.uk

The report was circulated to the following members prior to publication:
Local Member(s):
Other members:

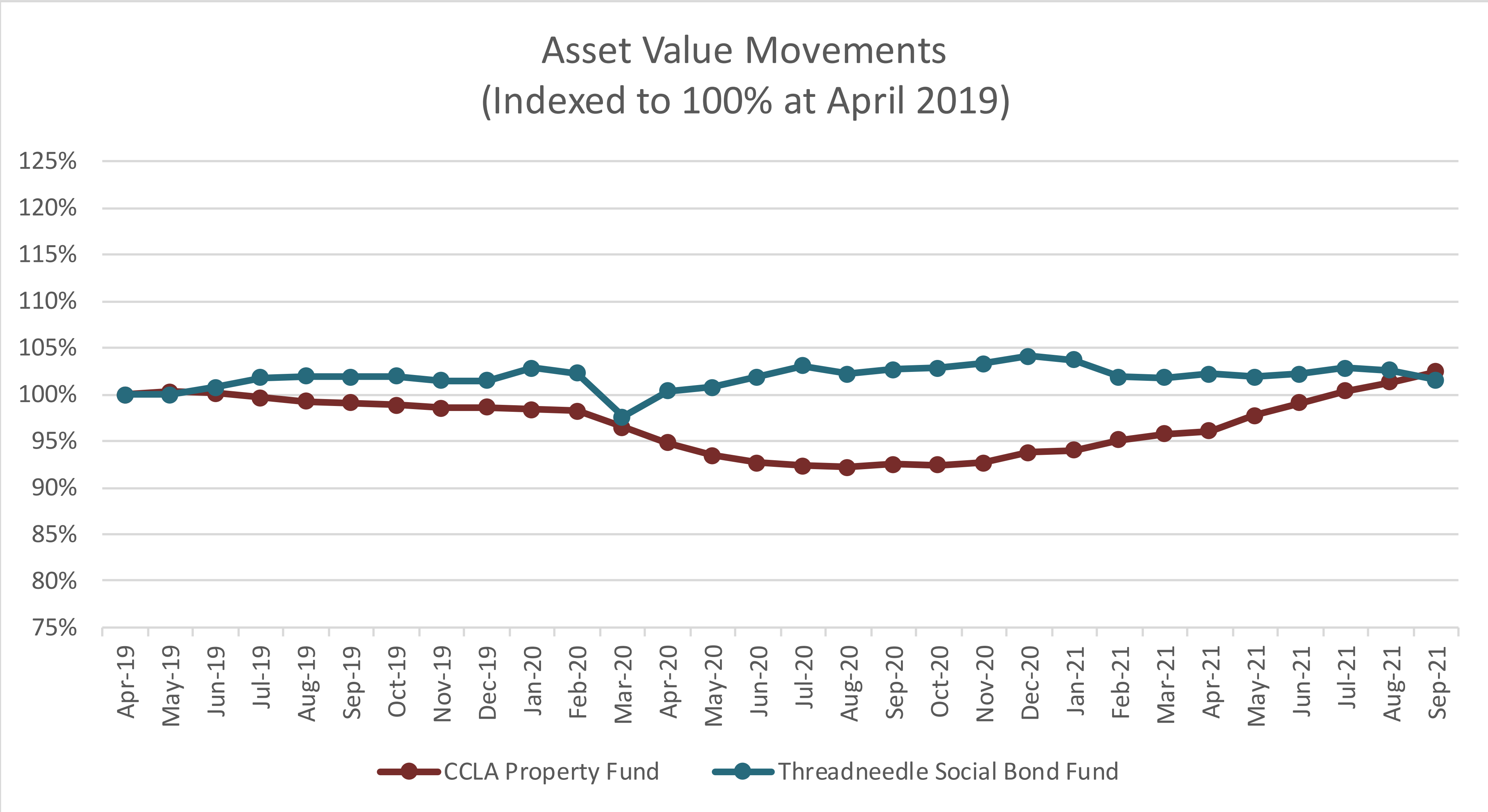
Appendix A



Appendix B


% Returns at 30/9/2021
CCLA LA Property Fund
Threadneedle Social Bond Fund
Santander 180 Day Notice Account
Santander 95 Day Notice Account
Guildford Borough Council
Lancashire County Council
Surrey County Council
Aberdeen City Council
Aberdeenshire Council
Warrington Borough Council
London Borough of Southwark
Leeds Building Society
Blackpool Borough Council
Yorkshire Building Society
Brentwood Borough Council
Yorkshire Building Society
Nationwide Building Society
Leeds Building Society
Cheltenham Borough Council
Ashford Borough Council
Skipton Building Society
Conwy County Borough Council
North Wales Fire Authority
Cornwall Council
Deutsche Managed GBP LVNAV Platinum
CCLA Public Sector Fund
Federated Prime Fund
BlackRock ICS Sterling Liquidity Fund
Aviva Liquidity Fund
Aberdeen Liquidity Fund
Insight Liquidity Fund
Lloyds Bank Secondary Account
0.00%
1.00%
2.00%
3.00%
4.00%
5.00%
%

Appendix C


Asset Value Movements
(Indexed to 100% at April 2019)
125%
120%
115%
110%
105%
100%
95%
90%
85%
80%
75%
Apr-19
May-19
Jun-19
Jul-19
Aug-19
Sep-19
Oct-19
Nov-19
Dec-19
Jan-20
Feb-20
Mar-20
Apr-20
May-20
Jun-20
Jul-20
Aug-20
Sep-20
Oct-20
Nov-20
Dec-20
Jan-21
Feb-21
Mar-21
Apr-21
May-21
Jun-21
Jul-21
Aug-21
Sep-21
CCLA Property Fund
Threadneedle Social Bond Fund

Cash Funds Summary Appendix D

SEPTEMBER 2021					
Inhouse Investments					
Internally Managed Funds	**£m**	**Net % Rate at 30/9/2021**	**Duration (days from inception)**	**Duration (days from end of September 2021)**	**Fitch Long Term Credit Rating**
Cornwall Council	10.0	0.03%	122	120	AA-
North Wales Fire Authority	3.0	0.04%	183	28	AA-
Conwy County Borough Council	3.0	0.04%	183	28	AA-
Skipton Building Society	20.0	0.04%	184	147	A-
Nationwide Building Society	20.0	0.07%	185	116	A
Ashford Borough Council	10.0	0.06%	243	187	AA-
Leeds Building Society	10.0	0.07%	273	36	A-
Leeds Building Society	10.0	0.10%	273	43	A-
Yorkshire Building Society	10.0	0.08%	273	53	A-
Brentwood Borough Council	5.0	0.08%	275	118	AA-
Yorkshire Building Society	10.0	0.08%	285	153	A-
Blackpool Borough Council	10.0	0.09%	316	202	AA-
Warrington Borough Council	10.0	0.10%	326	270	AA-
Lancashire County Council	10.0	0.12%	328	196	AA-
Surrey County Council	10.0	0.12%	336	193	AA-
Aberdeenshire Council	10.0	0.11%	336	201	AA-
Aberdeen City Council	10.0	0.11%	349	201	AA-
Cheltenham Borough Council	4.0	0.06%	349	348	AA-
London Borough of Southwark	5.0	0.10%	362	263	AA-
Guildford Borough Council	10.0	0.15%	364	151	AA-
Lloyds Bank Secondary Account	6.9	0.00%	same day	same day	A+
Santander 95 Day Notice Account	10.0	0.25%	90 days	90 days	A+
Santander 180 Day Notice Account	10.0	0.35%	180 days	90 days	A+
Total	**216.9**				

Appendix E

Economics and Interest Rates – Link Update as at 06.10.21

Economics Update

E1 As expected, the Bank of England's Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures on 24th September. Its forecasts were optimistic in terms of three areas:

- There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate.
- Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures.
- There is potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, Consumer Price Index inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.
- Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September.

E2 The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.

E3 **Significant risks to the forecasts**

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that supresses GDP growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding QE.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- Geo-political risks are widespread e.g., German general election in September 2021 produces an unstable coalition or minority government and a void in high-profile leadership in the EU when Angela Merkel steps down as Chancellor of Germany; on-going global power influence struggles between Russia/China/US.

E4 The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

E5 There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

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

E6 The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows:

1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.

E7 **COVID-19 vaccines.** These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel, and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

E8 **The balance of risks to the UK economy: -**
The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

E9 **US.** Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic party's determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the $900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American family plan over the next decade which are caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy had already been growing strongly during 2021.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
4. And the Fed was still providing monetary stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK. As an average since 2011, there has been a 75% correlation between movements in 10 year treasury yields and 10 year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

E10 There are also DOWNSIDE RISKS from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to keep an eye on.

E11 **EU.** The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

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

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E12 **China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China’s economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

E13 **Japan.** 2021 has been a patchy year in combating Covid. However, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.

E14 **World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of **world globalisation** and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

E15 **Supply shortages**. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California, and China. Such issues have led to misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

Interest Rate Forecasts

E16 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September meeting), although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

E17 **Forecasts for Bank Rate**

Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively brief time frame for the following reasons: -

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
- Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increase in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. Then we have the Government's upcoming budget in October, which could also end up in reducing consumer spending power.
- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- There are 1.6 million people coming off furlough at the end of September; how many of those will not have jobs on 1st October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that there could be further nasty surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.

In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon - in line with what the latest news is.

E18 Gilt yields and PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September.
The 50 year PWLB target certainty rate for new long-term borrowing started 2021/22 at 1.90%, rose to 2.00% in May, fell to 1.70% in August and returned to 2.00% at the end of September after the MPC meeting of 23rd September.

- The current PWLB rates are set as margins over gilt yields as follows: -.
  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

E19 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

E20 **PWLB RATES**. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets. Over the year prior to the coronavirus crisis, this resulted in many bond yields up to 10 years turning negative in the Eurozone. In addition, there was, at times, an inversion of bond yields in the US whereby 10 year yields fell below shorter-term yields. In the past, this has been a precursor of a recession.

E21 Gilt yields had, therefore, already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020 which caused gilt yields to spike up. However, yields then fell sharply in response to major western central banks taking rapid policy action to deal with excessive stress in financial markets during March and starting massive quantitative easing driven purchases of government bonds: these actions also acted to put downward pressure on government bond yields at a time when there was a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply.

E22 At the start of January 2021, all gilt yields from 1 to 8 years were negative: however, since then all gilt yields have become positive and rose sharply during the spring, especially in medium and longer-term periods, until starting a significant decline since May which was then sharply reversed in August / September. Repeated assurances by the Fed in the US, and by other major world central banks, that inflation would spike up after Covid restrictions were abolished, but would only be transitory, allayed investor fears until August / September when high inflation was again seen as a growing danger and both central banks in the US and UK gave indications that monetary policy tightening was now on the horizon. There is considerable concern that the US Fed is taking a too laid-back view that inflation pressures in the US are purely transitory and that they will subside without the need for the Fed to take significant action to tighten monetary policy.

E23 Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that rates will end up rising faster and further in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields.

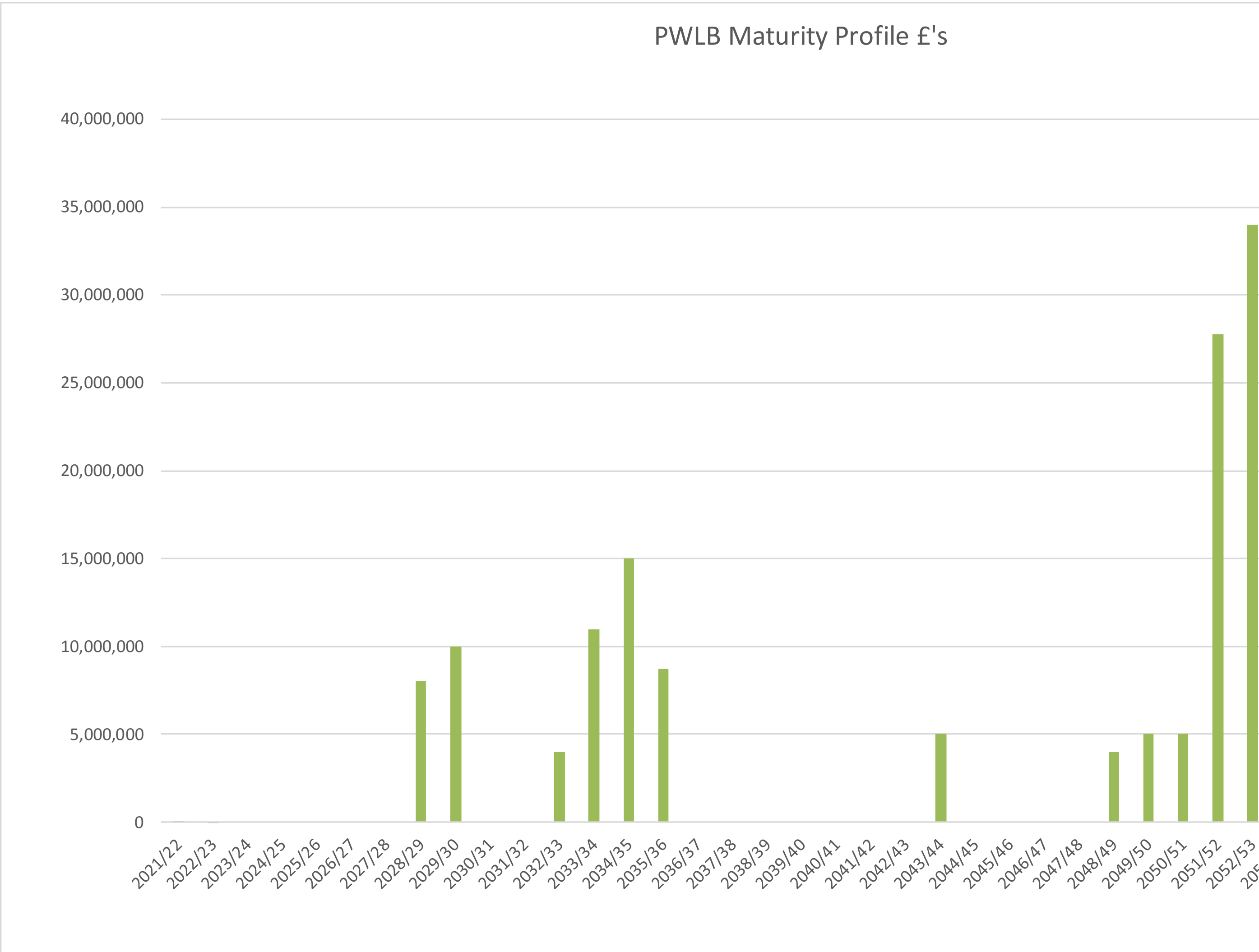
E24 Yields on 10 year Gilts and Treasuries initially both fell during the first quarter of 2020, as signs emerged that the COVID-19 virus would become a global pandemic which would lead to a sharp downturn in economic growth.

E25 The correlation between 10 year yields in the UK and the US lessened during the second half of 2020 when US yields displayed an increasing tendency to rise, whilst UK yields remained more range bound. This divergence was consistent with the relatively better economic performance registered by the US during the pandemic, which was aided by historically low US business inventory levels needing to be rebuilt.

E26 During late 2020 gilt yields rose significantly, reflecting optimism that the fast vaccine roll-out in the UK would support a strong economic recovery during 2021.

E27 During September 2021, treasury yields rose sharply in response to growing investor concerns around high inflation and indications from the Fed that tapering of quantitative easing purchases of treasuries are likely to occur soon. Gilts also rose sharply, as did investor concerns around a sharp increase in inflation in the UK which is now likely to go over 4%. In addition, the MPC meeting on 23rd September flagged up major concerns around the strength of inflation which may require Bank Rate to go up much faster than had previously been expected.

Appendix F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Prudential Indicators

Appendix G

(1). AFFORDABILITY PRUDENTIAL INDICATORS	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
	£'000	**£'000**	**£'000**
Capital Expenditure	168,424	193,190	141,152
	%	**%**	**%**
Ratio of financing costs to net revenue stream	5.85%	4.85%	4.90%
Gross borrowing requirement	**£'000**	**£'000**	**£'000**
Gross Debt	332,274	332,275	332,275
Capital Financing Requirement as at 31 March	314,406	405,061	463,032
Under/(Over) Borrowing	(17,868)	72,786	130,757
	£'000	**£'000**	**£'000**
In year Capital Financing Requirement	10,941	10,800	13,814
PRUDENTIAL INDICATOR	**2020/21**	**2021/22**	**2022/23**
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS			
Authorised limit for external debt -	**£'000**	**£'000**	**£'000**
Borrowing	374,000	467,000	582,000
other long term liabilities	12,000	12,000	12,000
TOTAL	**386,000**	**479,000**	**594,000**
Operational boundary for external debt -	**£'000**	**£'000**	**£'000**
Borrowing	321,406	398,870	494,922
other long term liabilities	10,000	10,000	10,000
TOTAL	**331,406**	**326,320**	**311,976**
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / fixed term investments	100%	100%	100%
Upper limit for variable rate exposure			
Net principal re fixed rate borrowing / fixed term investments	25%	25%	25%
Upper limit for total principal sums invested for over 365 days	**£'000**	**£'000**	**£'000**
(per maturity date)	£60,000	£60,000	£60,000

Appendix H

Prudential Indicators Glossary

Ratio of financing costs to net revenue stream

The ratio of financing costs to net revenue stream shows the estimated annual revenue costs of borrowing, less net interest receivable on investments, plus repayments of capital, as a proportion of annual income from council taxpayers and central government. The estimates of financing costs include current and future commitments based on the capital programme.

Gross Borrowing

Gross borrowing refers to the Authority's total external borrowing and other long term liabilities versus the Capital Financing Requirement.

Actual and Estimated Capital Expenditure

Actual and estimates of capital expenditure for the current and future years.

Capital Financing Requirement

The Capital Financing Requirement (CFR) represents capital expenditure financed by external debt and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR measures the Authority's underlying need to borrow externally for a capital purpose. The Authority has a treasury management strategy which accords with the CIPFA Code of Practice for Treasury Management in the Public Services.

Authorised Limit

In respect of its external debt, the Authority approves authorised limits for its total external debt gross of investments. These limits separately identify borrowing from other long-term liabilities such as finance leases. Authorised Limits are consistent with the Authority's current commitments, service plans, proposals for capital expenditure and associated financing, cash flow and accord with the approved Treasury Management Policy statement and practices. The Authorised Limit is based on the estimate of most likely prudent, but not necessarily the worst-case scenario and provides sufficient additional headroom over and above the Operational Boundary.

Operational Boundary

The Operational Boundary for external debt is based on the same estimates as the authorised limit but reflects the Head of Finance's estimate of the most likely, prudent but not worst-case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in-year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified.

Limits on Interest Rate Exposure

This means that the Authority will manage fixed and variable interest rate exposure within the ranges. This provides flexibility to take advantage of any favourable movements in interest rates.

Approved countries for investments as at 30th September 2021*.*

Based on lowest available rating

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

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