Capital Strategy and Treasury Management Strategy

Including Minimum Revenue Provision Policy Statement and Annual Investment Strategy

February 2021

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Introduction

1.1 The Capital and Treasury Management Strategies are fundamental to the effective delivery of the Council's priorities and Vision 2025. The provision of the right asset in the right place at the right time will ensure the effective and efficient delivery of a comprehensive range of quality services.

1.2 This strategy document provides 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.

1.3 It sets out an integrated plan for the future management of the Council's assets and its capital programme. It is a key document running alongside the Vision 2025 and the Medium-Term Financial Strategy (MTFS) and will provide the framework to facilitate a seamless interface between business planning and the management of assets and capital resources. This will ensure that the provision of resources and future investment are prioritised and ensures the effective and affordable management of the Council's assets.

1.4 The CIPFA 2017 Prudential Code and Treasury Management Code of Practice, sets out the new requirements in relation to the setting of a Capital Strategy. The new requirement asks local authorities to consider the longer term as well as the short and medium term to:

- Ensure that the capital expenditure plans of the council are affordable, prudent and sustainable.
- Support transparent options appraisal.
- Giving an outline of future commitments so that the affordability of both the long term plan and any new proposals can be properly understood.
- Inform prioritisation and timing of projects to ensure that both financial and operational capacity is available for delivery.
- Provide an overview of risk so that projects and proposals can be viewed in the overall risk context of capital and treasury investments.
- Enable the ongoing capital and revenue implications of capital expenditure to be better understood and planned for in the Financial Resource Plan.

1.5 This Strategy document provides both the Capital Strategy and the Treasury Management Strategy as they are inherently linked through the activities they undertake. The document sets out the Capital Programme to 2030/31 and the funding approach through treasury management activities.

1.6 Capital Strategy

1.7 The key aims of the Capital Strategy are to:

- Provide a clear context within which proposals for capital expenditure are evaluated to ensure all capital investment is targeted to deliver the Council's priorities.
- Clarity about how the Council identifies and prioritises capital requirements and proposals arising from various strategies including the Vision 2025, Service Improvement Plans, and other corporate strategies, and how they will be managed within the limited capital resources available.
- Challenge our current estate, continue with the programme of asset rationalisation, ensuring that assets retained are effective, efficient and economically sustainable to deliver services.
- Identify and consider options available to fund capital expenditure that minimises the ongoing revenue implications of historic capital expenditure and of any new investments.
- Use partnerships, both public and private, more effectively to support our overall strategy.
- Establish effective arrangements for managing capital schemes including assessment of outcomes and achievement of value for money.
- Ensure there is a full understanding of the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite

1.8 It is a requirement that the capital strategy demonstrates that the Local Authority takes both capital and investments decisions in line with service objectives. The capital strategy shows that the key drivers of the Council's Capital plans are captured through various plans across the authority. These include

- Highways Asset Management Plan (HAMP)
- Welsh Housing Quality Standard Plan (WHQS)
- Strategic Asset Management Plan
- Schools Transformation Plan
- Health and Care Strategy
- Service Plans

1.9 Treasury Management

1.10 The Treasury Management Strategy and Annual Investment Strategy report is a requirement of the CIPFA Code of Practice on Treasury Management and a requirement under the Local Government Act 2003. It has regard to the Guidance on Local Government Investments issued by the Welsh Government which requires the Treasury Management Strategy and Annual Investment Strategy to be approved by Full Council.

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.'

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

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

1.13 The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.14 This authority has engaged in only minimal commercial investments and has no (or immaterial) non-treasury investments.

1.15 Treasury Management and Capital Reporting Arrangements

1.16 The Council is currently required to receive and approve at Cabinet, as a minimum, three main treasury/capital reports each year, which incorporate a variety of policies, estimates and actuals.

- Prudential and treasury indicators and treasury and capital 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).
- Capital strategy and capital programme
- The treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- An investment strategy, (the parameters on how investments are to be managed).
- A mid-year treasury management report – This is primarily a progress report and will update members on the capital position, amending prudential indicators if necessary, and whether any policies require revision. In addition, this Council will receive further quarterly update reports.
- Monthly capital reports to Cabinet – Providing an update on the capital spend, reprofiling and virement changes and funding that support delivery of the programme, with a year-end reflection of the actual against plan and reasons for the final month's changes from the forecast.
- 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.
- The above Treasury reports are required to be adequately scrutinised before being recommended to the Cabinet and Council. This role is undertaken by the Audit Committee.

1.17 Treasury Management Strategy

The strategy for 2021/22 covers two main areas:

a) Capital issues

- The capital programme and funding regime and the associated prudential indicators.
- The minimum revenue provision (MRP) policy.

b) Treasury management issues

- The current treasury position.
- Treasury indicators which limit the treasury risk and activities of the Council.
- Prospects for interest rates.
- The borrowing strategy.
- Policy on borrowing in advance of need.
- Debt rescheduling.
- The investment strategy.
- Creditworthiness policy; and
- Policy on use of external service providers.

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

1.19 Training

1.20 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 Authority holds two briefing sessions per year for members and members must ensure that they attend at least one of these. The training needs of treasury management officers are periodically reviewed.

1.21 Financial training in managing the financial aspects of capital projects is available for those that manage projects and takes place regularly throughout the year.

1.22 Treasury Management Consultants

1.23 The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors. They also support on Capital advice. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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

Capital Strategy

2.1 Background

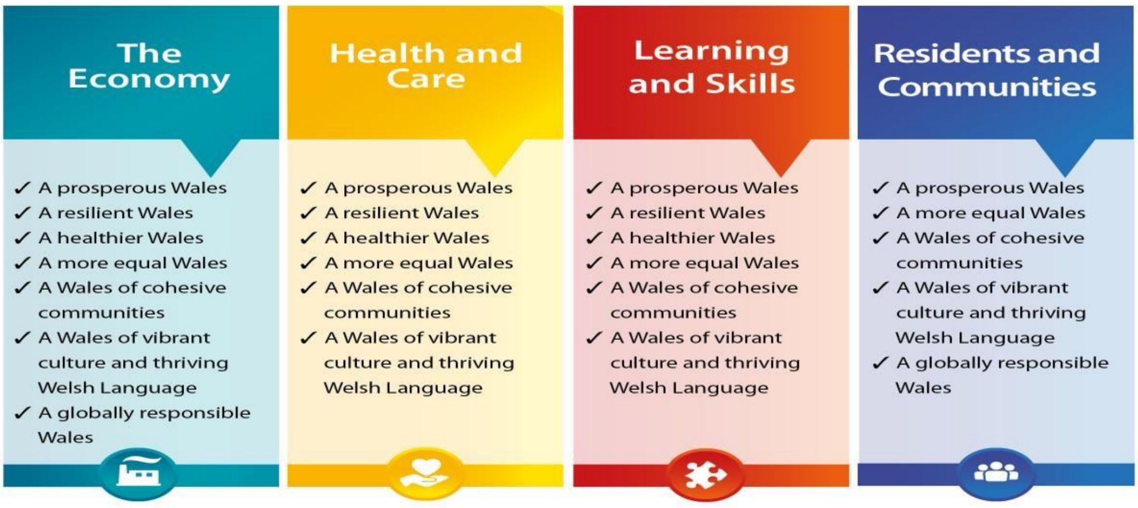
2.2 Part 1, Section 3 of the Local Government Finance Act 2003 requires that the Authority shall determine and keep under review how much it can afford to borrow. The Act is supported by the Prudential Framework for local authority capital investment and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Code). The CIPFA Prudential Code was revised in December 2017. The revised Code introduced a new requirement that all authorities produce a capital strategy, which sets out the long-term context in which capital expenditure and investment decisions are made.

2.3 The Capital Strategy and Treasury Management Strategy (TMS) are closely linked, and both are revised annually. The Capital Strategy defines the Council's spending and the TMS sets out how it will be funded and its impact on the overall financial standing of the Council.

2.4 Aims, Priorities and Principles

2.5 The purpose of this strategy is to set out the objectives, principles and governance framework to ensure that the Authority takes capital expenditure and investment decisions in line with service objectives that underpin the delivery of the Corporate Improvement Plan through Vision 2025. The Council's Vision sets out the key priorities and objectives of the Council for the period to 31 March 2025.

2.6 Vision 2025 sets out the long-term vision for the council under four priority areas (aligned to the Wellbeing of Future Generations Act 2015 objectives).



2.7 Programme Overview

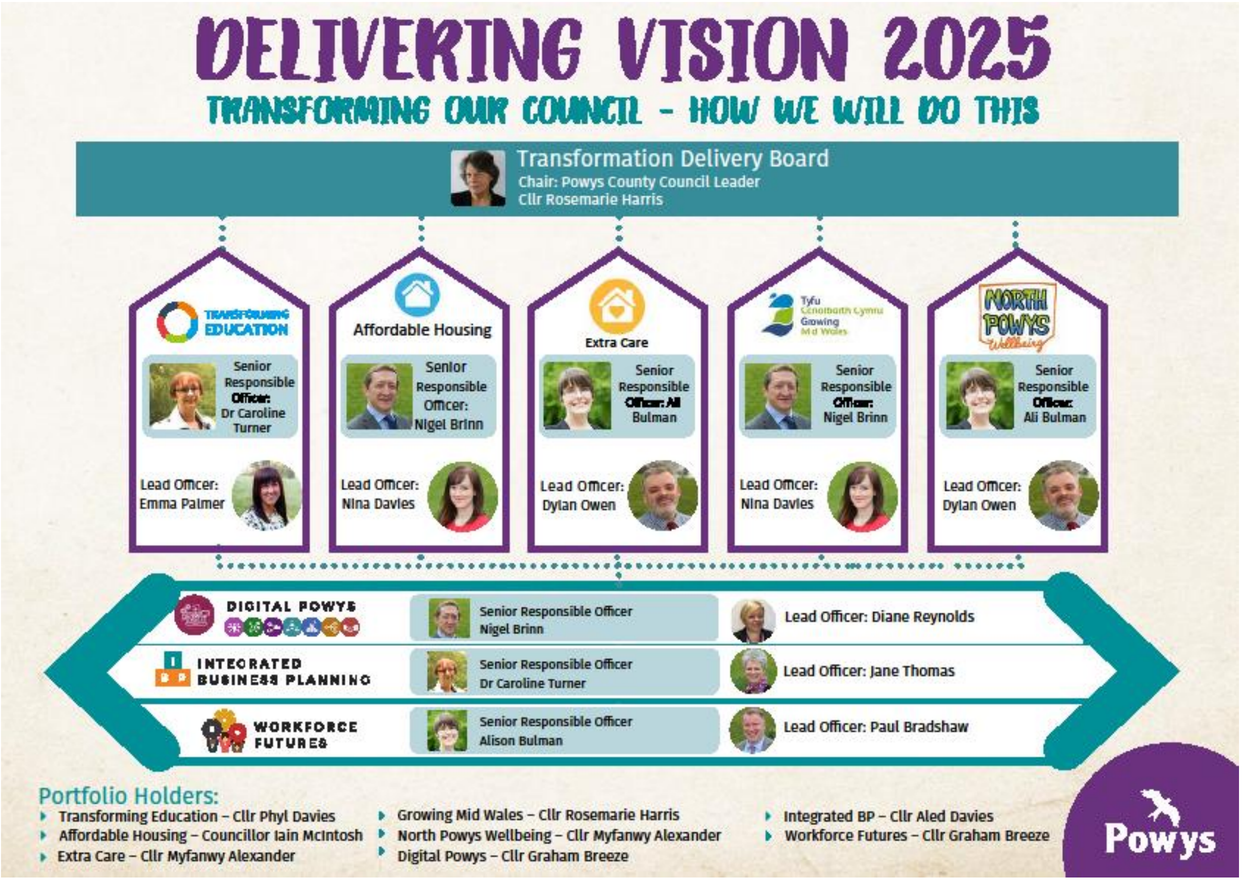
2.8 The Capital Programme is a key enabler to deliver the Councils ambition set out in Vision 2025. Broadly the programme covers three areas of expenditure:

- a core programme of schemes that are regulatory / statutory in nature, and minimise legal challenge or revenue risk, these schemes are related to day to day activities that will ensure the Council meets its statutory requirements.

- a retained asset programme to improve or enhance the life of existing assets, and

- an investment programme in schemes linked to the Council's strategic priorities, such as schemes to generate income and increase the diversification of the Council's property portfolio or reduce the revenue costs of running and maintaining the assets.

2.9 Vision 2025 will be delivered, in part, through its nine Transformation Programmes, as shown in the diagram below. The six Service Transformation programmes all require capital funding to deliver their transformation agenda.



Capital Investment across Services

2.10 The Council has developed its capital strategy which sets out a ten year long-term plan and demonstrates that the capital / investments decisions are taken in line with priorities and gives consideration to both risk/reward and impact; as well as properly taking account of stewardship, value for money, prudence, sustainability and affordability.

2.11 The Council will continue to invest in services that underpin the priorities set out as part of Vision 2025, the key themes have clear service projects:

Residents and the Community - We will support our residents and communities.

- **Housing -** The Council will continue to maintain for all the homes it owns the Welsh Housing Quality Standard (WHQS) with an ongoing capital programme in part funded through Welsh Government Funding and Supported Borrowing. The Housing Revenue Account Thirty Year Business Plan demonstrates an affordable capital strategy alongside delivering the day-to-day landlord service and has key objectives linked to the Local Housing Strategy. The Council has commenced the building of 100 new council dwellings as part of its commitment to complete 250 new homes by 2025. The Council will continue to fund a major programme of Disabled Facilities Grants enabled works and improvements to homes to improve the quality of life for people who need help to live as independently as possible. In addition, Housing Services will continue to support energy efficiency and bringing privately owned empty homes back into use through the SWAS (Safe Warm & Secure), Landlord Loans and the ZILF Co2i loan schemes.

- **Leisure Centres -** Since 2019 the Council has approved a five-year programme which has already enabled significant, essential replacement of plant, fixtures, end-of-life equipment, structural materials, playing surfaces and decoration. The Capital commitment supports the Council's 'landlord' responsibilities as part of the leisure contract but also ensures that the buildings are fit for purpose, compliant, attractive and provide a positive customer experience. Leisure Services in Powys not only support the overall well-being of our 'residents and communities' but contribute to the 'health & care' agendas, providing interventions and prevention programmes to help reduce the burden on health services; 'learning & skills' – as a collaborative partner to the School's Transformation Programme and for individuals to learn and develop though specific opportunities that the service provides or facilitates and the 'economy' by hosting and delivering local, regional and national events and competitions which draws significant numbers of visitors from across the UK to utilise the facilities we have in Powys.

- **Waste Strategy -** Powys County Council faces a stringent WG statutory recycling target of 64% for 2019/20 through to 70% for 2024/25. There is also a non-statutory WG target to reduce landfill to 10% by 2019/20 reducing to 5% by 2024/25. This has required a step change in the way all local authorities approach waste and recycling. The continued capital investment in the Waste and Recycling service will ensure that the Council is able to meet the targets whilst obtaining maximum value from the service. A network of assets under the Council's control allows flexibility to adapt to any changing requirements within the industry and Government policy and legislation. Some of these schemes are linked to efficiency savings and service improvements in future years.

- **Health and Care** – We will lead the way in effective, integrated rural health and care.

- **Social Care** - The capital programme focuses on supporting those who wish to remain in their own home rather than residential care and supports the integrated Health and Care Strategy for Powys. This strategy acknowledges that people in Powys live longer and healthier lives than elsewhere in Wales and that Powys is a place aspiring to help improve the wellbeing of all people. Capital funding mainly focus on accommodation options, including supporting the building and redevelopment of facilities to increase the stock of extra care housing, in collaboration with Powys Teaching Health Board and local Residential Social Landlords.

- **Assistive Technology** - has a key role to play in the modernisation of health and social care. With ever increasing technological advances, it offers a range of possibilities for greater choice, not only of how people can access the support they need, but also where and when they access support. In doing so, assistive technology enables people to take greater control, and to live independently for longer by preventing hospital admissions and premature moves to residential care. Enabling access to better accommodation options is essential in order to support independent living and reduce demand for other types of care.

Learning and Skills – We will strengthen learning and skills.

- **Schools Transformation -** The Council has developed a new ten year Strategy to Transform Education in Powys 2020-30 with the implementation of a major capital investment programme that will ensure that schools in Powys have inspiring, environmentally sustainable buildings that can provide opportunities for wider community activity, including where possible childcare services, early years, ALN, multi-agency support and community and leisure facilities. This will also include developing a reliable, high quality digital infrastructure. The Council is investing £147m over the next ten years in its schools through the current Band A and Band B of the Welsh Government's

21st C Schools Programme. The 21st C Schools Programme has a 65% capital intervention rate for mainstream schools, 75% for special schools and it also offers a new and innovative funding route where the intervention rate is 85% the Mutual Investment Model. The Council will develop its strategies to ensure maximisation of the potential investment opportunities that may be available via WG funding.
However, to deliver the full Schools Transformation Programme significant funding sources above what is currently included in the following Capital Programme will be required.
Alongside this, capital funding through our major repairs programme will be focussed on where the need is greatest, as identified through the Schools Service's Asset Management Plan.

The Economy – We will develop a vibrant economy.

- **Highways and Environment -** The Council has a statutory duty to maintain the adopted highway, maintained at public expense in a safe condition for the passage of the user. A strategic approach has been used to develop the HAMP in identifying and allocating resources for the management, operation, preservation and enhancement of the highway infrastructure to meet the needs of current and future customers. Current gross replacement cost of these assets is estimated at £4.4bn.

- **Property -** The vision is to ensure that through the Corporate Landlord initiative, the Council's assets are appropriately managed to provide safe, efficient, sustainable properties in the right locations to support the delivery of services and the achievement of key priorities. The Strategic Asset Board and the Strategic Asset Management Plan are the mechanisms in place to help deliver these priorities, which will ensure close working and collaboration across all service areas and partner organisations such as NPTC / PTHB. The Property team will be supported in this crucial work with investment provided to procure a new Property Management database which will provide a single point of reference for all aspects of the Council's operational and investment estate. A provisional property disposals programme has been developed over the next 10 years.

- **Regeneration, Property and Development -** The Council need to intervene where the private sector is not able to (for economic reasons) to create or facilitate investment in business units in order to keep and attract business to the County. The Abermule scheme is one such scheme that sees the Authority creating a business park on a former WG site which otherwise would not have been developed in the short to medium term. Capital investment will also form an important part of supporting the regeneration and viability of town centres. An initial annual allocation of £2 million starting in 2022-23 has been included as the Council's contribution towards the Mid Wales Growth Deal. As the plans for the deal develop the funding will be released to the relevant projects on completion of the relevant governance and approval processes.

- **County Farms -** It is essential that the Council manages its agricultural estate prudently, efficiently, and professionally. Effective management of County Farms estate will enable the continued opportunities already enjoyed by current tenant farmers and maintain an income stream. The financial demands of the Estate need to be evaluated against the competing demands across the council whilst noting the estate produces an annual surplus in its trading account. The opportunity for capital receipts will continue to arise as reviews are undertaken at each tenant departure from the Estate. An Invest to Save initiative is being developed which will see investments made to the Farm Estate which should create opportunities for capital receipts and also reduced revenue expenditure, for example barn conversions and subsequent sales.

- **Information Technology (IT) -** The service engages with change programmes so that investment and resource meets identified priorities. In respect of infrastructure, IT will seek to invest in up to date cloud based technologies including 'Azure' cloud technologies, improved telephony and mobile systems, WEB and share-point and improved wireless as well as further enabling our staff to work in an agile manner. In terms of applications, IT is looking to rationalise the number of systems through investment in replacement of legacy corporate systems and through modernisation of systems and applications to improve integration and provide an improved customer journey.

Investment in Commercial Activity

2.12 The commercial activity undertaken in the council relates to holding properties that are utilised by tenants, these include livestock markets, caravan park, restaurant and office space.

2.13 Around £240,000 in rental income is received each year.

2.14 The council has a trading company that is likely to become the vehicle that supports greater commercial activity, but any investment must evidence the following criteria:

- Support the strategic community objectives of the council.
- Have a balanced investment approach.
- Improve covenant strength.
- Drive income generation and maintain yield.

2.15 To ensure that the council is able to benefit from the lower borrowing rates offered by the Public Works Loans Board (PWLB) the council will currently not consider investing in additional commercial property.

Funding the Capital Strategy

2.16 The cost of funding the capital programme is closely monitored due to the impact on the budget and the ongoing funding constraints of the MTFS. The Council aims to minimise the cost of borrowing on the Financial Resource Model (FRM) and other sources need to be maximized such as grant funding. Funding capital from borrowing incurs extra costs from interest on the loan and the minimum revenue provision, repayment of the principal. Capital projects are prioritised where they can evidence a reduction in the cost of revenue, such as digital technologies or generate income such as building council dwellings.

2.17 The Housing Revenue Account (HRA) supports its own capital expenditure and provision for this is included in the HRA Business Plan. The surplus on the HRA account (excess of rental income over expenditure) is used to fund capital expenditure. This does not impact on the Council Fund. Although the HRA operates separately from the Council Fund, the Council does not borrow separately for Council Fund and HRA expenditure, all borrowing is combined, and the costs apportioned to the two funds based on the level of expenditure funded from borrowing for the two funds. The apportionment method is kept under review to ensure that it remains the most equitable method.

The Capital programme detailed at Appendix A, sets out how the programme is funded, the sources are explained below:

- **General Capital Grant –** This is a sum of money which is provided by the Welsh Government as part of the annual settlement. The Council is free to use the capital grant on any capital project it wishes.
- **Supported Borrowing** – The Council will borrow from establishments including the Public Works Loans Board (PWLB) to fund the expenditure. The revenue costs arising from the borrowing (Interest Costs and Minimum Revenue Provision) are funded by the Welsh Government through the annual revenue settlement, hence the term “Supported Borrowing”.
- **Unsupported Borrowing** – Again, the Council borrows the funding but is required to finance the revenue costs from its own resources. Projects funded by means of unsupported borrowing tend to be projects which deliver revenue savings, and these savings contribute to meet the additional revenue costs arising from the borrowing.
- **Specific Capital Grants –** The Council will be awarded capital grants which partly or fully fund the cost of a project. Capital grants usually come with restrictions surrounding the expenditure which can be funded and by when the expenditure must be incurred.

- **Revenue Contribution –** Services can contribute from their revenue budgets to fund projects. These contributions tend to be as a match funding to a project which is mainly funded from a specific capital grant.
- **Capital Receipts** – The funds generated from the sale of assets can be used to contribute to the funding of the capital programme. These are usually generated from the sale of surplus assets (normally land or buildings). The Councils' Capital Receipts Policy is set out in Appendix B.
- **Reserves** – Funding held in reserve, e.g., unapplied capital receipts, can be used to support the capital programme. Specific reserves can also be built up and set aside for this purpose.

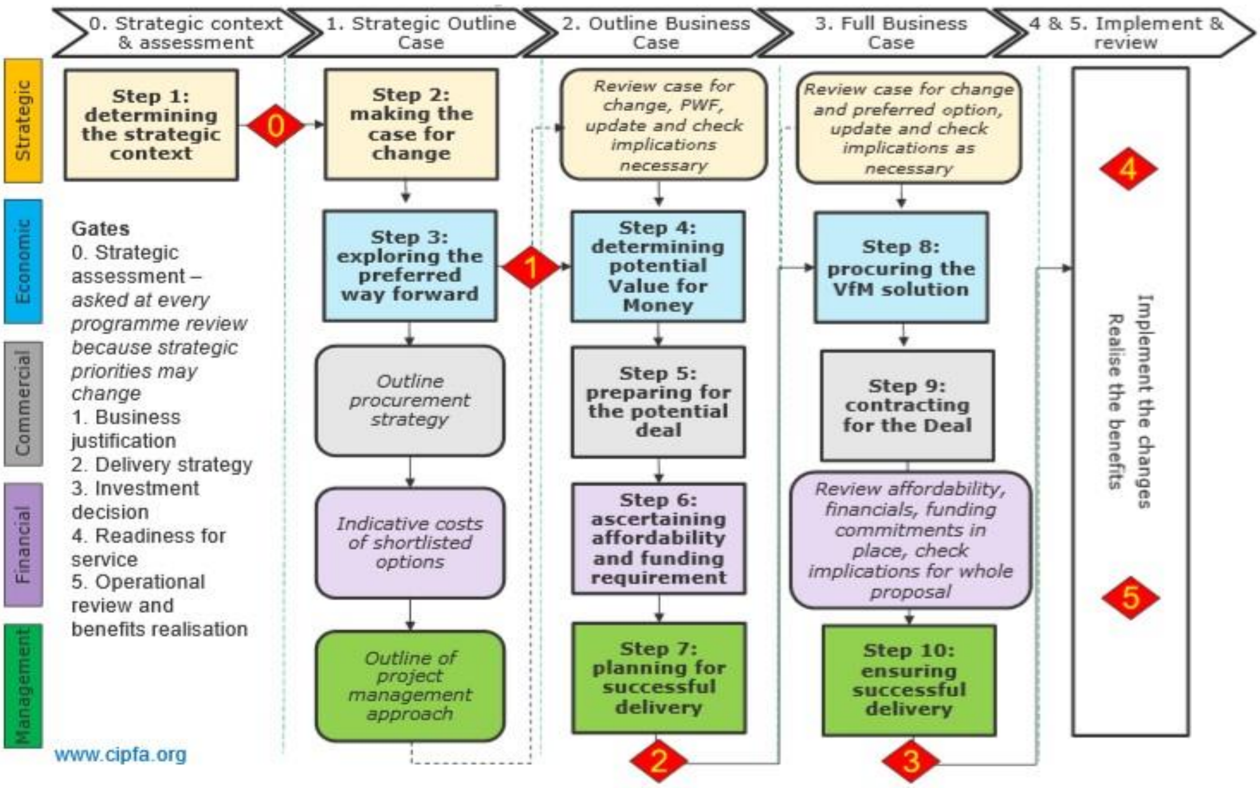
Capitalisation Direction and Transformation

2.18 In December 2017 the Secretary of State announced the continuation of the capital receipt flexibility programme for a further three years up to financial year 2021/22. This is significant as it gives authorities the continued freedom to use capital receipts from the sale of their own assets (excluding Right to Buy receipts) to help fund the revenue costs of transformational work and the release of savings.

2.19 Realisable capital receipts will be used to fund the cost of the transformation projects for the next two years. The capital receipts policy is provided at Appendix B and forms a key element of the MTFS.

Governance and Approval Approach

2.20 Welsh Government have adopted the Better Business Case approach to building, reviewing, and agreeing business cases. These principles have been adopted in the Councils' Capital Governance Framework. This approach introduces a more formal regime to follow and ensures consistency and a robust approach to developing each project. The diagram below sets out the gates and steps necessary to develop a capital from proposal through to a successful delivery. There has been an urgency in adopting this new regime to evidence stronger governance based on robust business cases from services.



2.21 The governance of this Capital Strategy follows the same process as the Revenue Budget Setting Process and is presented to the Cabinet as part of the MTFS which is then recommended to full Council for approval.

2.22 The three stages of the Governance Framework are:

- **Stage 1 - The Strategic Outline Case (SOC)**, these must be completed for the new bids and have necessary approval.

- **Stage 2 -** Once the SOC is approved, managers will need to complete more detailed work, particularly on the economics of the case, finances (detailed costings) and submit the **Outline Business Case (OBC)** for approval through the Strategic Asset Board, who provide challenge and then make recommendation to EMT / Cabinet to approve.

- **Stage 3 -** The **Final Business Case (FBC)** is the final gateway, and the project would move to the procurement stage. At this point the tender price for the project would be known and the risks quantified. Only when the FBC becomes a live project does the capital budget get allocated, which will improve our budget forecasting and profiling. Any revenue contributions including MRP costs would need to be built into the budget at stage 3.

  - For business cases between £75k and £1m a less formal business justification case will be adopted, being simpler and quicker to develop and proceed to project.
  - Each year there is a small bids programme funded by an allocation in the Capital
  - Programme for capital projects under £75k, these are dealt with through the Strategic Asset Board.
  - The Council is moving away from an annual capital cycle and using the new framework will have an ongoing process of projects in development through to approval through Cabinet and Council as needed with the necessary prudential indicators updated and presented.

Capital Programme 2021-2031

2.23 The overall capital programme for the Council in 2021/22 is £101.53 million, which includes £27.90 million for the HRA. Appendix A provides a full list of all the schemes.

2.24 The General Fund includes schemes which have previously been approved or are in progress and expected to continue into future years. These total £73.63 million. The programme includes a list of schemes that have had their Strategic Outline Case approved and have been progressed to Outline Business case. Providing the economic and financial justification stacks up these schemes are likely to develop to Final Business Case stage and become live projects, totalling £9.00 million. Split over two years, £6.34 million in 2021/22 and £2.66 million in 2022/23. An initial annual allocation of £2.00 million starting in 2022-23 has been included as the Council's contribution towards the Mid Wales Growth Deal. As the plans for the deal develop, the funding will be released to the relevant projects on completion of the relevant governance and approval processes.

2.25 The need to maintain the highways infrastructure through the HAMP has been highlighted at strategic level as a critical area of the council's long-term strategy. The programme now includes £5.00 million per annum for the HAMP and an additional £1.00 million per annum for street lighting column upgrades until 2029/30.

2.26 Overall additional borrowing requirements are estimated at £52.65 million in 2021/22, but it is likely that this figure will be less based on previous years slippage on spend and grants received in year.

2.27 The capital programme remains within budget for 2021/22 however additional revenue funding will need to be identified to fund investment in future years. The impact of the capital programme is set out through the following prudential indicators:

Capital Prudential Indicators

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

Capital Expenditure

2.29 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

£'m	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
Non-HRA	66.72	73.63	87.46	45.88	18.91	16.92	15.96	21.06	18.37	15.83
HRA	28.99	27.90	29.80	31.63	28.19	21.07	20.36	20.69	23.41	15.65
Total	95.71	101.53	117.26	77.51	47.10	38.00	36.32	41.75	41.78	31.48

2.30 **Other long-term liabilities** - The financing need set out in the table above excludes other long-term liabilities, such as leasing arrangements that already include borrowing instruments.

2.31 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a requirement to fund through borrowing, this figure is shown as the net financing need.

£'m	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
Capital receipts	3.79	3.85	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Capital grants	32.47	35.10	58.36	32.46	15.49	13.57	13.25	13.23	12.76	10.17
Revenue/Reserves	13.37	9.93	8.09	8.44	12.38	10.89	9.83	12.13	9.44	9.89
Net financing need for the year	46.07	52.65	50.57	36.37	18.98	13.29	12.99	16.14	19.33	11.16

The Council's Borrowing Need (the Capital Financing Requirement)

2.32 This is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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

2.34 The greater the CFR the larger the impact will be on the revenue budget, therefore in the long-term there will be a need to keep capital expenditure funded by borrowing at a level below the MRP budget in order to maintain the revenue budget at a sustainable level.

2.35 The Council is asked to approve the CFR projections below:

£'m	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
CFR – non HRA	317.77	352.95	383.30	398.71	399.32	399.38	399.48	402.33	405.05	404.70
CFR – HRA	105.00	115.62	126.14	136.19	142.96	144.29	145.14	146.32	150.63	149.60
Total CFR	422.77	468.58	509.45	534.90	542.28	543.66	544.62	548.65	555.68	554.30
Movement in CFR	42.60	45.81	40.87	25.45	7.38	1.38	0.96	4.02	7.03	-1.38
Movement in CFR Represented by:										
Net financing need for the year (above)	46.07	52.65	50.57	36.37	18.98	13.29	12.99	16.14	19.33	11.16
Less MRP/VRP and other financing movements	3.47	6.84	9.70	10.92	11.60	11.90	12.03	12.12	12.30	12.54
Movement in CFR	42.60	45.81	40.87	25.45	7.38	1.38	0.96	4.02	7.03	-1.38

Minimum Revenue Provision Policy Statement

2.36 MRP is an annual charge that Councils are required to pay for their debt liability in respect of capital expenditure funded by borrowing, for both the general fund and the Housing Revenue Account debt. This capital expenditure is set out as part of the CFR calculation and updated regularly to reflect borrowing need changes and the resultant costs; it is important to ensure that the debt is repaid over a period commensurate with that over which the capital expenditure provides benefit.

2.37 The debt repayment is a revenue charge, the minimum revenue provision (MRP), although additional voluntary payments are allowed if required voluntary revenue provision (VRP).

2.38 Welsh Government regulations have been issued which require the Council to approve the **MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision set out.

2.39 Recommendation - The Council is recommended to approve the following MRP Statement for the 2021/22 financial year:

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

- To continue to calculate the MRP on a 2% on a straight-line basis for borrowing Council Fund debt.

➢ From 1 April 2008 for all unsupported borrowing (including PFI and finance leases), the MRP policy is:

- To charge MRP over the asset life on an annuity basis.

➢ Estimated life periods will be determined under delegated powers. Whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the components of expenditure and will only be divided up in cases where there are two or more major components with substantially different economic lives.

These options provide for a reduction in the borrowing need over approximately the asset's life.

➢ There is a requirement on the HRA to make a minimum revenue provision of 2% of the reducing balance. The HRA MRP for prudential debt IS calculated using the asset life method.

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

➢ In addition, the guidance allows for MRP to be deferred for assets under construction and this part of the guidance is adopted because the asset is not used by the authority until it is operational and therefore the MRP will match the life of the asset.

2.40 **MRP Overpayments** - A change introduced by the revised Welsh Government MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31st March 2020 the total VRP utilised was £12.9m, with the expected total overpayments being £19.5m.

Risk Management

2.41 All large capital projects are managed under the Council's Project Management Methodology, which incorporates risk identification and risk management. The Council also has a Risk Management Policy which is applied to all its projects and activities.

2.42 For all capital projects, project managers update financial forecasts on a monthly basis identifying any areas subject to risk of overspend, underspend or slippage.

2.43 There is also a degree of funding risk in the Capital Programme, reliant as it is on future capital receipts, and the ability to be able to afford borrowing if necessary. These risks need to be managed and monitored on a regular basis, and action taken where necessary.

2.44 Risk appetite in this context is the level of risk that the Council is prepared to accept to be exposed to at any point in time in relation to its activities. It involves knowing what risks the Council wishes to avoid, what risks it is willing to accept and what risks it is willing and able to manage (including by transferring them to a third party, e.g., through insurance).

2.45 The risks are regularly monitored and managed both financially and operationally in accordance with council processes.

2.46 The Council is willing to accept the risks set out in this Strategy for projects that have Council approval provided that the project management ensures the appropriate mitigations are put in place to bring the project within acceptable risks margins.

2.47 The key financial risks inherent in the Council's Capital Programme include:

Description of Risk	**Potential Impact**
The longer a project takes to come to fruition, the greater the risk that the financial cost of the project will have increased, both due to the additional staff time spent on the project and the inflationary impact on the costs involved in bringing the asset into operation.	May result in financial pressures on the other projects/ programmes and service delivery.
There is a degree of correlation between the length of time a project spends in the feasibility and development stage and an increased risk of project failure or abandonment. Should a project fail for any reason, the regulations require all capital costs to be returned to revenue, which may create significant pressures, depending on the level of spend at that point.	May result in additional revenue pressures on delivery/services.
Project expenditure is higher than forecast estimates	May result in increased financial pressures/ limitations on future investment options.
Once a project has been delivered successfully the cash expended is then bound in the asset. In the case of the assets that are for service delivery and do not generate a rental income stream, the money invested in the asset is only recovered if and when the asset is sold at a future date. This carries inherent financial risks in that the asset may have decreased in value, depending on market conditions, or may not have increased in value sufficiently to mitigate the effects of inflation.	May result in increased financial pressures/limitations on future investment options.

Treasury Management Strategy

3.1 Background

3.2 The Council is required to operate a balanced budget which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned with cash being available when it is needed.

3.3 The second main function of the treasury management service is the funding of the Council's capital plans. These plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash involves arranging short or long-term loans or using longer-term cash flow surpluses.

3.4 The contribution the treasury management function makes to the authority is critical as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects.

3.5 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities as they usually arise from capital expenditure and are separate from the day-to-day treasury management activities. The IRFS 16 Leases accounting standard will from April 2022 require leases in, with the exception of low value and short term leases to be included on the balance sheet. These arrangements are not included in this report.

Borrowing Strategy

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

3.7 Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Head of Financial Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in borrowing rates, (e.g., due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.
- if it was felt that there was a significant risk of a much sharper rise in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

3.9 Policy on Borrowing in Advance of Need

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

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

3.12 Debt rescheduling

3.13 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates. If rescheduling was done, it will be reported to the Cabinet at the earliest meeting following its action.

3.14 New Financial Institutions as a source of Borrowing and / or types of Borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years)
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

3.15 Approved Sources of Long and Short term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	●

Capital Prudential and Treasury Indicators

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

Ratio of financing costs to net revenue stream

3.17 This indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue budget or HRA rental income (net revenue stream). The estimates of financing costs include current commitments and the proposals in this budget report. The future net revenue streams are estimated based on worst case scenarios.

£'m	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
Financing Costs	10.02	13.59	16.55	17.61	17.71	17.54	16.67	17.13	17.45	17.51
Net Revenue Stream	269.60	280.66	281.26	282.17	283.38	284.90	286.74	288.91	291.39	294.18
Council Fund	3.72%	4.84%	5.88%	6.24%	6.25%	6.16%	5.81%	5.93%	5.99%	5.95%
Financing Costs	5.27	5.75	6.35	6.98	7.59	8.02	7.79	7.96	8.07	8.39
Net Revenue Stream	25.65	25.88	26.99	28.24	29.61	30.98	32.28	33.46	34.64	35.85
HRA	20.54%	22.22%	23.52%	24.72%	25.64%	25.89%	24.14%	23.80%	23.30%	23.41%

Maturity structure of borrowing

3.18 These gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing and are required for upper and lower limits.

3.19 The Council is asked to approve the following treasury indicators and limits:

Maturity structure of borrowing 2020/21		
	Lower	**Upper**
Under 12 months	0%	40%
12 months to 2 years	0%	40%
2 years to 5 years	0%	40%
5 years to 10 years	0%	40%
10 years to 20 years	0%	40%
20 years to 30 years	0%	40%
30 years to 40 years	0%	40%
40 years to 50 years	0%	40%

3.20 Affordability prudential indicators

3.21 Prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following borrowing indicators:

3.22 Borrowing Indicators

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

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

Change in External Debt

£'m	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
Council Fund - External Debt										
Debt at 1st April	253.70	262.70	312.95	343.30	358.71	359.32	359.38	359.48	362.33	365.05
Expected change in Debt	9.00	50.25	30.35	15.41	0.60	0.06	0.11	2.84	2.73	-0.36
Estimated Gross Debt at 31st March	262.70	312.95	343.30	358.71	359.32	359.38	359.48	362.33	365.05	364.70
CFR	317.77	352.95	383.30	398.71	399.32	399.38	399.48	402.33	405.05	404.70
Under / (Over) Borrowing	55.06	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00	40.00

HRA - External Debt										
Debt at 1st April	94.01	105.00	115.62	126.14	136.19	142.96	144.29	145.14	146.32	150.63
Expected change in Debt	10.99	10.62	10.52	10.04	6.78	1.32	0.85	1.18	4.31	-1.03
Estimated Gross Debt at 31st March	105.00	115.62	126.14	136.19	142.96	144.29	145.14	146.32	150.63	149.60
CFR	105.00	115.62	126.14	136.19	142.96	144.29	145.14	146.32	150.63	149.60

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

3.26 The Head of Financial Services reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the next few years. This view takes into account current commitments, existing plans, and the proposals in this budget report. The projected increase in the CFR over the medium and longer term must be reviewed annually to ensure that the capital investment plans remain affordable, prudent and sustainable.

3.27 Treasury Indicators: limits to borrowing activity

Operational Boundary

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

3.29 The council has a long term liability of £19.50 million for a Section 106 obligation. This is not factored into any repayment plans at present, and borrowing is likely to be needed for this at some point in the future.

£'m	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
Operational Boundary	478.00	520.00	546.00	553.00	555.00	556.00	560.00	567.00	565.00	563.00

Authorised Limit

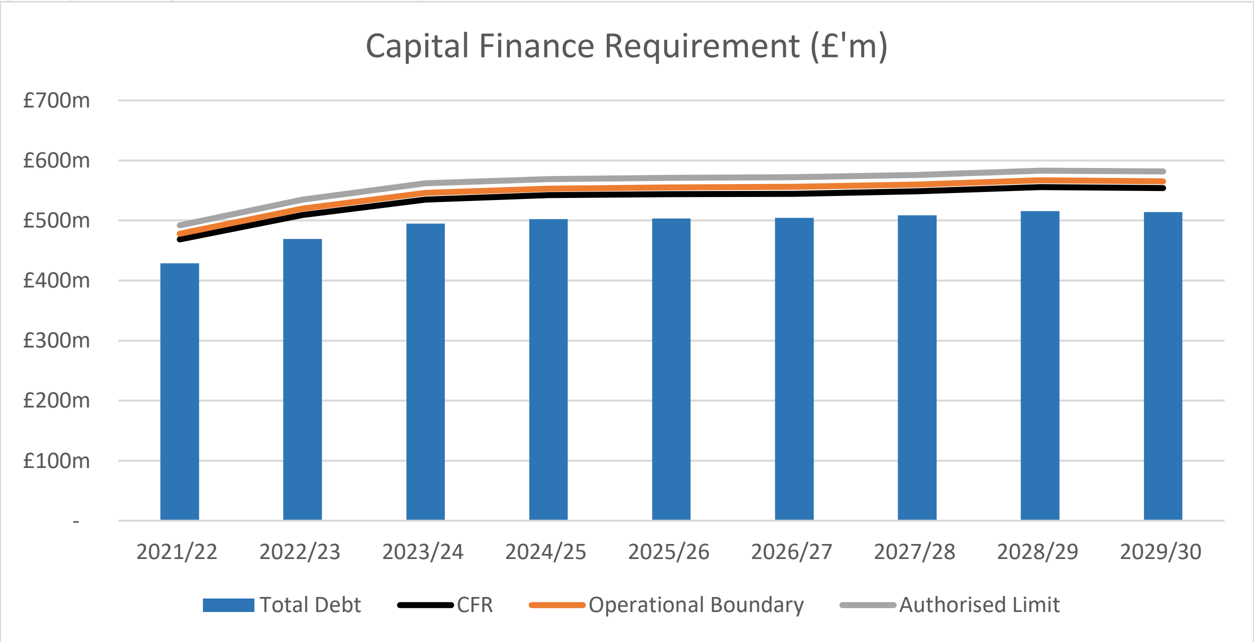
3.30 This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could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

3.31 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

3.32 The Council is asked to approve the following authorised limit.

£'m	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31
Authorised Limit	492.00	535.00	562.00	569.00	571.00	572.00	576.00	583.00	582.00	581.00

3.33 The chart below shows the relationship between the Total Debt, the Capital Financing Requirement (CFR), the Operational Boundary and Authorised Limit.



Annual Investment Policy

3.34 **Management of risk** - The Welsh Government and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This strategy deals solely with financial investments, (as managed by the treasury management team). Nonfinancial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.

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

- Welsh Government's Guidance on Local Government Investments 2019 ("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
- The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

3.35 The above guidance from the Welsh Government and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

- 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.
- Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
- Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- This authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are 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 except deposits with local authorities which can be for any period.
- Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e., an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
- Lending limits (amounts and maturity), for each counterparty will be set in conjunction with Link's matrices.
- This authority will set a limit for the amount of its investments which are invested for longer than 365 days.
- Investments will only be placed with counterparties from countries with a specified minimum sovereign rating.
- All investments will be denominated in sterling.

3.36 As a result of the change in accounting standards for 2020/21 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. The Welsh Government has passed a statutory override to allow Welsh local authorities time to adjust their portfolio of all pooled investments by delaying implementation of IFRS 9 for five years until 31st March 2023.

3.37 The council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance.

3.38 Creditworthiness policy

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

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

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

Yellow	5 years *
Dark pink	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
Light pink	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised or semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	not to be used

Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.

Please note: "fund" ratings are different to individual counterparty ratings, coming under either specific "MMF" or "Bond Fund" rating criteria.

3.41 The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

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

3.43 Credit ratings will be monitored daily through use of the Link Asset Services' creditworthiness service. If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap spreads against the iTraxx European Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

3.45 UK banks

3.46 Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks.

3.47 However, during Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on actual levels of credit losses. (Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets.

3.48 This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the UK 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%.

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

3.50 Although bank CDS prices (these are market indicators of credit risk) spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. Nevertheless, prices are still elevated compared to end-February 2020. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

3.51 Country limits

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

3.53 The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in paragraph 3.83. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

3.54 Investment strategy

3.55 **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.

3.56 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.

3.57 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.

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

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

2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Later years	2.00%

3.60 The overall balance of risks to economic growth in the UK is probably now skewed to the upside but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal the UK agrees as part of Brexit.

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

3.62 Negative investment rates

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

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

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

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

Investment treasury indicator and limit

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

3.68 The Council is asked to approve the following treasury indicator and limit:

Upper limit for principal sums invested for longer than 365 days			
£m	**2020/21**	**2021/22**	**2022/23**
Principal sums invested for longer than 365 days	£10m	£10m	£10m
Current investments as at 10.01.21 in excess of 1 year maturing in each year	Nil	Nil	Nil

3.69 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access accounts, money market funds and short-dated deposits.

3.70 **Investment performance / risk benchmarking –** The council will use an investment benchmark to assess the investment performance of its investment portfolio of 3 month LIBID uncompounded. The Council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors in determining suitable replacement investment benchmark(s) ahead of this cessation and will report back to members accordingly.

3.71 Interest Rate Forecasts - Brexit. The interest rate forecasts provided by Link were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU. 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.

3.72 The balance of risks to the UK

3.73 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.

3.74 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.

3.75 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 CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she 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.

3.76 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.

3.77 Treasury Management Practice – Credit and Counterparty Risk Management

3.78 Specified Investments - All such investments will be sterling denominated with maturities up to maximum of 1 year (except for deposits with local authorities which can be for any period), meeting the minimum 'high' quality criteria where applicable. (If a deposit is made for say 2 years, it starts as being a non-specified investment and remains as a non-specified investment even when it's time to maturity falls under 12 months). The criteria, time limits and monetary limits applying to institutions or investment vehicles are.

Institution	Maximum Investment per Group/Institution	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	£30m	Up to 364 days	As per Link's matrices
Foreign Banks	£5m	Up to 364 days	As per Link's matrices
Other Local Authorities	£25m	Up to 5 years	N/A

3.79 **Non specified Investments** - These are any investments which do not meet the specified investment criteria. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made, it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Institution	***Maximum Investment per Group/Institution***	***Maximum Length***	**Credit Rating/Other Assessment of Risk**
UK Banks	£10m (£5m limit with any one institution)	Up to 2 years	As per Link's matrices
Foreign Banks	£2m	Up to 2 years	As per Link's matrices
Money Market Funds (max. of 5)	£10m	N/A	All are AAA rated
Other Local Authorities	£10m	Up to 5 years	N/A
Note: Limits for Specified and Non-Specified are combined limits. The maximum limit will also apply to a banking group as a whole.			

3.80 In addition to treasury management investment activity, local authorities can utilise their powers to borrow in order to invest in other financial assets. Such activity includes loans supporting service outcomes, investment in or loans to subsidiaries, and investment property portfolios primarily for a financial return. Whilst these impact on treasury management activity, they are managed outside of this Treasury Management Strategy and approved separately as part of the Council's Capital expenditure plans arising from its Capital Strategy. Regulator concerns in relation to the extent of this activity have resulted in recent updates to CIPFA professional Codes of Practice including the Treasury Management Code. Whilst no national monetary, financial or other controls or limits are in place currently, regulations have been updated to ensure the risks and implications of such activities are clearly governed and understood over a long term period.

3.81 Approved Countries for Investments

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

3.83 Based on lowest available rating

- **AAA**

Australia	Denmark
Germany	Luxembourg
Netherlands	Norway
Singapore	Sweden
Switzerland	

- **AA+**

Canada	U.S.A.
Finland	

- **AA**

Abu Dhabi (UAE)	France

- **AA-**

Belgium	Hong Kong
Qatar	U.K.

3.84 **Prospect for Interest rates** - The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates, their latest update is provided at Appendix D.

3.85 Investment and Borrowing Rates

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

3.87 On 25th November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows.

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

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

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

Treasury Management Scheme of Delegation

3.90 The governance of the key decisions are set out below:

- **Full Council**
  - approval of annual strategy
- **Audit Committee**
  - reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- **Cabinet**
  - receiving and reviewing reports on treasury management policies, practices and activities
  - approval of amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
  - budget consideration and approval
  - approval of the division of responsibilities
  - receiving and reviewing regular monitoring reports and acting on recommendations
  - approving the selection of external service providers.

The Treasury Management Role of the Section 151 Officer

3.91 The role of the section 151 officer is set out below:

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

3.92 The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role:

- preparation of a capital strategy to include capital expenditure, capital financing, and treasury management, with a long term timeframe (say 20+ years – to be determined in accordance with local priorities).
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money.
- ensuring that due diligence has been carried out on all investments and is in accordance with the risk appetite of the authority.

Appendix A - Capital Programme 2021/31

	2020-21 £'m	2021-22 £'m	2022-23 £'m	2023-24 £'m	2024-25 £'m	2025-26 £'m	2026-27 £'m	2027-28 £'m	2028-29 £'m	2029-30 £'m	2030-31 £'m	Total £'m
Education												
Ysgol Bro Hyddgen	0.575	11.184	22.917	12.432								**47.107**
Welshpool C in W School	5.336											**5.336**
Ysgol Gymraeg y Trallwng	0.130	8.756	0.125									**9.011**
Ysgol Brynllywarch	0.400	5.433	2.814	0.163								**8.809**
Ysgol Cedewain	0.372	4.187	14.119	3.811								**22.490**
Other 21st Century School Schemes	3.003	3.299	22.095	7.196								**35.593**
Schools Major Improvements	3.592	2.090	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	**14.683**
Schools Other	1.053											**1.053**
Child Care Grant	3.254											**3.254**
	17.715	**34.949**	**63.069**	**24.602**	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**	**147.334**
Highways, Transport and Recycling												
Integrated Transport	0.356											**0.356**
Highways Lighting	1.262	1.250	1.250	1.200	1.000	1.000	1.000	1.000	1.000	1.000		**10.962**
Major Remedial Earthworks	0.150											**0.150**
Structural Drainage Improvements	0.210											**0.210**
Highways Strengthening	1.576											**1.576**
Structural Repairs Town Centre Footway												**0.000**
Advance Preparations												**0.000**
Structures Strengthening	0.100	0.550	0.550	0.600	0.500	0.100	0.200	3.000	3.000			**8.600**
Structural Maintenance - Roads	1.500	6.500	6.500	6.500	5.000	5.000	5.000	5.000	5.000	5.000		**51.000**
Surface Dressing												**0.000**
Residential Estates												**0.000**
Road Safety & Small Schemes	0.020											**0.020**
Local Road Safety												**0.000**
Salt Barns	0.113	0.050	0.750									**0.913**
Safe Route In Communities	0.050											**0.050**
Newtown De-Trunking Works	1.100											**1.100**
Countryside & Outdoor Recreation	0.439	0.618	0.020	0.015	0.015	0.015	0.015	0.015	0.015	0.015	0.015	**1.197**
Recycling	4.520	0.623										**5.143**
Local Transport Fund	0.700											**0.700**
Vehicle Replacement	7.571	2.680	1.021	1.215	5.202	3.710	2.651	4.949	2.254	2.714	2.714	**36.681**
Community Transport Enhancement	0.600											**0.600**
Major Strategic Schemes	2.321	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	**17.321**
Flood Alleviation Schemes	1.130											**1.130**
Active Travel Fund	1.608											**1.608**
	25.326	**13.771**	**11.591**	**11.030**	**13.217**	**11.325**	**10.366**	**15.464**	**12.769**	**10.229**	**4.229**	**139.317**

	2020-21 £'m	2021-22 £'m	2022-23 £'m	2023-24 £'m	2024-25 £'m	2025-26 £'m	2026-27 £'m	2027-28 £'m	2028-29 £'m	2029-30 £'m	2030-31 £'m	Total £'m
Property, Planning and Public Protection												
Regulatory Services	0.348											**0.348**
Closed Landfill Sites												**0.000**
County Farms	0.334	0.100	0.100	0.100								**0.634**
Business Parks	0.772	1.200										**1.972**
Office Accommodation	1.339	0.225										**1.564**
Depots												**0.000**
	2.793	**1.525**	**0.100**	**0.100**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**4.518**
Housing & Community Development												
Newtown Library Redevelopment		0.030										**0.030**
Library Self Service Terminals	0.009	0.050										**0.059**
Presteigne Library Works	0.035											**0.035**
Sports and Leisure Centres	2.054	1.457	0.364	0.302								**4.176**
Y Gaer	0.123											**0.123**
Radnorshire Museum Works	0.015											**0.015**
Powysland Co-Location	0.003											**0.003**
Captains Walk Gardens	0.031											**0.031**
Digital Labels at Y Gaer	0.028											**0.028**
Abritras Housing Software	0.002											**0.002**
Machynlleth Gypsy & Traveller Site	1.286											**1.286**
Safe, Warm & Secure	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	**2.200**
Co2I	0.048	0.048	0.048	0.048	0.048	0.048	0.048	0.048	0.048	0.048	0.048	**0.528**
Disabled Adaptation	1.300	1.300	1.300	1.300	1.300	1.300	1.300	1.300	1.300	1.300	1.300	**14.300**
Enable Public Sector Housing	0.087											**0.087**
Landlord Loans	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	0.200	**2.200**
ICF Extra Care - Welshpool		1.067										**1.067**
ICF Extra Care - Ystradgynlais		1.067										**1.067**
Loans to Registered Social Landlords		5.000	5.000	5.000								**15.000**
	5.422	**10.419**	**7.112**	**7.050**	**1.748**	**1.748**	**1.748**	**1.748**	**1.748**	**1.748**	**1.748**	**42.238**

	2020-21 £'m	2021-22 £'m	2022-23 £'m	2023-24 £'m	2024-25 £'m	2025-26 £'m	2026-27 £'m	2027-28 £'m	2028-29 £'m	2029-30 £'m	2030-31 £'m	Total £'m
Regeneration												
Community Halls	0.061											**0.061**
Newtown Green Infrastructure	0.500											**0.500**
Targeted Regeneration Investment Programme	0.700											**0.700**
Trip - Town Centre Property Investment	1.445											**1.445**
Other Economic Development	0.665											**0.665**
Autopalace R&D Centre	0.685											**0.685**
C.E.S.F.	0.001											**0.001**
Llandrindod Tesco Section 106	0.013											**0.013**
Riverside Enterprise Park	0.835											**0.835**
	4.904	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**4.904**
Information Services												
Hwb In-School Infrastructure	0.117											**0.117**
Hwb In Schools	1.050											**1.050**
Schools IT Equipment	0.066											**0.066**
IT Refresh Strategy	0.122	0.330	0.230	0.390	0.350	0.350	0.350	0.350	0.350	0.350	0.350	**3.522**
IT Infrastructure	0.177											**0.177**
Switches / Wi-Fi	0.010											**0.010**
Enterprise Monitoring	0.100											**0.100**
Other IT	0.042											**0.042**
Finance System	0.069											**0.069**
Share Point		0.085										**0.085**
IT System Rationalisation	0.213	0.200										**0.413**
IT Cyber Security Improvement	0.100	0.100	0.100	0.100	0.100							**0.500**
Cloud Services	0.050	0.415										**0.465**
Unified Communications	0.350											**0.350**
	2.465	**1.130**	**0.330**	**0.490**	**0.450**	**0.350**	**0.350**	**0.350**	**0.350**	**0.350**	**0.350**	**6.965**
Childrens' Services												
Redevelopment Golwg y Bannau/Camlas	0.069											**0.069**
Ynyswen Childrens Residential	0.018											**0.018**
Priory C In W Primary School		0.800										**0.800**
Open Door Former Oldford Primary School		0.292										**0.292**
Play Opportunities Play Pack	0.020											**0.020**
Play Opportunities Partners	0.100											**0.100**
	0.207	**1.092**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**1.300**

	2020-21 £'m	2021-22 £'m	2022-23 £'m	2023-24 £'m	2024-25 £'m	2025-26 £'m	2026-27 £'m	2027-28 £'m	2028-29 £'m	2029-30 £'m	2030-31 £'m	Total £'m
Adult Services, Commissioning												
Care Homes	0.590		0.100	0.110								**0.800**
Arlais/Lant Avenue	0.159											**0.159**
Dom Care System	0.014											**0.014**
SMAF IT Hardware Equipment	0.027											**0.027**
Telecare	0.071											**0.071**
Mobile Working and Transformation	0.100											**0.100**
Powys Smart Technology	0.045											**0.045**
Innovative Use of Robotics	0.200	0.200										**0.400**
Community Equipment	0.106	0.100										**0.206**
Castell Y Dail, Newtown	0.098											**0.098**
	1.412	**0.300**	**0.100**	**0.110**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**1.921**
Finance												
Small Capital Bids		0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	0.500	**5.000**
Mid Wales Growth Deal (TBC)			2.000	2.000	2.000	2.000	2.000	2.000	2.000	2.000	2.000	**18.000**
Pipeline Projects	3.426	6.340	2.658									**12.424**
Unallocated	0.183										4.669	**4.669**
Transformation	2.838	3.600										**6.438**
	6.448	**10.440**	**5.158**	**2.500**	**2.500**	**2.500**	**2.500**	**2.500**	**2.500**	**2.500**	**7.169**	**46.715**
Total	**66.691**	**73.626**	**87.460**	**45.882**	**18.915**	**16.923**	**15.964**	**21.062**	**18.367**	**15.827**	**14.496**	**395.212**
Financed by												
Supported Borrowing	9.366	6.992	4.586	4.586	4.586	4.586	4.586	4.586	4.586	4.586	4.586	57.633
Prudential Borrowing	23.546	32.489	32.527	18.423	3.931	3.431	3.531	6.331	6.331	3.331	2.000	135.871
Welsh Government Grant	17.386	22.574	44.245	16.421								100.626
General Capital Grant	4.605	4.598	4.598	4.598	4.598	4.598	4.598	4.598	4.598	4.598	4.598	50.585
Other Grants	1.452	0.022										1.474
Capital Receipts	3.795	3.848	0.248	0.248	0.248	0.248	0.248	0.248	0.248	0.248	0.248	9.875
Revenue/Reserves	6.542	3.103	1.256	1.605	5.552	4.060	3.001	5.299	2.604	3.064	3.064	39.149
	66.691	**73.626**	**87.460**	**45.882**	**18.915**	**16.923**	**15.964**	**21.062**	**18.367**	**15.827**	**14.496**	395.212

	2020-21 £'m	2021-22 £'m	2022-23 £'m	2023-24 £'m	2024-25 £'m	2025-26 £'m	2026-27 £'m	2027-28 £'m	2028-29 £'m	2029-30 £'m	2030-31 £'m	Total £'m
Housing Revenue Account												
Welsh Housing Quality Standard	9.925	9.223	8.352	5.690	4.260	4.150	4.895	5.300	9.350	9.785	9.985	**80.914**
Fit For Life	2.237	2.450	2.250	1.850	1.450	0.250	0.250	0.250	0.250	0.250	0.250	**11.737**
Love Where You Live	0.830	1.105	1.244	1.044	0.744	0.344	0.280	0.280	0.280	0.080	0.080	**6.311**
Green Powys	0.310	0.325	0.350	0.350	0.500	0.475	0.400	0.400	0.400	0.150	0.150	**3.810**
Compliance One Hundred	0.390	0.700	0.450	0.550	0.650	0.750	0.350	0.350	0.350			**4.540**
Estate Improvements	0.020	0.020	0.036	0.036	0.036	0.036	0.020	0.020	0.020	0.020	0.020	**0.284**
Community Alarms		0.600										**0.600**
New Builds / Repurchase	15.279	13.480	17.122	22.112	20.548	15.068	14.161	14.086	12.761	5.365	1.600	**151.581**
	28.991	**27.903**	**29.804**	**31.632**	**28.188**	**21.073**	**20.356**	**20.686**	**23.411**	**15.650**	**12.085**	**259.778**
Financed by												
Prudential Borrowing	13.134	13.169	13.458	13.363	10.466	5.269	4.869	5.225	8.414	3.242	3.286	**93.896**
Welsh Government Grant	9.026	7.903	9.514	11.438	10.891	8.973	8.655	8.629	8.165	5.577	4.259	**93.030**
Revenue/Reserves	6.831	6.831	6.831	6.831	6.831	6.831	6.831	6.831	6.831	6.831	4.540	**72.852**
	28.991	**27.903**	**29.804**	**31.632**	**28.188**	**21.073**	**20.356**	**20.686**	**23.411**	**15.650**	**12.085**	**259.778**

Appendix B - Capital Receipt Policy

Introduction

This policy is introduced to provide guidance to Senior Managers on the rules governing the application of Capital Receipts in Powys County Council. This guidance has been drafted in line with the two codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). These publications are:

- The Prudential Code for Capital Finance in Local Authorities
- The Code of Practice on Local Authority Accounting

The two publications referred to above contain guidance on capital receipts and local authority accounting that complements guidance issued by the Welsh Government.

In England and Wales, capital receipts are defined by Section 9(1) of the Local Government Act 2003 to include all instances where property, plant or equipment is disposed of for cash (subject to a £10,000 de minimis). All references to Capital Receipts in this policy therefore refers to this definition.

Application

This guidance should be read alongside the relevant direction issued by Welsh Ministers.

This guidance applies with effect from 1 April 2018 and for each subsequent financial year to which the use of capital receipts applies.

The direction makes it clear that local authorities cannot borrow to finance the revenue costs of service reform. Local authorities can only use capital receipts from the disposal of property plant and equipment assets received in the years in which this flexibility is offered. Officers must therefore not use stock of capital receipts to finance the revenue costs of qualifying projects.

Costs of Disposal

The statutory arrangements for capital receipts in England and Wales permit costs of disposals to be financed from the receipts generated, although there is a cap of 4% of the Capital Receipt for costs incurred in relation to non-housing disposals.

Qualifying Expenditure

The accounting process for disposals is complicated by the fact that proceeds from the sale of property, plant and equipment are generally subject to statutory restrictions over their use. Income that meets the definition of capital receipts is reserved for new capital investment or for the reduction of an authority's indebtedness. This definition has however been extended by a Capitalisation directive (April 2018) on the Flexible Use of Capital Receipt by the Welsh Cabinet

Secretary for Local Government and Public Services, in the exercise of his powers under section 16(2)(b) and 20 of the Local Government Act 2003), that the local authorities in Wales treat as capital expenditure, any expenditure which:

a) Is incurred by the Authorities that is designed to generate ongoing revenue savings in the delivery of services and/or transform service delivery in a way that reduces cost or demand for services in future years for any of the public sector delivery partners; and

b) Is properly incurred by the authorities for the financial years that begin on 1st April 2016, 1st April 2017, 1st April 2018, 1st April 2019, 1st April 2020 and 1st April 2021.

While this directive extends the scope of expenditure that qualify for the use of Capital Receipts, it also restricts the period during which the flexibility can be applied. Therefore, any decision to apply Capital Receipt, must meet the conditions of both the qualifying period and the qualifying expenditure.

The qualifying period during which flexibility can be applied is the financial years that begin from 1st April 2016 and end on 31st March 2022. This means that any Capital Expenditure received prior to 1st April 2016 or received after 31st March 2022 cannot be applied under the exemptions of the Capitalisation Directive. Capital Receipts received during the directive period can also not be applied with the same flexibility once the directive term has expired.

Qualifying expenditure is expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery in a way that reduces costs or demand for services in future years for the Authority or any of the delivery partners. This includes investment which supports economic growth projects which are also designed to reduce revenue costs or pressures over the longer term. Within this definition, it is for individual local authorities to decide whether or not a project qualifies for the flexibility.

The set up and implementation costs of any new processes or arrangements can be classified as qualifying expenditure. The ongoing revenue costs of the new processes or arrangements cannot be classified as qualifying expenditure.

Examples of qualifying expenditure

There are a wide range of projects that could generate qualifying expenditure and the list below is neither prescriptive nor exhaustive. Examples of projects include:

- Preparatory work necessary to support local authority mergers as part of the programme to reform local government in Wales.
- Sharing back-office and administrative services with one or more other council or public sector body.
- Investment in service reform feasibility work, e.g., setting up pilot schemes.
- Collaboration between local authorities and central government to free up land for economic use
- Funding the cost of service reconfiguration, restructuring or rationalisation (staff or non-staff), where this leads to ongoing efficiency savings or service transformation.
- Sharing Chief Executives, management teams or staffing structures.
- Driving a digital approach to the delivery of more efficient public services and how the public interacts with constituent authorities where possible.
- Aggregating procurement on common goods and services where possible, either as part of local arrangements or using the National Procurement Service, Crown Commercial Services or other central purchasing bodies which operate in accordance with the Wales Procurement Policy Statement.
- Improving systems and processes to tackle fraud and corruption in line with the Local Government Fraud and Corruption Strategy – this could include an element of staff training.
- Setting up alternative delivery models to deliver services more efficiently and bring in revenue (for example, through selling services to others); and
- Integrating public facing services across two or more public sector bodies (for example children's social care, trading standards) to generate savings or to transform service delivery.
- Investment which supports economic growth projects which are also designed to reduce revenue costs or pressures over the longer term, across one or more local authorities and/or other public sector bodies.

Use of Capital Receipts

The current policy for the use of Capital Receipts is contained in the Corporate Asset Policy.

- Capital Receipts will normally be credited to the Central Fund and will be used to progress the
- Council's principal objectives defined in the Corporate Improvement Plan. However, up to 4% of the capital receipt may be reclaimed by Property as permitted and approved costs of sale.
- Capital receipts from the sale of Farm or Agricultural land under the County Farm Estate and property vested in the HRA will be subject to the following apportionment:

This policy proposes the use of Capital Receipts to continue to be based on the following:

Type	Service Area	Corporate
Agricultural	0%	100%
HRA Dwellings and Land	100%	
Home finder Receipts	100%	
Vehicles	100%	

Appendix C – Economic Background - 11th January 2021

UK The key quarterly meeting of the Bank of England Monetary Policy Committee kept Bank Rate unchanged on 5th November 2020. However, it revised its economic forecasts to take account of a second national lockdown from 5th November 2020 to 2nd 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 when the current programme of £300bn of QE, announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".

Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:

- The economy would recover to reach its pre-pandemic level in Q1 2022
- The Bank also expects there to be excess demand in the economy by Q4 2022.
- CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the 'inflation risks were judged to be balanced'.

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

One key addition to **the Bank's forward guidance in August** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (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 and most of January 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 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, 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).

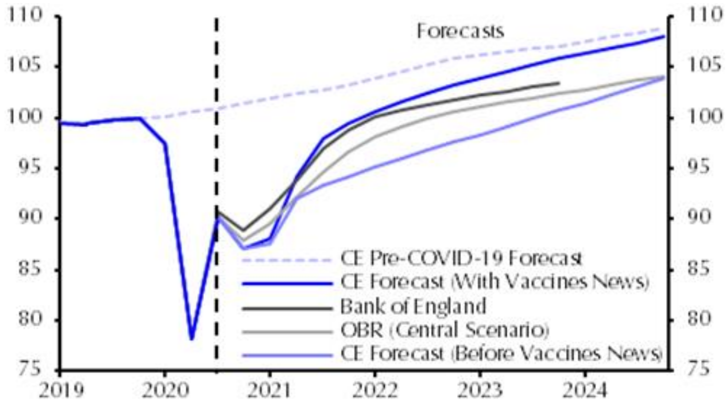
These announcements, plus expected further announcements that other vaccines could be approved soon, have enormously boosted confidence that **life could largely return to normal during the second half of 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning 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, 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 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 by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp 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 5th November, will have caused a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.

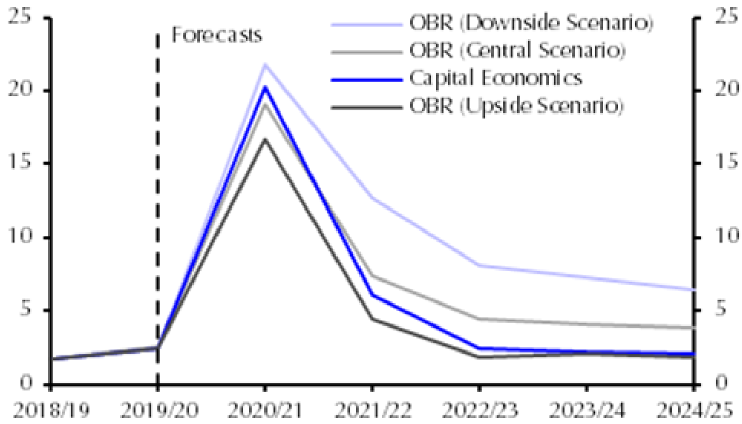
December 2020 / January 2021. Since then, there has been rapid back-tracking on easing restrictions due to the spread of a new mutation of the virus, and severe restrictions were imposed across all four nations. These restrictions were changed on 5.1.21 to national lockdowns of various initial lengths in each of the four nations as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under these new restrictions for some months; this means that the near-term outlook for the economy is 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)



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)



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

Brexit. While the UK has been gripped by the long running saga of whether or not a deal would be made by 31.12.20, the final agreement on 24.12.20, followed by ratification by Parliament and all 27 EU countries in the following week, has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

Monetary Policy Committee meeting of 17 December. All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy that it had highlighted in November. But this was caveated by it saying, "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." 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 30.4.21 until 31.10.21. (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.
- The furlough scheme was lengthened from the end of March to the end of April.

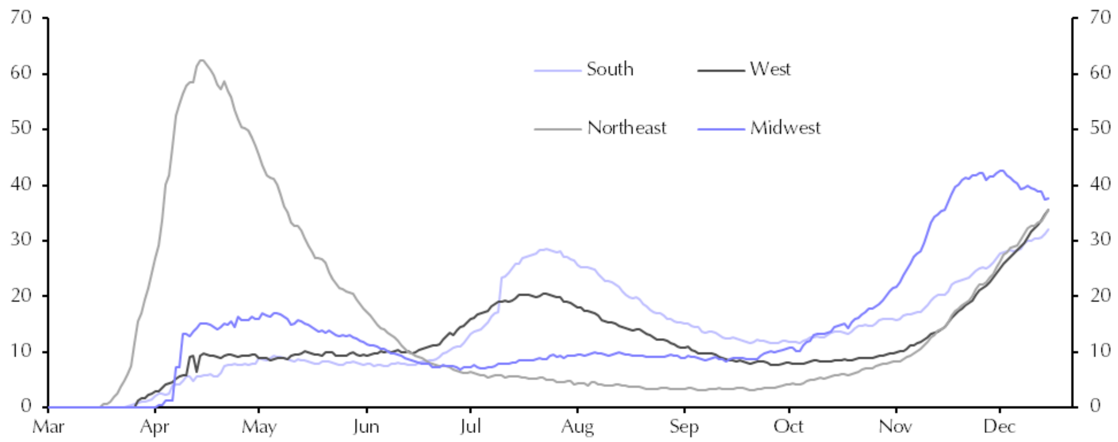
- The Budget on 3.3.21 will lay out the “next phase of the plan to tackle the virus and protect jobs”. This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

The **Financial Policy Committee** (FPC) report on 6.8.20 revised down their expected credit losses for the banking sector to “somewhat less than £80bn”. It stated that in its assessment, “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.

US. The result of **the November elections** 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. 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, suggests that the US could be in the early stages of a fourth wave. While the first wave in March and April 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 and retail sales dropping back. The economy is set for further weakness in December and into the spring. However, a $900bn fiscal stimulus deal passed by Congress in late December 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 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 FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

The Fed's meeting on **5 November** was unremarkable - but at a politically sensitive time around the elections. At its **16 December** 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, 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 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 meeting added a further €500bn to the 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 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 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.

Appendix D – Interest Rate Forecasts – 11th January 2021

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. These are forecasts for certainty rates, gilt yields plus 80bps:

Link Group Interest Rate View	9.11.20												
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	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

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 16th December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed, as this has now occurred, these forecasts do not need to be revised.

Gilt yields / PWLB rates

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

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during

March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

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