Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2021/22

Including commercial activities / non-treasury investments

INTRODUCTION

Background

1. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The function of treasury management is to ensure that the Council's capital programme and corporate investment plans are adequately funded, and the cashflow is adequately planned, with cash being available when it is needed to discharge the Council's legal obligations and deliver Council services. Surplus monies are invested to obtain an optimal return, while ensuring security of capital and liquidity.

2. CIPFA defines treasury management as:

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

3. The Council has formally adopted CIPFA's Code of Practice on Treasury Management and follows the key requirements of the Code as set out in Appendix 5.

4. The TMSS covers five main areas summarised below:

Section 1 Capital spending

- Capital strategy
- Commercial activity
- Capital Finance Requirement (CFR)
- Affordability
- Minimum Revenue Provision (MRP) policy statement

Section 2 Borrowing

- Overall borrowing strategy
- Post-PWLB interest rate increase borrowing strategy
- Alternative Borrowing Options
- Limits on external borrowing
- Maturity structure of borrowing
- Policy on borrowing in advance of need
- Debt rescheduling

Section 3 Managing cash balances

- The current cash position and cash flow forecast
- Prospects for investment returns
- Pension pre-funding payment
- Council policy on investing and managing risk
- Balancing short and long term investments

Section 4 Summary of Prudential Indicators

Section 5 Legal Implications

5. The Annual Investment Strategy (AIS) at Appendix 2 provides more detail on how the Council's surplus cash investments are to be managed in 2021/22. Approved schedules of specified and non-specified investments will be updated following consideration by Members and finalisation of 2021/22 budget plans.

SECTION 1 - CAPITAL SPENDING

Capital spending plans

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

7. Table 1 summarises the Council's capital expenditure plans, both in terms of those projects agreed previously, and those forming part of the current budget cycle. The table sets out the Council's current expectations reference the revenue or capital financing.

8. Compared with the forecast in the original 2020/21 TMSS, General Fund capital spend has slipped back by around £6m and HRA capital spend by £11m in 2019/20. The slippage is forecast to be recovered in the 2020/21 revised budget and subsequent years. However there remains a risk of further slippage in future years.

9. The risks are that:

- continued slippage in new starts will push borrowing requirements to later years when interest rates are forecast to be higher than currently;
- slippage in the programme of capital receipts may increase the need to borrow in the short to medium term.

Table 1 Capital spending and funding plans (Prudential Indicator 1)

2019/20 Actual £000s		2020/21 Forecast £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s	Total £000s
	Expenditure							
81,665	General Fund	91,583	95,281	61,570	41,404	6,722	48	296,608
41,144	HRA	58,776	68,192	34,423	29,209	18,791	18,480	227,871
122,809		**150,359**	**163,473**	**95,993**	**70,613**	**25,513**	**18,528**	**524,479**
	Funding							
	General Fund							
(31,198)	Government Grant	(21,759)	(16,748)	(26,564)	(16,205)	0	0	(81,276)
0	Other Contributions	(1,455)	(2,625)	(1,750)	0	0	0	(5,830)
(3,767)	Revenue Contributions	(4,250)	(54)	0	0	0	0	(4,304)
(16,639)	Capital Receipts	(12,265)	(6,563)	0	0	0	0	(18,828)
0	Self-Financed via Future Disposal	(37,446)	(56,210)	(19,258)	(16,328)	(5,722)	(48)	(135,012)
	HRA							
(10,587)	Major Repairs Reserve	(18,412)	(11,916)	(12,214)	(12,519)	(12,832)	(13,153)	(81,046)
(27,562)	Government Grant	(500)	(3,826)	(17,846)	(3,926)	0	0	(26,098)
0	Other Contributions	(4,068)	(4,384)	(5,006)	(1,100)	(1,163)	(4,470)	(20,191)
(1,271)	Revenue Contributions	(3,275)	(11,610)	(5,746)	(8,651)	(4,481)	0	(33,763)
(1,724)	Capital Receipts	(2,305)	(1,364)	(325)	(421)	(315)	(857)	(5,587)
0	Self-Financed via Future Disposal	0	(2,226)	(1,813)	(3,242)	0	0	(7,281)
(92,748)		**(105,735)**	**(117,526)**	**(90,522)**	**(62,392)**	**(24,513)**	**(18,528)**	**(419,216)**
30,061	**Net financing need for the year**	**44,624**	**45,947**	**5,471**	**8,221**	**1,000**	**0**	**105,263**

Commercial activity

10. As well as investing in assets owned by the Council and used in the delivery of services, the Council can also invest, where appropriate, in:

- infrastructure projects, such as green energy;
- loans to third parties;
- shareholdings, and loans to limited companies and joint ventures.

11. Such investments are treated as capital expenditure for treasury management and prudential borrowing purposes even though they do not create physical assets in the Council's accounts. Appropriate budgets in respect of these activities are agreed as part of the Council's budget setting and ongoing monitoring processes and considered as part of the Annual Investment Strategy.

12. Currently the Council is invested in the following activities which fall within the category of commercial activity under the CIPFA Prudential Code:

- a small commercial investment property portfolio comprising the Tramworks site acquired in October 2017 valued at £7.8m at 31 March 2020. The Council also has three industrial estates at Lockwood Road, Acacia and Hainault Road. These are held as operational assets as they were principally acquired for economic regeneration and fall outside the commercial activity category under the Prudential Code. Nonetheless they are managed to achieve a commercial rate of return.
- Investment in a number of Council companies summarised in Table 2 below.

Table 2 Investment in Council companies

Company name	Share holding	Nominal value £	Net Worth 31/3/2020 £000s
Subsidiaries			
Waltham Forest Services Ltd	100%	100	(31)
Waltham Forest Trading Ltd	100%	100	0
Sixty Bricks Ltd	100%	100	(1,444)
Walthamstow Scene Ltd	100%	1	0
Joint Venture			
More Homes Waltham Forest LL	50%	100	(865)
Associate			
NPS (London) Ltd	20%	2	(742)
Investments in PFI companies			
Waltham Forest Local Education Partnership Ltd	10%	5,500	(7)
BY Education (Waltham Forest) Holdings Ltd	10%	5,000	(367)
Total		**10,903**	**(3,456)**

13. In addition to the investment of £10,903 in the above companies, the Council has provided a loan facility for working capital to Sixty Bricks Ltd of £2m of which £1.444m has been advanced.

14. The Council has Board representation on all companies. The Council's Shareholder Committee represents its interests in its wholly owned companies and other companies, ensuring that they act in the interests of the borough and contribute to the Council's objectives.

15. The Council is not dependent on income generated from the companies, as they are primarily for delivering service policy objectives for the Council. The accumulated losses to date of £3.456m are largely concerned with initial set-up costs and expected to reverse over the next three years as the companies develop further. Equally, the Council's financial accounts review have highlighted any going concern or value for money issues. It should be noted that progress has been delayed in 2019/20 and 2020/21 by the impact of the Covid-19 pandemic.

Capital Financing Requirement (CFR)

16. The CFR measures the extent to which capital expenditure has not yet been financed from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

17. In addition to traditional capital expenditure on tangible assets, such as buildings, the CFR includes PFI schemes and finance leases. Whilst these increase the CFR, and therefore the Council's borrowing requirement, these contracts include an element of the charge to repay the financing provided by the PFI provider or the lessor. Consequently, the Council is not required to separately borrow for these schemes. At 31 March 2020, £47.4m of the CFR was in respect of PFI schemes and finance leases.

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

19. Table 3 shows that the CFR will increase over the medium term. Consequently, the capital financing charge to revenue will increase, reflecting the capital spending plans.

Table 3 Capital Financing Requirement forecast (Prudential Indicator 2)

2019/20 Actual £000s		2020/21 Forecast £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s
	CFR as at 31 March						
248,053	General Fund	262,461	275,542	289,540	298,411	299,411	299,411
200,631	HRA	230,847	263,713	255,186	254,536	254,536	254,536
448,684		**493,308**	**539,255**	**544,726**	**552,947**	**553,947**	**553,947**
	Annual change						
27,433	General Fund	14,408	13,081	13,998	8,871	1,000	0
0	HRA	30,216	32,866	(8,527)	(650)	0	0
27,433		**44,624**	**45,947**	**5,471**	**8,221**	**1,000**	**0**
	Reason for change						
35,384	Net financing	49,629	51,582	11,701	14,385	6,663	5,466
(7,951)	Less MRP	(5,005)	(5,635)	(6,230)	(6,164)	(5,663)	(5,466)
27,433		**44,624**	**45,947**	**5,471**	**8,221**	**1,000**	**0**

20. Table 4 below confirms that the Council's gross debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current year and the following financial years. This allows some flexibility for limited early borrowing for future years and ensures that borrowing is not undertaken for revenue purposes.

Table 4 Borrowing compared to the CFR (Prudential Indicator 3)

2019/20 Actual £000s		2020/21 Forecast £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s
338,694	Gross Projected Debt	275,035	268,974	262,750	259,235	245,751	245,421
448,684	Capital Financing Requirement	493,308	539,255	544,726	552,947	553,947	553,947
109,990	**Under/(over) borrowing**	**218,273**	**270,281**	**281,976**	**293,712**	**308,196**	**308,526**

Affordability

21. The objective of the affordability indicator is to ensure that the level of investment in capital assets proposed remains within sustainable limits and, in particular, the impact on the Council's "bottom line". The estimates of financing costs include current commitments and the proposals in the Council's budget report. Table 5 below sets out the expected ratio of capital financing costs to income for both General Fund and HRA activities:

Table 5 Ratio of capital financing costs to income Prudential Indicator 4)

2019/20 Actual		2020/21 Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
6.80%	General Fund	4.40%	5.38%	5.77%	5.76%	5.50%	5.19%
30.04%	HRA	32.23%	35.53%	34.55%	35.68%	34.44%	33.68%

22. For the medium-term, gross capital financing charges (loan interest, MRP and finance and PFI payments) for the General Fund capital programme are largely outweighed or balanced by income from investments and the commercial property portfolio.

23. The capital financing charges arising from the HRA capital programme increase in line with the forecast increase income, hence capital charges as a proportion of the HRA net revenue stream remain fairly steady. Table 4 shows an increase of 11% between the outturn for 2019/20 and the forecast for 2020/21. This is because depreciation charges (which fund the Major Repairs Reserve) are expected to double from £7m to £14m and continue to rise thereon. This reflects the increase in value of the housing stock anticipated from the completion of the HRA Major Works programme.

Minimum Revenue Provision Policy Statement

24. Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ('the 2003 Regulations') requires local authorities to 'charge to a revenue account a minimum revenue provision (MRP) for that year'. The minimum revenue provision is an annual amount set aside from the General Fund to meet the cost of capital expenditure that has not been financed from available resources, namely: grants, developer contributions (e.g. s.106 and community infrastructure levy) revenue contributions, earmarked reserves or capital receipts.

25. MRP is sometimes referred to as the mechanism for setting aside monies to repay external borrowing. In fact, the requirement for MRP set aside applies even if the capital expenditure is being financed from the Council's own cash resources and no new external borrowing or other credit arrangement has been entered into.

26. Regulation 28 of the 2003 Regulations requires full Council to approve a Minimum Revenue Provision (MRP) Statement setting out the policy for making MRP and the amount of MRP to be calculated which the Council considers to be prudent. This statement is designed to meet that requirement.

27. In setting a prudent level of MRP local authorities must "have regard" to guidance issued from time to time by the Secretary of State for Housing, Communities and Local Government. The

latest version of this guidance (version four) was issued by Ministry of Housing, Communities and Local Government (MHCLG) in February 2018.

28. In setting a level which the Council considers to be prudent, the Guidance states that the broad aim is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits to the Council.

29. The Guidance sets out four “possible” options for calculating MRP, as set out below,

Option	Calculation method	Applies to
1: Regulatory method	Formulae set out in 2003 Regulations (later revoked)	Expenditure incurred before 1 April 2008
2: CFR method	4% of Capital Financing Requirement	Expenditure incurred before 1 April 2008
3: Asset life method	Amortises MRP over the expected life of the asset	Expenditure incurred after 1 April 2008
4: Depreciation method	Charge MRP on the same basis as depreciation	Expenditure incurred after 1 April 2008

30. Two main variants of Option 3 are set out in the Guidance (i) the equal instalment method and (ii) the annuity method. The annuity method weights the MRP charge towards the later part of the asset’s expected useful life and is increasingly becoming the most common MRP option for local authorities.

31. The Guidance also includes specific recommendations for setting MRP in respect of finance lease, investment properties and revenue expenditure which is statutorily defined as capital expenditure under the 2003 Regulations (also referred to as revenue expenditure funded from capital under statute or REFCUS). Examples of REFCUS include capitalised redundancy costs, loans or grants to third parties for capital purposes, and the purchase of shares in limited companies.

32. Other approaches are not ruled out however they must meet the statutory duty to make prudent MRP provision each financial year.

33. The 2021/22 MRP policy does not propose any changes from the 2020/21 approved policy, which is at Appendix 1.

SECTION 2 - BORROWING

Overall borrowing strategy

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

35. The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. 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 long-term stability of the debt portfolio.

36. The key factors influencing the 2021/22 strategy are:

    - forecast borrowing requirements,
    - the current economic and market environment, and
    - interest rate forecasts.

37. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a source of temporary funding. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

38. Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Strategic Director Finance and Governance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

39. If it was felt that there was a significant risk of a much sharper rise in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Any such decisions will be reported back to Audit and Governance Committee and full Council at the next available opportunity.

Post-PWLB Interest Rate Change Borrowing Strategy

40. On 5 November 2020, the Public Works Loan Board (PWLB) reversed its decision to increase the cost of borrowing for local authorities for general fund purposes by 1%, bringing the rates offered in line with those for housing revenue account purposes. All new loans are therefore now subject to the relevant gilt yields +0.8% (certainty rate).

41. The Council's treasury management strategy permits borrowing from various sources, but it has not been previously anticipated that any alternatives to PWLB would need to be utilised, given the current low cost of PWLB funding.

42. The key advantage of PWLB is the speed and ease of transaction processing and the low fee and administration cost associated with the loans. Alternative types of funding could result in lengthy due diligence, consultancy costs, legal advice and fees and will be far more costly administratively.

Alternative Borrowing Options

43. Alternative options for funding to PWLB include:

- **Banks**

  Discussions with the Council's treasury consultant suggest that the Council could access borrowing from banks. However the recent decision by the PWLB to reverse the 1% additional cost of general fund borrowing have resulted in banks now being placed in an overly competitive environment.

- **Pension Fund institutional investors**

  Initial indications have suggested that the Council may be able to borrow from institutional investors at rates of around gilt yield plus 1.2% to 1.8% for periods of over 20 years, via a private placement agreement (PPA). Such an arrangement will be subject to extensive negotiations with the lenders, who will need to carry out due diligence on a Council's finances, budgets and balance sheet.

- **Bond issuance**

  A bond issue would first require the Council to become credit rated by one (or more) of the major ratings agencies: Fitch, S&P or Moody's. This is a complex, lengthy, repetitive and costly process. The precise rate offered will be market led and dependent on the financial resilience of the Council and the market's perception of its creditworthiness.

  Councils with significant reserves and a record of not overspending on budget will be able secure the most advantageous rates. Bond releases typically require a minimum size of at least £200m.

- **The Municipal Bonds Agency**

  This has been in existence since 2013 but has only recently transacted its first bond issuance and local authority borrower.

44. Alternative opportunities for the Council may well present themselves, and the borrowing strategy will be designed to allow for this. The 'benchmark' for a borrowing opportunity is regarded at around gilts +0.8%. It is unclear at this stage whether feasible PWLB competition will materialise, and it is likely to take some time to do so. Officers will continue to explore alternatives to the PWLB, working with the Council's treasury advisor, Link. PWLB rates will also be kept under regular and active review.

45. Immediate liquidity needs can be satisfied by borrowing from other local authorities in the short term, consistent with the Council's current approved treasury management strategy.

Limits on external borrowing

46. The Prudential Code requires the Council to set two limits on its total external debt, as set out in Table 6 below. The Authorised Limit has been increased in line with the CFR.

47. The limits are:

- **Authorised Limit for External Debt (Prudential Indicator 5a)** – This is the limit prescribed by section 3(1) of the Local Government Act 2003 representing the maximum level of borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term. This has been set at the level of the CFR forecast in Table 3 above.

- **Operational Boundary (Prudential Indicator 5b)** – This is the limit which external debt is not normally expected to exceed. The boundary is based on current debt plus anticipated net financing need for future years plus a tolerance of 10% on gross projected debt.

Table 6 Overall borrowing limits (Prudential Indicators 5a and 5b)

2019/20 Actual £000s		2020/21 Forecast £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s
	Authorised Limit:						
448,684	**Borrowing and other-long-term liabilities**	**493,308**	**539,255**	**544,726**	**552,947**	**553,947**	**553,947**
	Operational boundary:						
338,694	Borrowing	302,539	295,871	289,025	285,159	270,326	269,963
47,415	Other long-term liabliities	45,651	42,828	39,898	36,528	32,895	29,320
386,109	**Operational boundary**	**348,190**	**338,699**	**328,923**	**321,687**	**303,221**	**299,283**

48. The Strategic Director Finance and Governance reports that the Council complied with these prudential indicators in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this report.

Maturity structure of borrowing (Prudential Indicator 7)

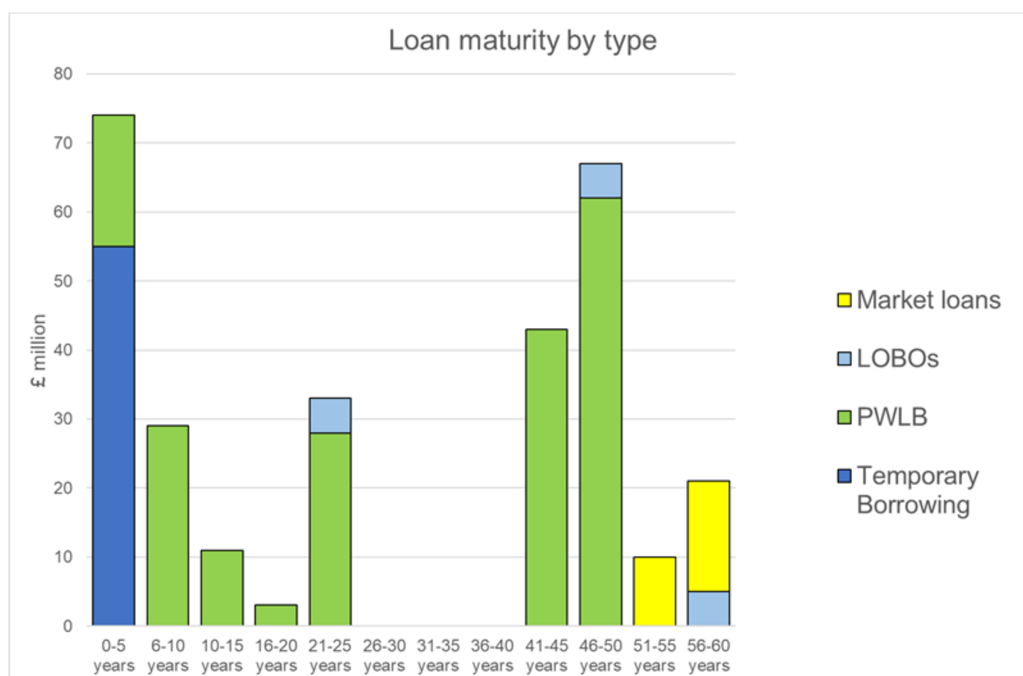
49. Managing the maturity profile of debt is essential for reducing the Council's exposure to large fixed rate sums falling due for refinancing within a short period, and thus potentially exposing the Council to additional cost. Table 7 below sets out current upper and lower limits for debt. The principal repayment profile for current council borrowing remains within these limits.

Table 7 Debt maturity profile limits

Actual maturity at 31 March 2020 %		Upper Limit %	Lower Limit %
20	Under12 months	50	0
1	1 to 2 years	30	0
4	3 to 5 years	30	0
10	6 to 10 years	30	0
64	more than 10 years	100	0

50. The chart below shows the maturity of loan debt by type of borrowing at 31 March 2020. Currently the borrowing strategy is to continue to use temporary borrowing while rates remain substantially below long-term interest rates.

Chart 1 Loan maturity by type of borrowing



51. Table 8 below sets out the upper limits for interest rate exposures.

Table 8 Interest rate exposures

	2020/21 Upper	2021/22 Upper	2022/23 Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%

52. In the event that there is a much sharper rise in long and short term rates than currently forecast, then the balance of the loan portfolio will be revisited with a view to taking on further longer term fixed rate borrowing in anticipation of future rate rises.

Policy on borrowing in advance of need

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

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

Debt rescheduling

55. As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the cost of debt repayment (premiums incurred).

56. The reasons for any rescheduling to take place will include:

- generating cash savings and/or discounted cash flow savings;

- helping to fulfil the treasury strategy; and
- enhancing the balance of the portfolio by amending the maturity profile and/or the balance of volatility.

57. Should an opportunity for debt rescheduling arise, it will be reported to the Audit and Governance Committee and full Council at the earliest meeting following its action.

SECTION 3 – MANAGING CASH BALANCES

The current cash position and cash flow forecast

58. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

59. As at 31 March 2020 core cash and short-term investments totalled £67.783m. The medium-term cashflow forecast is that it will remain around this level particularly while the Government provides Covid-19 funding for local businesses through grant supports schemes channelled through local authorities. Treasury officers will work closely with the Corporate Finance team to monitor slippage within the capital programme and income through the Collection Fund, which will impact on cashflow levels.

Prospects for investment rates

60. Investment returns are likely to remain exceptionally low during 2021/22 with little change in the following two years.

61. While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods.

62. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid-19 crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

63. As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the Debt Management Account Deposit Facility (DMADF), offer nil or negative rates for very short-term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

64. Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

65. In summary, Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

66. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are set out in Table 9 below (the long-term forecast is for periods over 10 years in the future):

Table 9 Forecast investment returns

Average earnings in each year	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Long-term later years	2.00%

Pension pre-funding payment

67. In view of the limited returns on investments externally, the Council will aim to extend its programme of prepaying pension contributions and it proposes delegated authority be granted to the Strategic Director Finance and Governance.

68. This strategy will benefit the Council in that the discount rate earned by paying pension fund contributions in advance at around 6.2% significantly outweighs the returns from direct investment in the money market which is currently generating a return of a little over 1%. In addition, it mitigates counter party risk.

Council policy on investing and managing risk

69. The aim is to manage risk and reduce the impact of any adverse movement in interest rates on the one hand but, at the same time, not setting the limits to be so restrictive that they impair opportunities to reduce costs or improve performance.

Balancing short and long-term investments

70. Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed. During 2019/20, other than investments in commercial activity referred to at para 12 of £8m no investments exceeded 364 days. This means the Council remains well within the upper limit for such investments of £70m.

Table 10 Investment limits (Prudential Indicator 6)

	2020/21 Forecast £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s
Upper limit for principal sums invested for more than 364 days	£70m or 50% of outstanding balances			

SECTION 4 - SUMMARY OF PRUDENTIAL INDICATORS (PIs)

71. The purpose of prudential indicators (PIs) is to provide a reference point or "dashboard" so that senior officers and Members can:

- easily identify whether approved treasury management policies are being applied correctly in practice and,
- take corrective action as required.

72. As the Council's S151 officer, the Strategic Director Finance and Governance has a responsibility to ensure that appropriate PIs are set and monitored and that any breaches are reported to Members.

73. The Strategic Director Finance and Governance has confirmed that the PIs set out below are all expected to be complied with in 2020/21 and he does not envisage at this stage that there will be any difficulty in achieving compliance with the suggested indicators for 2021/22.

PI ref	Para ref	Prudential Indicator	2019/20 Actual £000s	2020/21 Forecast £000s	2021/22 Proposed £000s
1	9	Capital expenditure	122,809	150,359	163,473
2	19	Capital Financing Requirement (CFR)	448,684	493,308	539,255
3	20	Net debt vs CFR - under/(over) borrowed	109,990	218,273	270,281
4	21	Ratio of financing costs to revenue stream:			
		General Fund	6.80%	4.40%	5.38%
		HRA	30.04%	32.23%	35.53%
5a	47	Authorised limit for external debt	448,684	493,308	539,255
5b	47	Operational debt boundary	386,109	348,190	338,699
6	70	Limit on surplus funds held for more than 364 days (i.e. non-specified investments)	£70m or 50% of outstanding balances	£70m or 50% of outstanding balances	£70m or 50% of outstanding balances
7	49	Maturity structure of borrowing:			
		Upper limit under 12 months	50%	50%	50%
		Lower limit 10 years and above	0%	0%	0%

SECTION 5 - LEGAL IMPLICATIONS

74. The Local Government Act 2003 provides that a local authority has the power both to borrow and invest money for any purpose relevant to its functions and for the prudent management of its financial affairs. The Act requires the Council to determine and to keep under review how much money it can afford to borrow. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended, provide that, in complying with this duty, the Council must have regard to the Prudential Code for Capital Finance in Local Authorities published by CIPFA. The Council is also required to have regard to the CIPFA Treasury Management Code of Practice.

75. The current CIPFA Treasury Management Code of Practice 2017 and the Secretary of State's Investment Code both require the Section 151 officer (Strategic Director Finance and Governance) to present an Annual Treasury Management Strategy Statement, which includes an Annual Investment Strategy, for the forthcoming year for approval by the Full Council before the beginning of each financial year.

76. The revised CIPFA Prudential Code for Capital Finance in Local Authorities sets out various indicators that are to be used to support capital expenditure plans and treasury management decisions. The prudential and treasury indicators have to be set by the Full Council when the budget is set and are monitored during the year. The prudential indicators are included in section 8 of this report.

77. The Council is also required to approve a Treasury Management Policy Statement setting out the overarching framework for treasury management services within the Council. This statement is set out in sections 5-7 of this report.

APPENDICES

1. Minimum Revenue Provision (MRP) Policy
2. Annual Investment Strategy
3. Approved Counterparty List
4. Approved Countries for Investments
5. CIPFA Treasury Management Code requirements including:
    a. Treasury Management Scheme of Delegation
    b. Treasury Management role of s.151 officer
6. Prospect for Interest Rates/ Economic Update

BACKGROUND PAPERS

1. Treasury Management Strategy Statement 2020/21 (Approved by Council March 2020)
2. Section 3 Local Government Act 2003
3. Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended
4. MHCLG Guidance on Minimum Revenue Provision (fourth edition) February 2018
5. MHCLG Capital Finance Guidance on Local Government Investments February 2018
6. CIPFA Prudential Code for Capital Finance in Local Authorities, 2017
7. CIPFA Treasury Management Code of Practice, 2017
8. CIPFA Treasury Management Guidance Notes 2018

APPENDIX 1

Minimum Revenue Provision (MRP) policy statement

1. Having regard to current Guidance on MRP issued by MHCLG and the “options” outlined in that Guidance, the Council is recommended to approve the following MRP Statement to take effect from 1 April 2021:

    - For all pre-2007/08 capital expenditure, MRP will be calculated on a straight-line to repay this element over 50 years;
    - except for invest-to-save schemes, all capital expenditure incurred since 2007/08, MRP will be based on expected useful asset lives (Option 3 – asset life), calculated using the annuity method;
    - for invest-to-save schemes MRP will be profiled to mirror the income generated from the scheme;
    - asset lives will be arrived at after discussion with valuers, but on a basis consistent with depreciation policies set out in the Council’s annual Statement of Accounts, and will be kept under regular review;
    - MRP for finance leases and service concession contracts shall be charged over the primary period of the lease, in line with the Guidance,
    - for expenditure capitalised by virtue of a capitalisation direction under section 16(2)(b) of the Local Government Act 2003 or Regulation 25(1) of the 2003 regulations, the ‘asset’ life should equate to the value specified in the statutory Guidance.

2. In applying ‘Option 3’:

    - MRP should normally begin in the financial year following the one in which the expenditure was incurred. However, in accordance with the statutory Guidance, commencement of MRP may be deferred until the financial year following the one in which the asset becomes operational;
    - the estimated useful lives of assets used to calculate MRP should not exceed a maximum of 50 years except as otherwise permitted by the Guidance (and supported by valuer’s advice);
    - if no life can reasonably be attributed to an asset, such as freehold land, the estimated useful life should be taken to be a maximum of 50 years;

APPENDIX 2

ANNUAL INVESTMENT STRATEGY

Investment policy

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

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

2. The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The above guidance from MHCLG and CIPFA places a high priority on the management of risk. This Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

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

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

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

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

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

      - **Non-specified investments** are any financial investments that are not loans and do not meet the criteria to be treated as specified investments. These tend to be lower credit quality than specified investments and carry a higher degree of credit risk.

   v. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).

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

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

   viii. As a result of the change in accounting standards for 2020/21 under IFRS 9, this authority will consider the implications of investment instruments which could result in an

adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

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

Creditworthiness Policy

4. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

5. After this main principle, the Council will ensure that:

- it maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the specified and non-specified investment sections below; and

- it has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

6. The Strategic Director Finance and Governance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

7. Credit rating information is supplied by the Council's treasury advisors, Link Asset Services,. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing.

8. The Council takes into account the following relevant matters when proposing counterparties:

- the financial position and jurisdiction of the institution;
- the market pricing of credit default swaps for the institution;
- any implicit or explicit Government support for the institution;
- Standard & Poor's, Moody's and Fitch's short and long term credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries; and
- core Tier 1 capital ratios.

9. Changes to the credit rating will be monitored and, in the event, that a counterparty is downgraded and does not meet the minimum criteria specified in Appendix 1, the following action will be taken immediately:

- no new investments will be made;
- existing investments will be recalled if there are no penalties; and
- full consideration will be given to recall or sale of existing investments which would be liable to penalty clause.

Specified and Non-specified investments

10. The MHCLG Guidance on Local Government Investments made under section 15(1) of the Local Government Act 2003, places restrictions on local authorities around the use of specified and non-specified investments.

11. A specified investment is defined as an investment which satisfies all of the conditions below:

- the investment and any associated cash flows are denominated in sterling;
- the investment has a maximum maturity of one year;
- the investment is not defined as capital expenditure; and
- the investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

12. Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. In addition to the long-term investments listed in the table at the end of Appendix 1, the following non-specified investments that the Council may make include:

- **Green Energy Bonds** - Investments in solar farms are a form of Green Energy Bonds that provide a secure enhanced yield. The investments are structured as unrated bonds and secured on the assets and contracts of solar and wind farms. Before proceeding with any such investment, internal and external due diligence will be undertaken in advance of investments covering the financial, planning and legal aspects.

- **Social Housing Bonds** – Various fund managers facilitate the raising of financing housing associations via bond issues. The investment is therefore asset backed and provides enhanced returns. Officers will need to undertake due diligence on each potential investment in order to understand the risks and likelihood of default. This is a type of vehicle a number of local authorities are involved which not only helps to meet a local authority's statutory duty to house the homeless, but also provides a return in excess of short-term investment rates.

- **Loans** - The Council will allow loans (as a form of investment) to be made to organisations delivering services for the Council where this will lead to the enhancement of services to the Council's Stakeholders. The Council will undertake due diligence checks to confirm the borrower's creditworthiness before any sums are advanced and will obtain appropriate levels of security or third party guarantees for loans advanced. The Council would expect a return commensurate with the type, risk and duration of the loan. A limit of £50 million for this type of investment is proposed with a duration commensurate with the life of the asset and Council's cash flow requirements. All loans will need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels.

- **Shareholdings in limited companies and joint ventures** – The Council invests in two forms of company:

  i. Trading vehicles which the Council has set up to undertake particular functions. These are not held primarily as investments but to fulfil Council service objectives. Examples include Sixty Bricks Ltd and the More Homes joint venture. Any new proposals will be subject to due diligence as part of the initial business case. As these are not to be held primarily as investment vehicles, then there is an expectation that they will break even.

  ii. Trading vehicles held for a commercial purpose where the Council is obliged to undertake transactions via a company vehicle. Examples include the companies set up under the former Building Schools for the Future programme which operate the schools PFI contracts.

13. For any such investments, specific proposals will be considered by the Strategic Director Finance and Governance after taking into account of the following:

- cash flow requirements
- investment period
- expected return
- the general outlook for short to medium term interest rates
- creditworthiness of the proposed investment counterparty
- other investment risks.

14. The nominal value of non-specified investments will be capped at £50m.

Country of Domicile

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

16. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch except the UK. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 4. This list will be kept under review and any proposed changes to the policy reported to the next meeting.

Schedule of investments

17. The criteria for providing a pool of high quality short, medium and long-term, cash-based investment counterparties along with the time and monetary limits for institutions on the Council's counterparty list are set out in Appendix 3.

18. Officers will monitor the impact of the UK's exit from the European Union on the names within the Council's counterparty list.

APPENDIX 3
Approved counterparty list

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
Specified Investments			
DMADF – UK Government	N/A	**100%**	6 months*
Money market funds: CNAV and VNVAV	AAA	100%	Daily Liquidity
Local authorities	N/A	100%	3 years
Barclays Bank plc (the Council's bankers)		£20m £5m	Overnight deposits ** Up to 12 months
Term deposits with banks and rated building societies	Yellow Purple Blue Orange Red Green		Up to 3 years Up to 3 years Up to 3 years Up to I year Up to 6 Months Up to 3 months
Current and Ex - Government Supported banks	Green	50%	Up to 1 year

* DMO – is the maximum period offered by the Debt Management Office of H.M.Treasury

** Over £20 million with the explicit agreement of the Director of Finance

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
Non-specified investments			
Term deposits with unrated Building Societies	Assets over £1.0bn	25%	12mths
UK Government supported banks and Ex- Government supported banks	n/a	£70m or 50% of total investments	3 yrs.
Pooled Vehicles: Enhanced Money Market Funds: UK Government and Government Guaranteed securities Pooled Property Funds Short – Term Investment – grade sterling denominated instruments	N/A	£10m	4yrs
UK Treasury Bills, Certificate of Deposits and T-bills	Yellow Purple Blue Orange Red Green No Colour		Up to 3 years Up to 2 years Up to I year Up to 6 Months Up to 6 Months Up to 3 months Not for use
Corporate Bonds including Floating Rate Notes (FRNs)	Minimum Credit Rating: BBB		3yrs

APPENDIX 4

APPROVED COUNTRIES FOR INVESTMENTS

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

Lowest available rating	Approved Country
AAA	Australia Denmark Germany Luxembourg Netherlands Norway Singapore Sweden Switzerland
AA+	Canada Finland U.S.A.
AA	Abu Dhabi (UAE) France
AA-	Belgium Hong Kong Qatar United Kingdom

APPENDIX 5
CIPFA TREASURY MANAGEMENT CODE

1. The Council has formally adopted CIPFA's Code of Practice on Treasury Management (updated 2017) and complies with the requirements of the Code as detailed in this appendix. There are no changes to the requirements formally adopted in the 2017 update with regard to reporting: these are listed below:

   - Maintaining a Treasury Management Policy Statement setting out the policies and objectives of the Council's treasury management activities.

   - Maintaining a statement of Treasury Management Practices that sets out the manner in which the Council will seek to achieve these policies and objectives.

   - Presenting the Full Council with an annual TMSS statement, including an annual investment strategy and Minimum Revenue Provision policy for the year ahead (this report) a half year review report and an annual report (stewardship report) covering compliance during the previous year.

   - A statement of delegation for treasury management functions and for the execution and administration of statement treasury management decisions. (see below)

   - Delegation of the role of scrutiny of treasury management activities and reports to a specific named body. At the London Borough of Waltham Forest this role is undertaken by the Audit and Governance Committee

Training

2. 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 training will be arranged as required.

3. The training needs of treasury management officers are periodically reviewed.

Treasury management consultants

4. The Council uses Link Group, Treasury solutions as its external treasury management advisors.

5. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

6. 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.

7. The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties. The commercial type investments require specialist advisers, and the Council uses Link Asset Treasury Services in relation to this activity.

Treasury Management Delegations and Responsibilities

8. The respective roles of the Council, Audit and Governance Committee and Section 151 officer are summarised below. Further details are set out in the Treasury Management Practices.

(i) Full Council

- Approval of annual strategy, mid-year review and Annual Report

(ii) Treasury Strategy Group/Strategic Director Finance and Governance

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit and Governance Committee with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;

- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;

- ensuring the adequacy of internal audit, and liaising with external audit;

- recommending the appointment of external service providers.

APPENDIX 6
Prospects for interest rates

1. The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 8.11.20. However, following the conclusion of the review of PWLB margins over gilt yields on 25.11.20, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps:

Link Group Interest Rate View 9.11.20														
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20														
	Dec-20	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
BANK RATE	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	0.10
3 month ave earnings	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	0.10
6 month ave earnings	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	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

2. The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

Gilt yields / PWLB rates

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

of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

4. Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

5. As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

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

- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. *(Please note that Link has concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects.)* It also introduced the following rates for borrowing for different types of capital expenditure: -

    - **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
    - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)

- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

- As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.

  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

- **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

- While this authority will not be able to avoid in the future borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

ECONOMIC BACKGROUND

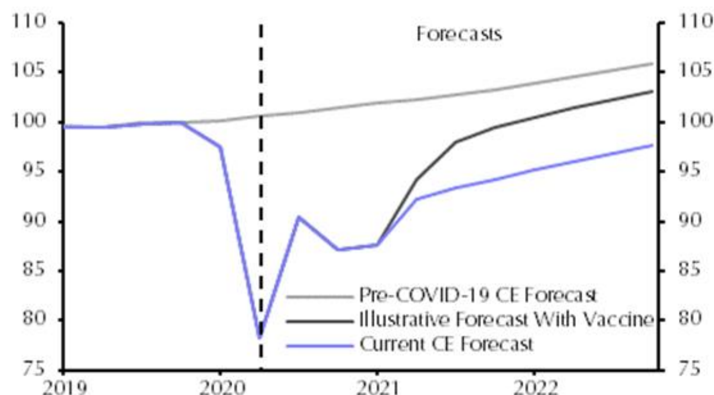
- **UK.** The Bank of England's Monetary Policy Committee kept **Bank Rate** unchanged on 5th November. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".
- Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:
  - The economy would recover to reach its pre-pandemic level in Q1 2022
  - The Bank also expects there to be excess demand in the economy by Q4 2022.

  - CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- One key addition to **the Bank's forward guidance** in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase through to quarter 1 2024 but there could well be no increase during the next five years due to the slow rate of recovery of the economy and the need for the Government to see the burden of the elevated debt to GDP ratio falling significantly. **Inflation** is unlikely to pose a threat requiring increases in Bank Rate during this period as there is likely to be spare capacity in the economy for a considerable time. It is expected to briefly peak at around 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.
- However, the minutes did contain several references to **downside risks**. The MPC reiterated that the "recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside". It also said "the risk of a more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. That could involve some or all of the lockdown being extended beyond 2nd December, a temporary relaxation of restrictions over Christmas, a resumption of the lockdown in January and lots of regions being subject to Tier 3 restrictions when the lockdown ends. Hopefully, restrictions should progressively ease during the spring. It is only to be expected that some businesses that have barely survived the first lockdown, will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to the end of 31st March will limit the degree of damage done.
- As for **upside risks**, we have been waiting expectantly for news that various **COVID19 vaccines** would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, their phase three trials are still only two-thirds complete. More data needs to be collected to make sure there are no serious side effects. We don't know exactly how long immunity will last or whether it is effective across all age groups. The Pfizer vaccine specifically also has demanding cold storage requirements of minus 70C that might make it more difficult to roll out. However, the logistics of production and deployment can surely be worked out over the next few months.

- However, there has been even further encouraging news since then with another two vaccines announcing high success rates. Together, these three announcements have enormously boosted confidence that **life could largely return to normal during the second half of 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels, which would help to bring the unemployment rate down. With the household saving rate currently being exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could begin to be eased, possibly in Q2 2021, once vulnerable people and front-line workers had been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% next year instead of 9%. But while this would reduce the need for more QE and/or negative interest rates, increases in Bank Rate would still remain some years away. There is also a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.
- **Public borrowing** is now forecast by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.
- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp but after a disappointing increase in GDP of only 2.1% in August, this left the economy still 9.2% smaller than in February; this suggested that the economic recovery was running out of steam after recovering 64% of its total fall during the crisis. The last three months of 2020 were originally expected to show zero growth due to the impact of widespread local lockdowns, consumers probably remaining cautious in spending, and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year also being a headwind. However, the second national lockdown starting on 5th November for one month is expected to depress GDP by 8% in November while the rebound in December is likely to be muted and vulnerable to the previously mentioned downside risks. It was expected that the second national lockdown would push back recovery of GDP to pre pandemic levels by six months and into sometime during 2023. However, the graph below shows what Capital

Economics forecast could happen if successful vaccines were widely administered in the UK in the first half of 2021; this would cause a much quicker recovery.

Level of real GDP (Q4 2019 = 100)



- There will be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

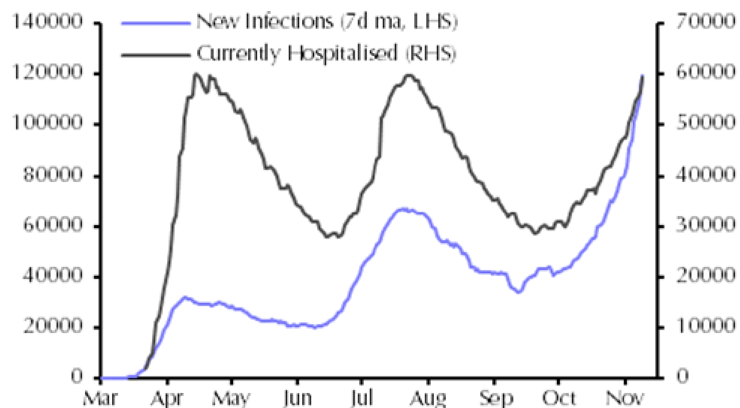
- The **Financial Policy Committee** (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

US. The result of **the November elections** means that while the Democrats have gained the presidency and a majority in the House of Representatives, it looks as if the Republicans will retain their slim majority in the Senate. This means that the Democrats will not be able to do a massive fiscal stimulus, as they had been hoping to do after the elections, as they will have to get agreement from the Republicans. That would have resulted in another surge of debt issuance and could have put particular upward pressure on debt yields – which could then have also put upward pressure on gilt yields. On the other hand, equity prices leapt up on 9th November on the first news of a successful vaccine and have risen further during November as more vaccines announced successful results. This could cause a big shift in investor sentiment i.e. a swing to sell out of government debt to buy into equities which would normally be expected to cause debt prices to fall and yields to rise. However, the rise in yields has been quite muted so far and it is too early to say whether the Fed would feel it necessary to take action to suppress any further rise in debt yields. It is likely that the next two years, and possibly four years in the US, could be a political stalemate where neither party can do anything radical.

The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the **pandemic** with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter

4, to the highest level since mid-August, suggests that the US could be in the early stages of a third wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the latest wave has been driven by a growing outbreak in the Midwest. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

COVID-19 New infections & hospitalisations



After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal. The Fed's meeting on 5 November was unremarkable - but at a politically sensitive time around the elections.

EU. The economy was recovering well towards the end of Q2 and into Q3 after a sharp drop in GDP caused by the virus, (e.g. France 18.9%, Italy 17.6%). However, growth is likely to stagnate during Q4, and Q1 of 2021, as a second wave of the virus has affected many countries, and is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected

countries. With inflation expected to be unlikely to get much above 1% over the next two years, the ECB has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. It is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support from governments. The current PEPP scheme of €1,350bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, the PEPP scheme is regarded as being a temporary measure during this crisis so it may need to be increased once the first PEPP runs out during early 2021. It could also decide to focus on using the Asset Purchase Programme to make more monthly purchases, rather than the PEPP scheme, and it does have other monetary policy options.

China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies.

However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

Japan. Japan's success in containing the virus without imposing draconian restrictions on activity should enable a faster return to pre-virus levels of output than in many major economies. While the second wave of the virus has been abating, the economy has been continuing to recover at a reasonable pace from its earlier total contraction of 8.5% in GDP. However, there now appears to be the early stages of the start of a third wave. It has also been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. There has also been little progress on fundamental reform of the economy. The change of Prime Minister is not expected to result in any significant change in economic policy.

World growth. While Latin America and India have, until recently, been hotspots for virus infections, infection rates have begun to stabilise. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and

production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

Summary

Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this is likely to result in more quantitative easing and keeping rates very low for longer. It will also put pressure on governments to provide more fiscal support for their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

The graph below as at 10th November, shows how the 10 and 30 year gilt yields in the UK spiked up after the Pfizer vaccine announcement on the previous day, (though they have levelled off during late November at around the same elevated levels): -

INTEREST RATE FORECASTS

Brexit. The interest rate forecasts provided by Link in paragraph 3.3 are predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. However, as the differences between a Brexit deal and a no deal are not as big as they once were, the economic costs of a no deal have diminished. The bigger risk is that relations between the UK and the EU deteriorate to such an extent that both sides start to unravel the agreements already put in place. So what really matters now is not whether there is a deal or a no deal, but what type of no deal it could be.

The differences between a deal and a no deal were much greater immediately after the EU Referendum in June 2016, and also just before the original Brexit deadline of 29.3.19. That's partly because leaving the EU's Single Market and Customs Union makes this Brexit a relatively "hard" one. But it's mostly because a lot of arrangements have already been put in place. Indeed, since the Withdrawal Agreement laid down the terms of the break-up, both the UK and the EU have made substantial progress in granting financial services equivalence and the UK has replicated the bulk of the trade deals it had with non-EU countries via the EU. In a no deal in these circumstances (a "cooperative no deal"), GDP in 2021 as a whole may be only 1.0% lower than if there were a deal. In this situation, financial services equivalence would probably be granted during 2021 and, if necessary, the UK and the EU would probably rollover any temporary arrangements in the future.

The real risk is if the UK and the EU completely fall out. The UK could override part or all of the Withdrawal Agreement while the EU could respond by starting legal proceedings and few measures could be implemented to mitigate the disruption on 1.1.21. In such an "uncooperative no deal", GDP could be 2.5% lower in 2021 as a whole than if there was a deal. The acrimony would probably continue beyond 2021 too, which may lead to fewer agreements in the future and the expiry of any temporary measures.

Relative to the slump in GDP endured during the COVID crisis, any hit from a no deal would be small. But the pandemic does mean there is less scope for policy to respond. Even so, the Chancellor could loosen fiscal policy by about £10bn (0.5% of GDP) and target it at those sectors hit hardest. The Bank of England could also prop up demand, most likely through more gilt and corporate bond purchases rather than negative interest rates.

Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

So in summary there is not likely to be any change in Bank Rate in 20/21 – 21/22 due to whatever outcome there is from the trade negotiations and while there will probably be some movement in gilt yields / PWLB rates after the deadline date, there will probably be minimal enduring impact beyond the initial reaction.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal the UK agrees as part of Brexit.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and

increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

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

- **UK** - further national lockdowns or severe regional restrictions in major conurbations during 2021.
- **UK / EU trade negotiations** – if they were to cause significant economic disruption and downturn in the rate of growth.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. In November, Hungary and Poland threatened to veto the 7 year EU budget due to the inclusion of a rule of law requirement that poses major challenges to both countries. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

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

- **UK -** stronger than currently expected recovery in UK economy, especially if effective vaccines are administered quickly to the UK population and lead to a resumption of normal life and a return to full economic activity across all sectors of the economy.

- **Post-Brexit** – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.

The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.