REPORT TO:	**GENERAL PURPOSES AND AUDIT COMMITTEE** **14 October 2021**
SUBJECT:	**Treasury Management Strategy Statement and Annual Investment Strategy** **End of Year Review 2020/2021**
LEAD OFFICER:	**Nigel Cook, Head of Treasury and Pensions**
CABINET MEMBER:	**Councillor Callton Young** **Cabinet Member for Resources and Financial Governance**
WARDS:	**All**

CORPORATE PRIORITY/POLICY CONTEXT:

Sound Financial Management. This Report details the Council's Treasury Management activities for the year 2020/2021 and its compliance with the 2017 Prudential Code for Capital Finance.

FINANCIAL SUMMARY:

This Report details the Council's Treasury Management activities for the year 2020/2021 and demonstrates its compliance with the 2017 Prudential Code for Capital Finance.

1. RECOMMENDATION

The Committee are recommended to:

1.1 Note the contents of this report.

2. EXECUTIVE SUMMARY

2.1 This Report is prepared in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) codes of practice in respect of capital finance and treasury management. The codes recommend that members are advised of the treasury management activities for the whole of each financial year and of compliance with the various strategies and policies agreed by the Council. This report:

- Reviews compliance with the Treasury Management Strategy Statement, Capital Strategy and Annual Investment Strategy as agreed by full Council (Budget Council) on 2 March 2020 (Minute A87/20 applies);
- Reviews treasury borrowing and investment activity for the period 1 April 2020 to 31 March 2021; and

- Demonstrates compliance with agreed Treasury and Prudential Indicators.

3 DETAIL

3.1 Background

3.1.1 CIPFA have issued two Codes of Practice (both in December 2017) which apply to the Treasury Management function:

- The Prudential Code for Capital Finance in Local Authorities; and
- Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

3.1.2 Under the Code of Practice, from the financial year 2019/2020, all local authorities are required to prepare a Capital Strategy which is to provide the following:

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed; and
- The implications for future financial sustainability.

3.1.3 The primary requirements of the Code for Treasury Management (the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes) are:

- The creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
- The creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
- Providing full Council with an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year;
- The delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. These functions are delegated to the Director Finance, Investment and Risk, Section 151 Officer and through him to the Head of Pensions and Treasury; and
- The delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this authority the delegated body is the General Purposes and Audit Committee.

3.1.4 This year-end report has been prepared in compliance with the Code of Practice and best practice and covers the following topics:

- An economic update of the 2020/2021 financial year (Section 3.2);
- A medium term interest rates forecast (Section 3.3);
- A review of the Council's Treasury Management Strategy Statement and Annual Investment Strategy (Section 3.4);
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators (Section 3.5);
- A review of the Council's borrowing strategy (Section 3.6);
- A review of the Council's investment strategy (Section 3.7);
- A review of any debt re-scheduling undertaken (Section 3.8);
- Compliance with Treasury and Prudential Limits (Section 3.9);
- Treasury Outturn (Section 3.10).

3.2 Economic update

3.2.1 A commentary entitled Economic Update provided by the Council's independent treasury advisers Link Asset Services (Link AM) for September 2021 is included as Appendix A.

3.3 Interest rate forecasts

3.3.1 Link provide updated forecasts of key interest rates on a regular basis and these are summarised in Table 1 below. These forecasts will be updated during the remainder of 2021/2022 and will inform decisions as to the timing and duration of borrowing decisions

Table 1: Interest Rate Forecasts

Link Group Interest Rate View	10.8.21										
	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	0.25	0.25	0.25	0.50
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30	0.50
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.50	0.50
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.70
5 yr PWLB	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.50	1.50
10 yr PWLB	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00
25 yr PWLB	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.40	2.50
50 yr PWLB	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.30

3.3.2 A commentary on these forecasts, also provided by Link AM, is included in Appendix B.

3.4 Treasury Management Strategy Statement and Annual Investment Strategy

3.4.1 The Treasury Management Strategy Statement and Annual Investment Strategy for 2020/2021 were approved by full Council (Budget Council) on 2 March 2020 (Minute A87/20 applies).

3.5 Capital Strategy and Prudential Indicators

3.5.1 Table 2 shows the original capital budget as agreed by full Council (Budget Council) on 2 March 2020 (Minute A86/20 refers), the revised outturn as reported in Croydon's General Fund & HRA Budget 2021/2022 to 2023/2024, as agreed by full Council on 8 March 2021 and the actual outturn. Members will note the reference to the Capitalisation Direction. This is a device of government that allows expenditure to be treated as capital expenditure when it would otherwise be charged to the Council's revenues. This spend can only be financed by borrowing from the Public Works Loan Board at a premium of 1% over the standard interest rate.

Table 2: Capital Expenditure Summarised by Services

Capital Expenditure by Service	Original Estimate £m	Revised Outturn Estimate £m	Outturn £m
Health, Wellbeing and Adults	3.0	7.2	2.8
Children, Families and Education	25.3	28.1	17.6
Place	159.4	43.3	33.1
Resources	113.8	11.0	9.9
HRA	35.7	101.7	22.9
Capitalisation Direction		70.0	65.8
Total	**337.2**	**261.3**	**152.1**

3.5.2 Table 3 details the funding sources of the capital programme. The need to borrow to finance capital investment increases the underlying need to borrow for capital purposes by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

Table 3: Financing of Capital Expenditure

Financing of Capital Expenditure	Original Estimate £m	Revised Outturn Estimate £m	Outturn £m
Capital receipts			10.8
Capital grants	24.9	39.2	18.8
Community Infrastructure Levy	7.4	9.5	7.9
Major Repairs Allowance	12.5	12.5	12.1
Capital reserves	3.3		
S106 payments		5.3	0.3
S141 payments		14.8	
Revenue	11.1	11.1	
Total financing	**59.2**	**92.4**	**49.9**
Borrowing requirement – General Fund	**272.7**	**45.6**	**36.4**
Borrowing requirement – HRA	**5.3**	**53.3**	
Borrowing requirement – Capitalisation Direction		**70.0**	**65.8**

3.5.3 The key controls for treasury management activity are the Prudential Indicators and compliance with them ensures that, over the medium term, borrowing will only be for a capital purposes. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2020/2021 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need as required. Table 4 shows changes in the CFR and borrowing over the year.

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Table 4: Capital Financing Requirement

	Original Estimate* £m	Outturn Projection** £m	Actual £m
Borrowing	1,708.0	1,654.8	1,443.5
Other long term liabilities	82.8	75.8	73.6
Total debt	1,790.8	1,730.6	1,520.1
CFR (year-end position)	1,799.5	1,730.6	1,628.5

*As reported to full Council on 2 March 2020
**As reported to General Purposes and Audit Committee on 14 January 2021

3.5.4 There are two Prudential Indicators relevant to the capital programme and its borrowing implications. These are the Operational Boundary (the expected debt position) and the Authorised Limit (the limit beyond which borrowing is prohibited). Table 5 shows the limits as agreed by the full Council on 2 March 2020 (Minute 87/20 applies).

Table 5: Key Prudential Indicators

	£m
Operational Boundary	1,885.8
Authorised Limit	1,935.8

3.5.5 Members will note that the Authorised Limit includes a buffer of £50m to cover unexpected cash flow shortages.

3.6 Borrowing Strategy

3.6.1 Throughout the financial year 2020/2021 the Council operated within the borrowing limits approved by full Council on 2 March 2020 (Minute 87/20 applies).

3.6.2 The level of the Council's borrowing, which is measured against the limits, was £1,520.8m on 1 April 2020 and £1,520.1m on 31 March 2021. At no point during the year was either the approved Operational Boundary or the Authorised Limit breached.

3.6.3 Table 6 shows the monthly movement of the actual debt during the year. Members should note that cash balances over the period were exceptionally high. This is due to a number of factors. First and foremost the COVID pandemic had a chilling effect on the construction industry so that projects were postponed and cash borrowed to fund this investment was not required. Much of this borrowing was undertaken in advance at advantageous rates. Members should note that is entirely legitimate practice as set out in the Treasury Management Code of Practice, which states that the 'organisation will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.' Secondly the financial difficulties faced by the Council have generated concerns that lending might dry up: this has not proved to be the case. Thirdly, there has been a significant margin of 40 to 50 basis points between PWLB debt and money available on the short cash markets. These savings have amounted to several hundred thousands pounds.

Table 6: Actual debt in 2020/2021

End of Month	PWLB	Market debt	Temporary borrowing	PFI and other	TOTAL
	£'000	£'000	£'000	£'000	£'000
March (2020)	907,426	260,575	277,000	75,821	1,520,822
April	907,426	283,575	284,000	75,821	1,550.822
May	907,426	263,575	307,000	75,821	1,553.822
June	907,426	238,575	342,000	75,821	1,563.822
July	907,426	273,575	347,000	75,821	1,603.822
August	907,426	276,075	339,000	75,821	1,598.322
September	907,426	276,075	338,000	75,821	1,597.322
October	907,426	261,075	309,000	75,821	1,553.322
November	907,426	236,075	314,000	75,821	1,533.322
December	907,426	226,075	333,000	75,821	1,542.322
January	907,426	221,075	343,000	75,821	1,547.322
February	907,426	221,075	333,000	75,821	1,537.322
March (2021)	897,426	221,075	328,000	73.584	1,520.085

3.6.4 During the year, to take advantage of the low levels of short term rates, particularly from other local authorities, all new borrowing was taken for periods of up to two years. No new long term PWLB debt was taken and £10m was repaid on maturity.

3.6.5 Borrowing will be taken up as required based on a continuing analysis of actual and projected expenditure over the different components of the capital programme and interest rates forecasts. It is likely that the Council will use a mixture of long term borrowing from the PWLB and the wider market, short term borrowing from other local authorities and internal balances. Borrowing will be undertaken to fit into the Council's existing debt maturity profile to move towards a more even distribution of maturities. Appendix C shows the movements in PWLB interest rates for various loan periods during the last year.

3.6.6 The Council's effective interest payable on long term debt currently stands at 2.56% with the maturity profile detailed in Appendix D.

3.7 Investment Strategy

3.7.1 From time to time, under Section 15 (1) of the Local Government Act 2003, the Secretary of State issues statutory guidance on local government investments to which local authorities are required to "have regard." This guidance was taken into account in the investment policy parameters set within the Council's Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy as approved by full Council on 2 March 2020 Minute A87/20 applies).

3.7.2 The current guidance defines investments as "Specified" and "Non-specified".

3.7.3 An investment is a specified investment if all of the following apply:

- the investment and any associated payments or repayments 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 described as high quality or with the UK Government, a UK local authority or a parish or community council.

3.7.4 A non-specified investment is any investment that does not meet all the conditions in paragraph 3.7.3 above.

3.7.5 All investments are managed in-house and it is the Council's priority when undertaking treasury activities to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. Investment instruments identified for use by the Council during 2020/2021 as included in the current Treasury Management Strategy are detailed in Appendix E.

3.7.6 During the year it was considered appropriate to keep investments short term to cover cash-flow needs and to seek out value available in periods of up to twelve months. Investments were only made with highly credit rated financial institutions using the Link AM suggested creditworthiness approach including a minimum sovereign credit rating and Credit Default Swap overlay information.

3.7.7 Investment activity during 2020/2021 conformed to the approved strategy. The Council has experienced no liquidity issues with an average monthly balance of £113m being maintained in temporary investments. Part of this sum is made up of core balances such as provisions and reserves set aside and cash balances that can, if necessary, be invested for longer periods to take advantage of favourable interest rates and to limit exposure to the risk of future rate movements.

3.7.8 The Interim Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the year.

3.7.9 As shown in Table 7 below, throughout the year the Treasury Management Team managed substantial balances with the month-end position rarely being below £100m and regularly exceeding £120m. In aggregate, deposits totalling £1,361.12m were invested with the average monthly balance yielding an investment rate of return of 0.15% compared to the LIBID 7 day rate of 0.05% for the period. Total investments outstanding at 31 March 2021 were £98.5m invested as follows: £5m with UK local authorities, £73.5m with AAA rated Money Market Funds and £20m with banks in UK.

Table 7: Month end balances

Month	General Fund £m	Pension Fund £m	Total £m
April	80.80	31.02	111.82
May	90.00	29.70	119.70
June	90.00	34.80	124.80
July	80.00	40.80	120.80
August	80.00	43.40	123.40
September	80.00	45.40	125.40
October	80.00	30.60	110.60
November	80.00	30.60	110.60
December	80.00	18.50	98.50
January	80.00	18.50	98.50
February	100.00	18.50	118.50
March	82.00	16.50	98.50

3.8 Repayment of Debt and Debt Rescheduling

3.8.1 Opportunities for debt rescheduling have been limited in the current economic climate. With high premiums being attached to the premature repayment of existing debt, opportunities for debt restructuring were minimal and none were taken.

3.9 Compliance with Treasury and Prudential Limits

3.9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The approved Treasury and Prudential Indicators, (affordability limits), are included in the approved Treasury Management Strategy Statement. During the year the Council has operated within the treasury and prudential indicators as detailed in Appendix F.

3.10 Treasury Outturn

3.10.1 The Treasury outturn position is summarised in the table below.

Table 8: Borrowing costs and investment income

	Budget £m	Outturn £m	Variance £m
GENERAL FUND			
Borrowing costs	23.054	25.841	1.474
Investment income	-11.318	-0.127	-4.012
TOTAL	11.736	25,714	-2.538
HRA			
Borrowing costs	12.120	11.986	-0.134
Investment income	n/a	n/a	n/a
TOTAL	12.120	11.986	-0.134

4. FINANCIAL CONSIDERATIONS

4.1 There are no financial considerations arising from this report.

Approved by: Richard Ennis, Interim Corporate Director of Resources (S151 Officer)

5. OTHER CONSIDERATIONS

5.1 There are no Customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report

6. HUMAN RESOURCES CONSIDERATIONS

6.1 There are no immediate HR issues arising from this report for Croydon Council employees or staff.

Approved by: Gillian Bevan, Head of HR – Resources

7. LEGAL CONSIDERATIONS

7.1 In relation to the Annual Investment Strategy, the Council is required to have regard to guidance issued by the Secretary of State under the Local Government Act 2003 section 15(1) (a) entitled “Statutory Guidance on Local Government Investments 3rd Edition” which is applicable from and effective for financial years commencing on or after 1 April 2018.

7.2 The Ministry of Housing Communities and Local Government (MHCLG) guidance is complemented by two codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) containing investment guidance namely Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and The Prudential Code for Capital Finance in Local Authorities.

7.3 By regulation 2 and 24 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended, local authorities are required to have regard to the current edition of the CIPFA codes.

7.4 The Local Government Act 2003 section 3(1) and (8) requires the council to determine and keep under review how much money it can afford to borrow. The function of determining and keeping these levels under review is a function reserved to Full Council.

7.5 In determining the Annual Minimum Reserves and the policy around such reserves, the Council shall have regard to guidance issued by the Secretary of State under the Local Government Act 2003 section 21(1A) entitled “Statutory guidance on minimum revenue provision”.

Approved by: Doutimi Aseh, Interim Director of Law & Governance and interim Deputy Monitoring Officer.

8. FREEDOM OF INFORMATION

8.1 This report contains only information that can be publicly disclosed.

9. DATA PROTECTION IMPLICATIONS

9.1 Will the subject of the report involve the processing of ‘personal data’?

No.

Has a data protection impact assessment (DPIA) been completed?

No. This report relates to matters relating to the administration of the LGPS and the Croydon Pension Fund.

Approved by: Richard Ennis, Interim Corporate Director of Resources (S151 Officer)

CONTACT OFFICER:

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BACKGROUND DOCUMENTS:

None

APPENDICES:

A Economic update September 2021
B Interest Rate Forecast August 2021
C PWLB maturity rates for year to 31 March 2021
D Debt maturity profile
E Investment Instruments
F Treasury and Prudential Indicators

APPENDIX A

Economic update (as prepared by Link Asset Services in the first week of September 2021)

MPC meeting 5.8.21

- The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; only one MPC member voted to stop these purchases now to leave total purchases £45bn short of the total target.
- While that was all very much unchanged from previous MPC decisions over the last year, there was a major shift from indicating no expected tightening any time soon to now flagging up that **interest rate increases were now on the horizon.** There was disagreement among MPC members, some of whom felt that the forward guidance that the MPC won't tighten policy until inflation "is achieving the 2% inflation target sustainably", had already been met. Although other MPC members did not agree with them, they did all agree that **"some modest tightening of monetary policy over the forecast period was likely to be necessary to be consistent with meeting the inflation target sustainably in the medium term".**
- The MPC was more upbeat in its new 2-3 year forecasts so whereas they had expected unemployment to peak at 5.4% in Q3, the MPC now thought that the peak had already passed. (It is to be noted though, that the recent spread of the Delta variant has damaged growth over the last couple of months and has set back recovery to the pre-pandemic level of economic activity till probably late 2021.)
- We have been waiting for the MPC to conclude a **review of its monetary policy** as to whether it should raise Bank Rate first before reducing its balance sheet (quantitative easing) holdings of bonds. This review has now been completed so we learnt that it will start to tighten monetary policy by: -
    1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
    2. Raising Bank Rate to 0.50% (1.50% previously), before starting on reducing its holdings.
    3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
    4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.
- What the MPC did not give us was any indication on when it would start raising Bank Rate. Inflation is currently expected to peak at over 4% during 2021. **The key issue** then is whether this is just going to be transitory inflation or whether it will morph into inflation which will exceed the MPC's 2% target <u>on an ongoing basis</u>. In his press conference, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it's worried that labour shortages will push up wage growth by more than it expects and that, as a result, CPI inflation will stay above the 2% target for longer. Which then raises an interesting question as to whether the million or so workers who left the UK during the pandemic, will come back to the UK and help to relieve wage inflation pressures. We also have an unknown as to how trade with the EU will evolve once the pandemic distortions have dissipated now that the UK no longer has tariff free access to EU markets.
- At the current time, the MPC's forecasts are showing inflation close to, but just below, its 2% target in 2 to 3 years' time. The initial surge in inflation in 2021 and 2022 is due to a combination of base effects, one off energy price increases and a release of pent-up demand, particularly from consumers who have accumulated massive savings during the pandemic, hitting supply constraints. However, these effects will gradually subside or fall out of the calculation of inflation. The issue for the MPC will, therefore, turn into a question of **when the elimination of spare capacity in the economy** takes over as being the main driver to push inflation upwards and this could then mean that the MPC will not start tightening policy until 2023. Remember, the MPC has sets its policy as being wanting to see inflation coming in <u>sustainably</u> over 2% to counteract periods when inflation was below 2%. While financial markets have been pricing in a hike in Bank

Rate to 0.25% by mid-2022, and to 0.50% by the end of 2022, they appear to be getting ahead of themselves. The first increase to 0.25% is more likely to come later; our forecast shows the first increase in Q1 of 23/24 and the second to 0.50% in Q4 of 23/24. The second increase would then open the way for the Bank to cease reinvesting maturing bonds sometime during 2024.

Gilt and treasury yields

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

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

These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards the goal of reaching full employment". However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK. **As an average since 2011, there has been a 75% correlation between movements in 10 year treasury yields and 10 year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.**

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

A new era – a fundamental shift in central bank monetary policy

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US before consideration would be given to increasing rates. Although there are nuances between the monetary policy of all three banks, the overall common ground is allowing the inflation target to be symmetrical so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time. ***For local authorities, this means that interest rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.*** Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures. Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

Globally, our views on economies are as follows: -

- **EU.** The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2.2% which is likely to continue into Q3, though some countries more dependent on tourism may struggle. There is little sign that underlying inflationary pressures are building to cause the ECB any concern.

- **China.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. Policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2021. However, the pace of economic growth will fall back after this initial surge of recovery from the pandemic. China is also now struggling to contain the spread of the Delta variant through sharp local lockdowns which will damage economic growth. There are also questions as to how effective Chinese vaccines are proving.

- **Japan.** After declaring a second state of emergency on 7th January, which depressed growth in Q1 2021, the economy was expected to make a strong recovery to pre-pandemic GDP levels in the rest of the year as the slow role out of vaccines eventually gathers momentum. However, the Delta variant has now raised questions as to whether lockdowns will be needed to contain it and to protect the health service from being overwhelmed.

- **World growth.** Further progress on vaccine rollouts, continued policy support, and the re-opening of most major economies should mean that global GDP growth in 2021 will grow at its fastest rate since 1973. The spread of the Delta variant poses the greatest risk to this view, particularly in large parts of the emerging world where vaccination coverage is typically lower than in advanced economies. Continued strong recovery will be accompanied by higher inflation. While most of the arithmetic and commodity price effects boosting inflation in recent months are behind us, goods shortages will last well into 2022 as order backlogs are worked through and inventories are replenished. What's more there is mounting evidence that rapid re-opening of economies generates labour shortages, which could exert further upward pressure on firms' costs. So, global inflation is unlikely to drop back until next year.

APPENDIX B

Interest rate forecast update (as prepared by Link Asset Services in the first week of August 2021)

The Council's treasury advisor, Link Group, provided the following forecasts on 10th August 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View	10.8.21										
	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	0.25	0.25	0.25	0.50
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30	0.50
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.50	0.50
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.70
5 yr PWLB	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.50	1.50
10 yr PWLB	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00
25 yr PWLB	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.40	2.50
50 yr PWLB	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.30

Additional notes by Link on this forecast table: -

- *LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.*
- *Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.*
- *We will maintain continuity by providing clients with LIBID investment benchmark rates on the current basis.*

The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings, although some forecasters had suggested that a cut into negative territory could have happened prior to more recent months when strong recovery started kicking in. However, the minutes of the Monetary Policy Committee in February 2021 made it clear that commercial banks could not implement negative rates within six months; by that time the economy would be expected to be recovering strongly and so there would be no requirement for negative rates. As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 1 of 2023/24 and another increase to 0.50% in quarter 4 of 23/24, as an indication that the Bank of England will be starting monetary tightening during this year.

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

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

At the start of January 2021, all gilt yields from 1 to 8 years were negative: however, since then all gilt yields have become positive and rose sharply, especially in medium and longer-term periods, until starting a significant decline since May. The main driver of the increases was investors becoming progressively more concerned at the way that inflation was expected to rise sharply in major western economies during 2021 and 2022. However, repeated assurances by the Fed in the US, and by other major world central banks, that inflation would spike up after Covid restrictions were abolished, but would only be transitory, have eventually allayed those investor fears. **However, there is an alternative view that the US Fed is taking a too laid-back view that inflation pressures in the US are purely transitory and that they will subside without the need for the Fed to take any action to tighten monetary policy. This could mean that US rates will end up rising faster and sharper if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields.**

As the interest forecast table for PWLB certainty rates, (gilts plus 80bps), above shows, there is likely to be an unwinding of the currently depressed levels of PWLB rates and a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

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

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

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

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is now to the upside though there are still residual risks from Covid variants - both domestically and their potential effects worldwide, and from various shortages.
-
- There is relatively little domestic risk of increases in Bank Rate exceeding 0.50% in the next two to three years and, therefore, in shorter-term PWLB rates.

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

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, resulting in further national lockdowns or severe regional restrictions.

- **MPC** acts too quickly in unwinding QE or increasing Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
-
- The Government implements an **austerity programme** that supresses GDP growth.

- **Labour and material shortages** do not ease over the next few months and further stifle economic recovery.

- The lockdowns cause major long-term **scarring of the economy.**

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- 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 which has still to be disbursed. These actions will help shield weaker economic regions in the near-term. 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 the extent of credit losses resulting from the pandemic.

- **German minority government & general election in September 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, because of the rise in popularity of the anti-immigration AfD party. Subsequently, the CDU has done badly in state elections, but the SPD has done even worse. Angela Merkel has stepped down from being the CDU party leader but remains as Chancellor until the general election in 2021. Her appointed successor has not attracted wide support from voters and the result of the general election could well lead to some form of coalition government, though there could be a question as to whether the CDU will be part of it which, in turn, could then raise an issue over the tenure of her successor. This then leaves a question mark over who the major guiding hand and driver of EU unity will be.

- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile and, therein, impact market confidence/economic prospects and lead to increasing safe-haven flows.
- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- **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: -

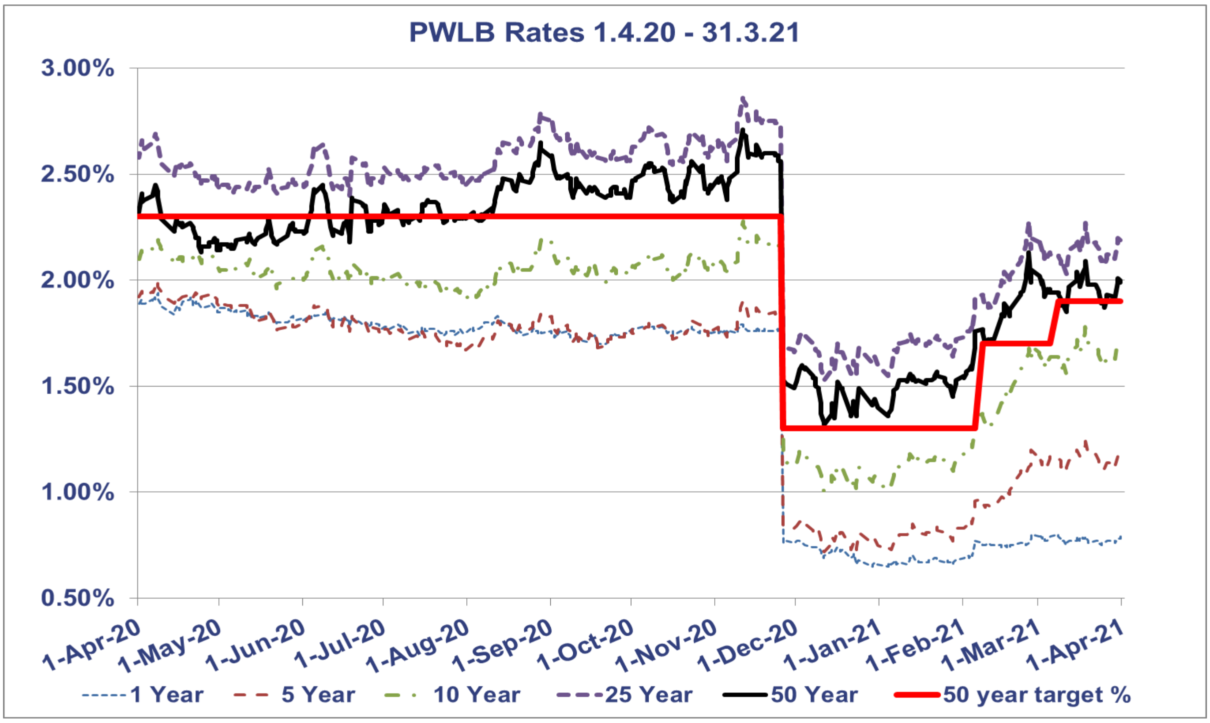
- Longer term **US treasury yields** rise strongly and pull UK gilt yields up higher than forecast.

- **Vaccinations** are even more successful than expected and eradicate hesitancy around a full return to normal life, which leads into a stronger than currently expected recovery in UK and/or other major developed economies.

- 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.

APPENDIX C

PWLB maturity rates for year to 31 March 2021



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Low date	04/01/2021	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.94%	1.99%	2.28%	2.86%	2.71%
High date	08/04/2020	08/04/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.43%	1.50%	1.81%	2.33%	2.14%
Spread	1.29%	1.27%	1.28%	1.33%	1.39%

PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and 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. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have seen, over the last two years, many bond yields up to 10 years in the Eurozone turn negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. 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.

Gilt yields fell sharply from the start of 2020 and then spiked up during a financial markets melt down in March caused by the pandemic hitting western countries; this was rapidly countered by central banks flooding the markets with liquidity. While US treasury yields do exert influence on UK gilt yields so that the two often move in tandem, they have diverged during the first three quarters of 2020/21 but then converged in the final quarter. Expectations of economic recovery started earlier in the US than the UK but once the UK vaccination programme started making rapid progress in the new year of 2021, gilt yields and gilt yields and PWLB rates started rising sharply as confidence in economic recovery rebounded. Financial markets also expected Bank Rate to rise quicker than in the forecast tables in this report.

At the close of the day on 31 March 2021, all gilt yields from 1 to 5 years were between 0.19 – 0.58% while the 10-year and 25-year yields were at 1.11% and 1.59%.

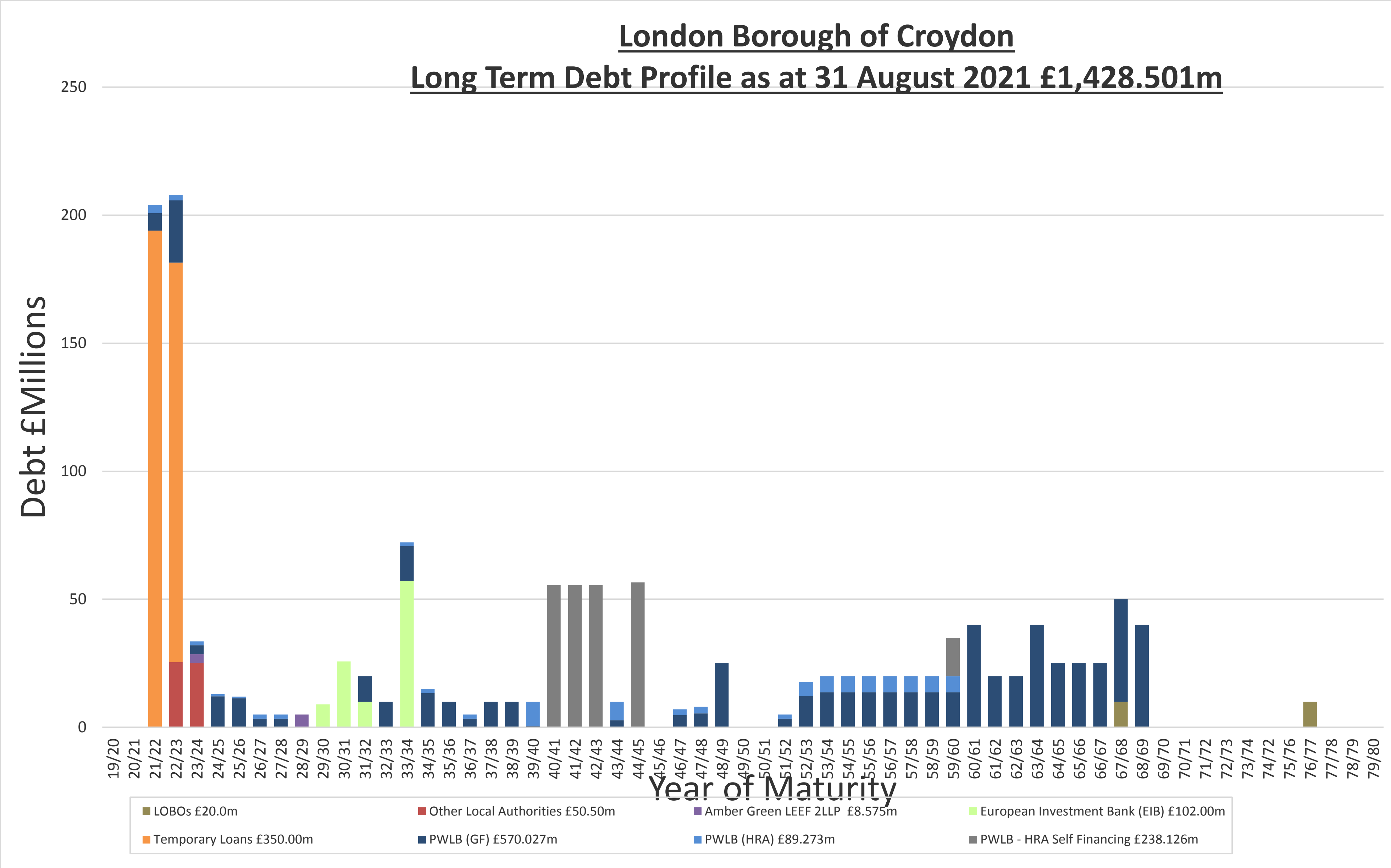
HM Treasury imposed **two changes of margins over gilt yields for PWLB rates in 2019/20** without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and **on 25th November 2020, 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)

There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not forecast to rise from 0.10% by March 2024 as the Bank of England has clearly stated that it will not raise rates until inflation is sustainably above its target of 2%; this sets a high bar for Bank Rate to start rising.

APPENDIX D

Debt maturity profile


London Borough of Croydon
Long Term Debt Profile as at 31 August 2021 £1,428.501m
Debt £Millions
250
200
150
100
50
0
19/20
20/21
21/22
22/23
23/24
24/25
25/26
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27/28
28/29
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69/70
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71/72
72/73
73/74
74/72
75/76
76/77
77/78
78/79
79/80
Year of Maturity
LOBOs £20.0m
Other Local Authorities £50.50m
Amber Green LEEF 2LLP £8.575m
European Investment Bank (EIB) £102.00m
Temporary Loans £350.00m
PWLB (GF) £570.027m
PWLB (HRA) £89.273m
PWLB - HRA Self Financing £238.126m

APPENDIX E

Investment instruments identified for use by the Council during 2020/21

Specified investments

AAA rated money market funds - limit £20m
Debt Management Office – no limit
Royal Bank of Scotland* – limit £25m
Duration of up to one year.

*Royal Bank of Scotland is included as a specified investment since it is the Council's banker and the UK Government holds a majority stake.

Non-specified investments

All institutions included on Link Asset Services' weekly "Suggested Credit List" – limit £10m
All UK local authorities – limit £10m
Duration to be determined by the "Suggested Credit List" from Link

Prudential and Treasury Indicators for 2020/21

Treasury Indicators	Treasury Management Strategy Statement £m	Actual £m
Authorised limit for external debt		
Borrowing	1,853.0	1,443.5
Other long term liabilities	82.8	73.6
TOTAL	1,935.8	1,520.1
Operational boundary for external debt		
Borrowing	1803.0	1,443.5
Other long term liabilities	82.8	73.6
TOTAL	1,885.8	1,520.1
Gross external debt	1,790.8	1,520.1
Investments – General Fund		82.0
Net borrowing		1,438.1
Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	0-25%	22.4%
12 months to 2 years	0-20%	6.6%
2 years to 5 years	0-30%	4.2%
5 years to 10 years	0-30%	5.3%
10 years and above	0-100%	61.5%

Prudential Indicators	Treasury Management Strategy	Actual

	Statement £m	£m
Capital expenditure		
General Fund	111.036	53.134
Commercial Activities / non-financial investments	190.510	10.267
Capitalisation Direction		65.820
HRA	35.701	22.834
TOTAL	337.247	152.055
Capital Financing Requirement (CFR)		
General Fund	1,461.317	1,274.519
HRA	338.139	353.965
TOTAL	1,799.456	1,628.484
Annual change in CFR		
General Fund	272.708	74.830
HRA	8.545	15.041
TOTAL	281.253	89.871
In year borrowing requirement	277.958	102.215