London Borough of Hammersmith & Fulham

Report to: Cabinet

Date: 01/02/2021

Subject: Treasury Management Strategy Statement 2021/22

Report of: Councillor Max Schmid - Cabinet Member for Finance and Commercial Services

Responsible Director: Phil Triggs - Director of Treasury and Pensions

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Summary

This report sets out the Council's proposed Treasury Management Strategy Statement and Annual Investment Strategy for 2021/22 and seeks authority for the Director of Finance to deliver the treasury management activities as set out in the report.

The report is also designed to demonstrate compliance with the Local Government Act 2003, other regulations and statutory guidance for ensuring that the Council's borrowing and investment plans are prudent, affordable and sustainable, and comply with statutory requirements.

Recommendations

1. That approval be given to the future borrowing and investment strategies as outlined in this report.

2. That the Director of Finance, in consultation with the Cabinet Member for Finance and Commercial Services, be delegated authority to manage the Council's cash flow, borrowing and investments in 2021/22 in line with this report.

3. In relation to the Council's overall borrowing for the financial year, to approve the Prudential Indicators as set out in this report and the revised Annual Investment Strategy set out in Appendix E.

Wards Affected: All

H&F Priorities

Our Priorities	Summary of how this report aligns to the H&F Priorities
• Building shared prosperity	Achieve best value for money in investment and borrowing decisions.
• Being ruthlessly financially efficient	Effective management of the Council's cashflow resources.

Financial Impact

This report is wholly of a financial nature.

Legal Implications

The Local Government Act 2003 and the regulations made under that Act require the Council to:

- set out an annual statement of its treasury management strategy for borrowing, having regard to the Prudential Code and setting out the Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

- prepare an Annual Investment Strategy, setting out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Treasury Management Strategy Statement and Annual Investment Strategy must both have regard to guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) and must be approved by the Full Council.

All other legal implications are contained within the body of the report.

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Background Papers Used in Preparing This Report (all Published)

- Treasury Management Strategy Statement 2020/21 (approved by Council February 2020)
- Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended
- MHCLG guidance on minimum revenue provision (4th Edition, 2018)
- MHCLG guidance on local government investments (3rd Edition, 2018)
- CIPFA Prudential Code for Capital Finance in Local Authorities (2018 Edition)
- CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2018 Edition)

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1. BACKGROUND

1.1 The Council is required to set a balanced budget, which means that resources available during the year is budgeted to meet expenditure. Part of the treasury management operation is to ensure that:

- The Council's capital programme and corporate investment plans are adequately funded;
- Cash flow is adequately planned, with cash being available when needed to discharge the Council's legal obligations and to deliver Council services;
- Surplus monies are invested wisely, in counterparties or financial instruments commensurate with the Council's low risk appetite, providing security of capital and adequate liquidity before considering investment yield.

1.2 Treasury Management Strategies provide a guide to the borrowing needs of the Council, essentially longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. The management of longer-term cash may involve arranging long or short-term loans, using cash flow surpluses, or restructuring any debts previously transacted to meet Council risk or cost objectives.

1.3 The Council has formally adopted CIPFA's Code of Practice on Treasury Management (the Code). The Code of Practice and Cross Sectoral Guidance Notes issued in 2018 require that each local authority has a Treasury Management Policy Statement that is approved by the Full Council, and this is set out in Appendix A.

1.4 The Council also follows other key requirements of the Code as set out in Appendix B. Prospects for interest rate changes and investment returns have been considered in developing and updating the Council's Treasury Management Strategies. The Bank of England published its latest Monetary Policy report in November 2020. CPI inflation forecasts were revised to 0.6% in 2020, 2.1% in 2021 and 2.0% in 2022.

1.5 In March 2020, the Bank of England responded to the COVID-19 outbreak by cutting rates from 0.50% to 0.25%, then further reduced to 0.10%. Recently, a unanimous decision was made on 5 November 2020 to keep rates at 0.10%. The Council's treasury management advisors, Link Asset Services, are currently forecasting the rate to remain unchanged for the next three years.

1.6 The importance of external economic factors is also a key driver in external parties setting rates and also the availability of instruments in which to invest and borrow. Appendix D sets out the present views of our treasury consultant, Link Asset Services.

1.7 Sections 4 to 6 of this report comprise the Council's Treasury Management Strategy Statement which covers three main areas as summarised below:

1. Borrowing

- Overall borrowing strategy
- Limits on external borrowing
- Maturity structure of borrowing
- Capital Financing Requirement (CFR) projections
- Affordability
- The Minimum Revenue Provision (MRP) policy
- Policy on borrowing in advance of need
- Debt rescheduling

2. Capital spending plans

- Capital spending plans
- Housing Revenue Account borrowing needs
- Other investment opportunities

3. Managing cash balances and investments

- Current cash position
- Cash flow forecast
- Prospects for investment returns
- Council policy on investing and managing risk
- Balancing short- and longer-term investments
- Annual Investment Strategy

1.8 Section 7 of the report summarises the key Prudential Indicators. These provide a reference point or "dash board" so that senior officers and Members can easily identify whether approved treasury management policies are being applied correctly in practice and take corrective action as required.

1.9 The Annual Investment Strategy in Appendix E provides more detail on how the Council's surplus cash investments are to be managed in 2021/22. Approved schedules of specified and non-specified investments will be updated following consideration by Members and finalisation of 2021/22 budget plans.

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

2. BORROWING

Overall borrowing strategy

2.1 The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

2.2 Given the significant cuts to public expenditure and, in particular, local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the long-term stability of the debt portfolio. The key factors influencing the 2021/22 strategy are:

- forecast capital funding;
- the current economic and market environment; and
- interest rate forecasts.

2.3 The Council is currently maintaining an under-borrowed position. This means that capital expenditure has not been fully funded from loan debt as other funding streams (such as government grants and third-party contributions, use of Council reserves and cash balances and capital receipts) have been employed where available. This policy has served the Council well over the last few years while investment returns have been low and counterparty risk has been relatively high.

2.4 However, officers are constantly reviewing the situation to see if this remains the appropriate solution, or whether the Council should undertake more long-term borrowing to match the anticipated Capital Financing Requirement over the next few years. Given that the Council's resources available for internal borrowing are expected to reduce as capital spending intensifies, the Council needs to maintain flexibility to borrow at opportune moments in line with the approved Prudential Indicators.

2.5 On 26 November 2020, the Public Works Loan Board (PWLB) reversed the decision to increase the cost of borrowing for local authorities by 1.00%. All new loans are therefore now subject to the relevant gilt yields +0.80% (certainty rate).

Alternatives to PWLB

2.6 The Council's treasury management strategy permits borrowing from various sources, but it has not been previously anticipated that any alternatives to PWLB would need to be utilised, given the current low cost of PWLB funding.

2.7 In addition to the low interest rate payable, the key advantage of PWLB is the speed and ease of transaction processing and the low fee and administration cost associated with the loans. Alternative types of funding could result in lengthy due diligence, consultancy costs, legal advice and fees, and will be far more costly administratively.

Range of options

2.8 Alternative options for funding to PWLB include:

- Banks
- Pension fund institutional investors
- Bond issuance
- The Municipal Bonds Agency

Banks

2.9 Discussions with the Council's treasury consultant suggest that the Council could access borrowing from banks. However, the recent decision by the PWLB to reverse the 1.00% additional cost of general fund borrowing has resulted in banks being placed in an overly competitive environment.

Pension fund institutional investors

2.10 Initial indications have suggested that the Council may be able to borrow from institutional investors at rates of around gilt yield plus 1.20% to 1.80% for periods of over 20 years, via a private placement agreement (PPA). Such an arrangement will be subject to extensive negotiations with the lenders, who will need to carry out due diligence on a Council's finances, budgets and balance sheet. Again, the recent decision by the PWLB has resulted a lower PWLB rate than expected from private placements.

Bond investors

2.11 A bond issuance would first require the Council to become credit rated by one (or more) of the major ratings agencies: Fitch, S&P or Moody's. This is a complex, lengthy, repetitive and costly process.

2.12 The precise rate offered will be market led and dependent on the financial resilience of the authority and the market's perception of its creditworthiness.

2.13 Councils with significant reserves and a record of not overspending on budget will be able to secure the most advantageous rates. Bond releases typically require a minimum size of at least £200m.

Municipal Bonds Agency

2.14 This has been in existence since 2013 but has only recently transacted its first bond issuance and local authority borrower, at a rate of 1.73%.

Future prospects

2.15 Alternative opportunities for the Council may well present themselves, and the borrowing strategy will be designed to allow for this. The ‘benchmark’ for a borrowing opportunity is regarded at around gilts +0.8%. It is unclear at this stage whether feasible PWLB competition will materialise, and it is likely to take some time to do so.

2.16 Officers will continue to explore alternatives to the PWLB, working with the Council’s treasury advisor, Link Asset Services. PWLB rates will also be kept under regular and active review.

3. Limits on external borrowing

3.1 The Prudential Code requires the Council to set two limits on its total external debt, as set out in Table 1 below. The limits for 2021/22 have remained at the same level compared with the 2020/21 Treasury Management Strategy Statement (TMSS) to reflect slippage in the capital programme from previous years. The limits are:

- **Authorised Limit for External Debt (Prudential Indicator 5a):** This is the limit prescribed by section 3(1) of the Local Government Act 2003, representing the maximum level of borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term.

- **Operational Boundary (Prudential Indicator 5b):** This is the limit which external debt is not normally expected to exceed. The boundary is based on current debt plus anticipated net financing need for future years.

Table 1: Overall borrowing limits

	2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Authorised Limit for External:				
Borrowing and other long-term liabilities	400	550	650	650
Operational Boundary for:				
Borrowing	325	480	550	570
Other long-term liabilities	15	15	15	15
TOTAL	**340**	**495**	**565**	**585**

Maturity structure of borrowing

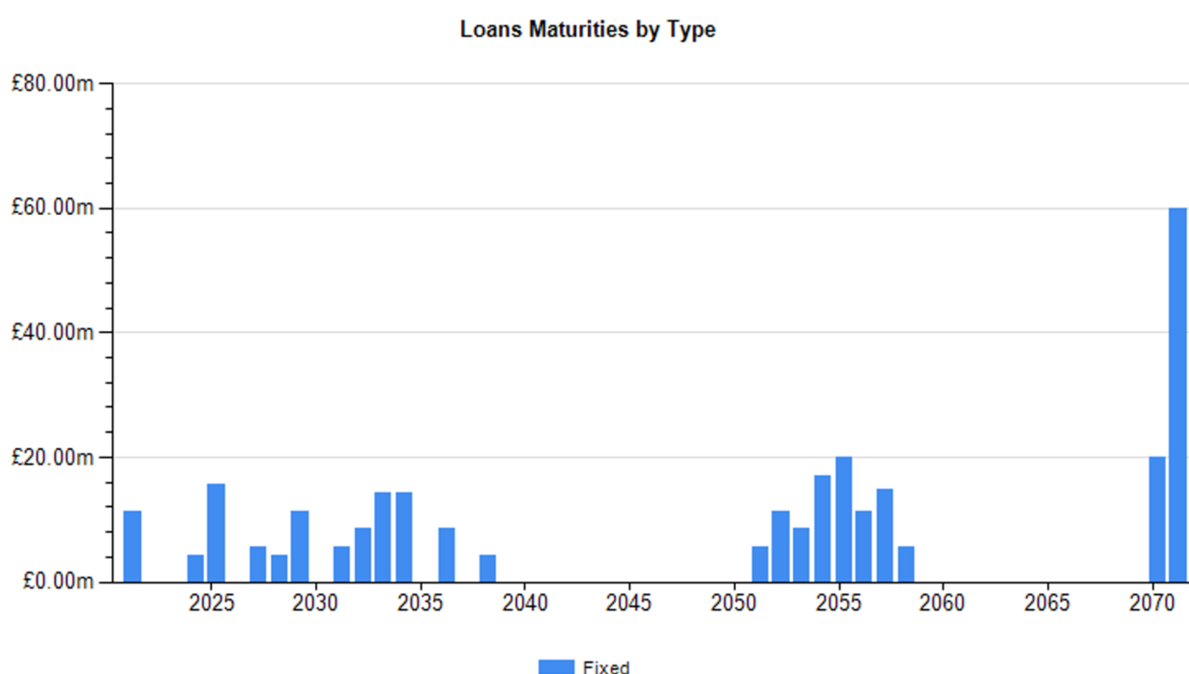
3.2 Managing the profile of when debt matures is essential for ensuring that the Council is not exposed to large fixed rate sums falling due for refinancing within a short time period, and thus potentially exposing the Council to additional risk and cost. Table 2 below sets out current upper and lower limits for debt maturity which are unchanged from 2020/21.

Table 2: Debt maturity profile limits

Actual Maturity at 30 Sep 2020		Lower Limit	Upper Limit
%		%	%
4	Under 12 months	0	15
0	12 Months and within 24 Months	0	15
7	24 Months and within 5 years	0	60
8	5 Years and Within 10 Years	0	75
81	10 Years and Above	0	100

Maturity profile of long-term borrowing

3.3 The chart below shows that the principal repayment profile for current council borrowing (as at 30th September 2020) remains within these limits.



Capital Financing Requirement (CFR)

3.4 The CFR measures the extent to which capital expenditure has not yet been financed from either revenue or other capital resources. Essentially, it

measures the Council's underlying borrowing need. Each year, the CFR will increase by the amounts of new capital expenditure not immediately financed.

3.5 Table 3a shows that the CFR will increase over the medium term. Consequently, the capital financing charge to revenue will increase, reflecting the capital spending plans.

Table 3a: Capital Financing Requirement forecast

2019/20 Actuals £m		2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
	CFR as at 30 September				
135	General Fund Closing CFR (detail in Table 3b)	163	209	258	233
216	Closing Forecast HRA CFR	229	271	297	339
351	**TOTAL**	**392**	**481**	**554**	**572**
	Annual Change				
47	General Fund	28	46	48	(24)
11	HRA	13	43	25	42
58	**TOTAL**	**41**	**89**	**74**	**18**

3.6 A more detailed analysis of the closing Forecast CFR is shown below:

Table 3b: General Fund Capital Financing Requirement forecast (detailed)

2019/20 Actuals £m		2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
114	General Fund CFR excluding self-financing schemes and loans	129	142	152	154
12	Self-financing schemes and loans	26	60	99	73
9	PFI and Finance lease liabilities	8	8	7	6
135	**TOTAL**	**163**	**209**	**258**	**233**

3.7 Table 4 below confirms that the Council's gross debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current year and the following two financial years. This allows some

flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes.

Table 4: Borrowing compared to the Capital Financing Requirement

2019/20 Actual £m		2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
243	Gross Projected Debt	283	386	459	477
351	Capital Financing Requirement	392	481	554	572
108	**Under/(over) borrowing**	**109**	**95**	**95**	**95**

Affordability

3.8 The objective of the affordability indicators is to ensure that the level of investment in capital assets proposed remains within sustainable limits and, in particular, the impact on the Council's "bottom line" as reflected in the impact on council tax and rent levels. Table 5 below sets out the expected ratio of capital financing costs to income for both General Fund and HRA activities:

Table 5: Ratio of capital financing costs to income

2019/20 Actual %		2020/21 Forecast %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %
(1.43)	General Fund	(0.94)	(0.61)	0.00	0.07
5.9	HRA	6.19	6.34	2.46	6.83

3.9 From 2021/22 onwards, gross capital financing charges (loan interest, MRP and finance and PFI payments) for the General Fund capital programme will start to increase as a proportion of the income from investments and the commercial property portfolio, as new debts are raised to close the gap between funding and the CFR.

3.10 The capital financing charges arising from the HRA capital programme increase in line with the forecast increased income, hence capital charges as a proportion of the HRA net revenue stream will remain fairly steady.

4 Minimum Revenue Provision (MRP) Policy

4.1 Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year. The accounting approach is to spread the cost over the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by

which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax.

4.2 Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended (Statutory Instrument (SI) 3146/2003) requires Full Council to approve a Minimum Revenue Provision (MRP) Statement setting out the policy for making MRP and the amount of MRP to be calculated which the Council considers to be prudent. In setting a level which the Council considers to be prudent, the Guidance states that the broad aim is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits to the Council.

Borrowing in advance of need

4.3 The Council has the power to borrow in advance of need in line with its future borrowing requirements under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended. 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. Currently, there are no plans to incur any additional external borrowing in the medium term.

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

Debt rescheduling

4.5 As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the cost of debt repayment (premiums incurred), which are very costly. Officers recently obtained a schedule of current premiums that would be payable on early redemptions from the Council's treasury advisor following discussions at the Audit and Pensions Committee on 1 December 2020. The amounts in the schedule re-affirm that it is not cost effective to pay PWLB loans prematurely

4.6 The reasons for any rescheduling to take place will include:

- generating cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy; and
- enhancing the balance of the portfolio by amending the maturity profile and/or the balance of volatility.

4.7 Consideration will also be given to identifying the potential for making savings by running down investment balances to repay debt prematurely as short-term rates on investments are likely to be lower than rates paid on current debt.

4.8 Any rescheduling must be authorised by the Director of Finance in consultation with the lead Cabinet Member.

5. CAPITAL

Capital spending plans

5.1 The Prudential Code requires that any borrowing and investment decisions are taken in the light of capital spending plans and consideration of how that proposed capital expenditure will be purchased. The Council's capital expenditure plans have been reported in the four-year capital programme 2020/21 to 2023/24 reported elsewhere on the Committee's agenda, both in terms of those agreed previously, and those forming part of the current budget cycle.

5.2 Any slippage against the capital programme, or new capital approvals, will impact on the figures reported throughout this report.

Housing Revenue Account (HRA) borrowing

5.3 From October 2018 onwards, local authorities with an HRA are no longer constrained by government controls over borrowing for house building and are able to borrow against their expected rental income, in line with the Prudential Code.

5.4 For the period 2020/21 to 2023/24, based on the planned four-year capital programme and due to reduced cash balances from the latter half of 2020/21 onwards, the HRA may need to actively consider new external borrowing.

5.5 Where the HRA is borrowing below its level of CFR and is under borrowed, the general fund will make an accounting charge to the HRA based on the average one-year LIBOR rate applied to the under borrowed position.

Other investment opportunities

5.6 As well as investing in assets owned by the Council and used in the delivery of services, the Council also invests, or may invest, where appropriate, in:

- Infrastructure projects, such as green energy;
- Loans to third parties;
- Shareholdings in limited companies and joint ventures.

5.7 Such investments are treated as expenditure for treasury management and Prudential borrowing purposes, even though they do not create physical

assets in the Council's accounts. Appropriate budgets in respect of these activities will be agreed as part of the Council's budget setting and ongoing monitoring processes and considered as part of the Annual Investment Strategy.

6. MANAGING CASH BALANCES

Current position and cash flow forecast

6.1 Table 6 below shows that cash balances have increased by £40m in the past six months which is due to the council taking out two HRA PWLB loans in April 2020 at low interest rates of 1.25% and 1.26%. The cash largely comprises the Council's usable reserves, capital receipts and unspent grants.

Table 6: Cash position at 30 September 2020

As at 31 March 2020			As at 30 September 2020	
Principal £m	Average Rate %		Principal £m	Average Rate %
		Investments		
209	0.8	Specified	243	0.2
0	0.0	Non-Specified	0	0.0
209		**Total**	**243**	
		Borrowing		
243	4.2	Public Works Loan Board	283	3.8
243		**Total**	**283**	

6.2 The Council aims to manage daily cash flow peaks and troughs to achieve a nil current account balance daily throughout the year. As such the average yearly surplus cash balances should be fully invested throughout.

Prospects for investment returns

6.3 Investment returns are likely to remain exceptionally low during 2021/22 with little change in the following two years. 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 six to 12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank of England 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-19 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.

6.4 Money Market Funds (MMFs) yields have continued to drift lower. Some managers have 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 available at the very short end of the market. This has seen a number of market operators, now including the Debt Management Account Deposit Facility (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.

6.5 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home. This has occurred when many local authorities are probably having difficulties accurately forecasting the inflow and outflow of grants received from the Government.

Council policy on investing and managing risk

6.6 The aim is to manage risk and reduce the impact of any adverse movement in interest rates on the one hand but, at the same time, not setting the limits to be so restrictive that they impair opportunities to reduce costs or improve performance.

Balancing short- and longer-term investments

6.7 During the first half of 2020/21, there have been no new investments of surplus funds for more than 364 days. The 2021/22 Annual Investment Strategy permits investing for more than 364 days. Using longer term maturity investments would improve yields; however, this needs to be balanced with liquidity needs.

Table 7: Investment limits

2019/20 Actual £m		2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
7	Upper Limit for principal sums invested for more the 364 days	120	120	120	120

Annual Investment Strategy

6.8 The Council holds significant invested funds, representing income received in advance of expenditure, balances and reserves.

6.9 The Local Government Act 2003 requires the Council to prepare an Annual Investment Strategy, setting out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. This strategy is set out in Appendix E.

6.10 Investments are made with reference to the core balance, future cash flow requirements and the outlook for interest rates. The Council's investment priorities will always be security of capital first, liquidity second, then investment yield.

7. SUMMARY OF PRUDENTIAL INDICATORS (PIs)

7.1 The purpose of prudential indicators (PIs) is to provide a reference point or "dashboard" so that senior officers and Members can:

- easily identify whether approved treasury management policies are being applied correctly in practice; and
- take corrective action as required.

7.2 As the Council's S151 officer, the Director of Finance has responsibility to ensure that appropriate Prudential Indicators are set and monitored and that any breaches are reported to Members.

7.3 The Director of Finance has confirmed that the PIs set out below are all expected to be complied with in 2020/21 and it is not envisaged at this stage that there will be any difficulty in achieving compliance with the suggested indicators for 2021/22

PI ref	Para ref		2020/21 indicator	2020/21 forecast	2021/22 proposed
1	5.1	Capital expenditure	£103m	£102m	£162m
2	3.4	Capital Financing Requirement (CFR)	£402m	£392m	£481m
3	3.7	Net debt vs CFR	£95m underborrowing	£149m underborrowing	£95m underborrowing
4	3.8	Ratio of financing costs to revenue stream	GF 1.81%	GF (0.94%)	GF (0.61%)
			HRA 28.94%	HRA 6.19%	HRA 6.34%
5a	3.1	Authorised limit for external debt	£400m	£243m	£550m
5b	3.1	Operational debt boundary	£340m	£243m	£495m
6	6.2	Working capital balance	£0m	£0m	£0m

7	6.7	Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	£120m	£0m	£120m
8	3.2	Maturity structure of borrowing	Upper limit under 12 months - 15%	Upper limit under 12 months - 5%	Upper limit under 12 months - 15%
			Lower limit 10 years and above - 100%	Lower limit 10 years and above - 78%	Lower limit 10 years and above - 100%

8. Reasons for Decision

This report represents the Council's Treasury Management Strategy Statement for 2020/2021. It is a regulatory requirement for this report to be reported to the Council. It is recommended that approval is given to the future borrowing and investment strategies as outlined in this report.

9. Equality Implications

The report is for noting. There are no equality implications for groups with protected characteristics (under the Equality Act 2010) as a result of this report. EIA's have been completed for each service area to which the underlying financing in this report relates to. Additionally, there is a general EIA which assesses the impacts on equality of the main items in the budget proposed to Full Council.

Implications verified by Mary Lamont, Strategic Head of People & Talent, tel. 0785 337 2862.

10. Risk Management Implications

Treasury Management contributes to all the Council Values and Delivery of Objectives. Management of treasury risks are commensurate to the risk appetite of the Council. The effective understanding, control and management of the many aspects of risk associated with treasury management are essential to achieving an authority's objectives. Risk management is therefore embedded throughout treasury guidance, policies and practices.

Treasury risks present themselves in many forms, from failure to optimise performance by not taking advantage of opportunities, to managing exposure to changing economic circumstances, most recently the situation is somewhat uncertain due to this Government's negotiations over the UK's departure from the European Union as expressed in section 6 of this report. In adopting a policy of managing risk, an authority is determining its level of risk acceptance.

The key challenge is to understand, identify, monitor and manage risks in a planned and effective way. Local authorities are required to report annually to Full Council on their treasury management strategy statement (TMSS) before the start of the year, which sets the objectives and boundaries for the approach to treasury activity.

The authority supplements this with treasury management practice schedules (TMPs), which set out the practical arrangement to achieve those objectives. The TMPs inform the day-to-day practices applied to manage and control treasury activities. Local authorities are typically financially risk averse and greatly value stability in order to form council tax and housing rent levels, through to general fund and HRA budgets.

Implications verified by: David Hughes, Director of Audit, Risk and Fraud, tel. 020 7361 2389.

11. Other Implications

The Council's borrowing and investment activity represents significant expenditure and income within the Borough and, consequently, where supplies are sourced locally, changes in borrowing or investment may impact either positively or negatively on local contractors and sub-contractors. Where capital expenditure increases, or is brought forward, this may have a beneficial impact on local businesses; conversely, where expenditure decreases, or is slipped, there may be an adverse impact on local businesses.

Implications verified by: Kamal Motalib, Economic Development Team, tel. 07739 316 957.

12. Consultation

Consultation took place with the Council's investment advisor, Link Asset Services, in respect of the economic and interest rate update.

List of Appendices:

Appendix A: Treasury Management Policy Statement
Appendix B: Meeting CIPFA requirements
Appendix C: Interest Rate Prospects
Appendix D: Economic Update
Appendix E: Annual Investment Strategy
Appendix F: Credit Ratings

APPENDIX A

THE TREASURY MANAGEMENT POLICY STATEMENT

The CIPFA recommendations contained in the Code of Practice and Cross Sectoral Guidance Notes issued as a revised version in 2009, 2011 and 2018 for Treasury Management in the Public Services require that each Local Authority has a Treasury Management Policy Statement that is approved by the Full Council.

CIPFA recommends that the Council's treasury management policy statement adopts the following form of words below to define the policies and objectives of its treasury management activities.

This Council defines its Treasury Management activities as:

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

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

This Council acknowledges that effective Treasury Management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance.

APPENDIX B

MEETING CIPFA REQUIREMENTS

The Council has formally adopted CIPFA's Code of Practice on Treasury Management (updated 2018) and complies with the requirements of the Code as detailed below:

- Maintaining a Treasury Management Policy Statement setting out the policies and objectives of the Council's treasury management activities

- Maintaining a statement of Treasury Management Practices that sets out the manner in which the Council will seek to achieve these policies and objectives

- Presenting the Full Council with an annual Treasury Management Strategy Statement, including an annual investment strategy and Minimum Revenue Provision policy for the year ahead (this report), a half year review report and an annual report (stewardship report) covering compliance during the previous year

- A statement of delegation for treasury management functions and for the execution and administration of treasury management decisions (see below).

- Delegation of the role of scrutiny of treasury management activities and reports to a specific named body. At the London Borough of Hammersmith and Fulham, this role is undertaken by the Audit and Pensions Committee.

Treasury Management Delegations and Responsibilities

The respective roles of the Council, Cabinet, Audit and Pensions Committee, and of the Section 151 officer and the Director of Treasury and Pensions are summarised below. Further details are set out in the Statement of Treasury Management Practices.

Council

Council will approve the annual treasury management strategy statement, including borrowing and investment strategies. In doing so, Council will establish and communicate its appetite for risk within treasury management having regard to the Prudential Code.

Cabinet

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual outturn report on treasury activities. Cabinet also approves revenue budgets, including those for treasury activities.

Audit and Pensions Committee

This committee is responsible for ensuring effective scrutiny of treasury strategy and policies.

Section 151 Officer

The role of the Section 151 is vested in the Director of Finance post (the S151 Officer), pursuant to Section 101 of the Local Government Act 1972 and by the Executive under Section 15 of the Local Government Act 2000.

The S151 Officer may authorise officers to exercise on their behalf functions delegated to them. Any decisions taken under this authority shall remain the responsibility of the S151 Officer and must be taken within the guidelines of the Treasury Management Strategy.

The S151 Officer has full delegated powers from the Council and is responsible for the following activities:

- Investment management arrangements and strategy;
- Borrowing and debt strategy;
- Monitoring investment activity and performance;
- Overseeing administrative activities;
- Ensuring compliance with relevant laws and regulations;
- Provision of guidance to officers and members in exercising delegated powers.

Director of Treasury and Pensions

Has responsibility for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Policy Statement and CIPFA's 'Standard of Professional Practice on Treasury Management'.

Treasury team

Undertakes day-to-day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures.

Training

The Code requires the S151 officer to ensure that Members with responsibility for making treasury management decisions and for scrutinising treasury functions to receive adequate training. The training needs of all officers are reviewed periodically as part of the Learning and Development programme. Officers attend various seminars, training sessions and conferences during the year and appropriate Member training is offered as and when needs and suitable opportunities are identified.

Monitoring and Reporting

The Treasury Management activities during the year will be included in the monitoring reports to the Audit, Pensions and Standards Committee.

The Council's Treasury Management Strategy will be approved annually by Full Council and there will also be a mid-year report. The aim of these reporting arrangements is to ensure that those with the responsibility for treasury management policies and activities and those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The Council will adopt the following reporting arrangements in accordance with the requirements of the revised code:

Area of Responsibility	Council / Committee / Officer	Frequency
Treasury Management Strategy	Full Council	Annually at meeting before the start of the financial year.
Scrutiny of Treasury Management Strategy	Audit and Pensions Committee	Annually
Treasury Management Strategy: Mid-year report	1. Audit and Pensions Committee 2. Cabinet	Annually after the first half of the financial year
Treasury Management Strategy: Updates / revisions at other times	1. Audit and Pensions Committee 2. Full Council	As and when required
Treasury Outturn Report	1. Audit and Pensions Committee 2. Full Council	Annually after year-end
Treasury Management Monitoring Reports	Director of Finance and Lead Cabinet Member for Finance and Commercial Services	Weekly/Monthly

APPENDIX C

PROSPECTS FOR INTEREST RATES

1. The Council has appointed Link Asset Services as its treasury advisor and part of its service is to assist the Council to formulate a view on interest rates. The following table gives our central view:

Link Group Interest Rate View 9.11.20								(The Capital Economics forecasts were done 11.11.20)						
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20														
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Bank Rate														
Link	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Capital Economics	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
5yr PWLB Rate														
Link	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80
Capital Economics	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	-	-	-	-	-
10yr PWLB Rate														
Link	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
Capital Economics	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	-	-	-	-	-
25yr PWLB Rate														
Link	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
Capital Economics	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	-	-	-	-	-
50yr PWLB Rate														
Link	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Capital Economics	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	-	-	-	-	-

Source: Link Asset Services

2. The COVID-19 outbreak has inflicted huge economic damage to the UK and global economies. After the Bank of England took emergency action on 19 March to cut the Bank Rate to 0.10%, with some forecasters suggesting future negative territory could happen.

3. However, the Governor of the Bank of England has made it clear that he 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 the Bank Rate is expected as economic recovery is expected to be only gradual and prolonged.

4. **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.

5. 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 during this time period.

6. Over the year prior to COVID-19, bond yields up to 10 years have turned negative in the Eurozone. Additionally, there has at times been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. Conversely, bond prices have been 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 therefore selling out of equities.

7. Gilt yields had therefore already been on a generally falling trend up until the COVID-19 crisis hit western economies during March 2020. After gilt yields spiked up during March 2020, we have seen these yields fall sharply to unprecedented lows as investors panicked 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, resulting in downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by the issuance of government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have remained at remarkably low rates so far in 2020/21.

8. 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 COVID-19 shut down period. From time to time, gilt yields and therefore PWLB rates can be subject to exceptional levels of volatility due to geopolitical events, sovereign debt crises, emerging market developments and sharp changes in investor sentiment, as shown on 9 November 2020 when the first results of a successful COVID-19 vaccine trial were announced. Such volatility could occur at any time during the forecast period.

APPENDIX D

ECONOMIC UPDATE

1. **UK:** The Bank of England's Monetary Policy Committee (MPC) kept the Bank Rate unchanged on 5 November 2020. However, it revised its economic forecasts to take account of a second national lockdown from 5 November to 2 December 2020 which is obviously going to delay any economic recovery and result in further damage to the economy. It therefore decided to commit to a further tranche of quantitative easing (QE) of £150bn, to start in January 2021 when the current programme of £300bn of QE announced in March to June expires. 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".

2. Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:
   a. The economy would recover to reach its pre-pandemic level in Q1 2022
   b. The Bank also expects there to be excess demand in the economy by Q4 2022.
   c. 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".

3. 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 six to 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.

4. One key addition to the Bank's forward guidance in August 2020 was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". One interpretation is that, even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise the 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 the Bank Rate. Link Asset Service's bank Rate forecast currently shows no increase through to Q1 2024 but there could well be no increase during the next five years due to the slow rate of recovery of the economy and the need for the Government to see the burden of the elevated debt to Gross Domestic product (GDP) ratio falling significantly. Inflation is unlikely to pose a threat requiring increases in the Bank Rate during this period as there is likely to be spare capacity in the economy for a

considerable time. It is expected to briefly peak at around 2% towards the end of 2021, but this is a temporary short-lived factor and so not a concern.

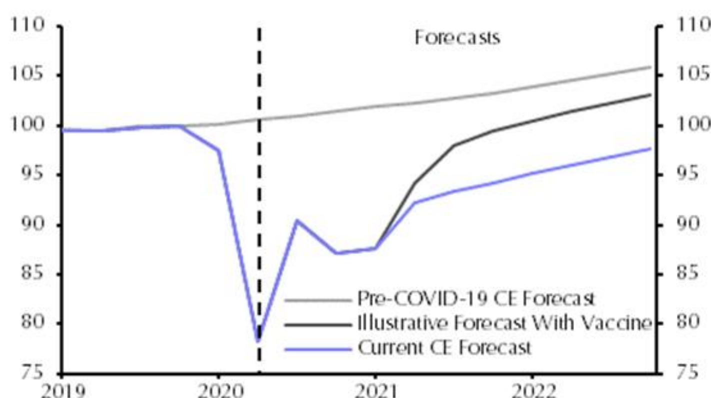
5. However, the minutes did contain several references to downside risks. The MPC reiterated that the “recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside”. It also said, “the risk of a more persistent period of elevated unemployment remained material”. Downside risks could well include severe restrictions remaining in place in some form during the rest of December 2020 and most of January 2021 too. That could involve some or all of the lockdown being extended beyond 2 December, a temporary relaxation of restrictions over Christmas, a resumption of the lockdown in January 2021 and many regions being subject to Tier 3 restrictions when the lockdown ends. Hopefully, restrictions should progressively ease during spring 2021. It is only to be expected that some businesses that have barely survived the first lockdown will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to 31 March 2021 will limit the degree of damage done.

6. As for the upside risk, the Pfizer announcement on 9 November 2020 was very encouraging as its 90% rate of effectiveness was much higher than the 50-60% rate of effectiveness reference flu vaccines which might otherwise have been expected. There has been even further encouraging news since then with another two vaccines, also announcing high success rates. Together, these three announcements have enormously boosted confidence that life could largely return to normal during the second half of 2021, with activity in the still depressed sectors, including restaurants, travel and hotels, returning to their pre-COVID-19 levels, which would help to bring the unemployment rate down. With the household saving rate currently being exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete but, if these vaccines prove to be highly effective, there is a possibility that restrictions could begin to be eased, possibly in Q2 2021, once vulnerable people and front-line workers had been vaccinated. At that point, there would be less reason to fear that hospitals could be further overwhelmed. Effective vaccines would radically improve the economic outlook once they have been widely administered and may allow GDP to rise to its pre-COVID-19 level a year earlier than otherwise, resulting in unemployment rate peaks at 7% next year instead of 9%. But, while this would reduce the need for more QE and/or negative interest rates, increases in the Bank Rate would still remain some years away. There is also a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.

7. Public borrowing is now forecast 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 undertaken 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 is being issued, and this is being done across the whole yield curve in all maturities. 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 an annual budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a less optimistic view of the impact that vaccines could make in the speed of economic recovery.

8. Overall, the pace of recovery was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp but after a disappointing increase in GDP of only 2.1% in August 2020, this left the economy still 9.2% smaller than in February 2020. This suggested that the economic recovery was running out of steam after recovering 64% of its total fall during the crisis. The last three months of 2020 were originally expected to show zero growth due to the impact of widespread local lockdowns, consumers probably remaining cautious in spending, and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year also being a headwind. However, the second national lockdown starting on 5 November 2020 for one month is expected to depress GDP by 8% in November 2020 while the rebound in December 2020 is likely to be muted and vulnerable to the previously mentioned downside risks. It was expected that the second national lockdown would push back recovery of GDP to pre pandemic levels by six months and into sometime during 2023. However, the graph below shows the Capital Economics forecast on what happen if successful vaccines were widely administered in the UK in the first half of 2021: this could cause a much quicker recovery.

Level of real GDP (Q4 2019 = 100)



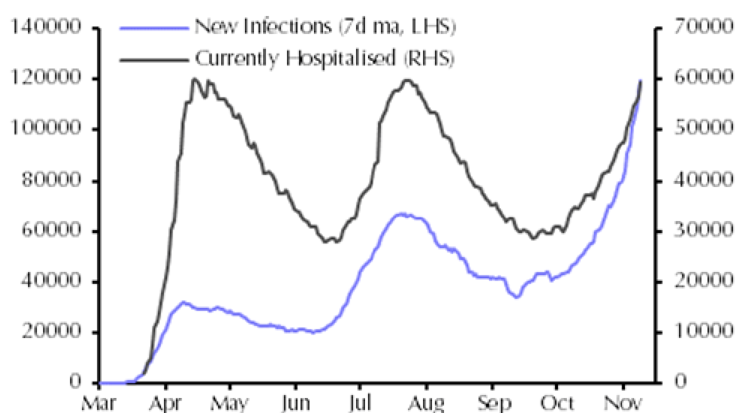
9. There will be some painful longer-term adjustments, e.g., office space and air travel, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of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

10. The Financial Policy Committee (FPC) report on 6 August 2020 revised down the 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%.

11. **US:** The result of the November 2020 US election means that while the Democrats have gained the presidency and a majority in the House of Representatives, it looks as if the Republicans will retain their slim majority in the Senate. This means that the Democrats will not be able to commit to significant fiscal stimulus, as they had been hoping to do after the elections, as they will have to get agreement from the Republicans. That would have resulted in another surge of debt issuance and could have put particular upward pressure on debt yields, which could have resulted in upward pressure on gilt yields. On the other hand, equity prices leapt up on 9 November 2020 on the first news of a successful vaccine and have risen further during November 2020 as more vaccines announced successful results. This could cause a big shift in investor sentiment, i.e., a swing to sell out of government debt to buy into equities which would normally be expected to cause debt prices to fall and yields to rise. However, the rise in yields has been quite muted so far and it is too early to say whether the US Federal Reserve would feel it necessary to take action to suppress any further rise in debt yields. It is likely that the next two years, and possibly four years in the US, could be a political stalemate where neither party can do anything radical.

12. The US economy had been recovering quite strongly from its contraction seen 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 Q4, to the highest level since mid-August 2020, suggests that the US could be in the early stages of a third wave. While the first wave in March and April 2020 was concentrated in the north-east, and the second wave in the south and west, the latest wave has been driven by a growing outbreak in the mid-west. 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 New infections & hospitalisations



13. After the Federal Reserve adopted its flexible average inflation target in late August 2020, the mid-September 2020 meeting of the Federal Reserve agreed to a toned down version of the new inflation target, stating 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, with long-term bond yields duly rising after its meeting. The Federal Reserve also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared with more directed central government fiscal policy. The FOMC’s updated economic and rate projections in mid-September 2020 showed that officials expect to leave the Federal Reserve funds rate at near-zero until at least end of 2023 and probably for another year or two beyond that. There is now some expectation that where the Federal Reserve 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.

14. **EU:** The economy was recovering well towards the end of Q2 and into Q3 2020 after a sharp drop in GDP caused by the COVID-19 virus (e.g. France -18.9%, Italy -17.6%). However, growth is likely to stagnate during Q4 and Q1 of 2021 as a second wave of the virus has affected many countries, and is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected countries. With inflation unlikely to get much above 1% over the next

two years, the European Central Bank (ECB) has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. It is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support from governments. The current Pandemic Emergency Purchase Programme (PEPP) scheme of €1,350bn 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, the PEPP scheme is regarded as being a temporary measure during this crisis so it may need to be increased once the first PEPP runs out during early 2021. It could also decide to focus on using the Asset Purchase Programme to make more monthly purchases, rather than the PEPP scheme, and it does have other monetary policy options.

15. **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, enabling 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 with 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.

16. **Japan:** Japan's success in containing the virus without imposing draconian restrictions on activity should enable a faster return to pre COVID-19 virus levels of output than in many major economies. While the second wave of the virus has been abating, the economy has been continuing to recover at a reasonable pace from its earlier total contraction of -8.5% in GDP. However, there now appears to be the early stages of the start of a third wave. It has also been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. There has also been little progress on fundamental reform of the economy. The change of Prime Minister is not expected to result in any significant change in economic policy.

17. **World growth:** While Latin America and India have, until recently, been hotspots for COVID-19 virus infections, infection rates have begun to stabilise. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Source: Link Asset Services

APPENDIX E

ANNUAL INVESTMENT STRATEGY

1. The Council holds significant invested funds, representing income received in advance of expenditure, balances and reserves. During the first half of the current year, the Council's average investment balance has been around £263m. Investments are made with reference to the core balance, future cash flow requirements and the outlook for interest rates.

2. The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Investment Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

3. In accordance with the above guidance and to minimise the risk to investments, the Council applies minimum acceptable credit criteria to generate a list of highly creditworthy counterparties, which will provide security of investments, enable diversification and minimise risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.

Investment return expectations

4. The 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.

5. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long-term forecast is for periods over ten years in the future):

Average earnings in each year	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.25%
2024/25	0.75%
Long term later years	2.00%

Source: Link Asset Services

6. The overall balance of risk to economic growth in the UK is probably relatively even but is subject to major uncertainty due to the COVID-19 virus. It may also be affected by what, if any, deal the UK agrees as part of the UK's exit from the EU. There is relatively little UK domestic risk of increases or decreases in the Bank Rate and shorter term PWLB rates until 2023/24 at the earliest.

Investment time limits

7. This limit is set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. For the year 2021/22, the proposed limit of investments for over 364 days is £120m as set out in the TMSS.

Investment Policy

8. The Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually 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 this end 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.

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

Creditworthiness Policy

10. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

    - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security; and
    - It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

11. The Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

12. The Council takes into account the following relevant matters when proposing counterparties:

    - the financial position and jurisdiction of the institution;

- the market pricing of credit default swaps[1] for the institution;
- any implicit or explicit Government support for the institution;
- Standard & Poor, Moody's and Fitch short- and long-term credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries; and
- Core Tier 1 capital ratios [2].

13. Changes to the credit rating will be monitored and, in the event that a counterparty is downgraded and does not meet the minimum criteria specified in Appendix E, the following action will be taken immediately:

    - no new investments will be made;
    - existing investments will be recalled if there are no penalties; and
    - full consideration will be given to recall or sale existing investments which would be liable to penalty clause.

Specified and Non-specified investments

14. The DCLG Guidance on Local Government Investments made under section 15(1) of the Local Government Act 2003, places restrictions on local authorities around the use of specified and non-specified investments. A specified investment is defined as an investment which satisfies all of the conditions below:

    - The investment and any associated cash flows are denominated in sterling;
    - The investment has a maximum maturity of one year;
    - The investment is not defined as capital expenditure; and
    - The investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

15. Investments with UK local authorities are deemed to be high credit quality because of the strong regulatory financial framework within which local authorities are required to operate and which mitigates against the risk of default, summarised below:

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[1] Credit Default Swaps (CDS) are tradable instruments where the buyer receives a pay-out from the seller if the party to whom the CDS refers (often a financial institution) has a "credit event" (e.g. default, bankruptcy, etc.). The price of the CDS gives an indication to the market's view of likelihood: the higher the price the more likely the credit event.

[2] The Tier 1 capital ratio is the ratio of a bank's core equity capital to its total risk-weighted assets (RWA). Risk-weighted assets are the total of all assets held by the bank weighted by credit risk according to a formula determined by the Regulator (usually the country's central bank). Most central banks follow the Basel Committee on Banking Supervision (BCBS) guidelines in setting formulae for asset risk weights.
The Core Tier 1 ratios for the four UK banks that the Council uses are: Barclays: 10.2%, HSBC: 11.2%, Lloyds: 12.0% and RBS: 10.8%.

- The requirement to set a balanced budget annually under sections 31A and 42A of the Local Government Finance Act 1992;
- The requirement to budget for a minimum level of reserves including risk under the Local Government Act 2003;
- The requirement for the S151 officer to issue a statutory report in the event that the authority intends to not set an adequate level of reserves or intends to undertake a course of action which he considers to be unlawful;
- The requirement for long-term borrowing to be solely for capital expenditure;
- The cap on excessive borrowing through the operation of the limits in the Prudential Code;
- All borrowing has to be secured on revenues of a local authority rather than assets.

16. All investments with local authorities will be subject to due diligence review of their accounts and financial health by the Tri-Borough Director of Treasury and Pensions and agreed with the Director of Finance.

17. A non-specified investment is any investment that does not meet all the conditions above. In addition to the long-term investments listed in the table at the end of Appendix E, the following non-specified investments that the Council may make include:

    - **Green Energy Bonds:** Investments in solar farms are a form of Green Energy Bonds that provide a secure enhanced yield. The investments are structured as unrated bonds and secured on the assets and contracts of solar and wind farms. Before proceeding with any such investment, internal and external due diligence will be undertaken in advance of investments covering the financial, planning and legal aspects.

    - **Loans:** The Council may consider advancing loans (as a form of investment) to organisations delivering services for the Council where this will lead to the enhancement of services to Council stakeholders. The Council will undertake due diligence checks to confirm the borrower's creditworthiness before any sums are advanced and will obtain appropriate levels of security or third party guarantees for loans advanced. The Council would expect a return commensurate with the type and duration of the loan. All loans would need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels.

    - **Shareholdings in limited companies and joint ventures:** The Council may invest in three forms of company:

        - Small scale businesses aimed at promoting economic growth in the area. Individual investments are no more than £0.5m and the aim is for these to be self-financing over the medium term. Any such loans will be subject to due diligence and the Council's Scheme of Delegation and Key Decision thresholds levels.

- Trading vehicles which the Council has set up to undertake particular functions. Currently the Council has interests in the following companies: Lyric Theatre Hammersmith Ltd, Hammersmith and Fulham Urban Studies Centre, Hammersmith and Fulham Bridge Partnership, HFS Developments LLP, HFS Developments 2 LLP, LBHF Ventures Ltd, LBHF Joint Ventures Ltd and LBHF Family Support Services Ltd. These are not held primarily as investments but to fulfil Council service objectives. Any new proposals will be subject to due diligence as part of the initial business case. As these are not to be held primarily as investment vehicles, then there is an expectation that they will break even.

- Trading vehicles held for a commercial purpose where the Council is obliged to undertake transactions via a company vehicle. These will be wholly owned subsidiaries of the Council with the aim of diversifying the investment portfolio risk.

18. For any such investments, specific proposals will be considered by the Director of Treasury and Pensions, and the Director of Finance in consultation with the Cabinet Member for Finance and Commercial Services and approvals to be in accordance with the Council's Constitution and governance processes, after taking into account:

    - cash flow requirements
    - investment period
    - expected return
    - the general outlook for short to medium term interest rates
    - creditworthiness of the proposed investment counterparty
    - other investment risks
    - due diligence review

The value of non-specified investments will not exceed their investment allocation.

Country of Domicile

19. The current TMSS allows deposits / investments with financial entities domiciled in the countries listed at the foot of the schedule of investments table.

Schedule of investments

20. The current criteria for providing a pool of high quality short, medium and long-term, cash-based investment counterparties along with the time and monetary limits for institutions on the Council's counterparty list are in the table below.

21. The counterparties and specific limits have been reviewed and updated.

All investments listed below must be sterling denominated

Investments	Minimum Credit Rating Required (S&P/Moody's/Fitch)	Maximum Individual Counterparty Investment Limit £m	Maximum tenor	Changes from the 2020/21 TMSS
DMO Deposits	Government Backed	Unlimited	6 months	No change
UK Government (Gilts/T-Bills/Repos)	Government Backed	Unlimited	Unlimited	No change
Supra-national Banks, European Agencies	LT: AA-/Aa3/AA-	£100m	5 years	No change
Covered Bonds	LT: AA+/Aa1/AA+	£100m	5 years	No change
Network Rail	Government guarantee	£200m maximum	Oct-52	No change
TfL	LT: AA/Aa/AA	£100m	3 years	No change
Collective Investment Scheme Investment Grade Bond Fund	Due diligence	£30m	Daily pricing	New addition
GLA	N/A	GLA: £100M	3 years	No change
UK Local Authorities (LA)		LA: £30m per LA, per criteria £200m in aggregate	3 years	No change
Commercial Paper issued by UK and European Corporates	LT: AA-/Aa3/AA- ST: F2/P-2/A-2	£20m per name £80m in aggregate	1 year	No change
Money Market Funds (MMF)	LT: AAA by at least one of the main credit agencies	£45m per Fund Manager £300m in aggregate	3-day notice	Limits increased
Enhanced Money Funds (EMF)	LT: AAA by at least one of the credit agencies ST: F2/P-2/A-2	£25m per fund manager, £100m in aggregate	Up to 7 day notice	No change

Investments	Minimum Credit Rating Required S&P/Moody's/Fitch	Maximum Individual Counterparty Investment Limit £m	Maximum tenor	Changes from the 2019/20 TMSS
UK Bank (Deposit/ Certificates of Deposit/ Short Dated Bonds)	LT: AA-/Aa3/AA- **or** UK Government Ownership greater than 25%	£70m	3-5 years	No change
	LT: A-/A3/A-	£50m	1-3 years	No change
	ST: F2/P-2/A-2	£50m	0-1 year	No change
Non-UK Bank (Deposit/Certificates of Deposit/Short Dated Bonds)	LT: AA-/Aa2/AA-	£50m	1-3 years	No change
	ST: F2/P-2/A-2	£30m	0-1 year	No change
Green Energy Bonds	Internal and External due diligence	Less than 25% of the total project investment or maximum of £20m per bond. £50m in aggregate	10 years	No change
Rated UK Building Societies	LT: A3/A- ST: P-2/A-2	£30m	3 years	No change
Sovereign approved list (AA- rated and above):	Abu Dhabi (UAE), Australia, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Luxembourg, Netherlands, Norway, Qatar, Singapore, Sweden, Switzerland, UK and USA			

UK T-Bills: UK Government Treasury Bills (T-Bills) are short term promissory notes issued by the UK Government at a discount to par, for tenors of up to one year.

UK Gilts: UK Government Gilts provide a greater yield than cash deposits with the DMO.

UK Government repurchase agreements (Repos): UK Government repurchase agreements are the purchase of UK Government securities with an agreement to resell them back at a higher price at a specific future date.

Commercial Paper (CP) is similar to a very short-term bond issue (up to one year), issued to investors on a discounted basis, and with the interest rate based on prevailing rates at the time of pricing.

Supra-national institutions are those that sovereign backed or supported institutions that span more than one country, such as the European Investment Bank, the European Bank of Reconstruction and Development, the World Bank, etc.

Network Rail: All Network Rail infrastructure debt is directly and explicitly backed by a financial indemnity from the Secretary of State for Transport acting for and on behalf of the government of the United Kingdom of Great Britain. The financial indemnity is a direct UK sovereign obligation of the crown and cannot be cancelled for any reason (prior to its termination date in October 2052). Propose to change TMSS limit to £200m and set the maximum maturity to Oct 2052.

APPENDIX F

CREDIT RATINGS

Long term ratings	Fitch	Moody's	S&P
Investment Grade Focuses on liquidity and ability to meet payment obligations on time	AAA	Aaa	AAA
	AA+	Aa1	AA+
	AA	Aa2	AA
	AA-	Aa3	AA-
	A+	A1	A+
	A	A2	A
	A-	A3	A-
	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
	BBB-	Baa3	BBB-
Non-investment grade (junk) Focus on recovery percentage in the event of partial or total default	BB+	Ba1	BB+
	BB	Ba2	BB
	BB-	Ba3	BB-
	B+	B1	B+
	B	B2	B
	B-	B3	B-
	CCC	Caa	CCC
	CC	Ca	CC
	C	C	C
	D		D

Short term ratings	Fitch	Moody's	S&P
Investment Grade	F1+	Prime-1	A-1+
	F1	Prime-2	A-1
	F2	Prime-3	A-2
	F3		A-3
Non-investment grade	B	Not Prime	B
	C		C
	D		D