GMCA GREATER MANCHESTER COMBINED AUTHORITY

Date: **22nd January 2021**

Subject: **GMCA Treasury Management Strategy Statement, Borrowing Limits and Annual Investment Strategy 2021/22**

Report of: **Steve Wilson, Treasurer of the GMCA**

PURPOSE OF REPORT

To set out the proposed Treasury Management Strategy Statement, Borrowing Limits and Prudential Indicators for 2021/22 to 2023/24 for the GMCA.

The Strategy reflects the current approved 2021/22 capital programmes for GMCA transport, economic development, Fire, Police and Waste. The capital programme will be revised as part of the budget reports going to GMCA for approval on 12th February 2021.

RECOMMENDATIONS:

The Audit Committee is asked to recommend that the GMCA approve the proposed Treasury Management Strategy Statement and Annual Investment Strategy to apply from the 1 April 2021, in particular:

- The Treasury and Prudential Indicators listed in Section **Error! Reference source not found.**.
- The Minimum Revenue Provision (MRP) Strategy outlined in Appendix A.
- The Treasury Management Policy Statement at Appendix B.
- The Treasury Management Scheme of Delegation at Appendix C.
- The Borrowing Strategy outlined in Section **Error! Reference source not found.**.
- The Annual Investment Strategy detailed in Sections **Error! Reference source not found.**.
- Delegation to the Treasurer to step outside of the investment limits to safeguard the GMCA's position, as outlined in paragraph **Error! Reference source not found.**

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BACKGROUND PAPERS:

- GMCA Audit Committee, 27th November 2020, Treasury Management Interim Update 2020/21
- GMCA Audit Committee 20th January 2020, GMCA Treasury Management Strategy, Borrowing Limits and Annual Investment Strategy 2020/21

TRACKING/PROCESS		
Does this report relate to a Key Decision, as set out in the GMCA Constitution or in the process agreed by the AGMA Executive Board		No
EXEMPTION FROM CALL IN		
Are there any aspects in this report which means it should be considered to be exempt from call in by the AGMA Scrutiny Pool on the grounds of urgency?	No	
AGMA Commission	TfGMC	Scrutiny Pool
N/A	N/A	N/A

Treasury Management Strategy for 2021/22

The treasury officers' views on interest rates, supplemented with leading market forecasts provided by the GMCA's treasury advisor, Link Asset Services, are what the suggested strategy, in respect of the following aspects, is based upon.

The strategy covers:

1. INTRODUCTION AND BACKGROUND

1.1 Treasury Management in Local Government is regulated by the CIPFA Code of Practice on Treasury Management in Local Authorities. The Authority has adopted the Code and complies with its requirements. A primary requirement of the Code is the formulation and agreement by the Authority of a Treasury Policy Statement which sets out Authority, Committee and Chief Financial Officer responsibilities, and delegation and reporting arrangements.

1.2 The purpose of this report is to set out the proposed Treasury Management Strategy Statement, Borrowing Limits and Prudential Indicators for 2021/22 to 2023/24 for the GMCA. The Strategy reflects the current approved 2021/22 capital programmes for GMCA transport, economic development, Fire, Police and Waste. The capital programme will be revised as part of the budget reports going to GMCA for approval on 12th February 2021.

Background

1.3 The GMCA 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 GMCA's low risk appetite, providing adequate liquidity initially before considering investment return.

1.4 The second main function of the treasury management service is the funding of the GMCA's capital plans, incorporating transport, economic development and regeneration, waste disposal and those relating to the Mayor's Police and Crime Commissioner (PCC) and Fire functions. These capital plans provide a guide to the borrowing need of the GMCA, essentially the longer-term cash flow planning, to ensure that the GMCA 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 the risk or cost objectives.

1.5 The contribution the treasury management function makes to the GMCA 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 General Fund Balances.

1.6 Chartered Institute of Public Finance and Accountancy (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.'

1.7 As such the GMCA regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

1.8 The GMCA also acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Reporting Requirements

1.9 The Local Government Act 2003 (the Act) and supporting regulations require the GMCA to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the GMCA's capital investment plans are affordable, prudent and sustainable.

1.10 The Act therefore requires the GMCA to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as Section 9 of this report); the Strategy sets out the GMCA's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.11 The GMCA has adopted the CIPFA Code of Practice on Treasury Management and this strategy has been prepared under the revised Code of December 2017. 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

1.12 The aim of the capital strategy is to ensure that all members of the GMCA fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

Treasury Management reporting

1.13 The GMCA 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.

1.14 **Prudential and treasury indicators and treasury 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 and borrowings are to be organised), including treasury indicators; and

- an investment strategy, (the parameters on how investments are to be managed).

1.15 **A mid-year treasury management report** (last received 27th November 2020) – This is primarily a progress report and will update Members of the Audit Committee on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

1.16 **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.

1.17 The above reports are required to be adequately scrutinised before being recommended to the GMCA. This role is undertaken by the Audit Committee. The Corporate Issues and Reform Overview and Scrutiny Committee may also request to receive such reports for consideration at their meetings.

Training

1.18 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. The training needs of treasury management officers are periodically reviewed.

Treasury management consultants

1.19 The GMCA uses Link Asset Services as its external treasury management advisors.

1.20 The GMCA 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.

1.21 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 GMCA 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.

2. CONSTITUTIONAL ARRANGEMENTS

2.1 Currently the GMCA's Treasury Management functions are operated under a service level agreement by Manchester City Council Treasury Management which reports directly to the GMCA Treasurer. It is intended that this arrangement continues during 2021/22 whilst consideration is given to developing an in-house function within the GMCA.

2.2 The treasury portfolio position for the GMCA will be managed at a Group level, including Transport for Greater Manchester (TfGM) and Greater Manchester Police (GMP), which means that the combined cash flows of all the consolidated organisations will be taken into account when investing temporary surplus funds or making arrangements to meet borrowing needs.

2.3 As part of the 2016 Autumn Statement, Government announced that it would give mayoral combined authorities powers to borrow for their new functions, which would allow

investment in economically productive infrastructure, subject to agreeing a borrowing cap with HM Treasury (HMT).

2.4 Subsequent work with HMT and Ministry of Housing, Communities and Local Government (MHCLG) has led to such an agreement which will limit the GMCA's long-term external debt in 2020/21 and the proposal for 2021/22 is as follows:

As at 31 March	**2020/2021**	**2021/22**
	£m	£m
Long term external debt	2,541	2,541

2.5 The above agreed limits have been derived from the current agreed long-term investment plans of the GMCA including Fire, Police and Waste.

2.6 The debt cap operates on long-term external debt and does not limit capital spending funded from internal cash flow or short-term external debt (less than 1 year). The agreement will be reviewed at least every 5 years with the first such review in 2019 but will also be reviewed in light of any initiative, local or national, which has a material impact on GMCA borrowing totals.

2.7 The projection of external debt figures outlined in this report fall well within the year end ceilings incorporated into the debt deal.

3 TREASURY LIMITS AND PRUDENTIAL INDICATORS

3.1 It is a statutory duty under Section 3 of the Act and supporting regulations that GMCA determines and keeps under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. In England, the Authorised Limit represents the legislative limit specified in the Act.

3.2 The GMCA must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon the future levies and precepts is acceptable.

3.3 When considering the Authorised Limit, the capital plans for inclusion in corporate financing include both external borrowing and other long-term liabilities, such as PFI and leasing arrangements.

3.4 The Authorised Limit is one of the Prudential and Treasury indicators recommended by the Code, which the GMCA operates for monitoring its treasury operations.

3.5 Listed below is the full set of indicators the Code recommends and are used by the GMCA. The Prudential Indicators are:

- Capital Expenditure
- Capital Financing Requirement (CFR)
- Authorised Limit – external debt
- Operational Boundary
- Actual external debt

- Gross Debt and the CFR
- Ratio of Financing Costs
- Maturity structure of fixed rate borrowing during the year
- Upper limit for total principal sums invested for over 364 days

4 CURRENT PORTFOLIO POSITION

4.1 The GMCA's forecast treasury portfolio position as at 31 March 2021 is:

		Principal		Ave rate
		£m	£m	%
Fixed rate funding	PWLB	562.5		4.57
	Market	90.0		4.15
	EIB	571.1		3.63
			1,223.6	
Variable rate funding	HILF – HMT[1]	210.4		0.00
	Market	15.0		4.50
			225.4	
Gross debt			**1,449.0**	
Money Market Funds			-	
Temporary Investments			15	0.00
DMO			-	
Net debt			**1,434.0**	

5 PRUDENTIAL AND TREASURY INDICATORS FOR 2021/22 TO 2023/24

5.1 Combined Prudential and Treasury Indicators are relevant for the purpose of setting an integrated treasury management strategy.

Capital Expenditure

5.2 This provides a summary of the GMCA's capital expenditure. It reflects matters previously agreed and proposed for the forthcoming financial periods. The extent to which such expenditure is to be financed will influence how the GMCA's Capital Financing Requirement Indicator will change. The capital programme will be updated and agreed as part of the budget process for 2021/22 to be approved by GMCA on 12th February 2021.

5.3 In reporting this Indicator to Members, the GMCA may choose to include a supplementary table detailing the resources to be applied to finance the capital spend and so highlight any net financing need over the reporting period.

[1] The HILF represents the Housing Investment Loans Fund, which was novated from Manchester City Council on 13 March 2019

	Actual 2019/20 £m	Estimate 2020/21 £m	Estimate 2021/22 £m	Estimate 2022/23 £m
Capital Expenditure	362.048	434.183	396.906	235.486
Financed by:				
Capital receipts	(21.230)	(6.851)	(33.282)	(17.000)
Revenue Contribution	(60.043)	(50.857)	(2.590)	(2.590)
Grants and other contributions	(110.897)	(186.376)	(135.494)	(89.441)
Total financing	(192.170)	(244.084)	(171.366)	(109.031)
Net financing need for the year	**169.878**	**190.099**	**225.540**	**126.455**

Capital Financing Requirement (CFR)

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

	Actual 2019/20 £m	Estimate 2020/21 £m	Estimate 2021/22 £m	Estimate 2022/23 £m
Opening CFR	**2,138.307**	**2,382.404**	**2,487.745**	**2,625.644**
Net financing need for the year	324.454	190.099	225.540	126.455
MRP and VRP	(80.357)	(84.758)	(87.641)	(82.458)
Movement in CFR	**244.097**	**105.341**	**137.899**	**33.997**

Authorised Limit

5.5 This represents a control on the maximum level of external debt the GMCA can incur. The Authorised Limit is a statutory limit determined under Section 3(1) of the Local Government Act 2003. The GMCA has no legal power to borrow in excess of the limits set. Revision of this Indicator would need to be approved by the GMCA in advance of any external debt taken on in excess of the limit then in force.

5.6 The Authorised Limit reflects a level of external debt that, whilst not desired, could be afforded by the GMCA in the short-term, but which is not sustainable in the longer-term.

	Estimate 2020/21 £m	Estimate 2021/22 £m	Estimate 2022/23 £m
Borrowing	2,620.644	2,736.520	2,888.208
Other long-term liabilities	52.425	48.860	44.835
Total Authorised Limit	2,673.069	2,785.379	2,933.043

Operational Boundary

5.7 The GMCA will also set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt, excluding investments, separately identifying borrowing from other long-term liabilities. This prudential indicator is referred to as the Operational Boundary.

5.8 Both the Authorised Limit and the Operational Boundary need to be consistent with the authority's plans for capital expenditure and financing; and with its treasury management policy statement and practices. The Operational Boundary should be based on the GMCA's estimate of most likely, i.e. prudent, but not worst case scenario. Risk analysis and risk management strategies should be taken into account.

5.9 The Operational Boundary should equate to the maximum level of external debt projected by this estimate. Thus, the Operational Boundary links directly to the GMCA's plans for capital expenditure; its estimates of capital financing requirement; and its estimate of cash flow requirements for the year for all purposes. The Operational Boundary is a key management tool for in-year monitoring.

5.10 It will probably not be significant if the Operational Boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the Operational Boundary would be significant and should lead to further investigation and action as appropriate.

	Estimate 2020/21 £m	**Estimate 2021/22 £m**	**Estimate 2022/23 £m**
Borrowing	2,501.524	2,612.132	2,756.926
Other long-term liabilities	50.042	46.639	42.797
Total Operational Boundary	2,551.566	2,658.771	2,799.723

Actual External Debt as at 31 March 2021

5.11 After the year end, the closing balance for actual gross borrowing plus (separately), other long-term liabilities is obtained directly from the GMCA's Balance Sheet. This prudential indicator is referred to as Actual External Debt.

5.12 The prudential indicator for Actual External Debt considers a single point in time and hence is only directly comparable to the Authorised Limit and Operational Boundary at that point in time.

	31 March 2021 £m
Borrowing	1,440.740
Other long-term liabilities	44.418
Total External Debt	**1,485.158**

Gross Debt and the CFR

5.13 The GMCA should only borrow to support a capital purpose, and borrowing should not be undertaken for revenue or speculative purposes. The GMCA should ensure that 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 the three subsequent financial years.

5.14 If the level of gross borrowing is below the GMCA's capital borrowing need – the CFR – it demonstrates compliance with this Indicator.

	Actual 2019/20 £m	**Estimate 2020/21 £m**	**Estimate 2021/22 £m**	**Estimate 2022/23 £m**
CFR	2,382.404	2,487.745	2,625.644	2,659.641
Gross borrowing	1,602.233	1,485.158	1,619.113	1,690.302
Under/(Over) borrowing	**780.171**	**1,002.587**	**1,006.531**	**969.339**

Gross External Debt

	Estimate 2020/21 £m	**Estimate 2021/22 £m**	**Estimate 2022/23 £m**
Loans at start of year	1,554.574	1,440.740	1,578.354
Lease/PFI liabilities at start of year	47.659	44.418	40.759
Total gross borrowing at start of year	**1,602.233**	**1,485.158**	**1,619.113**
New borrowing undertaken	-	225.540	126.455
Loan repayments	(113.834)	(87.926)	(51.184)
Lease and PFI repayments	(3.241)	(3.659)	(4.082)
Loans at end of year	1,440.740	1,578.354	1,653.625
Lease/PFI liabilities at end of year	44.418	40.759	36.677
Total gross borrowing at end of year	**1,485.158**	**1,619.113**	**1,690.302**

Ratio of Financing Costs to Net Revenue Stream

5.15 This Indicator shows the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream (levies, precepts and non-specific grant income). The higher the ratio, the higher the proportion of

resources tied up just to service net capital costs, and which represents a potential affordability risk.

	Estimate 2020/21 %	Estimate 2021/22 %	Estimate 2022/23 %
Ratio of Financing Costs to Net Revenue Stream	13.1	13.5	13.6

Maturity Structure of borrowing

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

	Lower Limit %	Upper Limit %
Under 12 months	0	50
12 months and within 24 months	0	50
24 months and within 5 years	0	50
5 years and within 10 years	0	50
10 years and above	0	100

5.17 The GMCA does not invest sums for longer than one year.

6. PROSPECTS FOR INTEREST RATES

6.1 The GMCA has appointed Link Asset Services as its treasury advisor and part of their service is to assist the GMCA to formulate a view on interest rates. Appendix G draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following gives Link's central view:

Link Asset Services Bank Rate forecast for financial year ends (March)

2021	0.10%
2022	0.10%
2023	0.10%

6.2 Whilst these are the current forecasts, due to uncertainties as a result of COVID-19 the market is unlikely going to see a rise in the foreseeable future.

Investment and borrowing rates

6.3 Investment returns are likely to remain low during 2021/22 due to the uncertainty caused by the ongoing global pandemic. In September 2020, the Bank of England said it is unlikely to introduce a negative Bank Rate in the next 6-12 months, but recognises it as one of the tools available.

6.4 Negative rates have already been seen in the market specifically when placing cash with the Debt Management Office and the Money Market Funds. Investing short term at a negative rate will remain to be the option of last resort. At such time this is no longer possible, alternative longer-term investments no greater than 364 days will be considered to ensure the delivery of value for money.

6.5 Borrowing interest rates remain at historic lows. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when the GMCA may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

6.6 There will remain a cost of carry (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

7. BORROWING STRATEGY

7.1 The GMCA currently has an under borrowed position, which means that the CFR, the underlying need to borrow, has not been fully funded by loan debt as cash supporting the GMCA's balances and reserves has been used as a temporary measure. The borrowing strategy of the GMCA is also heavily influenced by the cashflow. The GMCA, along with other Fire and OPCC authorities, receives pension grants from UK Central Government in July. Cash balances then reduce during the remainder of the year. The trend in cashflow shown below is expected to be replicated in 2021/22.

Borrowing Options

7.2 The GMCA's borrowing strategy will firstly utilise internal borrowing as forgoing investment income at historically low rates provides the cheapest option. However, as the overall forecast is for long term borrowing rates to increase slightly over the next few years, consideration must also be given to weighing the short-term advantage of internal borrowing against potential long-term costs.

7.3 New borrowing will be considered in the forms noted below. At the time of the borrowing requirement the options will be evaluated alongside their availability and an assessment made regarding which option will provide value for money. The options described below are not presented in a hierarchical order. At the point of seeking to arrange borrowing all options will be reviewed.

Public Works Loan Board (PWLB)

7.4 PWLB borrowing is available for between 1 and 50 year maturities on various bases. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt, and allow the GMCA to align maturities to MRP.

7.5 In February 2020 Parliament reformed the statutory basis of the PWLB, transferring lending powers to HM Treasury. In March 2020 the government consulted on revising the PWLB's lending terms to reflect the new governance arrangements as well as to end the situation in which a minority of authorities used PWLB loans to fund debt for yield activity via commercial investments. The government published its response to this consultation and implemented these reforms in November 2020.

7.6 Additional requirements to borrow from PWLB were introduced. Each authority that wishes to borrow from the PWLB will need to submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. Any investment assets bought primarily for yield will not be supported by PWLB.

7.7 Authorities will be asked to:

a) Categorise Capital Spending into: Service Spending, Housing, Regeneration, Preventative Action, Treasury Management, and Debt for Yield activity.
b) Provide a short description covering at least 75% of the spending in each category.
c) Provide assurance from the section 151 officer or equivalent that the local authority is not borrowing in advance of need and does not intend to buy investment assets primarily for yield.

European Investment Bank (EIB)

7.8 Rates can be forward fixed for borrowing from the EIB and this will continue to be considered as a primary borrowing source if the arrangement represents better value for money.

7.9 Historically, the EIB's rates for borrowing were generally favourable compared to PWLB, however following the U.K. withdrawal from the E.U. as well as the reversal of PWLB rates as described above results with a reduced margin of benefit when comparing to the PWLB.

The EIB appraises its funding plans against individual schemes, particularly around growth and employment and energy efficiency, and any monies borrowed are part of the GMCA's overall pooled borrowing. The GMCA has already accessed £571m of borrowing from the EIB.

Third Party Loans

7.10 These are loans from third parties that are offered at lower than market rates, for example, Salix Finance Ltd is offering loans to the public sector at 0% to be used specifically to improve their energy efficiency and reduce carbon emissions.

Housing Investment Funding (HIF)

7.11 The Housing Investment Fund was previously operated on behalf of Greater Manchester by Manchester City Council, but the novation to the GMCA was completed on 13 March 2019. All short-term individual loans part of the HIF novated to the GMCA by 30 March 2020.

7.12 The funding from UK Central Government is held as an interest free loan, until such time as an investment is made. At this point, the approved element of the loan becomes risk-based, with any losses met by UK Central Government (up to £60m overall) or by the GMCA. The interest rate on the loan from UK Central Government, once an investment is made, is at the EU Reference rate, and is funded from the interest received from the investments made as part of the Housing Investment Fund. Part of the Housing Investment Fund funding relating to capital receipts from the HCA will also be transferred to the GMCA at a later date. This funding is also held as an interest free loan, and similarly has a risk based return to UK Central Government.

7.13 At the time of writing the report, it is not clear how MHCLG are anticipating the Fund to operate from 1 April 2021. In particular, whether they will be providing any further cash advances to meet future loan requirements including future legal commitments that amount to £233m and approved loans, which amount to £277m. Detailed conversations are continuing to take place in order to determine the way in which the Fund will operate post 1 April 2021.

Market / Local Authority Loans

7.14 There are occasionally offers available from the general market. These would be utilised when they deliver better value. These types of borrowing will need to be evaluated alongside their availability, particularly whilst there is a very limited availability of traditional market loans.

Sensitivity of the forecast

7.15 In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. GMCA officers, in conjunction with the treasury advisors, will continually monitor both the prevailing interest rates and the market forecast, adopting the following responses to a change of sentiment:

> ***If it were felt that there was a significant risk of a sharp FALL in long and short term rates,*** e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed.

If it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that current forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, the portfolio position will be re-appraised. It is likely fixed rate funding will be drawn whilst interest rates were still relatively cheap.

External versus Internal borrowing

7.16 The next financial year is again expected to be one of historically low Bank Rate. This provides a continuation of the window of opportunity for organisations to fundamentally review their strategy of undertaking new external borrowing.

7.17 Over the next three years, investment rates are expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by limiting new external borrowing and by using internal cash balances to finance new capital expenditure, or to replace maturing external debt. This is referred to as internal borrowing and maximises short term savings.

7.18 Short term savings from avoiding new long-term external borrowing in 2021/22 will also be weighed against the potential for incurring additional long-term extra costs by delaying new external borrowing until later years. However, given the current interest rate forecast, future long-term borrowing costs are unlikely going to be material. Consideration will also be given to forward fixing rates via the EIB facility whilst rates are favourable.

7.19 Against this background, caution will continue to be adopted within 2021/22 treasury operations. The Treasurer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision-making body at the next available opportunity.

Policy on borrowing in advance of need

7.20 The GMCA 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 GMCA can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Forward Fixing

7.21 The GMCA will give consideration to forward fixing debt, whereby the GMCA agrees to borrow at a point in the future at a rate based on current implied market interest rate forecasts. There is a risk that the interest rates proposed would be higher than current rates, but forward fixing can be beneficial as the arrangement avoids the need to borrow in advance of need and suffer cost of carry. Any decision to forward fix will be reviewed for value for money, and will be reported to members as part of the standard treasury management reporting.

7.22 Forward fixing was a feature of the earlier EIB draw downs and may be available from various market sources.

Debt rescheduling

7.23 As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred). The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy; and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

7.24 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. All rescheduling will be reported to the GMCA at the earliest meeting following its action.

Lender Option Borrower Option (LOBO) loans

7.25 Within the portfolio there are 2 LOBO loans with Barclays which were taken out in 2005 and 2006 for a period of 60 years. Along with a number of local authorities, the GMCA has engaged specialist legal support to pursue a claim against Barclays in relation to elements of their loans.

8. ANNUAL INVESTMENT STRATEGY

Investment policy – management of risk

8.1 The GMCA'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")
- CIPFA Treasury Management Guidance Notes 2018

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

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

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

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the GMCA 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.

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

4. The GMCA has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists under the categories of 'specified' and 'non-specified' investments.

   - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
   - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by Members and officers before being authorised for use.

8.4 As a result of the change in accounting standards for 2020/21 under **IFRS 9,** the GMCA 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.

8.5 However, the GMCA 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.

<u>Specified and Non-Specified Investments</u>

8.6 Investment instruments identified for use in the financial year are listed below, and are all specified investments. Any proposals to use other non-specified investments will be reported to Members for approval.

	Minimum 'High' Credit Criteria	**Use**
Term deposits – banks and building societies[2]	See para 9.9	In-house / MCC
Term deposits – other local authorities	High security. Only one or two local authorities credit-rated	In-house / MCC

[2] Banks and Building Societies
The GMCA will keep the investment balance below or at the maximum limit based on the institutions credit rating. If this limit is breached, for example due to significant late receipts, the Treasurer will be notified as soon as possible after the breach, along with the reasons for it. Please note this relates to specific investments and not balances held within the GMCA's bank accounts, including the general bank account. The balance will be kept to the maximum investment limit of the institution, with any breaches reported to the Treasurer.

	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	UK Government backed	In-house / MCC
Certificates of Deposit issued by banks and building societies covered by UK Government guarantees	UK Government explicit guarantee	In-house / MCC
Money Market Funds (MMFs)	AAA_M	In-house / MCC
Treasury bills	UK Government backed	In-house / MCC
Covered Bonds	AAA	In-house / MCC

8.7 Specified investments are sterling denominated, with maturities up to a maximum of one year and meet the minimum 'high' rating criteria where applicable. Further details about some of the specified investments below can be found in later paragraphs within Section 9.

Creditworthiness policy

8.8 The GMCA applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modeling approach utilising credit ratings from the three main credit rating agencies; Fitch, Moody's and Standard & Poor's. Link supplement the credit ratings of counterparties with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap (CDS) spreads to provide early warning of likely changes in credit ratings; and
- sovereign ratings to select counterparties from only the most creditworthy countries.

8.9 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product is a series of colour-coded bands, which indicate the relative creditworthiness of counterparties. This classification is called durational banding.

8.10 The GMCA has regard to Link's approach to assessing creditworthiness when selecting counterparties. It will not apply the approach of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Link creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system does not give undue preponderance to just one agency's ratings.

8.11 In summary therefore the GMCA will approach assessment of creditworthiness by using the Link counterparty list as a starting point, and then applying as an overlay its own counterparty limits and durations. All credit ratings will be monitored on a daily basis and re-assessed weekly. The GMCA is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

8.12 If a downgrade results in the counterparty/investment scheme no longer meeting the GMCA's minimum criteria, its further use as a new investment will be withdrawn immediately.

8.13 In addition to the use of Credit Ratings, the GMCA will be advised of information in CDS against the iTraxx benchmark[3] and other market data on a weekly basis. Extreme market movements may result in the downgrade of an institution or removal from the GMCA's lending list.

8.14 Sole reliance will not be placed on the use of this external service. In addition GMCA will also use market data and market information, information on government support for banks and the credit ratings of that government support. The GMCA will assess investments only against the criteria listed above, and will not seek to evaluate an organisation's ethical policies when making assessments.

Investment Limits

8.15 In applying the creditworthiness policy described above, the GMCA holds the security of investments as the key consideration when making investment decisions. The GMCA will therefore only seek to make treasury investments with counterparties of high credit quality. The financial investment limits of banks and building societies are linked to their short and long-term ratings (Fitch or equivalent) as follows:

Banks & Building Societies/MMFs

Long Term	Amount
Fitch AA+ and above / AAAM	£25m
Fitch AA/AA-	£15m
Fitch A+/A	£15m
Fitch A-	£10m
Fitch BBB+	£10m

GMCA will only utilise institutions that have a short term rating of F2 or higher, (Fitch or equivalent).

Government (includes Debt Management Office)	£250m
Manchester City Council	£50m
Other Local Authorities	£20m

8.16 In seeking to diversify from solely bank deposits and investments with Local Authorities, the GMCA will utilise other investment types which are described in more detail below. However it is important that the investment portfolio is mixed to help mitigate credit risk and therefore the following limits will apply to each asset type:

Total Deposit	**£m**
Local Authorities (exc. HILF)	250

[3] The Markit iTraxx Senior Financials Index is a composite of the 25 most liquid financial entities in Europe. The index is calculated through an averaging process by the Markit Group and is used as the benchmark level of CDS spreads on Capita Asset Services' Credit List.

UK Government (inc. Debt Management Office and Treasury Bills)	250
Banks, Building Societies and Money Market Funds	150
Certificates of Deposit	25
Covered Bonds	25

8.17 In the current economic environment where markets are saturated with cash and rates are historically low as a result of the global pandemic, delivering secure liquidity and value for money is paramount. To do so, it is proposed that the DMO and Treasury Bill Limits are increased by £50m to £250m and Banks, Building Societies, and Money Market Funds limits are increased by £25m to £150m in 2021/22.

8.18 It may be prudent, depending on circumstances, to temporarily increase the limits shown above if it becomes increasingly difficult for officers to place funds. If this is the case officers will seek approval from the Treasurer for such an increase and approval may be granted at the Treasurer's discretion. Any increase in the limits will be reported to Members of the Audit Committee as part of the normal treasury management reporting process.

Money Market Funds

8.19 The removal of the implied levels of sovereign support that were built into ratings throughout the financial crisis has impacted on bank and building society ratings across the world. Rating downgrades can limit the number of counterparties available to the GMCA. To provide flexibility for the investment of surplus funds the GMCA will use Money Market Funds when appropriate as an alternative specified investment.

8.20 Money Market Funds are investment instruments that invest in a variety of institutions, therefore diversifying the investment risk. The funds are managed by a fund manager and they have objectives to preserve capital, provide daily liquidity and a competitive yield. The majority of money market funds invest both inside and outside the UK. Money Market Funds also provide flexibility as investments and withdrawals can be made on a daily basis.

8.21 Money Market funds are rated through a separate process to bank deposits. This looks at the average maturity of the underlying investments in the fund as well as the credit quality of those investments. It is proposed that the GMCA will only use Money Market Funds where the institutions hold the highest AAA credit rating.

8.22 As with all investments there is some risk with Money Market Funds, in terms of the capital value of the investment. From 2019 European Commission Financial regulations require that all Money Market Funds adopt or move to a Low Volatility Net Asset Value (LVNAV) basis. This basis provides a guarantee that every £1 invested in a Money Market Funds will be returned with a range of +/- 20 basis points, whilst the timing of the return is at the discretion of the Fund. (i.e. for every £100 invested the return will be guaranteed +/- 20 pence.

8.23 There is ever growing pressure the MMFs will generate negative returns. Partly because the markets are oversaturated with cash and partly because there is a lack of demand for cash as a result of uncertainties around how the world economies will continue to deal with COVID-19 Pandemic as well as how the economies will manage post the end of the

transition period. At the time of writing this report, negative rates have already been seen in MMFs, however Treasury Management has agreed with fund managers to waive administration fees for as long as possible in order to maintain a positive return. At such time, the waiving of fees is not possible alternative longer-term investments will be chosen.

Treasury Bills

8.24 These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is relatively low, although there is potential risk to value arising from an adverse movement in interest rates unless they are held to maturity.

8.25 Weekly tenders are held for Treasury Bills so the GMCA could invest funds on a regular basis, based on projected cash flow information. This would provide a spread of maturity dates and reduce the volume of investments maturing at the same time.

8.26 There is a large secondary market for Treasury Bills so it is possible to trade them in earlier than the maturity date if required; and also purchase them in the secondary market. It is anticipated however that in the majority of cases the GMCA will hold to maturity to avoid any potential capital loss from selling before maturity. The GMCA will only sell the Treasury Bills early if it can demonstrate value for money in doing so.

8.27 At the time of writing this report, Treasury Bills were yielding a negative return. Efforts to use Treasury Bills have been put on hold until the securities are once again yielding a higher than market average return.

Certificates of Deposit

8.28 Certificates of Deposit are short dated marketable securities issued by financial institutions, and as such counterparty risk is low. The instruments have flexible maturity dates, so it is possible to trade them in early if necessary, however there is a potential risk to capital if they are traded ahead of maturity and there is an adverse movement in interest rates. Certificates of Deposit are subject to bail-in risk as they are given the same priority as fixed deposits if a bank was to default. The GMCA would only deal with Certificates of Deposit that are issued by banks which meet the credit criteria.

Covered Bonds

8.29 Covered Bonds are debt instruments secured by assets such as mortgage loans. They are issued by banks and other non-financial institutions. The loans remain on the issuing institutions Balance Sheet and investors have a preferential claim in the event of the issuing institution defaulting. All issuing institutions are required to hold sufficient assets to cover the claims of all covered bondholders. The GMCA would only deal with bonds that are issued by banks which meet the credit criteria, or AAA rated institutions, (e.g. insurance companies).

Liquidity

8.30 Giving due consideration to the GMCA 's level of balances over the next year, the need for liquidity, its spending commitments and provisioning for contingencies, it is considered very unlikely that the GMCA will have cash balances to invest other than on a temporary basis. For this reason, no cash will be held in term deposit maturities in excess of 1 year.

Investment Strategy

8.31 In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

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

Investment returns expectations

Bank Rate is forecast to remain constant over the next few years at 0.10% by 2024. Bank Rate forecasts, provided by the GMCA's treasury advisors, for financial year ends (March) are:

2021/22	0.10%
2022/23	0.10%
2023/24	0.10%

8.33 The suggested budgeted investment earnings rates for returns on investments placed for periods during 2021/22 are not forecast to be greater than 0.00%-0.05%. The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over the Global Pandemic COVID-19 as well as post transition period adjustment, combined with a softening global economic picture.

8.34 As noted in the latest GMCA Treasury Management Interim Report 2020/21, negative rates are already being seen in the markets. At such time these negative rates will impact the Authority's short-term investments, alternative longer-term deposits will be necessary in order to protect the overall value for money. As discussed above, investing at a negative return will remain to be the option of last resort.

End of Year Investment Report

8.35 At the end of the financial year, the GMCA will receive a report on its investment activity as part of its Annual Treasury Report.

Policy on the use of External Service Providers

8.36 The GMCA uses Link Asset Services as external treasury management advisors and has access to another provider who is an approved supplier should a second opinion or additional work be required. The GMCA recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon its external service providers.

8.37 The GMCA recognises there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. It will ensure the terms of the Advisor's appointment and the methods by which their value is assessed and properly documented, and subject to regular review.

9. MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID) II PROFESSIONAL CLIENT STATUS

9.1 MIFID II is UK law and originates from European Commission legislation for regulation of European Union (EU) financial markets. The legislation requires firms offering products and services in Financial Markets and also external advisors to classify their clients as either Retail or Professional.

9.2 There are key differences between the Retail and Professional classifications, with the Professional classification assuming the client has a higher level of internal treasury expertise and experience. Financial firms may be unwilling to provide access to certain financial instruments to organisations with Retail status as such organisations have to be afforded more protections. Professional status will afford fewer protections, though eligibility for compensation from the Financial Services Compensation Scheme is not affected.

9.3 The default MIFID II classification is Retail and this applies to Local Authorities. There is a discretionary option where a client can elect to adopt Professional status and this will be granted if the client can demonstrate it meets the criteria required and can pass a qualitative test.

9.4 To continue to use the instruments available to it, the GMCA applied for and was granted MIFID II Professional status by each firm. MIFID II classification does not apply to cash deposits the GMCA places with the Bank of England or in its Call accounts held with banks. Failure to secure Professional status would have severely restricted the GMCA's ability to place funds with a diverse range of counterparties and was also likely to have significantly dampened the investment return possible. Any future new relationships with financial firms will also be approached on the basis of the GMCA evidencing its Professional status.

9.5 MIFID II also requires Professional status organisations to hold a Legal Entity Identifier, (LEI) if they wish to participate in financial instruments that are traded on an Exchange, e.g. these include Certificates of Deposit, Corporate Bonds, Treasury Bills, Gilts, etc. Trading in these instruments is included in this Treasury Management Strategy therefore the GMCA applied for and was granted a LEI in December 2017.

9.6 The risks associated with Professional Status are mainly that the protections given to Retail status clients are not available, moreover there is greater emphasis on internal decision making with limited reliance on advice and guidance provided by the financial firms. These risks are acknowledged, however it is believed that the existing risk framework for treasury management, including the Prudential Code and Treasury Management Code, will enable the GMCA to manage these risks. Without Professional Status the GMCA will be unable to continue trading in financial markets using past arrangements.

10. INVESTMENTS THAT ARE NOT PART OF TREASURY MANAGEMENT ACTIVITY

<u>Growing Places Fund (GPF)</u>

10.1 The Growing Places Fund (GPF) originally secured by the GMCA in 2012/13 totalled £34.5m of capital grant funding which is being used to provide up front capital investment in schemes. The Growing Places Fund has three overriding objectives:

- to generate economic activity in the short term by addressing immediate constraints:
- to allow Local Enterprise Partnerships (LEPs) to prioritise infrastructure needs, empowering them to deliver their economic priorities; and
- to establish sustainable recycled funds so that funding can be reinvested.

10.2 The full £34.5m has now been committed and the GMCA is fully in the recycling phase. There is likely to be opportunities to passport similar property investments using GMCA's own funds (prudential borrowing) to allow freeing up of GM wide Evergreen Funds for further investments.

Regional Growth Fund

10.3 The GMCA secured funds of £65m through two rounds of bidding for UK Central Government funding in 2012/13 and 2013/14. The Regional Growth Fund (RGF) has supported eligible projects and programmes raising private sector investment to create economic growth and lasting employment, with over 6,000 jobs being either created or safeguarded. As with the GPF the aim is to create a perpetual fund by using repaid loans to fund future commitments. The original funds were fully utilised by 2015/16.

Recycled Funds

10.4 Between 2018/19 and 2021/22 it is currently forecast that £55m will be recycled back out to businesses using capital receipts from both GPF and RGF. Given that both investment funds were funded through government grant there are no implications for the revenue budget should any loans default.

Housing Investment Fund

10.5 The Greater Manchester Housing Investment Fund has been designed to accelerate and unlock housing schemes. It will help build the new homes to support the growth ambitions across Greater Manchester.

Greater Manchester Loan Fund

10.6 The Greater Manchester Loan Fund (GMLF) was established in June 2013 in response to market constraints which significantly reduced the availability of debt finance. The GMLF was set up to provide debt finance of between £100k and £500k to small and medium enterprises in the Greater Manchester region, with the objective of generating business growth, creating and safeguarding jobs. A maximum of £10 million has been approved for use by the Fund.

Protos Finance Limited

10.7 In order to create capacity, GMCA is being asked to consider the purchase of a £12.1m loan committed by Evergreen to Protos Finance Limited. Protos Finance Limited is a subsidiary of Peel established to deliver the development of an industrial site in Cheshire for a variety of uses including waste to energy, biomass and environmental technology facilities. This will

free up resources in the Evergreen Fund and allow it to further invest in Greater Manchester.

11. SCHEME OF DELEGATION

11.1 Appendix C describes the responsibilities of member groups and officers in relation to treasury management.

12. ROLE OF THE SECTION 73 OFFICER

12.1 Appendix D notes the definition of the role of the Treasurer in relation to treasury management.

13. MINIMUM REVENUE PROVISION (MRP) STRATEGY

13.1 Appendix A contains the GMCA's policy for spreading capital expenditure charges to revenue through the annual MRP charge.

Appendix A

Minimum Revenue Policy Strategy

Capital expenditure is incurred on assets that will be of long-term benefit to the GMCA. Such expenditure may not be wholly charged to revenue in the year that it is incurred but may be spread over several years to match the time that the asset will benefit the GMCA and the services it provides. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP). It should be noted that the MRP liability is not directly related to the actual repayment of principal and interest on long term loans taken.

The GMCA is required by legislation to make a prudent MRP provision each year. The legislation is supported by guidance issued by the Secretary of State which requires the GMCA to approve an MRP Policy Statement before the start of each financial year and sets out 4 options for calculating prudent provision. These options are:

- **Option 1: Regulatory Method**

Under previous MRP regulations, the charge was set at a uniform rate of 4% of an authority's Capital Financing Requirement (CFR) at the start of the financial year. The CFR is derived from the balance sheet. With the introduction of the current MRP regime the Governments policy aim was that the move should not itself increase an authority's MRP liability. To achieve neutrality an amount, Adjustment A, was calculated at the point the change was made and is used to adjust the CFR each year. MRP under this method is calculated at 4% of the CFR less Adjustment A.

This option may only be used for capital expenditure incurred before 1st April 2008 or capital expenditure incurred after that date which is part of Supported Capital Expenditure (SCE). Currently no new SCE's are being issued.

- **Option 2: Capital Financing Requirement (CFR) Method**

This is a variation on option 1 based on 4% of the authority's CFR at the start of the financial year without the benefit of Adjustment A. Removal of the adjustment is likely to increases the MRP charge for most authorities.

This option may only be used for capital expenditure incurred before 1st April 2008 or capital expenditure incurred after that date which is part of Supported Capital Expenditure (SCE). Currently no new SCE's are being issued.

- **Option 3: Asset Life Method**

This can only be applied to capital expenditure incurred on or after 1st April 2008 and is intended to spread MRP over the estimated useful life of assets. It may be assessed in one of two ways:-

a) Equal Instalment Method
A simple formula generates equal annual instalments over the asset's estimated life. The formula allows for voluntary extra provision to be made in any year.

b) Annuity Method
Annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method

This can only be applied to capital expenditure incurred on or after 1 April 2008 and is based on the useful life of the asset using the standard accounting rules for depreciation. Any impairment charged to the income and expenditure account should also be included. MRP is made annually until the cumulative provision is equal to the expenditure originally financed by borrowing or credit arrangements, even if the asset is disposed of before that date. This method cannot be applied to Investment properties and Assets Held for Sale (AHFS) as they are not depreciated.

However, the guidance does not rule out use of an alternative method if the GMCA decides this is more appropriate. The GMCA may vary the methodologies it uses to make prudent provision during the year and if it does, should explain in its Statement why the change will better allow it to make prudent provision. The GMCA may choose to overpay MRP in any year. If so, the in year and cumulative amount overpaid should be disclosed in its Statement. It is possible to offset a previous year's overpayment against the current year's prudent provision. This should be disclosed in the statement together with any remaining cumulative overpayment.

The GMCA manages a diverse portfolio of assets and has considered the most appropriate option for each. Based on inherited MRP policies, legislation and guidance the GMCA is recommended to approve the following MRP Policy Statement for 2021/22:

The GMCA will assess its MRP charge for 2021/22 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under Section 21(1A) of the Local Government Act 2003.

- MRP in relation to capital expenditure incurred before 1 April 2008 will be based upon 4% of the adjusted Capital Financing Requirement (CFR) in accordance with Option 1: the Regulatory method of the guidance.
- For capital expenditure incurred between 1 April 2008 and 31 March 2018 the following will apply (being the policies adopted by the previous organisations):
    - For capital expenditure incurred on the Metrolink and Transport Delivery Programme schemes and Waste Disposal assets, MRP will be calculated using Option 3b: the Asset life (Annuity) method.
    - For capital expenditure incurred on PCC assets MRP will be calculated using Option 3a: the Asset Life (Equal Instalment) method.
    - For capital expenditure incurred on GM Fire assets MRP will be calculated using Option 4: the Depreciation method.
- For capital expenditure incurred on or after 1 April 2018, MRP will be calculated using option 3b: the Asset life (Annuity) method for all classes of asset. The interest rate applied will be a rate deemed appropriate over the useful life of the asset. Where capital expenditure is incurred to allow a future capital receipt to be generated, no MRP will be applied to any borrowing to be repaid out of the receipt.
- In March 2019, the GMCA received the novation of loans to the private sector developers from Manchester City Council, totalling £112m in relation to the Housing Investment Loans Fund. These had been funded from loans received from MHCLG. Future investment loans will continue to be made, taking the total outstanding to likely maximum of £240m. Government have guaranteed to meet the first £60m of losses of such loans and, as such, no MRP is being applied. In the event that any losses are projected to exceed that level, then the MRP/debt write down position will be reviewed.
- MRP in respect of on balance sheet leases and PFI contracts is regarded as met by the amount that writes down the balance sheet liability.
- MRP will generally commence in the financial year following the one in which the expenditure was incurred. However, for major expenditure on long life assets, the GMCA may postpone the commencement of MRP until the financial year following the one in which the asset becomes operational.

Estimated asset lives will reflect the life assigned to the asset on the asset register unless the GMCA considers a different life is more appropriate. Estimated asset lives will be determined in the year that MRP commences and may not subsequently be revised. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the GMCA. However, the GMCA reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

Appendix B

Treasury Management Policy Statement

1. This organisation defines its treasury management activities as:

   'The management of the organisation'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.'

2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The GMCA will invest its monies prudently, considering security first, liquidity second, and yield last, carefully considering its investment counterparties. It will similarly borrow monies prudently and consistent with the GMCA's service objectives.

Appendix C

Treasury Management Scheme of Delegation

(i) Full Authority

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

(ii) Responsible body – Audit Committee

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

(iii) Body with responsibility for scrutiny – Audit Committee

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

Appendix D

The treasury management role of the Section 73 officer

The S73 (responsible) Officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit; and
- recommending the appointment of external service providers.

Appendix E

Economic Background December 2020 – Link Asset Services

This section has been prepared by the Authority's Treasury Advisors, Link Asset Services, for the Treasury Management Strategy Statement 2021/22.

- **UK.** The key quarterly meeting of the Bank of England Monetary Policy Committee (MPC) kept **Bank Rate** unchanged on 5 November 2020. However, it revised its economic forecasts to take account of a second national lockdown from 5 November 2020 to 2 December 2020 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 2021 when the current programme of £300bn of QE, announced in March 2020 to June 2020, runs out. It did this so that 'announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target'.
- Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:
    - The economy would recover to reach its pre-pandemic level in Q1 2022
    - The Bank also expected there to be excess demand in the economy by Q4 2022.
    - Consumer Price Index (CPI) inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the 'inflation risks were judged to be balanced'.
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 - 12 months. However, rather than saying that it 'stands ready to adjust monetary policy', the MPC this time said that it will take 'whatever additional action was necessary to achieve its remit'. The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- One key addition to **the Bank's forward guidance in August 2020** was a new phrase in the policy statement, namely that 'it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably'. That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. **Inflation** is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short-lived factor and so not a concern.
- However, the minutes did contain several references to **downside risks**. The MPC reiterated that the 'recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside'. It also said 'the risk of a more persistent period of elevated unemployment remained material'. Downside risks could well include severe restrictions remaining in place in some form during the rest of December 2020 and most of January 2021 too. **Upside risks** included

the early roll out of effective vaccines.

- **COVID-19 vaccines.** We had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9 November 2020 was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, this vaccine has demanding cold storage requirements of minus 70c that impairs the speed of application to the general population. It has therefore been particularly welcome that the Oxford University/AstraZeneca vaccine has now also been approved which is much cheaper and only requires fridge temperatures for storage. The Government has 60m doses on order and is aiming to vaccinate at a rate of 2m people per week starting in January, though this rate is currently restricted by a bottleneck on vaccine production; (a new UK production facility is due to be completed in June 2021).

- These announcements, plus expected further announcements that other vaccines could be approved soon, have enormously boosted confidence that **life could largely return to normal during the second half of 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels; this would help to bring the unemployment rate down. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for 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 start to be eased, beginning possibly in Q2 2021 once vulnerable people and front-line workers have 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 Gross Domestic Product (GDP) to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% in 2021 instead of 9%.

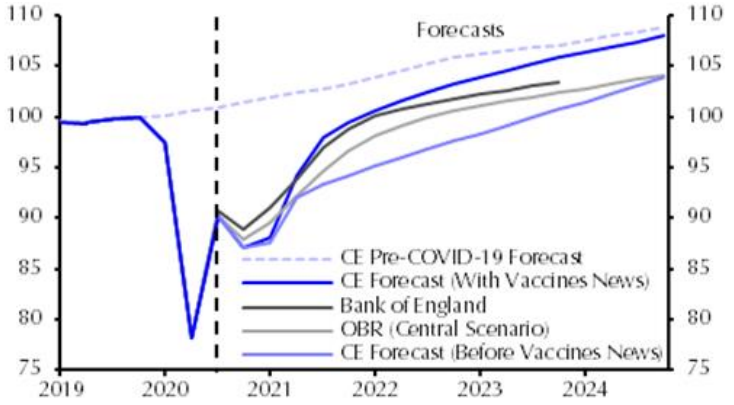
- **Public borrowing** was forecast in November 2020 by the Office for Budget Responsibility (OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so Public Works Loan Board (PWLB) rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. It is likely that the one month national lockdown that started on 5 November 2020, will have caused a further contraction of 8% m/m in November 2020 so the economy may have then been 14% below its pre-crisis level.

- **December 2020 / January 2021**. 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 January 2021 to national lockdowns of various initial lengths in each of the four nations as the National Health Service (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 grim. 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.

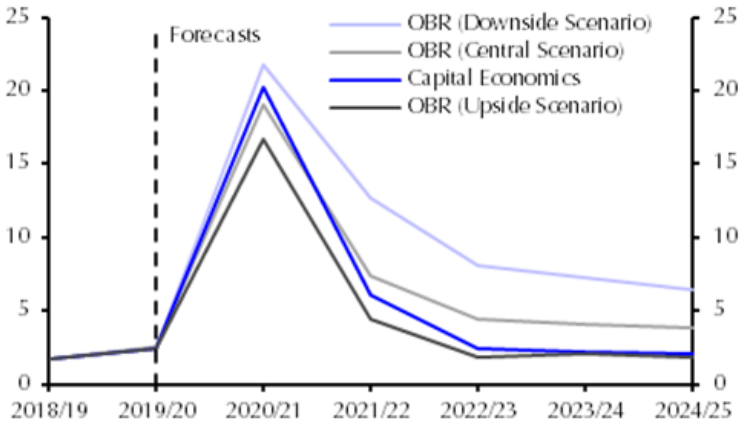
Chart: Level of real GDP (Q4 2019 = 100)



(if unable to print in colour…… the key describing each line in the above graph is in sequential order from top to bottom in parallel with the lines in the graph.

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 and so, (perversely!), depress economic growth and recovery.

Chart: Public Sector Net Borrowing (as a % of GDP)



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

- **Brexit.** While the UK has been gripped by the long running saga of whether or not a deal would be made by 31 December 2020, the final agreement on 24 December 2020, 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.

- **Monetary Policy Committee meeting of 17 December 2020.** All nine Committee members voted to keep interest rates on hold at +0.10% and the 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 2020. 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.' So, while the vaccine is a positive development, in the eyes of the MPC at least, the economy is far from out of the woods. As a result of these continued concerns, the MPC voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for six months from 30 April 2021 until 31 October 2021. (The MPC had assumed that a Brexit deal would be agreed.)

- **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 2021.
  - The furlough scheme was lengthened from the end of March 2021 to the end of April 2021.
  - The Budget on 3 March 2021 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

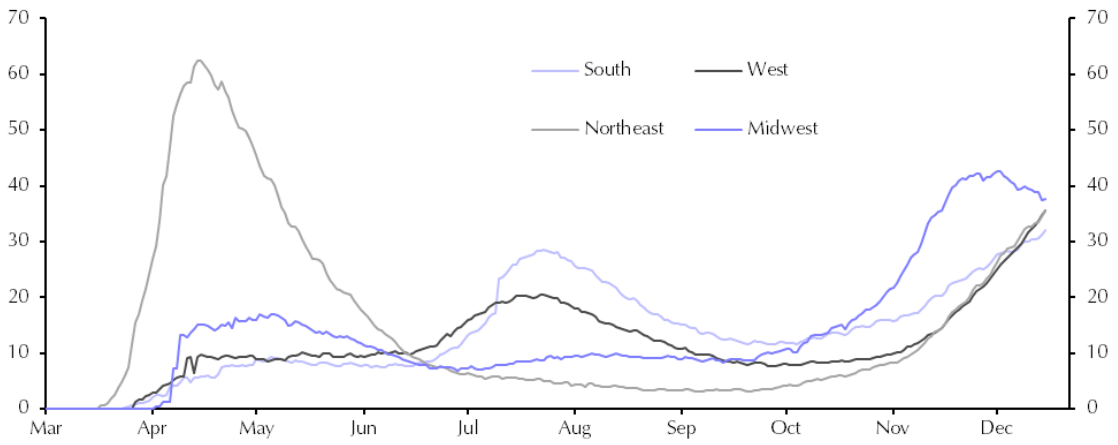
of economic recovery).

- The **Financial Policy Committee** (FPC) report on 6 August 2020 revised down their expected credit losses for the banking sector to 'somewhat less than £80bn'. It stated that in its assessment, 'banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection'. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

- **US.** The result of **the November 2020 elections** meant that while the Democrats gained the presidency and a majority in the House of Representatives, it looks as if the Republicans could retain their slim majority in the Senate provided they keep hold of two key seats in Georgia in elections in early January 2020. If those two seats do swing to the Democrats, they will then control both Houses and President Biden will consequently have a free hand to determine policy and to implement his election manifesto.

- **The economy** had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August 2020, suggests that the US could be in the early stages of a fourth wave. While the first wave in March 2020 and April 2020 was concentrated in the Northeast, and the second wave in the South and West, the third wave in the Midwest looks as if it now abating. However, it also looks as if the virus is rising again in the rest of the country. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

COVID-19 hospitalisations per 100,000 population



- The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November 2020 and retail sales dropping back. The economy is set for further weakness in December 2020 and into the spring. However, a $900bn fiscal stimulus deal passed by Congress in late December 2020 will

limit the downside through measures which included a second round of direct payments to households worth $600 per person and a three-month extension of enhanced unemployment insurance (including a $300 weekly top-up payment for all claimants). GDP growth is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

- After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September 2020 meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *'it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time.'* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary 'trap' like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The Federal Open Market Committee's (FOMC) updated economic and rate projections in mid-September 2020 showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

- The Fed's meeting on **5 November 2020** was unremarkable - but at a politically sensitive time around the elections. At its **16 December 2020** meeting the Fed tweaked the guidance for its monthly asset quantitative easing purchases with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that inflation will only get back to 2.0% in 2023, the vast majority expect the fed funds rate to be still at near-zero until 2024 or later. Furthermore, officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – which will also have an influence on gilt yields in this country.

- **EU.** In early December 2020, the figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3 the economy grew by 12.5% q/q leaving GDP down by 'only' 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Q4 and in Q1 of 2021, as a second wave of the virus has affected many countries: it 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 countries most affected by the first wave.

- With inflation expected to be unlikely to get much above 1% over the next two years, **the European Central Bank (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. The ECB's December 2020 meeting added a further €500bn to the Pandemic Emergency Purchase Programme (PEPP) scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of Targeted Longer-Term Refinancing Operations (TLTRO), (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022. The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before later in quarter 2 of 2021.

- **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

- **Japan.** A third round of fiscal stimulus in early December 2020 took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That's huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal effort should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

- **World growth.** World growth will have been in recession in 2020. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

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

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

Summary

Central banks are, therefore, likely to support growth by maintaining loose monetary policy through keeping rates very low for longer. Governments could also help a quicker recovery by providing more fiscal support for their economies at a time when total debt is affordable due to the very low rates of interest. They will also need to avoid significant increases in taxation or austerity measures that depress demand in their economies.

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

INTEREST RATE FORECASTS

Brexit. The interest rate forecasts provided by Link in paragraph 3.3 were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31 December 2020. 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.

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.

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

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

- **UK 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.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for 'weaker' countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next two or three years. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel's Christian Democratic Union (CDU) party was left in a vulnerable minority position dependent on the fractious support of the Social Democratic Party (SPD) party, as a result of the rise in popularity of the anti-immigration Alternative for Germany (AfD) party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she will remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU, and they had threatened to derail the 7 year EU budget until a compromise was thrashed out in late 2020. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

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

- **UK -** 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 rapid series of increases in Bank Rate to stifle inflation.

Appendix F

Prospects for Interest Rates – view of Link Asset Services as at 9 November 2020

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													
	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
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
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
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
5 yr PWLB	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	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	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	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

Appendix G

Glossary of Terms

Authorised Limit - This Prudential Indicator represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

Bank Rate - The rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Certificate of Deposits - Short dated marketable securities issued by financial institutions, and as such counterparty risk is low.

Counterparty - One of the opposing parties involved in a borrowing or investment transaction.

Covered Bonds - Debt instruments secured by assets such as mortgage loans. These loans remain on the issuer's balance sheet and investors have a preferential claim in the event of the issuing institution defaulting.

Credit Rating - A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

Discount - Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.

Fixed Rate Funding - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

Gilts - The loan instruments by which the Government borrows. Interest rates will reflect the level of demand shown by investors when the Government auctions Gilts.

High/Low Coupon - High/Low interest rate.

LIBID (London Interbank Bid Rate) - This is an average rate, calculated from the rates at which individual major banks in London are willing to borrow from other banks for a particular time period. For example, 6 month LIBID is the average rate at which banks are willing to pay to borrow for 6 months.

LIBOR (London Interbank Offer Rate) - This is an average rate, calculated from the rates which major banks in London estimate they would be charged if they borrowed from other banks for a particular time period. For example, 6 month LIBOR is the average rate which banks believe they will be charged for borrowing for 6 months.

Liquidity - The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

LOBO (Lender Option Borrower Option) - This is a type of loan where, at various periods known as call dates, the lender has the option to alter the interest rate on the loan. Should the lender exercise this option, the borrower has a corresponding option to repay the loan in full without penalty.

Market - The private sector institutions - Banks, Building Societies etc.

Maturity Profile/Structure - An illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Authority vulnerable to current interest rates in that year.

Monetary Policy Committee - The independent body that determines Bank Rate.

Money Market Funds - Investment instruments that invest in a variety of institutions, therefore diversifying the investment risk.

Operational Boundary - This Prudential Indicator is based on the probable external debt during the course of the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

Premium - Where the prevailing current interest rate is lower than the fixed rate of a long-term loan, which is being repaid early, the lender can charge the borrower a premium, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.

Prudential Code - The Local Government Act 2003 requires the Authority to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

PWLB - Public Works Loan Board. Part of the Government's Debt Management Office, which provides loans to public bodies at rates reflecting those at which the Government is able to sell Gilts.

Specified Investments - Sterling investments of not more than one-year maturity. These are considered low risk assets, where the possibility of loss of principal or investment income is very low.

Non-specified investments - Investments not in the above, specified category,

e.g., foreign currency, exceeding one year or outside our minimum credit rating criteria.

Treasury Bills - These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low.

Variable Rate Funding - The rate of interest either continually moves reflecting interest rates of the day, or can be tied to specific dates during the loan period.

Rates may be updated on a monthly, quarterly or annual basis.

Volatility - The degree to which the debt portfolio is affected by current interest rate movements. The more debt maturing within the coming year and needing replacement, and the more debt subject to variable interest rates, the greater the volatility.

Yield Curve - A graph of the relationship of interest rates to the length of the loan.

A normal yield curve will show interest rates relatively low for short-term loans compared to long-term loans. An inverted Yield Curve is the opposite of this.