NORTH YORKSHIRE COUNTY COUNCIL

AUDIT COMMITTEE

22 MARCH 2021

TREASURY MANAGEMENT STRATEGY

Report of the Corporate Director – Strategic Resources

1.0 PURPOSE OF THE REPORT

1.1 To review the 2021/22 Treasury Management Strategy

2.0 In its scrutiny role of the County Council's Treasury Management policies, strategies and day-to-day activities, the Audit Committee receives regular Treasury Management reports. These reports provide Audit Committee Members with details of the latest Treasury Management developments, both at a local and national level and enable them to review Treasury Management arrangements and consider whether they wish to make any recommendations to the Executive.

2.1 As the County Council is required to approve an up to date Annual Treasury Management before the start of the new financial year, it is therefore not realistic for the Audit Committee to review this document in advance of its submission to Executive and the subsequent consideration by County Council on 17 February 2021. A copy of the report was however shared informally with members of the Audit Committee in advance of the Executive meeting on 26 January 2021.

2.2 As in recent years it is therefore proposed that the Treasury Management Strategy 2021/22 (Annex1) is submitted for review by the Audit Committee on 22 March 2021. Any resulting proposals for change would then be considered at a subsequent meeting of the Executive. If any such proposals were accepted and required a change to the (by then) recently approved Strategy document the Executive would submit a revised document to the County Council at its meeting on 19 May 2021.

3.0 RECOMMENDATION

3.1 That Members review the 2021/22 Treasury Management Strategy.

GARY FIELDING

Corporate Director – Strategic Resources

March 2021

ANNEX 1

TREASURY MANAGEMENT STRATEGY 2021/22

1.0 Introduction

1.1 The County Council 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 County Council's low risk appetite, providing adequate liquidity initially before considering investment return.

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

1.3 The contribution the treasury management function makes to the authority 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.

1.4 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

1.5 CIPFA defines treasury management as:

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

2.0 Reporting requirements

2.1 Reporting arrangements in place relating to Treasury Management activities are highlighted below.

3.0 Capital Strategy

3.1 The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities 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.

3.2 The aim of this capital strategy is to ensure that all elected members on the County Council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

3.3 This Capital Strategy **Appendix D** is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset.

3.4 Where the County Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

3.5 If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

3.6 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

4.0 Treasury Management reporting

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

a) **Treasury Management Strategy** (this report) - The first, and most important report is forward looking and 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 borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

b) **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, the County Council will receive quarterly update reports.

c) **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

5.0 Scrutiny

5.1 Treasury Management reports are required to be adequately scrutinised before being recommended to the County Council. The scrutiny role is undertaken by the Audit Committee.

6.0 Treasury Management Strategy 2021/22

6.1 The Treasury Management strategy for 2021/22 covers two main areas:

a. Capital issues

- the capital expenditure plans and the associated prudential indicators; and
- the minimum revenue provision (MRP) policy.

b. Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the County Council;
- 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.

6.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

7.0 Training

7.1 The CIPFA Code requires the Section 151 Officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Member training has been provided by Treasury Management Consultants, Link Asset Services – Treasury Solutions, and further training will be provided as required.

8.0 Treasury management consultants

8.1 The County Council uses Link Asset Services - Treasury Solutions as its external treasury management advisors.

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

8.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The County Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

APPENDIX A

CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2023/24

1.0 Capital Expenditure

1.1 The County Council'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 members' overview and confirm capital expenditure plans.

1.2 This prudential indicator is a summary of the County Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	Later Yrs Estimate £m
Capital Expenditure:						
Health & Adult Services	0.7	2.6	8.2	0.3	0.0	3.2
Business & Environmental Services	69.5	111.5	76.4	12.8	0.2	1.4
Children & Young People's Services	20.1	33.7	31.4	11.8	4.6	15.0
Central Services	8.8	15.3	21.7	1.3	1.4	5.8
Total	**99.1**	**163.1**	**137.7**	**26.2**	**6.2**	**25.4**
Financed by:						
Capital Grants & Contributions	-70.0	-131.9	-98.7	-21.2	-2.1	-16.3
Direct Revenue Funding	-23.1	-12.6	-9.9	-4.1	-3.5	-0.6
Capital Receipts	-2.4	-5.4	-15.9	-12.2	-3.9	-21.6
Capital Borrowing Requirement	**3.6**	**13.2**	**13.2**	**-11.3**	**-3.3**	**-13.1**

1.3 The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown below:

Commercial activities / non-financial investments	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	Later Yrs Estimate £m
Capital Expenditure	0.0	0.0	0.0	0.0	0.0	0.0
Financing costs	0.0	0.0	0.0	0.0	0.0	0.0
Net financing need for the year	0.0	0.0	0.0	0.0	0.0	0.0
Percentage of total net financing need %	0.0	0.0	0.0	0.0	0.0	0.0

As the above table shows, the County Council's Capital Plan does not include any plans to purchase commercial assets primarily for yield.

2.0 The Borrowing Need (the Capital Financing Requirement)

2.1 The second prudential indicator is the County Council's Capital Financing Requirement (CFR). The CFR is 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 Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

2.2 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.

2.3 The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the County Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so The County Council is not required to separately borrow for these schemes.

£m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Capital Financing Requirement						
Capital Borrowing	295.5	291.5	290.7	291.4	270.6	260.3
Loans to Limited Companies	2.0	8.1	11.3	-11.2	-3.7	-16.3
Investment Properties	0.0	0.0	0.0	0.0	0.0	0.0
Other Long Term Liabilities (PFI / Leases)	155.1	151.6	176.1	170.5	165.2	159.8
Commercial activities / non-financial investments	0.0	0.0	0.0	0.0	0.0	0.0
Total CFR	**452.6**	**451.2**	**478.1**	**450.7**	**432.1**	**403.8**
Movement in CFR		**-1.4**	**26.9**	**-27.4**	**-18.6**	**-28.3**

Movement in CFR represented by						
Net financing need for the year (above)		13.2	13.3	-11.3	-3.3	-13.1
Less Long Term Liabilities Movements		-3.5	24.6	-5.6	-5.2	-5.5
Less MRP/VRP and other financing movements		-11.1	-10.8	-10.5	-10.1	-9.8
Movement in CFR		**-1.4**	**26.9**	**-27.4**	**-18.6**	**-28.3**

2.4 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 2.3 and the details above demonstrate the scope of this activity and, by approving these figures; consider the scale proportionate to the County Council's remaining activity.

3.0 Core funds and expected investment balances

3.1 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.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Forecasted Year end Cash Position £m	2019/20 Actual £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Reserves and Balances						
General Working Balance	27.6	27.8	27.8	27.8	27.8	27.8
Strategic Capacity Reserve	47.5	43.3	33.9	31.3	28.3	28.3
Schools Reserve	8.9	9.3	9.3	9.3	9.3	9.3
Other Earmarked Reserves	123.5	79.9	68.5	65.4	62.6	62.5
Total Reserves and Balances	**207.5**	**160.3**	**139.5**	**133.8**	**128.0**	**127.9**
Provisions	13.2	13.2	13.2	13.2	13.2	13.2
Cashflow (Inc Debtors, Creditors)	47.3	37.1	42.1	47.1	47.1	47.1
Personal Estates	10.7	11.0	11.0	11.0	11.5	12.0
Sub Total	**71.2**	**61.3**	**66.3**	**71.3**	**71.8**	**72.3**
Internal Capital Financing						
- Commercial Property	-11.9	-11.9	-11.9	-11.9	-11.9	-11.9
- Loans to Limited Companies	-12.0	-20.0	-27.2	-15.4	-11.8	-8.9
- Remaining Capital Borrowing Requirement	-10.4	-31.1	-40.5	-43.9	-34.3	-22.9
Total Internal Capital Financing	**-34.3**	**-63.0**	**-79.6**	**-71.2**	**-58.0**	**-43.7**
Total Cash Available to Invest	**244.4**	**158.6**	**126.2**	**133.9**	**141.8**	**156.5**

*Working capital balances shown are estimated year-end; these may be higher mid-year

4.0 Minimum revenue provision (MRP) policy statement

4.1 The County Council 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 it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

4.2 MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The County Council is recommended to approve the following MRP Statement.

a) for all capital expenditure incurred before 1 April 2008, MRP will be based on 4% of the Capital Financing Requirement (CFR) at that date;

b) for capital expenditure incurred after 1 April 2008 which is supported by Government Borrowing approvals, MRP to be based on 4% of such sums as reflected in subsequent CFR updates;

c) for locally agreed Prudential Borrowing on capital expenditure incurred after 1 April 2008, MRP will be calculated using the asset life method based on equal annual instalments over the estimated useful life of the asset for which the borrowing is undertaken:

d) In the case of long term debtors from loans, the amounts paid out are classed as capital expenditure for capital financing purposes. The expenditure is therefore included in the calculation of the County Council's Capital Financing Requirement. When the County Council receives the repayment of an amount loaned, the income will be classified as a capital receipt. Where the capital receipts will be applied to reduce the Capital Financing Requirement, there will be no revenue provision made for the repayment of the debt liability (i.e. unless the eventual receipt is expected to fall short of the amount expended).

Where expenditure is incurred to acquire and/or develop properties for resale, the Capital Financing Requirement will increase by the amount expended. Where the County Council will subsequently recoup the amount expended via the sale of an asset, the income will be classified as a capital receipt. Where the capital receipts will be applied to reduce the Capital Financing Requirement, there will be no revenue provision made for the repayment of the debt liability (i.e. unless the fair value of the properties falls below the amount expended).

Where expenditure is incurred to acquire properties meeting the accounting definition of investment properties, the Capital Financing Requirement will increase by the amount expended. Where the County Council will subsequently recoup the amount expended (e.g. via the sale of an asset), the income will be classified as a capital receipt. Where the capital receipts will be applied to reduce the Capital Financing Requirement, there will be no revenue provision made for the repayment of the debt liability (i.e. unless the fair value of the properties falls below the amount expended).

This approach also allows the County Council to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending. This approach is beneficial for projects that take more than one year to complete and is therefore included as part of the MRP policy.

e) for "on balance sheet" PFI schemes, MRP will be equivalent to the "capital repayment element" of the annual service charge payable to the PFI Operator and for finance leases, MRP will be equivalent to the annual rental payable under the lease agreement.

4.3 Therefore the County Council's total MRP provision will be the sum of (a) + (b) + (c) + (d) (as defined above) which is considered to satisfy the prudent provision requirement. Based on this policy, total MRP in 2021/22 will be about £10.8m (including PFI and finance leases).

1.0 BORROWING STRATEGY AND TREASURY PRUDENTIAL INDICATORS

1.1 The capital expenditure plans set out in Appendix A provide details of the service activity of the County Council. The treasury management function ensures that the County Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the County Council'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.

2.0 Current portfolio position

2.1 The overall treasury management portfolio as at 31 March 2020 and for the position as at 31 December 2020 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	Actual 31.03.20 £m	**Actual 31.03.20 %**	**Current 31.12.20 £m**	**Current 31.12.20 %**
Treasury Investments				
Banks	246.5	53	247.3	53
Building Societies	0	0	0	0
Local Authorities	192.0	41	194.0	42
Money Market Funds	20.0	4	20.0	4
Certificates of Deposit	0	0	0	0
Total managed in house	**458.5**	**99**	**461.3**	**99**
Property Funds	5.9	1	5.9	1
Total Managed Externally	**5.9**	1	5.9	1
Total Treasury Pool Investments	**464.4**	**100**	**467.2**	**100**
Less Other Bodies Investments	226.2		234.6	
Total NYCC Investments	**238.2**		**232.6**	
Treasury External Borrowing				
PWLB	243.1	92	227.1	92
LOBO's	20.0	8	20.0	8
Total NYCC External Borrowing	**263.1**	**100**	**247.1**	**100**
Net Treasury Investments / (Borrowing)	**(24.9)**		**(14.5)**	

2.2 The County Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
External Debt						
Debt at 1 April	285.1	263.1	236.0	221.8	208.5	208.5
Less Expected change in Debt	-22.0	-27.1	-14.2	-13.3	0.0	0.0
Debt at 31 March	**263.1**	**236.0**	**221.8**	**208.5**	**208.5**	**208.5**
Other long-term liabilities (OLTL)	155.1	151.6	176.2	170.6	165.4	159.9
Total Long Term Liability	**418.2**	**387.6**	**398.0**	**379.1**	**373.9**	**368.4**
Less Capital Financing Requirement	**452.6**	**451.2**	**478.1**	**450.7**	**432.1**	**403.8**
Under / (over) borrowing	**34.4**	**63.6**	**80.1**	**71.6**	**58.2**	**35.4**

2.3 Within the range of prudential indicators there are a number of key indicators to ensure that the County Council operates its activities within well-defined limits. One of these is that the County Council needs to ensure that its 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 or speculative purposes.

2.4 The Corporate Director – Strategic Resources reports that the County Council 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.

3.0 Treasury Indicators: limits to borrowing activity

3.1 **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.

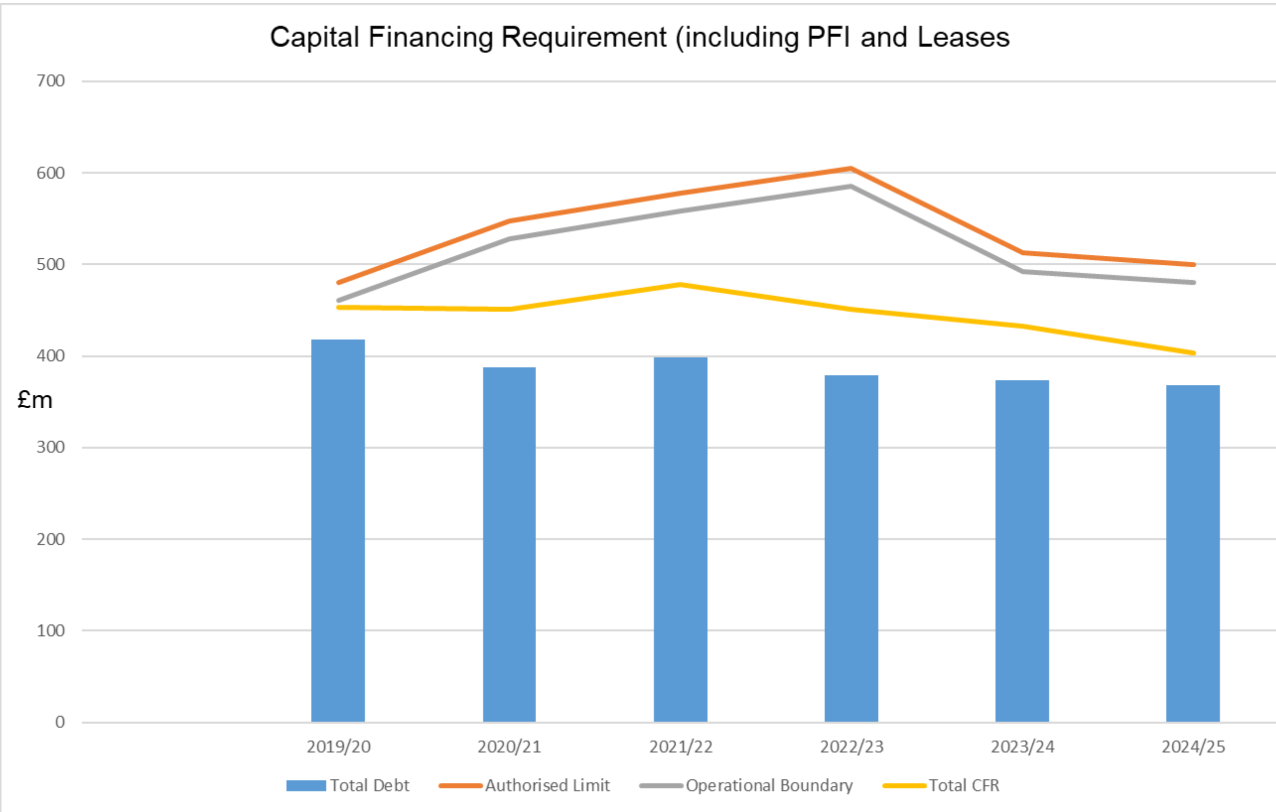
Operational boundary £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	375.9	381.7	414.2	327.2	320.0
Other long term liabilities	151.6	176.2	170.6	165.4	159.9
Commercial activities/ non-financial investments	0.0	0.0	0.0	0.0	0.0
Total	527.5	557.9	584.8	492.6	479.9

3.2 **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 legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. 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.

3.3 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 councils' plans, or those of a specific council, although this power has not yet been exercised.

3.4 The County Council is asked to approve the following authorised limit:

Authorised limit £m	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Debt	395.9	401.7	434.2	347.2	340.0
Other long term liabilities	151.6	176.2	170.6	165.4	159.9
Commercial activities/ non-financial investments	0.0	0.0	0.0	0.0	0.0
Total	547.5	577.9	604.8	512.6	499.9



4.0 Prospects for interest rates

4.1 The County Council has appointed Link Asset Services – Treasury Solutions as its treasury advisor and part of their service is to assist the County Council to formulate a view on interest rates. The following table shows their view on future interest rates.

Link Group Interest Rate View 9.11.20														
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20														
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

4.2 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting on 6th August, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

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

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

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

5.0 Investment and borrowing rates

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

5.2 **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were on negative yields during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for amending the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure.

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

6.0 Borrowing strategy

6.1 The County Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the County Council'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.

6.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Corporate Director – Strategic Resources 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 borrowing rates,* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed; or

- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

6.3 The internal borrowing position will be carefully reviewed and monitored on an ongoing basis in order to consider any changes to borrowing rates as well as current and future cash flow constraints.

6.4 Further long term external borrowing may be undertaken, in excess of the current forecasts, in the event that it is not possible or desirable to sustain the anticipated internal borrowing position.

6.5 The external borrowing requirement will be kept under review, and long term external loans will be secured within the parameters established by the authorised limit and operational boundary for external debt).

6.6 Opportunities to generate savings by refinancing or prematurely repaying existing long term debt will also be kept under review. Potential savings will be considered in the light of the current treasury position and the costs associated with such actions.

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

7.0 Policy on borrowing in advance of need

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

- there is a clear business case for doing so for the current Capital Plan;

- it will be used finance future debt maturity repayments;

- it will offer value for money can be demonstrated; and

- the County Council can ensure the security of such funds which are subsequently invested

7.2 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.

8.0 Debt rescheduling

8.1 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

8.2 If rescheduling was done, it will be reported to the Executive and Audit Committee as part of the quarterly Treasury Management Reports.

ANNUAL INVESTMENT STRATEGY

1.0 Investment policy – management of risk

1.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (**APPENDIX D**).

1.2 The County Council's investment policy has regard to the following: -

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

The County Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

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

a) 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;

b) 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 County Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings;

c) 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;

d) the County Council has defined the list of types of investment instruments that the treasury management team are authorised to use :-

- **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.

non-specified investments limit. The County Council has determined that it will limit the maximum total exposure to non-specified investments as being 20% of the total investment portfolio, (£40m);

e) **lending limits**, (amounts and maturity), for each counterparty will be set;

f) the County Council will set a limit for the amount of its investments which are invested for **longer than 365 days;**

g) investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**;

h) the County Council 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 County Council in the context of the expected level of cash balances and need for liquidity throughout the year;

i) all investments will be denominated in **sterling**; and

j) as a result of the change in accounting standards for 2020/21 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, (MHCLG), concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23.

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

2.0 Changes in risk management policy from last year

2.1 The above criteria are unchanged from last year.

3.0 Creditworthiness policy

3.1 The County Council applies the Creditworthiness Service provided by the Link Asset Services – Treasury Solutions. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- “watches” and “outlooks” from credit rating agencies;
- CDS spreads that may give early warning of likely changes in credit ratings; and
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product of this is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the County Council to determine the suggested duration for investments.

3.2 The Creditworthiness Service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency’s ratings.

3.3 Typically, the minimum credit ratings criteria the County Council use will be a short term rating (Fitch or equivalents) of F1 and a long term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

3.4 All credit ratings will be monitored daily. The County Council is alerted to changes to ratings of all three agencies through its use of the Creditworthiness Service.

3.5 If a downgrade results in the counterparty / investment scheme no longer meeting the County Council’s minimum criteria, its further use as a new investment will be withdrawn immediately.

3.6 In addition to the use of credit ratings the County Council will be advised of information in movements in Credit Default Swap spreads against the iTraxx European Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services – Treasury Solutions. Extreme market movements may result in downgrade of an institution or removal from the County Council’s lending list.

3.7 Sole reliance will not be placed on the use of this external service. In addition, the County Council will also use market data and market information, as well as information on any external support for banks to help support its decision making process.

3.8 All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

4.0 Country limits

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

4.2 **Non-specified investment limit.** The County Council has determined that it will limit the maximum total exposure to non-specified investments as being 20% of the total investment portfolio.

4.3 **Country limit.** The County Council has determined that it will only use approved counterparties from the UK and from non-UK countries with a minimum sovereign credit rating of *AA-* from Fitch. The list of countries that qualify using these credit criteria as at the date of this report is shown in Schedule 5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

5.0 Investment strategy

5.1 **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 daily cash flow requirements, 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; or
- 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.

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

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

Year	Budget %
2020/21	0.25
2021/22	0.25
2022/23	0.25
2023/24	0.25
2024/25	0.40
2025/26	0.60

5.3 The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus.

5.4 There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter-term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

5.5 While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

5.6 Money Market Funds (MMFs), have seen yields continue to drift lower. Some managers have already resorted to reducing fee levels to ensure that net yields for investors remain positive where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money held at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

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

6.0 Investment performance / risk benchmarking

6.1 The County Council will use an investment benchmark to assess the investment performance of its investment portfolio of Bank of England Base Rate.

7.0 End of year investment report

7.1 At the end of the financial year, the County Council will report on its investment activity as part of its Annual Treasury Report.

APPENDIX D

CAPITAL STRATEGY

1.0 BACKGROUND

1.1 The purpose of the Capital Strategy is to demonstrate that the County Council takes capital expenditure and investment decisions in line with corporate and service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. It sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

1.2 The Capital Strategy comprises a number of distinct, but inter-related, elements as follows:

a) **Capital Expenditure (Section 2)**

This section includes an overview of the governance process for approval and monitoring of capital expenditure, including the County Council's policies on capitalisation, and an overview of its capital expenditure and financing plans.

b) **Capital Financing and Borrowing (Section 3)**

This section provides a projection of the County Council's capital financing requirement, how this impacted by capital expenditure decisions and how it will be funded and repaid. It therefore sets out the County Council's borrowing strategy and explains how it will discharge its duty to make prudent revenue provision for the repayment of debt.

c) **Alternative Investments (Section 4)**

This section provides an overview of those of the County Council's current and proposed alternative investment activities that count as capital expenditure, including processes, due diligence and defining the County Council's risk appetite in respect of these.

d) **Chief Financial Officer's (Section 151) Statement (Section 5)**

This section contains the Chief Financial Officer's views on the deliverability, affordability and risk associated with the capital strategy

2.0 CAPITAL EXPENDITURE

Capitalisation Policy

2.1 Expenditure is classified as capital expenditure when it results in the acquisition or construction of an asset (e.g. land, buildings, roads and bridges, vehicles, plant and equipment etc.) that:

- will be held for use in the delivery of services, for rental to others, investment or for administrative purposes; and

- are of continuing benefit to the County Council for a period extending beyond one financial year.

2.2 Subsequent expenditure on existing assets is also classified as capital expenditure if these two criteria are met.

2.3 There may be instances where expenditure does not meet this definition but would be treated as capital expenditure, including:

- Where the County Council has no direct future control or benefit from the resulting assets, but would treat the expenditure as capital if it did control or benefit from the resulting assets; and

- Where statutory regulations require the County Council to capitalise expenditure that would not otherwise have expenditure implications according to accounting rules

2.4 The County Council operates de-minimis limits for capital expenditure. This means that items below these limits are charged to revenue rather than capital. The limits are currently as follows:

- General Limit: £ 20,000
- Schools Limit: £ 2,000

Governance

2.5 Capital expenditure is a necessary element in the development of the County Council's services since it generates investment in new and improved assets. Capital expenditure is managed through the Capital Plan – a three year capital budget set annually as part of the budget setting process and reviewed quarterly as part of performance monitoring arrangements.

2.6 The County Council's Financial Procedure Rules and the Asset Management Planning Framework provide a framework for the preparation and appraisal of schemes proposed for inclusion in the Capital Plan, appropriate authorisations for individual schemes to proceed and facilitate the overall management of the Capital Plan within defined resource parameters.

2.7 The Corporate Director –Strategic Resources shall determine the format of the Capital Plan and the timing of reports relating to it. The approved Capital Plan will comprise a number of individual schemes each of which will be quantified in overall project terms or on an annualised basis, as appropriate. Each Director shall prepare a draft Capital Plan for their service, in consultation with the Corporate Director – Strategic Resources, for submission to the Executive. The Capital Plan should identify planned expenditure, and funding, at proposed individual scheme or programme level.

2.8 The Corporate Director – Strategic Resources is responsible for preparing an overall Capital Plan for consideration by the Executive, and approval by the County Council, the funding of which shall be compatible at all times with the Treasury Management Policy Statement of the County Council. Individual schemes shall only be included in the Capital Plan following a project appraisal process undertaken in accordance with the guidelines defined in the Asset Management Planning Framework and in accordance with the Property Procedure Rules.

Capital Expenditure and Funding Plans

2.9 The County Council's capital expenditure plans as per the Capital Plan are set out in **Appendix A.**

2.10 When expenditure is classified as capital expenditure for capital financing purposes, this means that the County Council is able to finance that expenditure from any of the following sources:

a) **capital grants and contributions** - amounts awarded to the County Council in return for past or future compliance with certain stipulations;

b) **capital receipts** – amounts generated from the sale of assets and from the repayment of capital loans, grants or other financial assistance;

c) **revenue contributions** – amounts set aside from the revenue budget in the Reserve for Future Capital Funding; and

d) **borrowing -** amounts that the Council does not need to fund immediately from cash resources, but instead charges to the revenue budget over a number of years into the future.

The implications of financing capital expenditure from 'borrowing' are explained in section 3 below.

3.0 CAPITAL FINANCING REQUIREMENT AND BORROWING

Context

3.1 The County Council is required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities (referred to as the 'Prudential Code') when assessing the affordability, prudence and sustainability of its capital investment plans.

3.2 Fundamental to the prudential framework is a requirement to set a series of prudential indicators. These indicators are intended to collectively build a picture that demonstrates the impact over time of the County Council's capital expenditure plans upon the revenue budget and upon borrowing and investment levels, and explain the overall controls that will ensure that the activity remains affordable, prudent and sustainable.

3.3 A summary of the actual prudential indicators for 2019/20, and the estimates for 2020/21 through to 2023/24, are provided in **Schedule 2**.

Capital Financing Requirement (CFR)

3.4 When capital expenditure is funded from borrowing, this does not result in expenditure being funded immediately from cash resources, but is instead charged to the revenue budget over a number of years. It does this in accordance with its policy for the repayment of debt, which is set out in **Appendix A.**

The forward projections of the CFR reflect:

- Additional capital expenditure from borrowing or further credit arrangements resulting in an increase to the CFR and

- Revenue budget provision being made for the repayment of debt, which results in a reduction to the CFR).

3.5 The actual CFR for 2019/20 and forward projections for the current and forthcoming years are as follows:

	2019/20 Actual £m	2020/21 Probable £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Capital Borrowing	295.5	291.5	290.6	291.3	270.4	260.2
Loans to Limited Companies	2.0	8.1	11.3	-11.2	-3.7	-16.3
Investment Properties	0.0	0.0	0.0	0.0	0.0	0.0
Other Long Term Liabilities	155.1	151.6	176.2	170.6	165.4	159.9
Total Capital Financing Requirement	**452.6**	**451.2**	**478.1**	**450.7**	**432.1**	**403.8**

3.6 The forecast reduction in the CFR is a result of the annual provision for the repayment of debt each year being in excess of the amount of capital expenditure that it is intended to finance from borrowing based on the current capital programme up to 2023/24. The CFR may potentially increase dependent on the level of capital investment undertaken.

3.7 The CFR may potentially increase dependent on the level of capital investment undertaken. The investments in commercial property are classed as capital expenditure. As commercial investments are funded from core cash balances, the investments are effectively funded from internal borrowing for capital accounting purposes. As a result, expenditure on commercial property investments are included in the calculation of the Capital Financing Requirement (CFR). When the County Council ultimately disinvests and sells the properties, the income will be classed as a capital receipt and applied to reduce the CFR. The County Council will not borrow to fund commercial investment through loans from PWLB or money markets.

External Borrowing Limits

3.8 The County Council is only permitted to borrow externally (including via credit arrangements) up to the level implied by its Capital Financing Requirement (CFR). To ensure that external borrowing does not exceed the CFR, other than in the short term, limits are established for external debt, as follows:

- **Authorised Limit** – this defines the maximum amount of external debt permitted by the County Council, and represents the statutory limit determined under section 3 (1) of the Local Government Act 2003; and

- **Operational Boundary** – this is an estimate of the probable level of the County Council's external debt, and provides the means by which external debt is managed to ensure that the 'Authorised Limit' is not breached.

3.9 The proposed limits make separate provision for external borrowing and other long-term liabilities, and are based upon an estimate of the most likely but not worst case scenarios. They allow sufficient headroom for fluctuations in the level of cash balances and in the level of the CFR.

3.10 Alternative Investment activities are likely to be classed as capital expenditure. The Alternative Investments Strategy is still evolving though and, in the event that major initiatives are proposed, in excess of those already in the Capital Programme, it may be necessary to review the current borrowing limits.

3.11 The agreed **Operational Boundary** and **Authorised Limits** for external debt are as follows:

	2020/21 Probable £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Debt outstanding at start of year	**263.1**	**328.8**	**347.5**	**380.9**	**307.2**
+ **External borrowing requirements**					
Capital borrowing requirement	13.2	13.2	-11.3	-3.3	-13.1
Replacement borrowing	27.1	14.2	13.3	0.0	0.0
MRP charged to Revenue	-11.1	-10.8	-10.5	-10.1	-9.8
Borrowing b/fwd from 2019/20	0.0	0.0	0.0	0.0	0.0
Internally funded variations	63.6	16.3	55.2	-60.3	15.7
Sub-total	**92.8**	**32.9**	**46.7**	**-73.7**	**-7.2**
- External debt repayment	-27.1	-14.2	-13.3	0.0	0.0
Forecast Debt Outstanding	**328.8**	**347.5**	**380.9**	**307.2**	**300.0**
+ Other 'IFRS' long term liabilities PFI / Leases	151.6	176.2	170.6	165.4	159.9
Total Debt Outstanding	**480.4**	**523.7**	**551.5**	**472.6**	**459.9**
+ Provision for					
Debt rescheduling	15.0	15.0	15.0	15.0	15.0
Potential capital receipts slippage	5.0	5.0	5.0	5.0	5.0
New borrowing taking place before principal repayments made	27.1	14.2	13.3	0.0	0.0
Operational Boundary for year	527.5	557.9	584.8	492.6	479.9
+ Provision for cash movements	20.0	20.0	20.0	20.0	20.0
Authorised Limit for year	547.5	577.9	604.8	512.6	499.9

Borrowing Strategy

3.12 The County Council's Borrowing Strategy is set out in **Appendix B**.

3.13 The County Council is currently maintaining an under borrowed position. This means the Capital Financing Requirement (CFR) has not been fully funded from long-term external borrowing as cash supporting the County Council's reserves and balances has been used as a short term measure.

The use of internal borrowing has been an effective strategy in recent years as:

- It has enabled the County Council to avoid significant external borrowing costs; and
- It has mitigated significantly the risks associated with investing cash in what has often been a volatile and challenging market.

3.14 The internal borrowing position will be carefully reviewed and monitored on an ongoing basis in order to consider any changes to borrowing rates as well as current and future cash flow constraints.

3.15 Further long term external borrowing may be undertaken, in excess of the current forecasts, in the event that it is not possible or desirable to sustain the anticipated internal borrowing position.

3.16 The external borrowing requirement will be kept under review, and long term external loans will be secured within the parameters established by the Authorised Limit and operational boundary for external debt).

3.17 Opportunities to generate savings by refinancing or prematurely repaying existing long term debt will also be kept under review. Potential savings will be considered in the light of the current treasury position and the costs associated with such actions.

Minimum Revenue Provision

3.18 The County Council sets cash resources aside from the Revenue Budget each year to repay the borrowing. This practice is referred to as the minimum revenue provision (MRP) for the repayment of debt.

3.19 The Capital Financing Requirement (CFR) provides a measure of the amount of capital expenditure which has been financed from borrowing that the County Council yet to fund from cash resources.

3.20 Statutory guidance requires MRP to be provided annually on a prudent basis. In accordance with the requirement to make a prudent 'revenue provision for the repayment of debt', the County Council ensures that debt is repaid over a period that is commensurate with the period over which the capital expenditure provides benefit. The revenue budget provision for MRP charges in 2021/22 has been compiled on a basis consistent with this policy.

4.0 ALTERNATIVE INVESTMENTS

Introduction

4.1 The prolonged low interest rate environment has resulted in reduced returns on treasury management investments. Moreover, the introduction of the general power of competence has given local authorities far more flexibility in the types of activity they can engage in. These changes in the economic and regulatory landscape, combined with significant financial challenges, have led many authorities to consider different and more innovative types of investment.

4.2 CIPFA recently issued an update to its Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (the Treasury Management Code). One of the main changes introduced by the new Code is to require authorities to incorporate all of the financial and non-financial assets held for financial return in authorities' annual capital strategies.

4.3 Separately, the Ministry of Housing, Communities and Local Government recently updated its Statutory Guidance on Local Authority Investments, which reinforces the need for Commercial Activities to be included in the Capital Strategy.

4.4 In addition, Her Majesty's Treasury introduced revised lending terms for borrowing from the PWLB on 25 November 2020. Under the revised lending terms, the government has now ended access to the PWLB for Local Authorities that wish to buy commercial assets primarily for yield, as assessed by the statutory section 151 officer. Local Authorities remain free to buy commercial assets primarily for yield, but are not be able to take out new loans from the PWLB in year where they have any plans to buy commercial assets at any point over the following 3 year period (any loans taken out under the old system are not be affected by this change). As a result, of the revised lending terms the government has now cut PWLB lending rates.

4.5 The 2021 Capital Plan does not include any plans to purchase commercial assets primarily for yield.

4.6 The 2021 Capital Plan does include £8.4m relating to expenditure on Alternative Investments, but this specifically relates to Loans to the County Councils Limited Companies. Loans to subsidiary companies provide working capital/financial assistance and are not commercial arrangements primarily for yield.

4.7 The County Council continues to review potential commercial investments, but will now consider any potential investment opportunities alongside the implications for PWLB borrowing going forward.

4.8 The County Council does not borrow to fund commercial investment through loans from the PWLB or money markets.

4.9 All alternative investment activities are subject to approval in accordance with the County Council's governance framework for decision making.

Alternative Investment Objectives

4.10 The primary objectives of alternative investment activities are:

- Security – to protect the capital sums invested from loss; and
- Liquidity – ensuring the funds invested are available for expenditure when needed.

4.11 The generation of yield is distinct from these prudential objectives. However, once proper levels of security and liquidity are determined, it is then reasonable to consider what yield can be obtained consistent with these priorities.

4.12 Non-core activities and investments are primarily undertaken by the County Council in order to generate income to support the delivery of a balanced budget. Such investments are only entered following a full assessment of the risks and having secured expert external advice (i.e. where it is relevant to do so).

4.13 An overall maximum exposure of £60m for alternative investments was approved by Executive on 15 January 2019.

Commercial Investment Board

4.14 Given the technical nature of potential alternative investments and strong linkages to the County Council's Treasury Management function, appropriate governance and decision making arrangements are needed to ensure robust due diligence in order to make recommendations for implementation. As a result, a Commercial Investment Board has been established. All investments will be subject to consideration and where necessary recommendations of the Commercial Investment Board.

4.15 The Board is not be a constituted body and therefore does not have formal decision making powers. However, it is the chief means of identifying, reviewing and recommending schemes for investment decisions. Formal decisions on investments will be taken within the existing delegations namely through delegated authority to the Corporate Director - Strategic Resources and further decisions as made by the Executive.

4.16 The Board has delegated authority to approve individual investments up to a limit of £2.5m per investment and up to a total of £10m in any one financial year (approved by Executive 15 January 2019). Investments in excess of this will be submitted to the Executive for approval.

4.17 The responsibilities of the Board also include:

- to consider appropriate due diligence proportionate to the investment / risk / reward proposed;
- terminate investments should concerns be raised - to consider and recommend cases for early termination of alternative investments;
- to monitor returns against approved performance targets;
- to report performance of alternative investments to the Executive on a quarterly basis; and
- to make recommendations to Executive on any proposed changes to the framework.

Membership of the Board is as follows:

- Executive Member for Finance (Chair);
- Executive Member for Growth;
- Corporate Director Strategic Resources;
- Corporate Director Business and Environmental Services;
- Assistant Director Strategic Resources; and

- Assistant Director BES - Growth, Planning and Trading Standards

Investment Properties

4.18 Options are continually reviewed the acquisition of land and buildings for investment purposes, rather than for the supply of goods or services or for administrative purposes. Such assets will be classified as Investment Properties.

4.19 Investment properties are measured at their fair value annually (which will ensure the valuation reflects the market conditions at the end of each reporting period). The fair value measurement will enable the County Council to assess whether the underlying assets provide security for capital investment. Where the fair value of the underlying assets is no longer sufficient to provide security against loss, mitigating actions will be considered, to ensure that appropriate action is taken to protect the capital sum invested.

Loans to Third Parties

4.20 Loans to third parties will be considered, as part of a wider strategy for local economic growth, even though they may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

4.21 Such loans will be considered when all of the following criteria are satisfied:

- the loan is given towards expenditure which would, if incurred by the County Council, be capital expenditure;

- the purpose for which the loan is given is consistent with the County Council's corporate / strategic objectives and priorities;

- due diligence is carried out that confirms the County Council's legal powers to make the loan, and that assesses the risk of loss over the loan term; and

- a formal loan agreement is put in place which stipulates the loan period (*which will not exceed 25 years*), repayment terms and loan rate (which will be set at a level that seeks to mitigate any perceived risks of a loss being charged to the General Fund, and takes appropriate account of state aid rules) and any other terms that will protect the County Council from loss.

The County Council does not currently have in place any loans with third parties.

Loans to Limited Companies

4.22 The County Council has made a number of loans in recent years for policy reasons and will continue to monitor and review this position.

a) the County Council's general investment powers under this Annual Treasury Management and Investment Strategy come from the Local Government Act 2003 (Section 12). Under this Act a local authority has the power to invest for any purpose relevant to its functions or for the purpose of the prudent management of its financial affairs;

b) in addition to investment, the County Council has the power to provide loans and financial assistance to Limited Companies under the Localisation Act 2011 (and also formally under the general power of wellbeing in the Local Government Act 2000) which introduced a general power of competence for authorities;

c) any such loans to limited companies will not be classed as investments made by the County Council. Instead they will be classed as capital expenditure and will be approved, financed and accounted for accordingly;

d) at present the County Council has made several loans to companies in which it has an equity investment. In all cases loan limits are set, and reviewed periodically, by the Executive;

The County Council's loans to limited companies are set out in **paragraph 4.25.**

Other Alternative Investments

4.23 Consideration of individual investment opportunities is subject to detailed business cases and subject to review and approval by the Alternative Investment Board and Executive. The Capital Strategy will be updated should further investment opportunities be developed during 2021/22 and/or in the event that the statutory Guidance on Local Authority Investments, when issued, requires further content to be included.

Current Alternative Investment Position

4.24 In order to manage risk appropriately, achieve targets for investment returns, deliver a diverse portfolio and maintain a level of liquidity, the Commercial Investment Board has established an investment framework. The investment framework provides a range of investment options and investment limits for each option.

The current investment framework and current alternative position is as follows:

Type of Investment	Risk	Maximum Exposure £m	Maximum Term Years	Target Rate (above BBR) %	Invested as at 31/12/20 £m	Rate of Return %
Alternative treasury instruments						
Money Market Funds	Low	20.0	1 – 5	>0.10	20.0	0.0
Enhanced Cash Funds		20.0			0.0	-
Certificates of Deposit		20.0			0.0	-
Property Funds		20.0			5.9	3.66
Total Alternative Treasury Instruments					**25.9**	**0.84**
Other Alternative Investments						
Loans to Council Companies	Low - Medium	25.0	10	4.00	23.2	4.01
Spend to Save	Low	5.0	7	4.00	-	-
Loans to Housing Associations	Medium	10.0	20	3.00	-	-
Solar Farms (or similar)	Medium	5.0	20	7.00	-	-
Commercial Investments	High	20.0	10	5.00	11.9	1.56
Total Other Alternative Investments *					**35.1**	**3.18**

* Total Alternative Investments capped at £60m

4.25 The County Council has the following loans to subsidiaries in place as at 31 December 2020

Subsidiary	Total Loan Agreed £m	Loan Advanced £m	Loan Terms Years	Interest Rate %	Loan Balance £m
NYnet	10.00	Overdraft	n/a	3.0+Base	11.9
Yorwaste – Loan 1	3.70	2017/18	10	4.0+Base	3.7
Yorwaste – Loan 2	3.85	2017/18	10	4.0+Base	2.7
Brierley Homes	2.75	2017/18	2	6.0+Base	4.6
First North Law	0.25	2017/18	10	4.0+Base	0.1
NY Highways	11.00	2020/21	10	6.5+base	0.2
Total					**23.2**

4.26 The County Council has the following Commercial Property Investments in place as at 31 December 2020

Property	Amount £m	Net Yield %
Bank Unit in Stafford Town Centre	0.9	0.6
Harrogate Royal Baths	9.5	6.1
Co-op in Somercotes	1.5	5.3
Total	**11.9**	**1.6**

5.0 CHIEF FINANCIAL OFFICER'S (SECTION 151) STATEMENT

Background

5.1 The Prudential Code for Capital Finance in Local Authorities (the Prudential Code) plays a key role in capital finance in local authorities. Local authorities determine their own programmes for investment that are central to the delivery of quality public services. The Prudential Code was developed by CIPFA as a professional code of practice to support local authorities in taking their decisions. Local authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

5.2 In financing capital expenditure, local authorities are governed by legislative frameworks, including the requirement to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

5.3 In order to demonstrate that capital expenditure and investment decisions are taken in line with service objectives and properly take account of stewardship, value for money, prudence, sustainability and affordability, the Prudential Code requires authorities to have in place a Capital Strategy that sets out the long term context in which capital expenditure and investment decisions are made, and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

5.4 The Prudential Code requires the Chief Financial Officer to report explicitly on the affordability and risk associated with the Capital Strategy. The following are specific responsibilities of the Section 151 Officer:

- recommending clauses, treasury management policy/practices for approval, reviewing regularly, and monitoring compliance;
- submitting quarterly treasury management reports;
- submitting quarterly capital budget 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;

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management;

- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;

- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;

- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;

- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources;

- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;

- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;

- ensuring that members are adequately informed and understand the risk exposures taken on by an authority;

- ensuring that the authority has adequate expertise, either in house or externally provided; and

- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed.

5.5 The Capital Strategy provides an overview of the governance process for approval and monitoring of capital expenditure. These processes are well established and are highly effective in ensuring delivery of the County Council's capital investment plans. In addition, the Capital Strategy and Prudential Indicators also demonstrates that the capital expenditure, investment and financing plans of the County Council are robust, affordable and sustainable."

SCHEDULES

1. Treasury Management Policy Statement
2. Prudential Indicators Update for 2021/22 to 2023/24
3. Economic background
4. Specified and Non Specified Investments
5. Approved Lending List
6. Approved countries for investments

SCHEDULE 1

NORTH YORKSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

1.0 BACKGROUND

1.1 The County Council has adopted the **CIPFA Code of Practice on Treasury Management in the Public Services** as updated in 2017. This Code sets out a framework of operating procedures to reduce treasury risk and improve understanding and accountability regarding the Treasury position of the County Council.

1.2 The CIPFA Code of Practice on Treasury Management requires the County Council to adopt the following four clauses of intent:

a) the County Council will create and maintain as the cornerstone for effective Treasury Management

   i. a strategic **Treasury Management Policy Statement** (TMPS) stating the policies, objectives and approach to risk management of the County Council to its treasury management activities;

   ii. a framework of suitable **Treasury Management Practices** (TMPs) setting out the manner in which the County Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities. The Code recommends 12 TMPs;

b) the County Council delegates responsibility for the implementation and regular monitoring of its Treasury Management policies and practices to the Executive and for the execution and administration of Treasury Management decisions to the Corporate Director – Strategic Resources who will act in accordance with the Council's TMPS, TMPs, as well as CIPFA's Standard of Professional Practice on Treasury Management;

c) the County Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategies and Policies; and

d) the County Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategies and Policies.

1.3 The **CIPFA Prudential Code for Capital Finance in Local Authorities** (updated in 2017) and the terms of the **Local Government Act 2003**, together with 'statutory' Government Guidance, establish further requirements in relation to treasury management matters, namely

a) the approval, on an annual basis, of a set of **Prudential Indicators**; and

b) approval, on an annual basis, of an **Annual Treasury Management Strategy**, an **Annual Investment Strategy**, an annual **Minimum Revenue Provision (MRP)** policy statement and a **Capital Strategy** with an associated requirement that each is monitored on a regular basis with a provision to report as necessary both in-year and at the financial year end.

1.4 This current Treasury Management Policy Statement (TMPS) was approved by County Council on 17 February 2021.

2.0 TREASURY MANAGEMENT POLICY STATEMENT (TMPS)

2.1 Based on the requirements detailed above a TMPS stating the policies and objectives of the treasury management activities of the County Council is set out below.

2.2 The County Council defines the policies and objectives of the treasury management activities of the County Council as follows: -

a) the management of the County Council's 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;

b) the identification, monitoring and control of risk will be the prime criteria by which the effectiveness of the treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the County Council and any financial instrument entered into to manage these risks; and

c) effective treasury management will provide support towards the achievement of the business and service objectives of the County Council as expressed in the Council Plan. The County Council is committed to the principles of achieving value for many in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

2.3 As emphasised in the Treasury Management Code of Practice, responsibility for risk management and control of Treasury Management activities lies wholly with the County Council and all officers involved in Treasury Management activities are explicitly required to follow Treasury Management policies and procedures.

3.0 TREASURY MANAGEMENT PRACTICES (TMPs)

3.1 The CIPFA Code of Practice on Treasury Management requires a framework of Treasury Management Practices (TMPs) which:

a) set out the manner in which the County Council will seek to achieve the policies and objectives; and

b) prescribe how the County Council will manage and control those activities;

3.2 The CIPFA Code of Practice recommends 12 TMPs. A list of the 12 TMPs is as follows: -

TMP 1	Risk management
TMP 2	Performance measurement
TMP 3	Decision-making and analysis
TMP 4	Approved instruments, methods and techniques
TMP 5	Organisation, clarity and segregation of responsibilities, and dealing arrangements
TMP 6	Reporting requirements and management information arrangements
TMP 7	Budgeting, accounting and audit arrangements
TMP 8	Cash and cash flow management
TMP 9	Money Laundering
TMP 10	Training and qualifications
TMP 11	Use of external service providers
TMP 12	Corporate governance

4.0 PRUDENTIAL INDICATORS

4.1 The Local Government Act 2003 underpins the Capital Finance system introduced on 1 April 2004 and requires the County Council to "have regard to" the **CIPFA Prudential Code for Capital Finance in Local Authorities**. This Code which was last updated in December 2017, requires the County Council to set a range of Prudential Indicators for the next three years

a) as part of the annual Budget process, and;

b) before the start of the financial year;

to ensure that capital spending plans are affordable, prudent and sustainable.

4.2 The Prudential Code also requires appropriate arrangements to be in place for the monitoring, reporting and revision of Prudential Indicators previously set.

4.3 The required Prudential Indicators are as follows:-

- Capital Expenditure - Actual and Forecasts
- estimated ratio of capital financing costs to the Net Revenue Budget
- Capital Financing Requirement
- Gross Debt and the Capital Financing Requirement
- authorised Limit for External Debt
- operational Boundary for External Debt
- Actual External Debt
- Maturity Structure of Borrowing
- Total Principal Sums Invested for periods longer than 365 days

4.4 The County Council will approve the Prudential Indicators for a three year period alongside the annual Revenue Budget/Medium Term Financial Strategy at its February meeting each year. The Indicators will be monitored during the year and necessary revisions submitted as necessary via the Quarterly Performance and Budget Monitoring reports.

4.5 In addition to the above formally required Prudential Indicators, the County Council has also set two local ones as follows:

a) to cap Capital Financing costs to 10% of the net annual revenue budget; and

b) a 30% limit on money market borrowing as opposed to borrowing from the Public Works Loan Board.

5.0 ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY

5.1 A further implication of the Local Government Act 2003 is the requirement for the County Council to set out its Treasury Management Strategy for borrowing and to approve an Annual Investment Strategy (which sets out the County Council's policies for managing its investments and for giving priority to the security and liquidity of those investments).

5.2 The Government's guidance on the Annual Investment Strategy, updated in February 2018, states that authorities can combine the Treasury Management Strategy Statement and Annual Investment Strategy into one report. The County Council has adopted this combined approach.

5.3 Further statutory Government guidance, last updated with effect from February 2018, is in relation to an authority's charge to its Revenue Budget each year for debt repayment. A Minimum Revenue Provision (MRP) policy statement must be prepared each year and submitted to the full Council for approval before the start of the financial year.

5.4 The County Council will approve this combined Annual Strategy alongside the annual Revenue Budget/Medium Term Financial Strategy at its February meeting each year.

6.0 **REVIEW OF THIS POLICY STATEMENT**

6.1 Under Financial Procedure Rule 14, the Corporate Director – Strategic Resources is required to periodically review this Policy Statement and all associated documentation. A review of this Statement, together with the associated annual strategies, will therefore be undertaken annually as part of the Revenue Budget process, together with a mid year review as part of the Quarterly Treasury Management reporting process and at such other times during the financial year as considered necessary by the Corporate Director – Strategic Resources.

Approved by County Council
17 February 2021

SCHEDULE 2

PRUDENTIAL INDICATORS UPDATE – FOR 2021/22 TO 2023/24

CAPITAL EXPENDITURE & EXTERNAL DEBT INDICATORS	Comment

1 Estimated Ratio of capital financing costs to the net Revenue Budget

(a) *Formally required Indicator*

This reflects capital financing costs (principal plus interest) on external debt plus PFI and finance leasing charges less interest earned on the temporary investment of cash balances.
The estimated ratios of financing costs to the net Revenue Budget for the current and future years, and the actual figure for 2018/19 are as follows:

Year	Executive August 2020 Basis	%	Update January 2021 Basis	%
2019/20	actual	10.8	actual	10.8
2020/21	estimate	10.7	probable	10.7
2021/22	estimate	10.8	estimate	10.8
2022/23	estimate	10.3	estimate	10.2
2023/34	estimate	-	estimate	9.5

(b) *Local Indicator*

This local Indicator reflects a policy decision to cap Capital Financing costs at 10% of the net annual Revenue Budget. The Indicator is different to the formally required Indicator at (a) above in that it only reflects the cost components of interest on external debt plus lost interest on internally financed capital expenditure, together with a revenue provision for debt repayment. Unlike the formally required PI it does not reflect interest earned on surplus cash balances or PFI / finance leasing charges.

Year	Executive August 2020 Basis	%	Update January 2021 Basis	%
2019/20	actual	6.2	actual	6.2
2020/21	estimate	5.7	probable	5.7
2021/22	estimate	5.3	estimate	5.3
2022/23	estimate	5.1	estimate	5.0
2023/24	estimate	-	estimate	4.6

Comment

The estimates of financing costs include current Capital Plan commitments based on the latest 2020/21 Q3 Capital Plan.

The updated estimates for 2020/21 to 2023/24 reflect the net effect of a range of factors, principally

(a) savings being achieved through the ongoing policy of financing capital borrowing requirements internally from cash balances

(b) variations in the level of annual borrowing requirements resulting from a range of factors, but principally capital expenditure slippage between years

(c) variations in borrowing costs (interest plus a revenue provision for debt repayment) reflecting latest interest rate forecasts to 2023/24

(d) variations in interest earned on cash balances resulting from continuing current historically low interest rates but offset by continuing higher levels of cash balances (formal Indicator only).

Prudential Indicator	Comment
2 Capital Expenditure - Actual and Forecasts The actual capital expenditure that was incurred in 2019/20 and the latest estimates of capital expenditure to be incurred for the current and future years are:	

Year	Executive August 2020		Update January 2021	
	Basis	£m	Basis	£m
2019/20	actual	99.1	actual	99.1
2020/21	estimate	176.8	probable	163.1
2021/22	estimate	43.0	estimate	137.7
2022/23	estimate	10.3	estimate	26.2
2023/24	estimate	-	estimate	6.2

The above figures reflect the updated Capital Plan (Q1 2020/21) together with:-

(i) expenditure on fixed assets funded directly from the Revenue Budget and not included in the Capital Plan.

(ii) an estimated allowance for future expenditure re-phasing between years.

Comment:

This Indicator now reflects the Capital Outturn in 2019/20 and the Capital Plan update for Q3 2020/21.

The variations are principally a result of:-

(a) additional provisions and variations to existing provisions which are self-funded from Capital Grants and Contributions, revenue contribution and earmarked capital receipts

(b) Capital expenditure re-phasing between years including slippage from 2019/20 outturn and Q3 2020/21 to later years

(c) various other Capital approvals and refinements reflected in the latest Capital Plan update

Prudential Indicator	Comment

3 Capital Financing Requirement (CFR)

Actuals and estimates of the Capital Financing Requirement (CFR) at the defined year ends are as follows:

Date	Executive August 2020				Update January 2021			
	Basis	Borrowing	Other Long Term liabilities (PFI etc)	Total	Basis	Borrowing	Other Long Term liabilities (PFI etc)	Total
		£m	£m	£m		£m	£m	£m
31 Mar 20	actual	297.5	155.1	452.6	actual	297.5	155.1	452.6
31 Mar 21	estimate	294.4	151.6	446.0	probable	299.6	151.6	451.2
31 Mar 22	estimate	292.1	176.2	468.3	estimate	301.9	176.2	478.1
31 Mar 23	estimate	270.2	170.6	440.8	estimate	280.1	170.6	450.7
31 Mar 24	estimate	-	-	-	estimate	266.7	165.4	432.1

The CFR measures the underlying need for the County Council to borrow for capital purposes. In accordance with best professional practice, the County Council does not earmark borrowing to specific items or types of expenditure. The County Council has an integrated treasury management approach and has adopted the CIPFA Code of Practice for Treasury Management. The County Council has, at any point in time, a number of cashflows, both positive and negative, and manages its treasury position in terms of its overall borrowings and investments in accordance with its approved Annual Treasury Management Strategy. In day to day cash management, no distinction is made between revenue and capital cash. External borrowing arises as a consequence of all the financial transactions of the County Council as a whole and not simply those arising from capital spending. In contrast, the CFR Indicator reflects the County Council's underlying need to borrow for capital purposes only.

Comment:

The January 2021 figures were based on a Capital Plan approved as at 31 December 2020.
The updated figures reflect the following variations figures

(a) re-phasing between years of expenditure that is funded from borrowing including slippage between years identified at 2019/20 outturn and Q3 2020/21

(b) capital receipts (including company loans) slippage between years that affect year on year borrowing requirements

(c) variations in the level of the Corporate Capital Pot which is used in lieu of new borrowing until the Pot is required

(d) additions and variations to schemes/provisions approved that are funded from Prudential Borrowing

(e) variations in the annual Minimum Revenue Provision for debt Repayment which arise from the above

(f) Other Long Term Liabilities now include the Allerton Waste Recovery Park PFI Scheme

Prudential Indicator	Comment
4 Gross Debt and the Capital Financing Requirement The Prudential Code emphasises that in order to ensure that over the medium term debt will only be for a capital purpose, the County Council should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the previous year (2019/20), plus the estimate of any additional capital financing requirement for the current (2020/21) and next two financial years (2021/22 and 2022/23). If, in any of these years, there is a reduction in the capital financing requirement, this reduction should be ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt. This Prudential Indicator is referred to as gross debt and the comparison with the capital financing requirement (**Indicator 3**) and is a key indicator of prudence. The Corporate Director – Strategic Resources reports that the County Council had no difficulty in meeting this requirement up to 2019/20 nor are any difficulties envisaged for the current or future years of the Medium Term Financial Strategy up to 2022/23. For subsequent years, however, there is potential that the County Council may not be able to comply with the new requirement as a result of the potential for the annual Minimum Revenue Provision (MRP) reducing the Capital Financing Requirement below gross debt. This potential situation will be monitored closely. This opinion takes into account spending commitments, existing and proposed Capital Plans and the proposals in the Revenue Budget 2020/21 and Medium Term Financial Strategy report.	This Prudential Indicator was changed in 2013/14 to reflect the comparison of gross debt (external debt plus other long term liabilities) with the Capital Financing Requirement (CFR). The comparator debt figure had previously been net debt which was gross debt less investments. The Prudential Code requires that where there is a significant difference between the gross debt and the gross borrowing requirement, as demonstrated by the CFR, then the risks and benefits associated with this strategy should be clearly stated in the annual Treasury Management Strategy. The County Council's gross debt figure is currently significantly below the CFR figures shown in **Indicator 3** because of annual capital borrowing requirements being funded internally from cash balances (i.e. running down investments) rather than taking out new external debt. This situation, however, could be reversed in future as a result of two key factors: (i) externalising some or all of the internally financed CFR together with (ii) the potential for the annual Minimum Revenue Provision (MRP) for debt repayment reducing the CFR below gross debt because the debt cannot readily be prematurely repaid without incurring significant penalties (premiums). This potential situation will be monitored carefully by the Corporate Director – Strategic Resources.

Prudential Indicator	Comment
5 Authorised Limit for External Debt In respect of its external debt, it is recommended that the County Council approves the following Authorised Limits for its total external debt for the next three financial years. The Prudential Code requires external borrowing and other long term liabilities (PFI and Finance leases) to be identified separately. The authorised limit for 2020/21 will be the statutory limit determined under section 3(1) of the Local Government Act 2003.	The Corporate Director – Strategic Resources confirms that these authorised limits are consistent with the County Council's current commitments, updated Capital Plan and the financing of that Plan, the 2020/21 Revenue Budget and Medium Term Financial Strategy and with its approved Treasury Management Policy Statement. The Corporate Director – Strategic Resources also confirms that the limits are based on the estimate of most likely prudent, but not worst case, scenario with sufficient headroom over and above this to allow for operational issues (e.g. unusual cash movements). To derive these limits a risk analysis has been applied to the Capital Plan, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes. The updated figures reflect a number of refinements which are also common to the Capital Financing Requirement (see **Indicator 3**) and Operational Boundary for external debt (see **Indicator 6**). Explanations for these changes are provided under **Indicators 3 and 6** respectively.

Year	Executive August 2020			Update January 2021		
	External Borrowing	**Other long term liabilities**	**Total Borrowing Limit**	**External Borrowing**	**Other long term liabilities**	**Total Borrowing Limit**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
2020/21	385.5	151.6	537.1	395.9	151.6	547.5
2021/22	382.2	176.2	558.4	401.7	176.2	577.9
2022/23	409.3	170.6	579.8	434.2	170.6	604.8
2023/24	-	-	-	347.2	165.4	512.6
2024/25	-	-	-	340.0	159.9	499.9

Prudential Indicator	Comment
6 Operational Boundary for External Debt It is recommended that the County Council approves the following Operational Boundary for external debt for the same period. The proposed operational boundary for external debt is based on the same estimates as the Authorised Limit (ie **Indicator 5** above) but also reflects an estimate of the most likely prudent, but not worst case, scenario without the additional headroom included within the Authorised Limit to allow for eg unusual cash flows.	The Operational Boundary represents a key management tool for the in year monitoring of external debt by the Corporate Director – Strategic Resources. The updated figures reflect refinements which are common to the Capital Financing Requirement (see **Indicator 3** above), together with (a) relative levels of capital expenditure funded internally from cash balances rather than taking external debt (b) loan repayment cover arrangements and the timing of such arrangements These two financing transactions affect external debt levels at any one point of time during the financial year but do not impact on the Capital Financing Requirement.

Year	**Executive August 2020**			**Update January 2021**		
	External Borrowing	**Other long term liabilities**	**Total Borrowing Limit**	**External Borrowing**	**Other long term liabilities**	**Total Borrowing Limit**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
2020/21	365.5	151.6	517.1	375.9	151.6	527.5
2021/22	362.2	176.2	538.4	381.7	176.2	557.9
2022/23	389.2	170.6	559.8	414.2	170.6	584.8
2023/24	-	-	-	327.2	165.4	492.6
2024/25	-	-	-	320.0	159.9	479.9

Prudential Indicator	Comment
7 Actual External Debt The County Council's external debt is set out below and consists of external borrowing from the PWLB and money markets plus other long term liabilities such as PFI and finance leases which are classified as external debt for this purpose.	The updated estimates for the 3 years to 31 March 2024 reflect refinements which are common to the Capital Financing Requirement (see **Indicator 3** above) together with the relative levels of capital expenditure internally funded from cash balances rather than taking external debt.

Year	Executive August 2020				Update January 2021			
	Basis	Borrowing	Other Long Term liabilities (PFI etc)	Total	Basis	Borrowing	Other Long Term liabilities (PFI etc)	Total
		£m	£m	£m		£m	£m	£m
31 Mar 2020	actual	263.1	155.1	418.2	actual	263.1	155.1	418.2
31 Mar 2021	estimate	236.0	151.6	387.6	probable	236.0	151.6	387.6
31 Mar 2022	estimate	221.8	176.2	398.0	estimate	221.8	176.2	398.0
31 Mar 2023	estimate	208.5	170.6	379.1	estimate	208.5	170.6	379.1
31 Mar 2024	estimate	-	-	-	estimate	208.5	165.4	373.9

It should be noted that actual external debt is not directly comparable to the Authorised Limit (**Indicator 5 above**) and Operational Boundary (**Indicator 6 above**) since the actual external debt reflects a position at one point in time.

Prudential Indicator	Comment
8 Limit of Money Market Loans (Local Indicator) Borrowing from the money market for capital purposes (as opposed to borrowing from the PWLB) is to be limited to 30% of the County Council's total external debt outstanding at any one point in time. The actual position at 31 March 2020 was 8% (£20m out of a total of £263.1m) against an upper limit of 30%	This limit was introduced as a new Local Prudential Indicator in 2009/10, although the 30% limit has featured as part of the Borrowing Policy section of the County Council's Annual Treasury Management and Investment Strategy for many years.

Prudential Indicator	Comment

9 Maturity Structure of Borrowing

The upper and lower limits for the maturity structure of County Council borrowings are as follows:-

The amount of projected borrowing maturing in each period as a percentage of total projected borrowing that is fixed rate:

Period	Lower Limit %	Upper Limit %	Memo item - actual at 1 April 20 %	Memo item - actual at 1 April 21 %
under 12 months	0	50	6	6
12 months & within 24 months	0	25	6	6
24 months & within 5 years	0	50	3	7
5 years & within 10 years	0	75	3	3
10 years and within 25 years	0	100	7	8
25 years and within 50 years	0	100	74	70
			100	100

These limits are reviewed annually and have been updated to reflect the current maturity structure of the County Council’s debt portfolio.

Prudential Indicator	Comment
10 Total Principal Sums Invested for periods longer than 365 days The 2020/21 aggregate limit of £40m for 'non specified' investments longer than 365 days is based on a maximum of 20% of estimated 'core cash funds' up to 2023/24 being made available for such investments. The purpose of this prudential limit for principal sums invested for longer than 365 days is for the County Council to contain its exposure to the possibility of loss that might arise as a result of it having to seek early repayment or redemption of principal sums invested.	**No change to this limit is proposed.** The County Council currently has no such investments that fall into this category. Prior to 1 April 2004, Regulations generally prevented local authorities from investing for longer than 365 days. As a result of the Prudential Regime however, these prescriptive regulations were abolished and replaced with Government Guidance from April 2004. This Guidance gives authorities more freedom in their choice of investments (including investing for periods longer than 365 days) and recognises that a potentially higher return can be achieved by taking a higher (ie longer term) risk. This flexibility requires authorities to produce an Annual Investment Strategy that classifies investments as either **Specified** (liquid, secure, high credit rating & less than 365 days) or **Non Specified** (other investments of a higher risk). Non Specified investments are perfectly allowable but the criteria and risks involved must be vigorously assessed, including professional advice, where appropriate. Therefore investments for 365 days+ are allowable as a Non Specified investment under the Government Guidance. The use of such investments is therefore now incorporated into the County Council's Annual Treasury Management and Investment Strategy.

SCHEDULE 3

ECONOMIC BACKGROUND

1.0 **The UK.**

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

- the economy would recover to reach its pre-pandemic level in Q1 2022;
- an expectation that there will be excess demand in the economy by Q4 2022; and
- CPI inflation forecast to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".

1.2 Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.

1.3 The **Bank's forward guidance** in August stated "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". Inflation is unlikely to cause increases in Bank Rate during this period as there is likely to be spare capacity in the economy for a considerable time. It is expected to briefly peak at around 2% towards the end of 2021, but this is a temporary short-lived factor.

1.4 However, the minutes did contain several references to **downside risks**. The MPC reiterated that the "recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside". It also said "the risk of a more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. That could involve some or all of the lockdown being extended beyond 2nd December, a temporary relaxation of restrictions over Christmas, a resumption of the lockdown in January and many regions being subject to Tier 3 restrictions when the lockdown ends. Hopefully, restrictions should progressively ease during the spring. It is only to be expected that some businesses that have barely survived the first lockdown, will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to the end of 31 March will limit the degree of damage done.

1.5 As for upside risks, the announcements in relation to the production and distribution of a COVID19 vaccine have boosted confidence that life could largely return to normal during the second half of 2021, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels, which would help to bring the unemployment rate down. With the household saving rate currently being exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could begin to be eased, possibly in Q2 2021, once vulnerable people and front-line workers had been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% next year instead of 9%. But while this would reduce the need for more QE and/or negative interest rates, increases in Bank Rate would still remain some years away. There is also a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.

1.6 Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp but after a disappointing increase in GDP of only 2.1% in August, this left the economy still 9.2% smaller than in February; this suggested that the economic recovery was running out of steam after recovering 64% of its total fall during the crisis. The last three months of 2020 were originally expected to show zero growth due to the impact of widespread local lockdowns, consumers probably remaining cautious in spending, and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year also being a headwind. It was expected that the second national lockdown would push back recovery of GDP to pre pandemic levels by six months and into sometime during 2023. However, now that there is high confidence that successful vaccines will be widely administered in the UK in the first half of 2021; this would cause a much quicker recovery than in their previous forecasts.

1.7 Since then, there has been rapid back-tracking on easing restrictions due to the spread of a new mutation of the virus, and severe restrictions were imposed across all four nations. These restrictions were changed on 5.1.21 to national lockdowns of various initial lengths in each of the four nations as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under these new restrictions for some months; this means that the near-term outlook for the economy is extremely challenging. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow GDP to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022. Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant caveat is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development and vaccine production facilities are being ramped up around the world.

1.8 This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade would have major repercussions for public finances as it would be consistent with the government deficit falling to around 2.5% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assumed that there is a reasonable Brexit deal and also that politicians do not raise taxes or embark on major austerity measures risking economic growth and recovery.

1.9 **Brexit.** The final agreement on 24.12.20, followed by ratification by Parliament and all 27 EU countries in the following week, has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

1.10 **Monetary Policy Committee meeting of 17 December.** All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy that it had highlighted in November. But this was caveated by it saying, "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." As a result of these continued concerns, the MPC voted to extend the availability of the Term Funding Scheme, with additional incentives for SMEs for six months from 30.4.21 until 31.10.21.

1.11 **Fiscal policy**. In the same week as the MPC meeting, the Chancellor made a series of announcements to provide further support to the economy: -

- an extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
- the furlough scheme was lengthened from the end of March to the end of April.
- the Budget on 3.3.21 will lay out the "next phase of the plan to tackle the virus and protect jobs". This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

The Global Ecomony

2.0 **USA.**

2.1 The result of the November elections means that while the Democrats have gained the presidency and a majority in the House of Representatives, it looks as if the Republicans will retain their slim majority in the Senate. This means that the Democrats will not be able to do a massive fiscal stimulus, as they had been hoping to do after the elections, as they will have to get agreement from the Republicans. Equity prices leapt up on 9th November on the first news of a successful vaccine and have risen further during November as more vaccines announced successful results. However, the rise in yields has been quite muted so far and it is too early to say whether the Fed would feel it necessary to take action to suppress any further rise in debt yields. It is likely that the next two years, and possibly four years in the US, could be a political stalemate where neither party can do anything radical.

2.2 The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases to the highest level since mid-August, suggests that the US could be in the early stages of a third wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the latest wave has been driven by a growing outbreak in the Midwest. The latest upturn poses a threat that the recovery in the economy could stall. This is the single biggest downside risk to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

2.3 However, with the likelihood that highly effective vaccines are going to become progressively widely administered during 2021, this should mean that life will start to return to normal during quarter 2 of 2021. Consequently, there should be a sharp pick-up in growth during that quarter and a rapid return to the pre-pandemic level of growth by the end of the year.

2.4 The Federal Open Market Committee's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

3.0 EUROZONE

3.1 The economy was recovering well towards the end of Q2 and into Q3 after a sharp drop in GDP caused by the virus. However, growth is likely to stagnate during Q4, and Q1 of 2021, as a second wave of the virus has affected many countries, and is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected countries. With inflation expected to be unlikely to get much above 1% over the next two years, the ECB has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. It is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support from governments.

3.2 However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle during the closing and opening quarters of this year and next year respectively before it finally breaks through into strong growth in quarters 2 and 3. The ECB will now have to review whether more monetary support will be required to help recovery in the shorter term or to help individual countries more badly impacted by the pandemic.

4.0 CHINA

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

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

5.0 JAPAN

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

6.0 WORLD GROWTH

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

6.2 Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

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

6.4 A surge in investor confidence, as a result of successful vaccines, may help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

7.0 INTEREST RATE FORECASTS

7.1 The interest rate forecasts provided by Link were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. There is therefore no need to revise these forecasts now that a trade deal has been agreed. Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

7.2 The real risk is if the UK and the EU cannot agree. The UK could override part or all of the Withdrawal Agreement while the EU could respond by starting legal proceedings and few measures could be implemented to mitigate the disruption on 1.1.21. The acrimony would probably continue beyond 2021 too, which may lead to fewer agreements in the future and the expiry of any temporary measures.

7.3 Relative to the slump in GDP endured during the COVID crisis, any hit from a no deal would be small. But the pandemic does mean there is less scope for policy to respond. Even so, the Chancellor could loosen fiscal policy by about £10bn (0.5% of

GDP) and target it at those sectors hit hardest. The Bank of England could also prop up demand, most likely through more gilt and corporate bond purchases rather than negative interest rates.

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

8.0 The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is still subject to some uncertainty due to the virus and the effect of any mutations, and how quick vaccines are in enabling a relaxation of restrictions.; and

- there is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

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

- **UK government** takes too much action too quickly to raise taxation or introduce austerity measures that depress demand in the economy.;

- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate;

- a resurgence of the **Eurozone sovereign debt crisis;**

- weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic;

- **German minority government & general election** in 2021;

- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile;

- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been a rise in anti-immigration sentiment in Germany and France;

- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows; and

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

- **UK -** a significant rise in inflationary pressures e.g. caused by a stronger than currently expected recovery in the UK economy after effective vaccines are administered quickly to the UK population, leading to a rapid resumption of normal life and return to full economic activity across all sectors of the economy;

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

SCHEDULE 4

NORTH YORKSHIRE COUNTY COUNCIL ANNUAL INVESTMENT STRATEGY 2021/22 – SPECIFIED INVESTMENTS

Investment	Security / Minimum Credit Rating	Circumstances of Use
Term Deposits with the UK Government or with UK Local Authorities (as per Local Government Act 2003) with maturities up to 1 year	High security as backed by UK Government	In-house
Term Deposits with credit rated deposit takers (Banks and Building Societies), including callable deposits with maturities less than 1 year	Organisations assessed as having "high credit quality"within the UK or from Countries with a minimum Sovereign rating of AA- for the country in which the organisation is domiciled	In-house
Certificate of Deposits issued by credit rated deposit takers (Banks and Building Societies) up to 1 year		Fund Manager or In-house "buy and hold" after consultation with Treasury Management Advisor
Forward deals with credit rated Banks and Building Societies less than 1 year (i.e. negotiated deal plus period of deposit)		In-house
Term Deposits with Housing Associations less than 1 year		In-house
Money Market Funds i.e. collective investment scheme as defined in SI2004 No 534 (*These funds have no maturity date*)	Funds must be AAA rated	In-house After consultation with Treasury Management Advisor Limited to £20m
Gilts (with maturities of up to 1 year)	Government Backed	Fund Manager or In-house buy and hold after consultation with Treasury Management Advisor
Bonds issued by a financial institution that is guaranteed by the UK Government (as defined in SI 2004 No 534) with maturities under 12 months (*Custodial arrangements required prior to purchase*)	Government Backed	After consultation with Treasury Management Advisor

SCHEDULE 4

NORTH YORKSHIRE COUNTY COUNCIL ANNUAL INVESTMENT STRATEGY 2021/22 – NON-SPECIFIED INVESTMENTS

Investment	Security / Minimum Credit Rating	Circumstances of Use	Max % of total investments	Maximum investment with any one counterparty	Max. maturity period
Term Deposit with credit rated deposit takers (Banks & Building Societies), UK Government and other Local Authorities with maturities greater than 1 year	Organisations assessed as having "high credit quality" under the Credit Worthiness Policy	In-house	100% of agreed maximum proportion of Core Cash funds (£40m)	£5m	5 years
Certificate of Deposit with credit rated deposit takers (Banks & Building Societies) with maturities greater than 1 year Custodial arrangements prior to purchase	Organisations assessed as having "high credit quality" under the Credit Worthiness Policy	Fund Manager or In-house "buy & hold" after consultation with Treasury Management Advisor	100% of agreed maximum proportion of Core Cash funds (£40m)	£5m	5 years
Callable Deposits with credit rated deposit takers (Banks & Building Societies) with maturities greater than 1 year	Organisations assessed as having "high credit quality" under the Credit Worthiness Policy	In-house	50% of agreed maximum proportion of Core Cash funds (£20m)	£5m	5 years
Term Deposits with Housing Associations with maturities greater than 1 year	Organisations assessed as having "high credit quality" under the Credit Worthiness Policy	In-house	25% of agreed maximum proportion of Core Cash funds (£10m)	£5m	5 years

Investment	Security / Minimum Credit Rating	Circumstances of Use	Max % of total investments	Maximum investment with any one counterparty	Max. maturity period
Forward Deposits with a credit rated Bank or Building Society > 1 year (i.e. negotiated deal period plus period of deposit)	Organisations assessed as having "high credit quality" under the Credit Worthiness Policy	In-house	25% of agreed maximum proportion of Core Cash funds (£10m)	£5m	5 years
Bonds issued by a financial institution that is guaranteed by the UK Government (as defined in SI2004 No534) with maturities in excess of 1 year Custodial arrangements required prior to purchase	AA or Government backed	Fund Manager or In-house "buy & hold" after consultation with Treasury Management Advisor	25% of agreed maximum proportion of Core Cash funds (£10m)	n/a	5 years
Bonds issued by Multilateral development banks (as defined in SI2004 No534) with maturities in excess of 1 year Custodial arrangements required prior to purchase	AA or Government backed	Fund Manager or In-house "buy & hold" after consultation with Treasury Management Advisor	25% of agreed maximum proportion of Core Cash funds (£10m)	£5m	5 years
UK Government Gilts with maturities in excess of 1 year Custodial arrangements required prior to purchase	Government backed	Fund Manager	25% of agreed maximum proportion of Core Cash funds (£10m)	n/a	5 years
Collateralised Deposit	UK Sovereign Rating	In-house	25% of agreed maximum proportion of Core Cash funds (£10m)	n/a	5 years

Investment	Security / Minimum Credit Rating	Circumstances of Use	Max % of total investments	Maximum investment with any one counterparty	Max. maturity period
Property Funds	Organisations assessed as having "high credit quality"	In-house after consultation with Treasury Management Advisor	100% of agreed maximum proportion of Core Cash funds (£40m)	£5m	10 years

SCHEDULE 5

APPROVED LENDING LIST 2021/22

Maximum sum invested at any time (The overall total exposure figure covers both Specified and Non-Specified investments)

	Country	Specified Investments (up to 1 year)		Non-Specified Investments (> 1 year £40m limit)	
		Total Exposure £m	Time Limit *	Total Exposure £m	Time Limit *
UK "Nationalised" banks / UK banks with UK Central Government involvement					
Royal Bank of Scotland PLC (RFB)	GBR	75.0	365 days	-	-
National Westminster Bank PLC (RFB)	GBR				
UK "Clearing Banks", other UK based banks and Building Societies					
Santander UK PLC (includes Cater Allen)	GBR	60.0	6 months	-	-
Barclays Bank PLC (NRFB)	GBR	75.0	6 months	-	-
Barclays Bank UK PLC (RFB)	GBR				
Bank of Scotland PLC (RFB)	GBR	60.0	6 months	-	-
Lloyds Bank PLC (RFB)	GBR				
Lloyds Bank Corporate Markets PLC (NRFB)	GBR				
HSBC Bank PLC (NRFB)	GBR	30.0	365 days	-	-
HSBC UK Bank PLC (RFB	GBR				
Goldman Sachs International Bank	GBR	60.0	6 months		
Sumitomo Mitsui	GBR	30.0	6 months		
Standard Chartered Bank	GBR	60.0	6 months		
Handlesbanken	GBR	40.0	365 days		
Nationwide Building Society	GBR	40.0	6 months	-	-
Leeds Building Society	GBR	20.0	3 months	-	-
High Quality Foreign Banks					
National Australia Bank	AUS	30.0	365 days	-	-
Commonwealth Bank of Australia	AUS	30.0	365 days		
Toronto-Dominion Bank	CAN	30.0	365 days		
Credit Industriel et Commercial	FRA	30.0	6 months	-	-
Landesbank Hessen-Thueringen Girozentrale (Helaba)	GER	30.0	365 days		
DBS (Singapore)	SING	30.0	365 days		
Local Authorities					
County / Unitary / Metropolitan / District Councils		20.0	365 days	5.0	5 years
Police / Fire Authorities		20.0	365 days	5.0	5 years
National Park Authorities		20.0	365 days	5.0	5 years
Other Deposit Takers					
Money Market Funds		20.0	365 days	5.0	5 years
Property Funds		5.0	365 days	5.0	10 years
UK Debt Management Account		100.0	365 days	5.0	5 years

Based on data as 31 December 2020

SCHEDULE 6

APPROVED COUNTRIES FOR INVESTMENTS

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

Sovereign Rating	Country
AAA	Australia Denmark Germany Luxemburg Netherlands Norway Singapore Sweden Switzerland
AA+	Canada Finland USA
AA	Abu Dhabi (UAE) France
AA-	Belgium Hong Kong Qatar UK