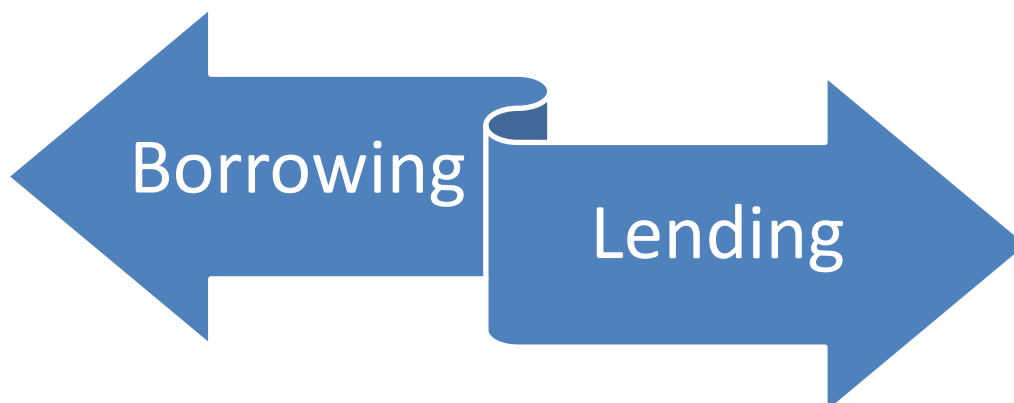


FAREHAM
BOROUGH COUNCIL

**TREASURY MANAGEMENT
STRATEGY
AND
INVESTMENT STRATEGY
2021/22**



INTRODUCTION

WHAT IS TREASURY MANAGEMENT?

1. Treasury Management is defined as:

The management of the organisation's cash flows, its banking, money market and capital market transactions;

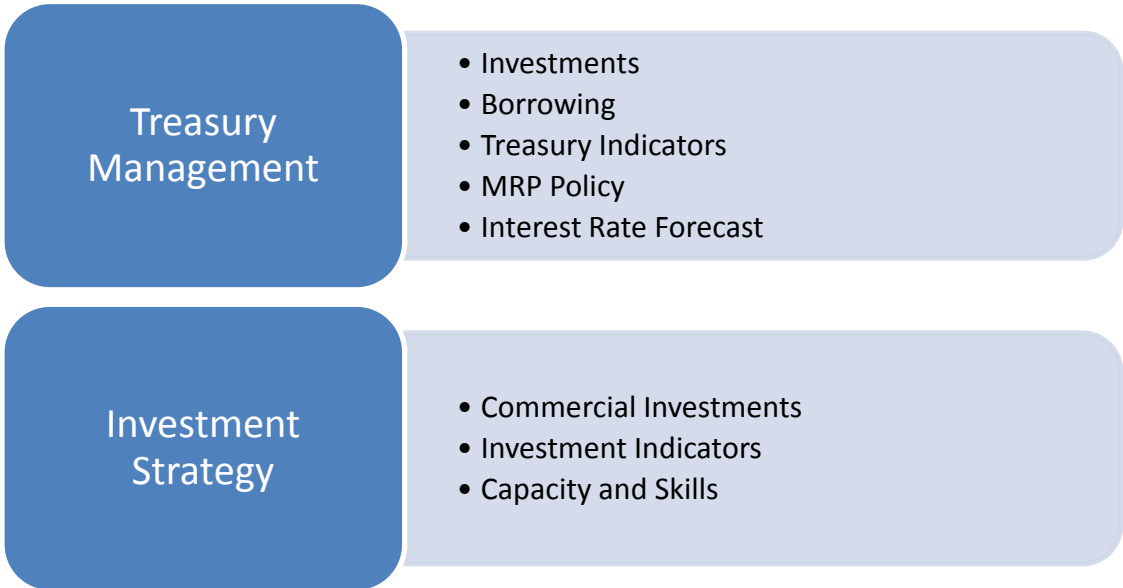
the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.

2. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. There are two aspects to the treasury management service:

- a) To ensure the cash flow is adequately planned, with **cash being available when it is needed**. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- b) To ensure the cash flow meets the Council's **capital plans**. These capital plans provide a guide to the **borrowing need** of the Council. Essentially this is the longer term cash flow planning to ensure that the Council can meet its capital spending requirements. The management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CONTENT OF THE TREASURY MANAGEMENT AND INVESTMENT STRATEGIES

3. These strategies set out the expected approach to treasury management and investment activities for 2021/22. It covers two main areas:



4. The content of the Strategies is designed to cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

REPORTING REQUIREMENTS

5. The Council receives and approves three main reports each year in relation to Treasury Management, which incorporate a variety of policies, estimates and actuals. The three reports are:



6. The Executive Committee is responsible for the implementation and monitoring of these reports whilst the Audit and Governance Committee is responsible for the effective scrutiny of the treasury management strategy and policies.

TREASURY MANAGEMENT STRATEGY

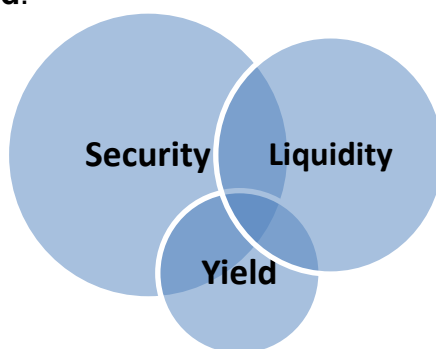
INVESTMENTS

Current Portfolio Position

7. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £14 million and £44 million. The higher balances are due to COVID-19 related Government grants received in advance and are expected to reduce in the forthcoming year.

Treasury Investment Strategy

8. The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investments before seeking the highest rate of return, or **yield**.



9. 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 of 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.
10. 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.
11. Given the increasing risk and very low returns from short-term unsecured bank investments, the Council has diversified **into more secure and/or higher yielding asset classes**. This is the case for the estimated £12 million that is available for longer-term investment. The Council's surplus cash remains invested in short-term unsecured bank deposits and money market funds. This diversification represents a continuation of the strategy adopted in 2018/19.
12. 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 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.

Approved Counterparties

13. The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the limits shown.

Sector	Time Limit	Counterparty Limit	Sector Limit
UK Government	50 years	Unlimited	n/a
Local authorities and other government entities	25 years	£4m	Unlimited
Secured investments*	25 years	£4m	Unlimited
Banks (unsecured)*	13 months	£2m	Unlimited
Building Societies (unsecured)*	13 months	£2m	£4m
Money market funds*	n/a	£4m	Unlimited
Strategic pooled funds	n/a	£4m	£20m

14. 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-**. 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.
15. For entities without published credit ratings, investments may be either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £2 million per counterparty as part of a diversified pool.
16. Summary of counterparty types:
- a) **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 Government are deemed to be zero risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.
 - b) **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

- c) **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. See below for arrangements relating to operational bank accounts.
- d) **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.
- e) **Strategic Pooled Funds:** Bond, equity and property funds that 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.
17. The Council may also invest its surplus funds in corporates (loans, bonds and commercial paper issued by companies other than banks), registered providers (loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations) and real estate investment trusts, subject to meeting the minimum credit rating criteria and time limits recommended by the Council's treasury advisers.

Operational Bank Accounts

18. The Council may incur operational exposures, for example through current accounts, collection 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 below £4 million per bank. 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

19. 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, and

- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
20. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day 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

21. 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 and reports in the quality financial press and analysis and advice from the Council 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 credit rating criteria.
22. 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 investment returns to fall but will protect the principal sum invested.
23. The following **internal measures** are also in place:
- Investment and borrowing decisions formally recorded and endorsed using a Counterparty Decision Document.
 - Monthly officer reviews of the investment and borrowing portfolio and quarterly reviews with the Chief Executive Officer.

Investment Limits

24. The Council’s revenue reserves available to cover investment losses are forecast to be £5 million on 31st March 2021. In order to minimise 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 **£4 million**. A group of entities under the same ownership will be treated as a single organisation for limit purposes.
25. Limits are also placed on fund managers, investments in brokers’ nominee accounts and foreign countries as in the table 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.

	Cash limit
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£4m per country

Liquidity Management

26. The Council uses a purpose-built cash flow forecasting spreadsheet 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.
27. The Council will spread its liquid cash over at least **four 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.

BORROWING

Current Portfolio Position

28. The Council's borrowing position at 31 March 2020, with forward projections are summarised below.

£'000	2020/21 Revised	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt at 1 April	57,700	59,700	72,700	81,700	79,700
Expected change in debt	2,000	13,000	9,000	(2,000)	(2,000)
Gross Debt at 31 March	59,700	72,700	81,700	79,700	77,700

29. Debt at 31 March 2021 is projected to be lower than originally estimated last year due to the use of internal borrowing rather than borrowing externally to fund the capital programme.

Borrowing Strategy

30. The Council's main objective when borrowing money is to strike an appropriately low risk balance between **securing low interest costs** and achieving **certainty of those costs** over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
31. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.
32. With short-term interest rates currently much lower than long-term rates, it is likely

to be more cost effective in the short term to either **use internal resources**, or to **borrow short-term** loans instead.

33. By doing so, the Council can reduce net borrowing costs (despite foregone investment income) and **reduce overall treasury risk**. The benefits of internal borrowing or short-term 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.
34. Our treasury advisers will assist the Council with this '**cost of carry**' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
35. The Council has previously raised all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.
36. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield.
37. Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.
38. In addition, the Council may borrow further short-term loans to cover unexpected cash flow shortages.

Sources of Borrowing

39. The approved sources of long-term and short-term borrowing are:
 - HM Treasury's PWLB lending facility (formerly the Public Works Loan Board).
 - Any institution approved for investments.
 - 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 the Hampshire County Council Pension Fund).
 - Capital market bond investors.
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.
40. 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

41. **Municipal Bonds Agency:** 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 full Council.
42. **Short-Term and Variable Rate Loans:** These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.
43. **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. 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 cost saving or a reduction in risk.
44. **Borrowing Limits:** These have been set as part of the Capital Strategy for 2021/22.

TREASURY MANAGEMENT INDICATORS

45. The Council measures and manages its exposures to treasury management risks using the following three treasury management indicators.
46. *Treasury Management Indicator 1 - Principal sums invested for 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 year end will be:

£M	2020/21 Revised	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Limit on principal invested beyond year end	15	15	15	15	15

47. *Treasury Management Indicator 2 - Maturity structure of borrowing:* This treasury 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:

Maturity structure of borrowing	Upper Limit %	Lower Limit %
- Loans maturing within 1 year	50	0
- Loans maturing within 1 - 2 years	50	0

- Loans maturing within 2 - 5 years	50	0
- Loans maturing within 5 - 10 years	50	0
- Loans maturing in over 10 years	100	100

48. 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.
49. *Treasury Management Indicator 3 - Housing Revenue Account (HRA) ratios:* As a result of the HRA Reforms in 2012, the Council moved from a subsidy system to self-financing and was required to take on **£49.3 million** of debt. The table below shows additional local indicators relating to the HRA in respect of this debt.

	2020/21 Revised	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
HRA debt £'000	49,268	49,268	49,268	49,268	49,268
HRA revenues £'000	12,263	12,353	13,039	13,571	13,994
Number of HRA dwellings	2,401	2,422	2,422	2,414	2,406
Ratio of debt to revenues %	4.02:1	3.99:1	3.78:1	3.63:1	3.52:1
Debt per dwelling £	£20,518	£20,340	£20,340	£20,407	£20,475
Debt repayment fund £'000	£4,560	£5,700	£6,840	£7,980	£9,120

MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

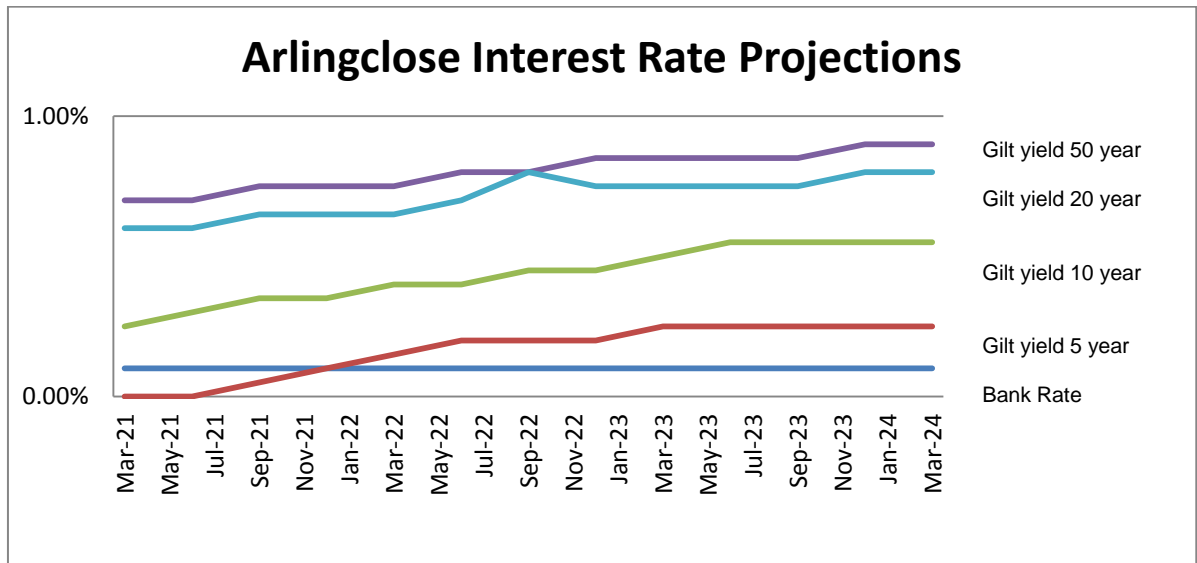
50. Where the Council finances capital expenditure by debt, it must **put aside resources to repay that debt** in later years. The amount charged to the revenue budget for the repayment of debt is known as **Minimum Revenue Provision (MRP)**.
51. The Council is required to set an annual policy on the way it calculates the prudent provision for the repayment of General Fund borrowing. The main policy adopted is that MRP will be determined by charging the expenditure over the **expected useful life** of the relevant assets on an **annuity basis** starting in the year after the asset becomes operational. This calculation will be reviewed on a case by case basis depending on the circumstances and with a view to minimising the impact on the council tax payer.
52. Where expenditure is on an asset which will be held on a short-term basis (up to 5 years), no MRP will be charged. However, the capital receipt generated by the sale of the asset will be used to repay the debt instead.
53. No MRP will be charged in respect of assets held within the HRA, in accordance with MHCLG Guidance and capital expenditure incurred during 2021/22 will not be subject to an MRP charge until 2022/23.

INTEREST RATE FORECAST

54. The Council's treasury management advisers assist the Council to formulate a

view on interest rates. The latest detailed economic and interest rate forecast provided by Arlingclose is attached at Annex 1.

55. The following graph and commentary gives the Arlingclose’s central view on interest rates.



56. The Council’s treasury management adviser Arlingclose is forecasting that 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 Bank of England (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.
57. 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.

Other Items

58. The CIPFA Code requires the Council to include the following in its Treasury Management Strategy.
59. **Policy on Apportioning Interest to the HRA:** On 28 March 2012, the Council borrowed £40 million from the Public Works Loan Board (PWLb) to buy itself out of the HRA subsidy System. The monies were borrowed by the General Fund on behalf of the HRA. The interest on these loans is charged to the HRA on a half-yearly basis at the rate charged by PWLB. A further £9.268 million was lent by the General Fund to the HRA to complete the buyout. Interest on this element is charged at the average weighted rate of the PWLB loans.

60. The unfunded HRA capital financing requirement is also charged to the HRA at the average weighted rate of the PWLB loans.
61. The General Fund credits the HRA with interest earned on HRA credit balances calculated on the monthly movement in reserve balances and applied at year end. The rate used is the weighted interest rate on General Fund investments and cash balances.
62. **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, the Chief Financial Officer believes this to be the most appropriate status.

Financial Implications

63. The budget for interest received in 2021/22 for the General Fund is £818,700 and the HRA is £98,000 and the budget for debt interest paid in 2021/22 is £259,000 for the General Fund and £1,794,900 for the HRA. If actual levels of investments and borrowing, and actual interest rates differ from that forecast, performance against budget will be correspondingly different.

Other Options Considered

64. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain

Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain
---------------------------	--	--

INVESTMENT STRATEGY

65. 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).
66. This investment strategy meets the requirements of statutory guidance issued by the Government in January 2018 and focuses on the third of these categories.
67. The Council does not currently have any service investments.

COMMERCIAL INVESTMENTS

68. The Council invests in local and some regional UK commercial property with the intention of making a profit that will be spent on local public services.
69. Since the Executive approval of a Commercial Property Investment Acquisition Strategy in January 2013, the Council has purchased commercial investment properties currently valued at **£35.3 million**, as summarised below, averaging a return of **6.8%**.

Property Type	Current Value £'000
Retail	22,195
Commercial	11,078
Other	2,050
Total	35,323

70. The Council's total Commercial property portfolio, shown below, is valued at **£64.3 million** and includes Fareham Shopping Centre, Faretec and industrial estates at Palmerston Business Park and Newgate Lane.

Property Type	Current Value £'000
Retail	36,077
Commercial	18,796
Other	4,403

Office	3,786
Leisure	1,202
Total	64,264

71. A fair value assessment of the Council's more recent commercial property purchases has been made within the past twelve months, and the underlying assets provide security for capital investment.
72. The Council assesses the risk of loss before entering into and whilst holding property investments. These risks are managed by ensuring:
- funds available for new purchases are disaggregated to limit the overall impact that any single investment would have on the Council's finances;
 - new purchases are only considered with existing tenants of "high quality" and sufficiently long tenancy term;
 - appropriate checks are carried out to ascertain the tenant's reliability;
 - other "due diligence" is undertaken to protect the Council's investment as far as possible such as checks on planning conditions, land contamination issues and planning policy issues.

Proportionality

73. The Council is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives is dependent on achieving the expected net profit from investments over the lifecycle of the Medium-Term Financial Strategy.

£'000	2019/20 Actual	2020/21 Revised	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Gross service expenditure	50,017	46,353	45,281	46,251	46,603	46,836
Investment income	4,442	4,521	4,308	4,521	4,521	4,521
Proportion	8.9%	9.8%	9.5%	9.8%	9.7%	9.7%

INVESTMENT INDICATORS

74. The Council has set the following three investment indicators to assess the Council's total risk exposure as a result of its investment decisions.
75. *Investment Indicator 1 - Total risk exposure:* The first indicator shows the Council's total exposure to potential investment losses.

Total Investment Exposure £'000	2019/20 Actual	2020/21 Revised	2021/22 Estimate
Treasury Management Investments	16,300	12,000	12,000
Commercial Investments	64,068	64,068	64,068
Total	80,368	76,068	76,068

76. *Investment Indicator 2 - How investments are funded:* 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 following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Investments Funded by Borrowing £'000	2019/20 Actual	2020/21 Revised	2021/22 Estimate
Treasury Management Investments	0	0	0
Commercial Investments	31,790	31,042	30,272
Total	31,336	31,042	30,272

77. *Investment Indicator 3 - 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.

Investments Net Rate of Return	2019/20 Actual	2020/21 Revised	2021/22 Estimate
Treasury Management Investments	3.0%	2.8%	3.5%
Commercial Investments	3.6%	2.2%	1.1%
Total	3.6%	2.3%	1.6%

CAPACITY AND SKILLS

Training

78. The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.
79. Treasury management officers regularly attend training courses, seminars and conferences provided by the Council's treasury management advisers and CIPFA.
80. Property services officers also regularly attend training courses, seminars and conferences provided RICS (Royal Institution of Chartered Surveyors) accredited/approved providers.

Use of Treasury Management Consultants

81. The Council has appointed Arlingclose as treasury management advisers and receives specific advice on investment, debt and capital finance issues.
82. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.
83. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and

subjected to regular review.

ARLINGCLOSE ECONOMIC AND INTEREST RATE FORECAST

Economic Background – January 2021

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 Authority'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.

The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

Credit Outlook – January 2021

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.

Underlying assumptions – December 2020

- 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 – December 2020

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Our 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, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.