Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Cambridgeshire Police And Crime Commissioner
2022/23

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1 INTRODUCTION

1.1 Background

The Police and Crime Commissioner ("the Commissioner") is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Commissioner's low risk appetite, providing adequate security and liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Commissioner's capital plans. These capital plans provide a guide to the borrowing need of the Commissioner, essentially the longer term cash flow planning, to ensure that the Commissioner can meet the 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 the Commissioner's risk or cost objectives.

Separate to this, the capital strategy sets out the investment required in capital assets that the Commissioner anticipates making for the medium term. The Treasury Management strategy summarises the planned capital expenditure and sets out how the Commissioner will manage borrowings and investments over the short and medium term. Alongside this, the asset management strategy will set out the framework for managing the property portfolio effectively in the short and medium term. It will guide future strategic property decisions to make sure the Commissioner manages the asset portfolio sustainably and efficiently so that it can adapt to remain fit for the future and support frontline delivery.

The contribution the treasury management function makes to the Commissioner is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

"The management of the local authority's [including the Commissioner'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."

This Commissioner has not engaged in any commercial investments and has no non-treasury investments.

To summarise, Treasury management is the management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. The prime objective of the Commissioner's investment strategy is to maintain capital security whilst ensuring that there is the necessary liquidity to carry out its business. Within these constraints, the strategy aims to maximise returns.

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities, including the Commissioner, to prepare a capital strategy report, which will provide the following:

- a high-level long term 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.

The aim of this capital strategy is to ensure that the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite are understood.

1.2.2 Treasury Management reporting

The Commissioner is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report – This will update the Commissioner on the progress of the capital and treasury position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations at the year end compared to the estimates within the strategy.

1.2.3 Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Commissioner. This role is undertaken by the Chief Finance Officer and the Business Co-ordination Board.

1.3 Treasury Management Strategy for 2022/23

The strategy for 2022/23 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the Minimum Revenue Provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Commissioner;

- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Department for Levelling Up, Housing and Communities (DLUHC) MRP Guidance, the CIPFA Treasury Management Code and DLUHC Investment Guidance.

Affordability and Financial Planning: The Capital Programme and the MTFS will include forecasts on capital expenditure, revenue consequences of capital programmes and the requirement to financially support capital investment, mainly through borrowing. This work will have identified the potential financial position for the Force in respect of the coming medium term, taking into account core known information and stated assumptions

Capital Sustainability: For the period of the Medium Term Financial Strategy (MTFS) 2022/23 to 2025/26) there is a move away from funding of the capital programme through use of capital reserves and grants into a position of funding through borrowing for specific projects. The replacement of the Parkside police station and custody provision in South Cambridgeshire is the largest capital project in recent years and will require a significant amount of capital investment.

Approval Process: Once the Commissioner has approved the capital programme, then capital expenditure can be committed against these approved schemes. Whether capital projects are funded from grant, capital allocations or borrowing, the revenue costs must be able to be met from existing revenue budgets. Following approval by the Commissioner capital expenditure is then monitored on a regular basis at the Force Executive Board and the Business Coordination Board meetings.

Capital receipts: Capital receipts cannot be spent on revenue items but will reduce the requirement for borrowing. The Commissioner is currently reviewing the pool of surplus land and underutilised assets in its portfolio, and is appraising options to collaborate with Cambridgeshire Fire and Rescue Service (CFRS) in accommodating both police and fire together, which releases surplus land and building to realise capital receipts.

Prudential Borrowing: The Commissioner can set their own borrowing levels based on capital need and the ability to pay for the borrowing. The levels will be set by using the indicators and factors set out in the Prudential Code. The borrowing costs are not supported by the Government so the Commissioner needs to ensure the repayment costs can be funded. Due to the ongoing debt charges (i.e. MRP and external interest charges) the Chief Finance Officer (CFO) will keep under review external borrowing and any potential alternative funding source for financing the capital programme.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that those with responsibility for treasury management, particularly those responsible for its scrutiny, receive adequate training in treasury management. The Commissioner and members of the substantive Joint Audit Committee will be provided with appropriate training. The training needs of treasury management officers are periodically reviewed.

2 THE CAPITAL PROGRAMME 2022/23 – 2025/26

The Commissioner's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in the prudential indicators, which are designed to assist with this overview and confirmation of capital expenditure plans. These indicators are separated out in Appendix 5.1, with the following table providing a overview.

Table 1

£000's		2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Opening Capital Financing Requirement (CFR)		**22,206**	**21,982**	**26,879**	**27,886**	**46,447**	**46,973**
Capital investment:							
Tangible assets additions		4,543	12,294	9,871	26,063	30,367	14,467
Intangible assets additions		269	-	-	-	-	-
TOTAL CAPITAL EXPENDITURE	(A)	**4,812**	**12,294**	**9,871**	**26,063**	**30,367**	**14,467**
Source of Finance:							
Capital receipts		(537)	(1,551)	(4,025)	(3,275)	-	(11,027)
Government Grants		(269)	(166)	-	-	-	-
Other sources		(119)	-	-	-	-	-
		(925)	**(1,717)**	**(4,025)**	**(3,275)**	**-**	**(11,027)**
Sums set aside from Revenue:							
Direct revenue contributions		(2,073)	(3,691)	(3,840)	(3,440)	(3,440)	(3,440)
		(2,073)	**(3,691)**	**(3,840)**	**(3,440)**	**(3,440)**	**(3,440)**
Reserves:							
Tfr from Capital Reserves		-	-	(187)	-	-	-
Tfr from Other Reserves		(1,316)	(1,008)	-	-	-	-
		(1,316)	**(1,008)**	**(187)**	**-**	**-**	**-**
TOTAL FINANCING	(B)	**(4,314)**	**(6,416)**	**(8,052)**	**(6,715)**	**(3,440)**	**(14,467)**
Net financing need	(A)+(B)	**498**	**5,878**	**1,819**	**19,348**	**26,927**	**-**
Minimum Revenue Provision (MRP)	(C)	**(722)**	**(981)**	**(812)**	**(787)**	**(1,313)**	**(1,429)**
Movement in CFR	(A)+(B)+(C)	**(224)**	**4,897**	**1,007**	**18,561**	**25,614**	**(1,429)**
Closing Capital Financing Requirement	(D)	**21,982**	**26,879**	**27,886**	**46,447**	**72,061**	**45,544**
Borrowing represented by:							
Loan Finance		17,302	16,740	19,153	37,492	61,511	60,107
Finance Lease		23	16	8	1	-	-
TOTAL BORROWING	(E)	**17,325**	**16,756**	**19,161**	**37,493**	**61,511**	**60,107**
Under/(Over) borrowing	(D)-(E)	**4,657**	**10,123**	**8,725**	**8,954**	**10,550**	**(14,563)**

Table 1 shows the movement in Capital Financing Requirement from the audited position in the 2020/21 accounts to the end of the Medium-Term Financial Strategy period. This takes account of the capital programme for the same period.

Total capital expenditure is shown, which for 2022/23 to 2025/26 amounts to £80.7m and includes a major project to replace the Parkside police station and custody provision in South Cambridgeshire, alongside several other large projects.

Total financing includes the different sources of financing, direct revenue contributions and use of capital reserves.

The Minimum Revenue Provision is a charge to the revenue budget to reflect a repayment of the capital outlay (see 2.4 for more detail).

The Net Financing Need is the difference of capital expenditure to the total of financing available; this shows the requirement to borrow to support the current plans.

Table 1 also shows the currently under-borrowed position which is the difference of the Capital Financing Requirement and the current level of Loans and Finance Leases outstanding. The Commissioner needs to ensure that the gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. The estimated over-borrowed position of 2025/26 is a result of the expected capital receipt from the sale of Parkside Police station. The timing of this will become clearer over time and a related short-term loan will be used to bridge the financing gap until the receipt is due, therefore, the temporary over-borrowed position in 2025/26 is currently forecast to reduce to £0.5m in 2026/27 following the maturity of the loan. This forecast, and with it the taking of the short-term loan, will change inline with any anticipated programme changes.

2.1 Capital expenditure

The Commissioner's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle are summarised within **Table 1**, and how the plans are being financed by capital or revenue resources. Any shortfall of resources results in a borrowing need.

2.2 The Commissioner's borrowing need (the Capital Financing Requirement)

The Capital Financing Requirement (CFR) is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Commissioner's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

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 assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Commissioner's borrowing requirement, these types of scheme include a borrowing facility and so the Commissioner is not required to separately borrow for these schemes. The Commissioner currently has £23k (shown in **Table 1**, Finance Lease) of such schemes within the CFR.

2.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). **Table 2** shows estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Table 2 – Cash available to invest

YEAR END RESOURCES £000's		2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
General and Earmarked Reserve		16,229	15,426	15,887	15,431	15,294	15,144
Capital Receipts Reserve		187	187	-	-	-	-
TOTAL RESERVES		**16,416**	**15,613**	**15,887**	**15,431**	**15,294**	**15,144**
Provisions		1,312	1,312	1,312	1,312	1,312	1,312
TOTAL CORE FUNDS AVAILABLE	(A)	**17,728**	**16,925**	**17,199**	**16,743**	**16,606**	**16,456**
Working Capital:							
Stock		1,037	1,037	1,037	1,037	1,037	1,037
Debtors		34,790	34,790	34,790	34,790	34,790	34,790
Creditors		(42,944)	(42,944)	(42,944)	(42,944)	(42,944)	(42,944)
		(7,117)	**(7,117)**	**(7,117)**	**(7,117)**	**(7,117)**	**(7,117)**
Under / (Over) borrowing		4,657	10,123	8,725	8,954	10,550	(14,563)
TOTAL EXISTING REQUIREMENT	(B)	**(2,460)**	**3,006**	**1,608**	**1,837**	**3,433**	**(21,680)**
Cash available to invest	(A)-(B)	**20,188**	**13,919**	**15,591**	**14,906**	**13,173**	**38,136**

Table 2 above shows the value of the remainder of core funds available to invest after consideration of cash backed reserves, provisions and the under-borrowed amount are offset against the working capital requirements of the organisation. The levels of provision and working capital are projected forward at the same level as for 2020/21 as no significant changes are envisaged.

2.4 Minimum revenue provision (MRP) policy statement

The Commissioner is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although the Commissioner is also allowed to undertake additional voluntary payments if required (voluntary revenue provision – VRP).

DLUHC regulations have been issued which require the Commissioner to approve **an MRP Statement** in advance of each year. A variety of options are provided to authorities, so long as there is a prudent provision. The Commissioner is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** – MRP will follow the existing practice outlined in former DLUHC regulations. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life.

Repayments included in annual PFI or finance leases are applied as MRP.

MRP Overpayments – a change introduced by the revised DLUHC MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2021 the total VRP overpayments were zero.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Commissioner. The Treasury Management function ensures that the Commissioner's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Commissioner's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The overall Treasury Management portfolio as at 31 March 2021 and for the position as at 31 January 2022 are shown below for both borrowing and investments.

Table 3

TREASURY PORTFOLIO				
	31 March 2021		31 January 2022	
Treasury Investments	**£000**	**%**	**£000**	**%**
Banks (UK)	14,380	100%	12,735	52%
Banks (Rest of World)	0	0%	6,000	25%
Local Authorities	0	0%	0	0%
DMADF (H.M. Treasury)	0	0%	0	0%
Money Market Funds	0	0%	5,710	23%
Certificates of Deposit	0	0%	0	0%
Total Managed In-house	**14,380**	**100%**	**24,445**	**100%**
Bond Funds	0	0%	0	0%
Property Funds	0	0%	0	0%
Total Managed Externally	**0**	**0%**	**0**	**0%**
Total Treasury Investments	**14,380**	**100%**	**24,445**	**100%**
Treasury External Borrowing				
Local Authorities	0	0%	0	0%
PWLB	17,301	100%	16,984	100%
Total External Borrowing	**17,301**	**100%**	**16,984**	**100%**
Net Treasury Investments / (Borrowing)	**(2,921)**		**7,461**	

The Commissioner's forward projections for borrowing are summarised in **Table 1**, which shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Within the prudential indicators there are a number of key indicators to ensure that the Commissioner's activities are operated within well-defined limits. One of these is that the Commissioner needs to ensure that the gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Finance Officer reports that the Commissioner complied with this prudential indicator 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 budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

In order to calculate an operational boundary, an operational buffer of 10% is added to the value of the Capital Financing Requirement. In addition, where there is the potential for borrowing to be needed earlier than planned, the estimated loan requirement is also added.

The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Commissioner. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all authorities and councils' plans, or those of a specific authority or council, including the Commissioner, although this power has not yet been exercised.
2. The authorised limit has been determined to be 15% in excess of the operational boundary.
3. The below highlights the Authorised Limit the Commissioner has approved for 2022/23 and forecasts the changes expected over the period to 2025/26:

Table 4

LIMITS TO BORROWING ACTIVITY £000's	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Capital Financing Requirement (CFR)	21,982	26,879	27,886	46,447	72,061	45,544
Operational Margin (10% of CFR)			2,789	4,645	7,206	4,554
			30,675	**51,092**	**79,267**	**50,098**
Borrowing Capability Factor *			19,348	26,927	-	14,774
OPERATIONAL BOUNDARY	**36,047**	**69,567**	**50,023**	**78,019**	**79,267**	**64,872**
AUTHORISED LIMIT (15% above Operational Boundary)	**41,454**	**80,002**	**57,526**	**89,722**	**91,158**	**74,603**

** Net Financing Need (see Table 1) for following year brought forward - this allows for borrowing in readiness for expected capital outlay*

3.3 Borrowing strategy

The Commissioner is currently maintaining an under-borrowed position (see **Table 1**). This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Commissioner's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 Treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and 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. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.4 Policy on borrowing in advance of need

The Commissioner will not borrow more than, or in advance of, the need 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 Commissioner can ensure the security of such funds.

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.

3.5 Debt rescheduling

There are no plans for rescheduling our current borrowing in the debt portfolio. All rescheduling will be discussed with the Commissioner or Deputy Commissioner prior to any decision being taken.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Commissioner's investment policy has regard to the following:

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

The Commissioner's investment priorities will be security first, liquidity second, then return.

The above guidance from the DLUHC and CIPFA place a high priority on the management of risk. The Commissioner has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. 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.
2. 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 Commissioner will engage with advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
3. 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.
4. The Commissioner 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 of one year.
    - 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. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
5. Non-specified investments limit. The Commissioner has determined that zero Non-specified investments will be undertaken. This will limit the maximum total exposure to non-specified investments to 0% of the total investment portfolio, (see paragraph 4.3).
6. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
7. The Commissioner will set a limit for the amount of the investments which are invested for longer than 365 days, (see paragraph 4.4).

8. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 4.3).
9. The Commissioner has engaged external consultants to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of the Commissioner in the context of the expected level of cash balances and need for liquidity throughout the year.
10. All investments will be denominated in sterling.
11. As a result of the change in accounting standards for 2019/20 under IFRS 9, the Commissioner 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.

However, the Commissioner will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year - The above criteria are unchanged from last year.

4.2 Creditworthiness policy

The primary principle governing the Commissioner's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Commissioner 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 Commissioner's prudential indicators covering the maximum principal sums invested.

The CFO will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Commissioner for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Commissioner may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services, our treasury consultants, on all active counterparties that comply with the criteria below. 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. For instance, a negative rating Watch applying to a counterparty at the minimum of the Commissioner's criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the Commissioner will only use banks which:
  i. are UK banks; and/or
  ii. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA- and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
  iii. Short Term – F1
  iv. Long Term – A-
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above.
- Banks 3 – The Commissioner's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Money market funds (MMFs) CNAV – AAA
- Money market funds (MMFs) LVNAV – AAA
- Money market funds (MMFs) VNAV – AAA
- Ultra-Short Dated Bond Funds with a credit rating of at least 1.25 – AAA
- Ultra-Short Dated Bond Funds with a credit rating of at least 1.50 - AAA
- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, parish councils, Commissioners etc

A limit of 0% will be applied to the use of non-specified investments.

Use of additional information other than credit ratings. Additional requirements under the Code require the Commissioner to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Commissioner's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Rating	**Money and/or % Limit**	**Time Limit**
Banks 1 - higher quality	A- / F1	25% of available funds (max £10m)	364 days
Banks 2 – part nationalised	A- / F1	25% of available funds (max £10m)	364 days
Commissioner' bank (when not within Banks 1)		£10m	Overnight
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£10m	364 days
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money market funds CNAV	AAA	100% of available funds	Liquid
Money market funds LVNAV	AAA	100% of available funds	Liquid
Money market funds VNAV	AAA	100% of available funds	Liquid
Ultra-Short Dated Bonds Funds	AAA	100% of available funds	Liquid

The proposed criteria for specified and non-specified investments are shown in Appendix 5.4 for approval.

4.3 Country and sector limits

Due care will be taken to consider the country, group and sector exposure of the Commissioner's investments.

The Commissioner has determined that approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch or equivalent will be used. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition:

- no more than 50% of available funds will be placed in a country outside of the UK (this applies to Banks 1 (see 4.2 above) only, not Money Market funds);
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

4.4 Investment strategy

In-house funds - 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). 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.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations - The current forecast shown in appendix 5.4, includes a forecast for a first increase in Bank Rate in May 2022, though it could come in February.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as:

2022/23	0.50%
2023/24	0.75%
2024/25	1.00%
2025/26	1.25%
Later years	2.00%

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Commissioner's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Commissioner has approved the treasury indicator and limit for investments greater than 365 days as:

Maximum principal sums invested > 364 days	2021/22	2022/23	2023/24
Principal sums invested > 364 & 365 days	£0	£0	£0

For its cash flow generated balances, the Commissioner will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 365 days) in order to benefit from the compounding of interest.

4.5 Investment risk benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

- Security - the Commissioner's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:
  - 0.03% historic risk of default when compared to the whole portfolio.
- Liquidity - in respect of this area the Commissioner seeks to maintain:
  - Bank overdraft - £100k
  - Liquid short term deposits having the lower of at least £5m or 25% of funds available with a week's notice.
- Yield - local measures of yield benchmarks are:
  - Investments - internal returns above the overnight LIBOR rate -0.25%

4.6 End of year investment report

At the end of the financial year, the Commissioner will report on the investment activity as part of the Annual Treasury Report.

APPENDICES

1. Prudential and treasury indicators
2. Interest rate forecasts
3. Economic background
4. Treasury management practice – credit and counterparty risk management
5. Treasury management scheme of delegation
6. The treasury management role of the section 151 officer

4.7 APPENDIX: Prudential and Treasury Indicators 2022/23 – 2025/26

4.7.1 Capital Expenditure

This provides a summary of the Commissioner's capital expenditure. It reflects matters previously agreed and those proposed for the forthcoming financial periods.

Capital Expenditure		2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Total Capital Expenditure	(A)	**4,812**	**12,294**	**9,871**	**26,063**	**30,367**	**14,467**
Financed by:							
Capital receipts		(537)	(1,551)	(4,025)	(3,275)	-	(11,027)
Revenue contribution		(2,073)	(3,691)	(3,840)	(3,440)	(3,440)	(3,440)
Grants and other contributions		(1,704)	(1,174)	(187)	-	-	-
Finance lease and PFI liabilities		-	-	-	-	-	-
Total Financing	(B)	**(4,314)**	**(6,416)**	**(8,052)**	**(6,715)**	**(3,440)**	**(14,467)**
Net financing need for year	(A)-(B)	**498**	**5,878**	**1,819**	**19,348**	**26,927**	**-**

4.7.2 Capital Financing Requirement

This shows the difference between the Commissioner's capital expenditure and the revenue or capital resources set aside to finance that spend. The CFR will increase where capital expenditure takes place and will reduce as the Commissioner makes Minimum Revenue Provision ("MRP") or Voluntary Revenue Provision ("VRP") or otherwise sets aside revenue or capital resources to finance expenditure.

Capital Financing Requirement	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Opening CFR	22,206	21,982	26,879	27,886	46,447	46,973
Capital spend	4,812	12,294	9,871	26,063	30,367	14,467
Resources used	(4,314)	(6,416)	(8,052)	(6,715)	(3,440)	(14,467)
MRP & VRP	(722)	(981)	(812)	(787)	(1,313)	(1,429)
Closing CFR	**21,982**	**26,879**	**27,886**	**46,447**	**72,061**	**45,544**

4.7.3 Authorised Limit

This represents a control on the maximum level of external debt the Commissioner can incur. The Commissioner has to show this aggregate amount split into the element in respect of actual external borrowing and that which relates to 'other long-term liabilities' - the latter being credit arrangements, as defined in statute and which will include the principle element of any finance lease or Private Finance Initiative obligations payable.

Authorised Limit	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Borrowing	41,254	79,802	57,326	89,522	90,958	74,403
Other Long Term Liabilities	200	200	200	200	200	200
Total Authorised Limit	**41,454**	**80,002**	**57,526**	**89,722**	**91,158**	**74,603**

4.7.4 Operational Boundary

This is the limit beyond which external debt is not normally expected to exceed. Again, the Commissioner is required to disclose an aggregate limit and separately disclose the element that relates to actual external borrowing and that which relates to other long-term liabilities. Unlike the Authorised Limit, the Operational Boundary is not an absolute limit but it reflects the Commissioner's expectations of the level at which external debt would not ordinarily be expected to exceed.

Operational Boundary	**2020/21 Actual**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**
Borrowing	35,947	69,467	49,923	77,919	79,167	64,772
Other Long Term Liabilities	100	100	100	100	100	100
Total Operational Boundary	**36,047**	**69,567**	**50,023**	**78,019**	**79,267**	**64,872**

4.7.5 External Debt

The Commissioner has to disclose the closing balance for actual gross borrowing in respect of the financial period just ended, together with the level of other long-term liabilities and so the actual aggregate level of external debt at the Balance Sheet date. This clarifies the overall level of external debt, and allow comparison to the Commissioner's actual borrowing need as provided by the Gross debt and the CFR Indicator.

Actual External Debt as at 31st March	**2021/22 Estimate**
Borrowing	16,740
Other Long Term Liabilities	16
Total External Debt	**16,756**

4.7.6 Gross Debt and the Capital Financing Requirement

The Commissioner should only borrow to support a capital purpose, and borrowing should not be undertaken for revenue or speculative purposes. If the level of gross borrowing is below the Commissioner's capital borrowing need – the CFR – it demonstrates compliance with the requirement of this Indicator.

Gross Debt and the CFR	**2020/21 Actual**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**
CFR	21,982	26,879	27,886	46,447	72,061	45,544
Gross Borrowing	17,325	16,756	19,161	37,493	61,511	60,107
Under/(Over) Borrowing	**4,657**	**10,123**	**8,725**	**8,954**	**10,550**	**(14,563)**

4.7.7 Ratio of Financing Costs

This Indicator shows the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream – i.e. taxation and non-specific grant income. The higher the ratio, the higher the proportion of resources tied up just to service net capital costs, and which represent a potential affordability risk.

Ratio of Financing Costs		2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Interest cost on existing borrowing		604	579	553	526	526	526
Interest cost on new borrowing		-	-	70	514	1,091	1,074
Gains/losses on debt rescheduling		-	-	-	-	-	-
Interest and investment income		(114)	(20)	(50)	(50)	(50)	(50)
MRP & VRP		722	981	812	787	1,313	1,429
Total Financing Costs	(A)	**1,212**	**1,540**	**1,385**	**1,777**	**2,880**	**2,979**
Net Budget Requirement	(B)	**152,467**	**161,654**	**171,431**	**178,286**	**184,037**	**188,000**
Ratio of financing costs	(A)/(B)	**0.79%**	**0.95%**	**0.81%**	**1.00%**	**1.56%**	**1.58%**

4.7.8 Maturity Structure of Borrowing

The Commissioner is required to set gross limits on maturities for the periods shown and covers both fixed and variable rate borrowings. The reason being to try and control the Commissioner's exposure to large sums falling due for refinancing.

Maturity structure of borrowing:	Actual	Lower Limit	Upper Limit
Under 12 months	3%	0%	100%
12 to 24 months	4%	0%	100%
2 to 5 years	12%	0%	100%
5 to 10 years	18%	0%	100%
Over 10 years	63%	0%	100%

4.7.9 Limit for Principal Sums Invested for Longer Than a Year

This Indicator is seeking to support control of liquidity risk. The limits should be set with regard to the Commissioner's liquidity needs and reduce the potential need to have to make early exit from an investment in order to recover funds.

	Actual	Limit
Upper limit on total principal sums invested longer than a year	£ -	£ -

A limit of zero is set to ensure that investments are not tied up for any period greater than 12 months.

4.8 APPENDIX: Interest Rate Forecasts 2022 - 2025

The PWLB rates below are based on the new margins over gilts announced on 20th December 2021. PWLB forecasts shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30
Bank Rate														
Link	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
Capital Economics	0.25	0.25	0.50	0.75	0.75	0.75	0.75	1.00	1.00	-	-	-	-	-
5yr PWLB Rate														
Link	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
Capital Economics	1.40	1.40	1.50	1.50	1.60	1.70	1.70	1.80	1.90	-	-	-	-	-
10yr PWLB Rate														
Link	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
Capital Economics	1.60	1.60	1.70	1.70	1.80	1.80	1.90	2.00	2.00	-	-	-	-	-
25yr PWLB Rate														
Link	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
Capital Economics	1.80	1.80	1.90	1.90	2.00	2.10	2.10	2.20	2.30	-	-	-	-	-
50yr PWLB Rate														
Link	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30
Capital Economics	1.40	1.50	1.60	1.70	1.80	1.90	2.00	2.20	2.30	-	-	-	-	-

4.9 APPENDIX: Economic Background

Foreword

The below narrative was composed in early January and reflects the position at that point. With such a fast changing landscape, it became apparent that the Bank of England was likely to raise interest rates in response to the unrelenting inflationary pressure. On the 3rd February 2022, as this report goes out, the Bank took the decision to raise the base rate to 0.50% and comment in the following overview may already feel outdated. Much of the analysis remains true, however, and the context should be considered with the shift of rate up 25 basis points as the higher than expected inflation figures have weighted heavily in the MPC's decisions.

The Bank appears more hawkish in three ways. First, the vote was 5-4 and the four in the minority all wanted to raise rates to 0.75%. Second, not only has the Bank decided to start unwinding QE in line with its previous guidance, but it has said it will sell its £20bn holdings of corporate bonds. That's a quicker rundown of the balance sheet than expected. Third, the MPC revised up its CPI inflation forecast so that it peaks at 7.25% in April and is further above the 2.0% target for all of 2022 and 2023. The Bank also revised down its GDP growth forecasts for 2022 (from 3.75% to 3.25%). And based on the markets expectations that rates will rise to 1.5% by mid-2023, it forecast that CPI inflation will be just 1.6% in three years' time. That suggests the Bank doesn't think rates need to rise to 1.5%. Overall, it appears that the Bank is trying to get back to its inflation target.

COVID-19 vaccines

These were the game changer during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, the bursting onto the scene of the Omicron mutation at the end of November, rendered the initial two doses of all vaccines largely ineffective in preventing infection. This has dashed such hopes and raises the spectre again that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that this mutation is very fast spreading with the potential for total case numbers to double every two to three days, although it possibly may not cause so much severe illness as previous mutations. Rather than go for full lockdowns which heavily damage the economy, the government strategy this time is focusing on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection, as a booster has been shown to restore a high percentage of immunity to Omicron to those who have had two vaccinations. There is now a race on between how quickly boosters can be given to limit the spread of Omicron, and how quickly will hospitals fill up and potentially be unable to cope. In the meantime, workers have been requested to work from home and restrictions have been placed on large indoor gatherings and hospitality venues. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in sectors like restaurants, travel, tourism and hotels which had been hit hard during 2021, but could now be hit hard again by either, or both, of government restrictions and/or consumer reluctance to leave home. Growth will also be lower due to people being ill and not working, similar to the pingdemic in July. The economy, therefore, faces significant headwinds although some sectors have learned how to cope well with Covid. However, the biggest impact on growth would come from another lockdown if that happened. The big question still remains as to whether any further mutations of this virus could develop which render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- In December, the Bank of England became the first major western central bank to put interest rates up in this upswing in the current business cycle in western economies as recovery progresses from the Covid recession of 2020.
- The next increase in Bank Rate could be in February or May, dependent on how severe an impact there is from Omicron.

- If there are lockdowns in January, this could pose a barrier for the MPC to putting Bank Rate up again as early as 3rd February.
- With inflation expected to peak at around 6% in April, the MPC may want to be seen to be active in taking action to counter inflation on 5th May, the release date for its Quarterly Monetary Policy Report.
- The December 2021 MPC meeting was more concerned with combating inflation over the medium term than supporting economic growth in the short term.
- Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022.
- However, the MPC will want to normalise Bank Rate over the next three years so that it has its main monetary policy tool ready to use in time for the next down-turn; all rates under 2% are providing stimulus to economic growth.
- We have put year end 0.25% increases into Q1 of each financial year from 2023 to recognise this upward bias in Bank Rate - but the actual timing in each year is difficult to predict.
- Covid remains a major potential downside threat in all three years as we ARE likely to get further mutations.
- How quickly can science come up with a mutation proof vaccine, or other treatment, – and for them to be widely administered around the world?
- Purchases of gilts under QE ended in December. Note that when Bank Rate reaches 0.50%, the MPC has said it will start running down its stock of QE.

MPC MEETING – 16th December 2021

The Monetary Policy Committee (MPC) voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.

The MPC disappointed financial markets by not raising Bank Rate at its November meeting. Until Omicron burst on the scene, most forecasters, therefore, viewed a Bank Rate increase as being near certain at this December meeting due to the way that inflationary pressures have been comprehensively building in both producer and consumer prices, and in wage rates. However, at the November meeting, the MPC decided it wanted to have assurance that the labour market would get over the end of the furlough scheme on 30th September without unemployment increasing sharply; their decision was, therefore, to wait until statistics were available to show how the economy had fared at this time.

On 10th December we learnt of the disappointing 0.1% m/m rise in GDP in October which suggested that economic growth had already slowed to a crawl even before the Omicron variant was discovered in late November. Early evidence suggests growth in November might have been marginally better. Nonetheless, at such low rates of growth, the government's "Plan B" COVID-19 restrictions could cause the economy to contract in December.

On 14th December, the labour market statistics for the three months to October and the single month of October were released. The fallout after the furlough scheme was smaller and shorter than the Bank of England had feared. The single-month data were more informative and showed that LFS employment fell by 240,000, unemployment increased by 75,000 and the unemployment rate rose from 3.9% in September to 4.2%. However, the weekly data suggested this didn't last long as unemployment was falling again by the end of October. What's more, the 49,700 fall in the claimant count and the 257,000 rise in the PAYE measure of company payrolls suggests that the labour market strengthened again in November. The other side of the coin was a further rise in the number of vacancies from 1.182m to a record 1.219m in the three months to November which suggests that the supply of labour is struggling to keep up with demand, although the single-month figure for November fell for the first time since February, from 1.307m to 1.227m.

These figures by themselves, would probably have been enough to give the MPC the assurance that it could press ahead to raise Bank Rate at this December meeting. However, the advent of Omicron potentially threw a spanner into the works as it poses a major headwind to the economy which, of itself, will help to cool the economy. The financial markets, therefore, swung round to expecting no change in Bank Rate.

On 15th December we had the CPI inflation figure for November which spiked up further from 4.2% to 5.1%, confirming again how inflationary pressures have been building sharply. However, Omicron also caused a sharp fall in world oil and other commodity prices; (gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies).

Other elements of inflation are also transitory e.g., prices of goods being forced up by supply shortages, and shortages of shipping containers due to ports being clogged have caused huge increases in shipping costs. But these issues are likely to clear during 2022, and then prices will subside back to more normal levels. Gas prices and electricity prices will also fall back once winter is passed and demand for these falls away.

Although it is possible that the Government could step in with some fiscal support for the economy, the huge cost of such support to date is likely to pose a barrier to incurring further major economy wide expenditure unless it is very limited and targeted on narrow sectors like hospitality, (as announced just before Christmas). The Government may well, therefore, effectively leave it to the MPC, and to monetary policy, to support economic growth – but at a time when the threat posed by rising inflation is near to peaking!

This is the adverse set of factors against which the MPC had to decide on Bank Rate. For the second month in a row, the MPC blind-sided financial markets, this time with a surprise increase in Bank Rate from 0.10% to 0.25%. What's more, the hawkish tone of comments indicated that the MPC is now concerned that inflationary pressures are indeed building and need concerted action by the MPC to counter. This indicates that there will be more increases to come with financial markets predicting 1% by the end of 2022. The 8-1 vote to raise the rate shows that there is firm agreement that inflation now poses a threat, especially after the CPI figure hit a 10-year high this week. The MPC commented that "there has been significant upside news" and that "there were some signs of greater persistence in domestic costs and price pressures".

On the other hand, it did also comment that "the Omicron variant is likely to weigh on near-term activity". But it stressed that at the November meeting it had said it would raise rates if the economy evolved as it expected and that now "these conditions had been met". It also appeared more worried about the possible boost to inflation form Omicron itself. It said that "the current position of the global and UK economies was materially different compared with prior to the onset of the pandemic, including elevated levels of consumer price inflation". It also noted the possibility that renewed social distancing would boost demand for goods again, (as demand for services would fall), meaning "global price pressures might persist for longer". (Recent news is that the largest port in the world in China has come down with an Omicron outbreak which is not only affecting the port but also factories in the region.)

On top of that, there were no references this month to inflation being expected to be below the 2% target in two years' time, which at November's meeting the MPC referenced to suggest the markets had gone too far in expecting interest rates to rise to over 1.00% by the end of the year.

These comments indicate that there has been a material reappraisal by the MPC of the inflationary pressures since their last meeting and the Bank also increased its forecast for inflation to peak at 6% next April, rather than at 5% as of a month ago. However, as the Bank retained its guidance that only a "modest tightening" in policy will be required, it cannot be thinking that it will need to increase interest rates that much more. A typical policy tightening cycle has usually involved rates rising by 0.25% four times in a year. "Modest" seems slower than that. As such, the Bank could be thinking about raising interest rates two or three times next year to 0.75% or 1.00%.

In as much as a considerable part of the inflationary pressures at the current time are indeed transitory, and will naturally subside, and since economic growth is likely to be weak over the next few months, this would appear to indicate that this tightening cycle is likely to be comparatively short.

As for the timing of the next increase in Bank Rate, the MPC dropped the comment from November's statement that Bank Rate would be raised "in the coming months". That may imply another rise is unlikely at the next meeting in February and that May is more likely. However, much could depend on how adversely, or not, the economy is affected by Omicron in the run up to the next meeting on 3rd February. Once 0.50% is reached, the Bank would act to start shrinking its stock of QE, (gilts purchased by the Bank would not be replaced when they mature).

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

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

US

Shortages of goods and intermediate goods like semi-conductors, have been fuelling increases in prices and reducing economic growth potential. In November, CPI inflation hit a near 40-year record level of 6.8% but with energy prices then falling sharply, this is probably the peak. The biggest problem for the Fed is the mounting evidence of a strong pick-up in cyclical price pressures e.g., in rent which has hit a decades high.

Shortages of labour have also been driving up wage rates sharply; this also poses a considerable threat to feeding back into producer prices and then into consumer prices inflation. It now also appears that there has been a sustained drop in the labour force which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023 while core inflation is likely to remain elevated at around 3% in both years instead of declining back to the Fed's 2% central target.

Inflation hitting 6.8% and the feed through into second round effects, meant that it was near certain that the Fed's meeting of 15th December would take aggressive action against inflation. Accordingly, the rate of tapering of monthly $120bn QE purchases announced at its November 3rd meeting. was doubled so that all purchases would now finish in February 2022. In addition, Fed officials had started discussions on running down the stock of QE held by the Fed. Fed officials also expected three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy. The first increase could come as soon as March 2022 as the chairman of the Fed stated his view that the economy had made rapid progress to achieving the other goal of the Fed – "maximum employment". The Fed forecast that inflation would fall from an average of 5.3% in 2021 to 2.6% in 2023, still above its target of 2% and both figures significantly up from previous forecasts. What was also significant was that this month the Fed dropped its description of the current level of inflation as being "transitory" and instead referred to "elevated levels" of inflation: the statement also dropped most of the language around the flexible average inflation target, with inflation now described as having exceeded 2 percent "for some time". It did not see Omicron as being a major impediment to the need to take action now to curtail the level of inflationary pressures that have built up, although Fed officials did note that it has the potential to exacerbate supply chain problems and add to price pressures.

See also comments in paragraph 3.3 under PWLB rates and gilt yields.

EU

The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery was then within 0.5% of its pre Covid size. However, the arrival of Omicron is now a major headwind to growth in quarter 4 and the expected downturn into weak growth could well turn negative, with the outlook for the first two months of 2022 expected to continue to be very weak.

November's inflation figures breakdown shows that the increase in price pressures is not just due to high energy costs and global demand-supply imbalances for durable goods as services inflation also rose. Headline inflation reached 4.9% in November, with over half of that due to energy. However, oil and gas prices are expected to fall after the winter and so energy inflation is expected to plummet in 2022. Core goods inflation rose to 2.4% in November, its second highest ever level, and is likely to remain high for some time as it will take a long time for the inflationary impact of global imbalances in the demand and supply of durable goods to disappear. Price pressures also increased in the services sector, but wage growth remains subdued and there are no signs of a trend of faster wage growth which might lead to persistently higher services inflation - which would get the ECB concerned. The upshot is that the euro-zone is set for a prolonged period of inflation being above the ECB's target of 2% and it is likely to average 3% in 2022, in line with the ECB's latest projection.

ECB tapering. The ECB has joined with the Fed by also announcing at its meeting on 16th December that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases for over half of next year. However, as inflation will fall back sharply during 2022, it is likely that it will leave its central rate below zero, (currently -0.50%), over the next two years. The main struggle that the ECB has had in recent years is that inflation has been doggedly anaemic in sticking below the ECB's target rate despite all its major programmes of monetary easing by cutting rates into negative territory and providing QE support.

The ECB will now also need to consider the impact of Omicron on the economy, and it stated at its December meeting that it is prepared to provide further QE support if the pandemic causes bond yield spreads of peripheral countries, (compared to the yields of northern EU countries), to rise. However, that is the only reason it will support peripheral yields, so this support is limited in its scope.

The EU has entered into a period of political uncertainty where a new German government formed of a coalition of three parties with Olaf Scholz replacing Angela Merkel as Chancellor in December 2021, will need to find its feet both within the EU and in the three parties successfully working together. In France there is a presidential election coming up in April 2022 followed by the legislative election in June. In addition, Italy needs to elect a new president in January with Prime Minister Draghi being a favourite due to having suitable gravitas for this post. However, if he switched office, there is a significant risk that the current government coalition could collapse. That could then cause differentials between Italian and German bonds to widen when 2022 will also see a gradual running down of ECB support for the bonds of weaker countries within the EU. These political uncertainties could have repercussions on economies and on Brexit issues.

CHINA

After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of 2020; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021.

However, the pace of economic growth has now fallen back in 2021 after this initial surge of recovery from the pandemic and looks likely to be particularly weak in 2022. China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. Chinese consumers are also being very wary about leaving home and so spending money on services. However, with Omicron having now spread to China, and being much more easily transmissible, this strategy of sharp local lockdowns to stop the virus may not prove so successful in future. In addition, the current pace of providing boosters at 100 billion per month will leave much of the 1.4 billion population exposed to Omicron, and any further mutations, for a considerable time. The People's Bank of China made a start in December 2021 on cutting its key interest rate marginally so as to stimulate economic growth. However, after credit has already expanded by around 25% in just the last two years, it will probably leave the heavy lifting in supporting growth to fiscal stimulus by central and local government.

Supply shortages, especially of coal for power generation, were causing widespread power cuts to industry during the second half of 2021 and so a sharp disruptive impact on some sectors of the economy. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

JAPAN

2021 has been a patchy year in combating Covid. However, recent business surveys indicate that the economy has been rebounding rapidly in 2021 once the bulk of the population had been double vaccinated and new virus cases had plunged. However, Omicron could reverse this initial success in combating Covid.

The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was actually negative in July. New Prime Minister Kishida, having won the November general election, brought in a supplementary budget to boost growth, but it is unlikely to have a major effect.

WORLD GROWTH

World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum in the second half of the year, though overall growth for the year is expected to be about 6% and to be around 4-5% in 2022. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. While headline inflation will fall sharply, core inflation will probably not fall as quickly as central bankers would hope. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

SUPPLY SHORTAGES

The pandemic and extreme weather events, followed by a major surge in demand after lockdowns ended, have been highly disruptive of extended worldwide supply chains. Major queues of ships unable to unload their goods at ports in New York, California and China built up rapidly during quarters 2 and 3 of 2021 but then halved during quarter 4. Such issues have led to a misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. The latest additional disruption has been a shortage of coal in China leading to power cuts focused primarily on producers (rather than consumers), i.e., this will further aggravate shortages in meeting demand for goods. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods available to purchase.

4.10 APPENDIX: Prospects for interest rates

The Commissioner has appointed Link Group as its treasury advisor and part of their service is to assist the Commissioner to formulate a view on interest rates. Link provided the following forecasts on 20th December 2021. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View 20.12.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

Over the last two years, 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 until raising it to 0.25% at its meeting on 16th December 2021.

Significant risks to the forecasts

- Mutations of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns. 25% of the population not being vaccinated is also a significant risk to the NHS being overwhelmed and lockdowns being the only remaining option.
- Labour and supply shortages prove more enduring and disruptive and depress economic activity.
- The Monetary Policy Committee acts 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.
- The Monetary Policy Committee tightens monetary policy too late to ward off building inflationary pressures.
- The Government acts too quickly to cut expenditure to balance the national budget.
- 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.
- Longer term US treasury yields rise strongly and pull gilt yields up higher than forecast.
- 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 Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

The balance of risks to the UK economy

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

Forecasts for Bank Rate

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons:

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.
- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.
- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 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.

US treasury yields

During the first part of 2021, 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. This was then followed by additional Democratic ambition to spend $1trn on infrastructure, (which was eventually passed by both houses later in 2021), and an even larger sum on an American families plan over the next decade; this is still caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus was happening at a time when:

1. A fast vaccination programme had enabled a rapid opening up of the economy during 2021.
2. The economy was growing strongly during the first half of 2021 although it has weakened overall during the second half.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing substantial stimulus through monthly QE purchases during 2021.

It was not much of a surprise that a combination of these factors would eventually cause an excess of demand in the economy which generated strong inflationary pressures. This has eventually been recognised by the Fed at its December meeting with an aggressive response to damp inflation down during 2022 and 2023.

At its 3rd November Fed meeting, the Fed decided to make a start on tapering its $120bn per month of QE purchases so that they ended next June. However, at its 15th December meeting it doubled the pace of tapering so that they will end all purchases in February. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that Treasury yields will rise over the taper period and after the taper ends, all other things being equal. The Fed also forecast that it expected there would be three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy.

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 monitor.

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 (see below). Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two 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 actually turn out to be in both the US and the UK and so put upward pressure on 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?

As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases eventually needed to suppress inflation, are likely to be faster and stronger than Bank Rate increases in the UK. This is likely to put upward pressure on treasury yields which could then spill over into putting upward pressure on UK gilt yields.

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the 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 Russia, China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

The balance of risks to medium to long term PWLB rates:

There is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era for local authority investing - 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.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.
- For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.
- 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.

Investment and borrowing rates

- Investment returns are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.
- 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 and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps 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 current 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. Our long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing if an authority is seeking to avoid a “cost of carry” but also wishes to mitigate future re-financing risk.
- While this authority will not be able to avoid borrowing to finance new capital expenditure, 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.

4.11 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The DLUHC issued Investment Guidance in 2018, and this forms the structure of the Commissioner's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils and authorities to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires the Commissioner to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The former Police Authority adopted the Code in February 2006 and the Commissioner will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced the treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Commissioner will use. These are high security (i.e. high credit rating, although this is defined by the Commissioner, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Commissioner is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Commissioner has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, housing association, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society). For category 5 this covers bodies with a minimum Short Term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's and / or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Commissioner has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are set out below:

	Fitch Rating	**Money and/or % Limit**	**Time Limit**
Banks 1 - higher quality	A- / F1	25% of available funds (max £10m)	364 days
Banks 2 – part nationalised	A- / F1	25% of available funds (max £10m)	364 days
Commissioner' bank (when not within Banks 1)		£10m	Overnight
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£10m	364 days
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money market funds CNAV	AAA	100% of available funds	Liquid
Money market funds LVNAV	AAA	100% of available funds	Liquid
Money market funds VNAV	AAA	100% of available funds	Liquid
Ultra-Short Dated Bonds Funds	AAA	100% of available funds	Liquid

Non-specified investments – not used

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Commissioner receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Commissioner's CFO, and if required new counterparties which meet the criteria will be added to the list.

4.12 APPENDIX: Treasury Management scheme of delegation

(i) Commissioner / Business Co-Ordination Board (BCB)

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Commissioner / BCB

- 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) Resources Group / Commissioner

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

4.13 APPENDIX: The Treasury Management role of the section 151 officer

The S151 officer (CFO to Commissioner)

- 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.