Audit and Governance Committee

22nd January 2021

Title of Report	Strategy Reports 2021/22.
Purpose of Report	To provide the Committee with the proposed Capital Strategy, Treasury Management Strategy Statement and Investment Strategy for 2021/22 and the Minimum Revenue Provision Policy.
Recommendations	To consider, and comment as appropriate, on the proposed strategies for 2021/22, including the Minimum Revenue Provision Policy.
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Report

The Chartered Institute for Public Finance and Accounting (CIPFA) 2017 Prudential Code, Treasury Management Code of Practice and Ministry of Housing Communities and Local Government (MHCLG) 2018 guidance requires the Council to produce:

- A Capital Strategy (Annex 1),
- A Treasury Management Strategy (Annex 2) and
- An Investment Strategy covering non-treasury investments (included in Annex 2).

These strategies are included within the Medium Term Financial Strategy (MTFS) for approval by full Council in February 2021.

Capital Strategy 2021/22

Introduction

This capital strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this annex.

Capital Expenditure and Financing

Capital expenditure is where the Council spends money on assets, such as property or vehicles that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. Subject to all Financial Regulations and Accounting Instructions, Directors have the authority to incur expenditure provided in the capital programme approved by the County Council.

Expenditure may not be incurred if it is contrary to, or not wholly in accordance with, the Policy Framework or Capital Programme. Virements and changes to approved capital schemes can be made in accordance with the Accounting Instructions.

In 2021/22, the Budget set for planned capital expenditure is £221.9 million, summarised below.

Table 1: Estimates of Capital Expenditure

Estimates of Capital Expenditure	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
General Fund services	88.460	123.473	221.948	78.985	222.168
PFI and Finance Leases	80.369	0.000	0.000	0.000	0.000
TOTAL	**168.829**	**123.473**	**221.948**	**78.985**	**222.168**

Governance:

For the majority of service areas service managers bid annually to include projects in the Council's capital programme. The Council's project appraisal process is the methodology employed to evaluate schemes included in the MTFS. The elements are:

- Scheme description
- Fit against the Council's priorities
- Costs including whole life costs and scheme phasing
- Available funding and source
- Revenue consequences
- Risk assessment

- VAT issues
- Planning and site issues
- Target dates

Analysis of existing approved schemes will be carried out at each MTFS refresh to identify all “non-committed” schemes. If necessary these will be re-prioritised against other priority schemes awaiting approval. Capital resources will also be made available to deliver schemes that meet the Council’s “invest to save” criteria.

All Highway related projects, with a few limited exceptions are subjected to a mathematical assessment process applicable to the area of the service involved. The exceptions are the allocations that are set aside for reactive works which relates to urgent work necessary to keep the network in a safe and operational state, Community Offer where we match contributions from the community and low cost minor works where the Council reacts to needs on a local basis.

The Council has a statutory obligation to ensure there are sufficient local school places available across the County. The capital and grant funding it receives is prioritised against schemes which have been identified to meet forecast growth (basic need) in areas where additional places are required and where the condition of the school’s infrastructure needs updating and replacing. Annual monitoring of pupils forecasts and housing, together with annual inspections of school site and premises ensure the information is up to date to inform planned decisions. The Council produced a draft School Places Strategy document (2018- 2023). The strategy, which was approved by Cabinet in December 2018, is a key framework document for the Council in considering any statutory proposals for changes to school organisation including the commissioning of new schools and will inform future capital investment priorities.

The final capital programme is presented to Cabinet in January and to Council in February each year.

Full details of the Council’s current capital programme can be found in the MTFS: https://www.gloucestershire.gov.uk/council-and-democracy/performance-and-spending/budget-and-medium-term-financial-strategy/

Financing Capital Expenditure

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council’s own resources (revenue, reserves and capital receipts) or debt (including internal borrowing), leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Financing the Capital Programme

Capital Financing	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
External Sources	58.087	84.190	138.670	36.614	200.018
Internal Resources, Capital	12.602	20.068	34.951	11.304	2.001
Internal Resources, Revenue	5.786	6.900	10.309	2.667	0.949
Debt	11.985	12.315	38.018	28.400	19.200
Sub Total	**88.460**	**123.473**	**221.948**	**78.985**	**222.168**
PFI and Finance Leases	80.369	0.000	0.000	0.000	0.000
Total	**168.829**	**123.473**	**221.948**	**78.985**	**222.168**

Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as the minimum revenue provision (MRP) and leased PFI assets are financed via lease payments. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP, PFI and lease payments are as follows (there are no plans to use capital receipts in this way at the current time):

Table 3: Replacement of Debt Finance

Replacement of Debt Finance	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Minimum Revenue Provision	6.600	7.079	7.570	8.600	9.374
PFI and Finance Leases	1.098	1.338	1.177	1.468	1.268
Total	**7.698**	**8.418**	**8.747**	**10.067**	**10.642**

MRP is increasing due to more reliance on debt financing / internal borrowing to fund the approved capital programme - details of which can be found in the MTFS. The Council's full MRP statement is available within the Treasury Management Strategy, Annex 2 below.

The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP payments and capital receipts used to replace debt. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Capital Financing requirement

Capital Financing Requirement	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
General Fund services	291.436	296.671	327.119	346.919	356.746
PFI and Finance Leases	98.408	97.070	95.893	94.425	93.157
TOTAL CFR	**389.844**	**393.741**	**423.012**	**441.345**	**449.903**

Asset management:

To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. This document seeks to align the asset portfolio with the needs of the Council.

The Council's asset management strategy is available on the Council's website, www.gloucestershire.gov.uk

Asset disposals:

When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Since 2016/17 new capital receipts can also be used to fund the revenue costs of transformation projects designed to generate ongoing revenue savings in the delivery of public services and / or to transform service delivery in a way that reduces costs or demand for services in the future. The proposed budget 2021/22 does not anticipate the use of capital receipts in this way, however given the on going transformation programme and the financial challenges faced by the Council as a result of the COVID-19 pandemic it may become necessary to consider using capital receipts in this flexible manner in future. Using capital receipts in this way will require the approval of the Council.

Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £21.5 million of capital receipts in the coming financial year as follows:

Table 5: Capital Receipts

Capital receipts	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Asset sales	12.602	9.962	21.502	17.962	3.750
Investment Platform	0.037	0.035	0.028	0.000	0.000
TOTAL	**12.639**	**9.997**	**21.530**	**17.962**	**3.750**

Treasury Management

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

Due to decisions taken in the past, the Council is currently projected to have £261.8 million borrowing as at the end of March 2021 at an average interest rate of 4.72%

and £362.3 million treasury investments at an average rate of 1.273%, projected as at the end of March 2021.

Borrowing strategy:

The Council is currently holding all new long term external borrowing requirements internally. However, should the Council need to externalise this debt or take short term debt for cash flow purposes the main objectives when borrowing will be to achieve a low but certain cost of finance, while retaining flexibility should plans change in future. These objectives are often conflicting and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.15%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%).

Projected levels of the Council's total outstanding debt (which comprises borrowing and PFI liabilities are shown below, compared with the capital financing requirement (see above).

Table 6: Gross Debt and the Capital Financing Requirement

Gross Debt and the Capital Financing Requirement	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Debt (incl. Other Liabilities)	368.194	358.893	347.771	334.203	324.935
Capital Financing Requirement	389.844	393.741	423.012	441.345	449.903

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Council complies with this currently and in the longer term.

Liability benchmark:

To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing minimum level of borrowing required to keep investments at a minimum level. This benchmark is currently -£13.0 million as a result of the historical borrowing portfolio of the Council and the level of balances and reserves. The benchmark is forecast to increase to £44.5 million over the next three years due to the additional borrowing proposed. In effect, this is saying that if we had no additional investment balances / surplus cash during 2020/21 the Council would not need to borrow currently to support the capital programme.

Table 7: Borrowing and the Liability Benchmark

Borrowing and the Liability Benchmark	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Outstanding borrowing	269.786	261.823	251.878	239.778	231.778
Liability benchmark	-38.964	-13.029	15.019	34.719	44.546

The table shows that the Council expects to remain borrowed above its liability benchmark in the medium term. This is because the Council has a large historic debt portfolio, and due to the high premiums that would be incurred on the early repayment of this debt, it is not currently feasible to reduce the level of borrowing. Any new debt requirements are currently held internally, reducing the cost of carry and this additional debt results in the Council being above the liability benchmark from 2021/22. This new debt would only be externalised if it become uneconomical to hold it internally.

The purpose of the liability benchmark is to assist the Council when making decisions about affordability of the capital programme and the need to borrow in the future.

Affordable borrowing limit:

The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 8: Authorised Limit and Operational Boundary for External Debt

Authorised limit and operational boundary	**2019/20 Limit £m**	**2020/21 Limit £m**	**2021/22 Limit £m**	**2022/23 Limit £m**	**2023/24 Limit £m**
Total Authorised Limit for External Debt and Other Liabilities	**440.000**	**455.000**	**500.000**	**500.000**	**495.000**
Split: External Debt	341.592	357.930	404.107	405.575	401.843
Other Liabilities	98.408	97.070	95.893	94.425	93.157
Total Operational Boundary for External Debt	**420.000**	**435.000**	**480.000**	**480.000**	**475.000**
Split: External Debt	321.592	337.930	384.107	385.575	381.843
Other Liabilities	98.408	97.070	95.893	94.425	93.157

Further details on borrowing are available within the treasury management strategy at Annex 2 below. The Council's proposed capital programme will be contained within these affordability limits.

Treasury Investment strategy:

Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management however MHCLG guidance requires that an non treasury management Investment Strategy is maintained and can be included as part of the Treasury Management Strategy.

The Council's policy on treasury investments is to prioritise security and liquidity over yield that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Following the Motion agreed by Council in November 2019 the Council has developed and implemented a Responsible Investment Policy, which rules out new investments in fossil fuel companies.

Table 9: Treasury Manasgement Investments

Treasury Management Investments	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Near-term investments	180.4	146.5	108.5	76.7	58.8
Longer-term investments	121.9	121.9	121.9	121.9	121.9
TOTAL	**302.3**	**268.4**	**230.4**	**198.6**	**180.7**

Further details on treasury investments are within the Treasury Management and Investment strategy, Annex 2.

<u>Governance:</u>

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Section 151 Officer and staff, who must act in line with the treasury management strategy approved by annually by Council in February. Regular reports on treasury management activity are presented to Audit and Governance Committee. The Audit and Governance Committee is responsible for scrutinising treasury management decisions.

<u>Investments for Service Purposes</u>

The Council makes investments to assist local public services; this could include making loans to local service providers, small businesses to promote economic growth and Council subsidiaries that provide services. In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.

<u>Governance</u>:

Decisions on service investments are made by the relevant service manager in consultation with the Section 151 Officer and must meet the criteria and limits laid down in Accounting Regulations and the Treasury Management and Investment Strategy. Most loans and shares are capital expenditure and significant purchases will be approved as part of the capital programme.

Further details on service investments are within the Treasury Management and Investment Strategy, Annex 2.

<u>Commercial Activities</u>

With central government financial support for local public services declining, many local authorities have invested in commercial property for financial gain.

With financial return being the main objective, Council's will generally accept higher risk on commercial investment, in line with business cases, than it would for treasury investments. The principal risk exposure includes gaps in rental income, falls in capital value, delays in occupation. Should the Council choose to pursue commercial activities, the risks will be managed in line with a comprehensive business case.

Governance:

Decisions on commercial investments will be made by the Section 151 Officer in line with the criteria and limits approved by full Council in the Treasury Management and Investment Strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

Further details on commercial activities are within the Treasury Management and Investment Strategy, Annex 2.

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP payments are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 10: Proportion of financing costs to net revenue stream

	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Proportion of Financing Costs to Net Revenue Stream	5.78%	6.20%	6.23%	6.63%	6.70%

Further details on the revenue implications of capital expenditure are within Annex 8 of the MTFS document.

Sustainability:

Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because new schemes are robustly challenged through the capital bid process.

Knowledge and Skills

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council pays for staff to study towards relevant professional qualifications.

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers.

Asset valuations are co-ordinated internally by the Council's Valuation Service Team, with valuations carried out through a combination of the Council's internal valuers and, where necessary, external valuers (RICS qualified). The Valuation Service Team ensures all valuations are carried out in accordance with the methodologies and bases for estimation set out in the professional standards of the Royal Institution of Chartered Surveyors.

Annex 2

Treasury Management Strategy Statement and Investment Strategy 2021/22

Introduction

Treasury management is the management of the Councils cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered within this Strategy as per MHCLG guidance.

External Context

<u>Economic background</u>
The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU) will remain major influences on the Council's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

Credit Update

After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.

Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest Rate Forecast

The Council's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

Local Context

At 31st March 2021 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) is estimated to be £393.7 million, while usable reserves and working capital which are the underlying resources available for investment are estimated at £362.3 million. This is set out in further detail at Appendix B. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

The Council currently has £261.8 million of external borrowing, a £97.1 million lease liability (including PFI and the Waste liability) and £367.3 million (as at 29th October 2020) of internal investments. This is set out in further detail at Appendix B, and forecasts changes in these sums are shown in the balance sheet analysis at Table 1 below.

The Council's current strategy is not to borrow but to hold lower investment balances, sometimes known as internal borrowing. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2021/22.

Table 1: Balance Sheet Summary and Forecast

Balance Sheet Summary	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
General Fund CFR	389.844	393.741	423.012	441.345	449.903
Less: Other debt liabilities	98.408	97.070	95.893	94.425	93.157
Loans CFR	**291.436**	**296.671**	**327.119**	**346.919**	**356.746**
Less: External borrowing	269.786	261.823	251.878	239.778	231.778
Internal (over) borrowing	**21.650**	**34.848**	**75.241**	**107.141**	**124.968**
Less: Usable reserves	244.300	223.600	226.000	226.100	220.100
Less: Working capital	79.600	79.600	79.600	79.600	79.600
(Investments) or New borrowing	**(302.250)**	**(268.352)**	**(230.359)**	**(198.559)**	**(174.732)**

Liability benchmark

To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated and presented in the Capital Strategy, showing the lowest risk level of borrowing. This benchmark is currently -£13.2 million and is forecast to rise to £44.5 million over the next three years as the Council seeks to hold new capital borrowing requirements internally.

Borrowing Strategy

The total borrowing requirement at the end of 2020/21 is forecast to be £393.7 million (equivalent to the CFR). This is financed by historic external and a lease liability. The Council's aim is to both repay maturing debt, and where possible some of the existing debt when opportunities to do this arise. The Council also considers new borrowing where it can be shown to be prudent and financial beneficial to do so. In 2020/21 £8.0 million maturing external debt was repaid with £9.9 million being forecast to be repaid in 2021/22.

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

The Councils borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely that in the event that the Council needed to borrow it would be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as official interest rates remain low, it is unlikely to be sustained in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this ‘cost of carry’ and breakeven analysis.

In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

Sources of Borrowing and Portfolio Implications

The approved sources of long-term and short-term borrowing are:

- HM Treasury’s PWLB lending facility (formerly the Public Works Loan Board)
- UK local authorities
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Gloucestershire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback.

The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board (PWLB) but will consider long-term loans from other sources including banks, pensions and local authorities, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Audit and Governance Committee.

The Council holds £33.050 million of Lender's Option Borrower's Option (LOBO) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBO's have options during 2021/22, however lenders are unlikely to exercise their options in the current low interest rate environment. The situation with these LOBOs will be kept under regular review and the Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Previously a further £8.0 million of loans with Barclays were classified as LOBOs, however Barclays have now fixed the interest rates on these loans until maturity. These are now classified as fixed rate market loans.

Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see Financial Derivatives section below).

Debt Rescheduling

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Some bank lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

Borrowing and rescheduling activity will be reported to the Audit and Governance Committee in the Annual Treasury Management Report, the Mid Year Report and any other treasury management reports presented to Audit & Governance Committee.

Treasury Investment Strategy

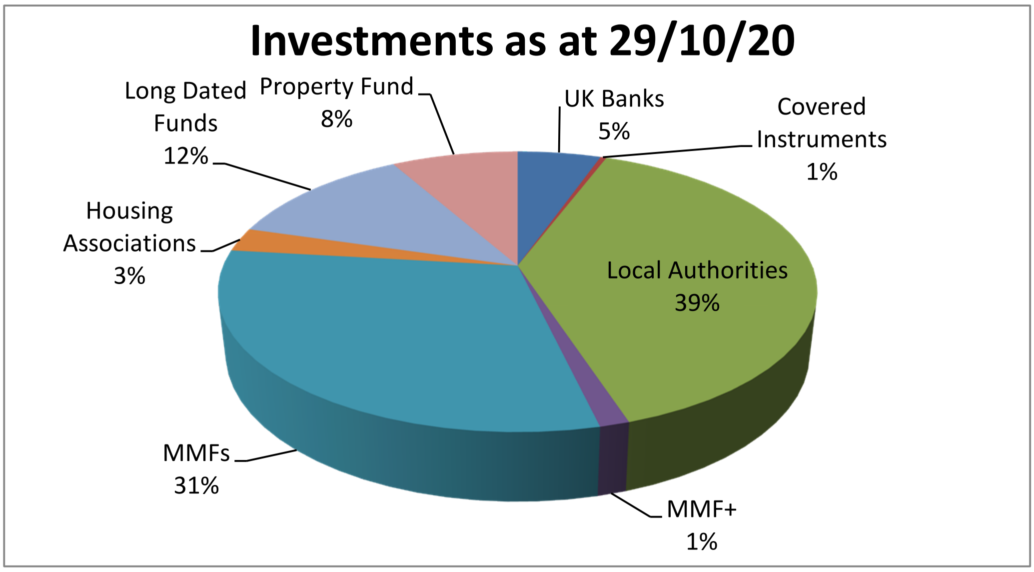
The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2020/21 the Council's internal treasury investment balance has ranged between £308.8 million and £384.8 million. Balances are expected to start falling as internal borrowing starts to become a feature of future years.

The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates:

The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue its strategy of diversifying into more secure and / or higher yielding asset classes during 2021/22. This is especially the case for funds available for longer-term investment. The pie chart below shows how the Council's surplus cash is currently invested.



Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

The Council may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty), the time limits shown and the

Responsible Investment Policy incorporated as part of the Treasury Management Policies.

Table 2: Approved Investment Counterparties

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£15m	Unlimited
Secured investments *	25 years	£30m	Unlimited
Banks (unsecured) *	13 months	£15m	Unlimited
Building societies (unsecured) *	13 months	£15m	£30m
Registered providers (unsecured) *	5 years	£15m	£30m
Money market funds *	n/a	£30m / fund	Unlimited
Strategic pooled funds	n/a	£30m	£150m
Real estate investment trusts	n/a	£30m	£30m
Other investments *	5 years	£15m	£30m

* Minimum credit rating: Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-

Table 2 should be read in conjunction with the notes below:

- **Credit Rating:**
  Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

  For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £100,000 per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

- **Government:**
  Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

- **Secured Investments:**
  These investments are secured on the borrower's assets, which limits the potential losses in the event of insolvency. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and

unsecured investments in any one bank will not exceed the cash limit for secured investments.

- **Banks and Building Societies Unsecured:**
  Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

- **Registered Providers (unsecured):**
  Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England). As providers of public services, they retain the likelihood of receiving government support if needed.

- **Money market funds:**
  Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

- **Strategic Pooled Funds:**
  Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

- **Real estate investment trusts:**
  Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

- **Other investments:**
  This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Council's investment at risk.

- **Operational bank accounts:**

The Council may incur operational exposures, for example though current accounts, and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept to a minumum. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

- **Risk assessment and credit ratings:**
  Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
  - no new investments will be made,
  - any existing investments that can be recalled or sold at no cost will be,
  - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

  Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

  Other information on the security of investments:

  The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Investment Limits

The Council's holds general revenue reserves which would be available to cover investment losses. However, in order to limit this risk, in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £30.0 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 3: Investment Limits

	Cash limit
Any group of pooled funds under the same management	£30m per manager
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£30m per country

Liquidity management:
The Council uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

The Council will spread its liquid cash over at least three providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating	A

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£50m

Interest rate exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise / fall in interest rates	£901,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

Maturity structure of borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	25%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Table 5: Upper Limit

	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Upper Limit for total principal sums invested over 364 days	200.000	200.000	200.000	200.000	200.000

The Council's Approach to Responsible Investment

The Council has implemented a Responsible Investment Policy for future Treasury Management investment.

I. For direct investments, the Council will seek to ensure that counterparties (excluding the UK Government and other UK Local Authorities) have no direct investment in Fossil Fuel companies prior to investing.

II. For additional investments into Pooled Funds the Council will seek to ensure that any fund used does not have exposure to Fossil Fuel investments prior to investing.

Non Treasury Investment Strategy

The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- to support local public services by lending to or buying shares in other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This section of the report is concerned with meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories, service and commercial investments.

Service Investments: Loans

The Council can lend money to support local public services and stimulate local economic growth. The Council has previously made a £100,000 investment in the Funding Circle platform, designed to support local businesses and economic growth within Gloucestershire. The Council is currently disinvesting from the platform and to date has received back £71,838.90.

Where loans are made for service purposes accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. Following changes to Accounting Standards the figures for loans in the Council's statement of accounts from 2018/19 onwards will be shown net of this loss allowance, where material.

Service Investments: Shares

The Council holds shares costing £1 in Ubico Ltd. The fair value of the council's interest in the company at 31st March 2020 is considered to be nil, since it is a wholly local authority owned not-for-profit 'Teckal' company. As a 'Teckal' company it is treated as if it were an in house department and the shareholder councils are able to enter into service contracts with the company without undertaking an EU compliant procurement process.

Commercial Investments: Property

The Council has not invested in Commercial Property to date and has no plans to do so.

It has however invested in Gloucestershire based regeneration projects which have a commercial element and will continue to look at similar regeneration projects in future. Should the Council identify such a regeneration opportunity it will require a detailed business case and will only do so in accordance with government guidance. The Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

The Council will assess the risk of loss before entering into and whilst holding property investments by producing a comprehensive business plan and monitoring performance on an ongoing basis.

Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

The Council has guaranteed to cover the liabilities associated with the pensions of ex-employees following the transfers of council services to external bodies. These arrangements are monitored and assessed to ensure that any provision for possible liabilities are made, and included within the Statement of Accounts.

Capacity, Skills and Culture

The Council provides training from our Treasury Management Advisors to members of the Audit and Governance Committee on an annual basis, to ensure that they are fully aware of the investments included in the Treasury Management Strategy and Investment Strategy. This training will also cover the requirements of the Capital Strategy and the non Treasury Management investments. This ensures that members can take informed decisions on the investments being included in the strategies, and have the opportunity to challenge their use to ensure that they fully understand the implications of the investment.

Where commercial deals are to be negotiated, Finance will be involved to ensure that the core principles of the prudential framework and of the regulatory regime within which local authorities operate is taken into account.

Investment Indicators

The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down, and guarantees the Council has issued over third party loans, if any. It assumes that balances for treasury investments reduce as reserves reduce.

Table 1: Total Investment Exposure

Total investment exposure	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Treasury management investments	308.8	274.9	236.9	205.1	187.2
Service investments: Loans	0.0	0.0	0.0	0.0	0.0
Commercial investments: Property	0.0	0.0	0.0	0.0	0.0
Total Exposure	**308.8**	**274.9**	**236.9**	**205.1**	**187.2**

Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However the table below shows that the Council will not hold any investments funded by borrowing as usable capital receipts plus its working capital are expected to exceed total investments. This is indicative that the Council uses internal borrowing to fund part of its capital programme..

Table 2: Investments funded from

Investments funded by borrowing	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Treasury management investments	-15.1	-28.3	-68.7	-100.6	-118.5
Commercial investments: Property	0.0	0.0	0.0	0.0	0.0
Total Funded by Borrowing	**-15.1**	**-28.3**	**-68.7**	**-100.6**	**-118.5**

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred. Where a negative return is shown, this has occurred as costs are greater than investment income received.

Table 3: Investment RoR

Investments net rate of return	2019/20 Actual %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %
Treasury management investments	1.78	1.82	1.86	1.90	1.95
Service investments: Loans	4.50	0.00	0.00	0.00	0.00

Other items

The CIPFA Code requires the Council to include the following in its treasury management strategy.

Financial Derivatives

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Markets in Financial Instruments Directive

The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, this is the most appropriate status.

2021/22 Minimum Revenue Provision Statement

The Minimum Revenue Provision (MRP) was introduced when the Local Government Capital Finance System was changed on 1 April 1990. CLG's Guidance on MRP places a duty on local authorities to make a prudent provision for debt redemption.

Guidance has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003. The MRP Statement must be submitted to Council before the start of the financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement would be put to Council at that time.

In line with Council policy on the repayment of debt, and with the continuation of capital grants by government, the Council has not borrowed externally to fund the capital programme over the last 8 years. Opportunities are now limited for the repayment of debt early due to the low interest rate environment, meaning that high premiums would need to be paid should the Council wish to restructure or repay external debt early. Maturing debt will continue to be redeemed over the next few years, and where opportunities present to repay internal borrowing this will be by way of a voluntary revenue provision.

In order to ensure that the MRP charge remains prudent, the Council regularly reviews its Capital Financing Requirement. To reduce the amount of excess MRP set aside, the Council changed its policy for supported capital expenditure in 2015/16. The method used is similar to other local authorities and sets aside a fixed sum of MRP each year. For Gloucestershire the fixed sum was set at £8.2m.

Following further review of the Capital Financing Requirement and the Prudential Indicators, and discussions with the Council's treasury advisors (Arlingclose) and external auditor (Grant Thornton) the MRP charge was further reduced during 2017/18 for existing debt to £6.2 million. This change still allows for a prudent provision for the repayment of existing debt, and ensures that Prudential Indicators are not breeched.

The asset life of capital assets obtained through the capital programme will form the basis of calculating an annual MRP provision for any new borrowing requirement going forward. For any commercial related investments a business case review will be carried out and an appropriate provision for the repayment of any debt taken, set aside.

MRP in respect of PFI and finance leases brought on Balance Sheet under the IFRS-based Code of Practice will match the annual principal repayment for the associated deferred liability.

Appendix A

Arlingclose's Economic and Interest Rate Forecast

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Underlying Assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.

- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.

- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.

- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.

- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.

- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- The central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out, especially with likely emergency action in response to a no-deal Brexit.
- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.
- Downside risks remain in the near term, as the government continues to react to the escalation in infection rates and the Brexit transition period comes to an end.

Appendix B

EXISTING PORTFOLIO PROJECTED FORWARD

	Portfolio 29-Oct-20 Actual £m	Average Rate %	31-Mar-21 Estimate £m	31-Mar-22 Estimate £m	31-Mar-23 Estimate £m	31-Mar-24 Estimate £m
External Borrowing						
Fixed Rate – PWLB	220.773	4.89	220.773	210.828	198.728	190.728
Fixed Rate – Market	33.050	4.24	33.050	33.050	33.050	33.050
Variable Rate – PWLB	0.000	0.00	0.000	0.000	0.000	0.000
Variable Rate – Market	8.000	5.00	8.000	8.000	8.000	8.000
Total External Borrowings	**261.823**	**4.79**	**261.823**	**251.878**	**239.778**	**231.778**
Other long-term liabilities (PFI)	97.070		97.070	95.893	94.425	93.157
Total External Debt	**358.893**		**358.893**	**347.770**	**334.203**	**324.935**
Treasury Investments:						
Managed in house						
- Short term deposits and monies on call and Money Market Funds	235.968	0.56	198.968	160.950	132.550	113.350
- Long Term investments (over 12 months)	56.300	1.29	88.300	88.300	88.300	88.300
Managed externally / Strategic Funds	75.000	4.00	75.000	75.000	75.000	75.000
Total Investments	**367.268**	1.37	**362.268**	**324.250**	**295.850**	**276.650**
Net (Borrowing) / Investment Position	**8.375**		**3.375**	**(23.520)**	**(38.353)**	**(48.285)**