APPENDIX 1: Interest Rate Forecasts 2021 - 2024

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table provides Link's latest central view.

Period	Bank Rate	PWLB Borrowing Rates % (including certainty rate adjustment of 20 basis points)			
	%	5 year	10 year	25 year	50 year
Sep 2021	0.10	1.20	1.60	1.90	1.70
Dec 2021	0.10	1.20	1.60	2.00	1.80
Mar 2022	0.10	1.20	1.70	2.10	1.90
Jun 2022	0.10	1.30	1.70	2.20	2.00
Sep 2022	0.10	1.30	1.80	2.30	2.10
Dec 2022	0.10	1.30	1.80	2.30	2.10
Mar 2023	0.10	1.40	1.90	2.30	2.10
Jun 2023	0.25	1.40	1.90	2.40	2.20
Sep 2023	0.25	1.40	1.90	2.40	2.20
Dec 2023	0.25	1.50	2.00	2.40	2.20
Mar 2024	0.50	1.50	2.00	2.50	2.30

APPENDIX 2: Extract from Credit Worthiness Policy

(Linked to Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management)

Annual Investment Strategy:

The key requirements of both the CIPFA Code of Practice on Treasury Management in the Public Services and MHCLG’s Investment Guidance are to set an annual investment strategy, as part of its annual Treasury Management Strategy for the following year, covering the identification and approval of the following:

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

Specified investments: These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. They also include investments which were originally classed as being non-specified investments, but which would have been classified as specified investments apart from originally being for a period longer than 12 months, once the remaining period to maturity falls to under twelve months. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government, such as the Debt Management Account Deposit Facility (DMADF), UK Treasury bills or a gilt with less than one year to maturity;
2. Supranational bonds of less than one year’s duration;
3. A local authority, housing association, parish council or community council;
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating (AAA) by a credit rating agency; and
5. A body that is considered of a high credit quality (such as a bank or building society).

Within these bodies, and in accordance with the Code, the Council has set additional criteria to define the time and amount of monies which will be invested in these bodies, as shown in the table further below.

Non-Specified Investments: These are any investments which do not meet the specified investment criteria, and include certificates of deposit issued by banks or building societies, fixed deposits with building societies that do not meet the basic secruity requirements of specified investments, corporate bonds, and property funds. Provision has been made in the Strategy to invest in a limited number of lower rated building societies within the restrictions set out, certifcates of deposit with both banks and building societies, and pooled asset funds (should the relevant opportunity arise). The Council will seek guidance on the status of any pooled fund or collective investment scheme it may consider using, and appropriate due diligence will also be undertaken before investment of this type is undertaken.

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

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

These factors are weighted and combined with an overlay of CDS spreads. The end product is a series of ratings (colour coded) to indicate the relative creditworthiness of counterparties. These ratings are used by the Council to determine the suggested duration for investments.

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

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	**Max % of total investments/ £ limit per institution**	**Max. maturity period**
DMADF – UK Government	N/A	100%	6 months
UK Government gilts	UK sovereign rating	£20m	1 year
UK Government Treasury bills	UK sovereign rating	£60m	6 months
Money Market Funds - CNAV	AAA	£30m	Liquid
Money Market Funds - LVNAV	AAA	£30m	Liquid
Money Market Funds - VNAV	AAA	£30m	Liquid
Local authorities	N/A	£10m	1 year
Term deposits with banks and building societies	Yellow* Purple Blue Orange Red Green No Colour	£30m £25m £40m £25m £20m £15m Not for use**	Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 100 days Not for use**
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	£40m £25m £20m £15m Not for use**	Up to 1 year Up to 1 year Up to 6 Months Up to 100 days Not for use**

Term deposits or CDs with building societies on Link's counterparty list rated 'No colour'	BBB-	£10m	Up to 3 months
Call accounts and notice accounts	Yellow* Purple Blue Orange Red Green No Colour	£30m £25m £40m £25m £20m £15m Not for use	Liquid
Pooled asset funds		£50m	At least 5 years

*for UK Government debt, or its equivalent, Constant Net Asset Value (CNAV) money market funds and collateralised deposits where the collateral is UK Government debt.

**except for those building societies rated BBB- or higher as set out elsewhere in the table.

The monitoring of investment counterparties: The credit rating of counterparties will be monitored regularly, on at least a weekly basis. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Group as and when ratings change, and the impact of those changes are assessed promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest upon maturity. Any counterparty failing to meet the criteria will be removed from the lending list immediately, and if required new counterparties which meet the criteria will be added to the list. Any fixed term investment held at the time of the downgrade will be left to mature as such investments cannot be broken mid-term.

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

Accounting treatment of investments: The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

APPENDIX 3: Benchmarking Extract

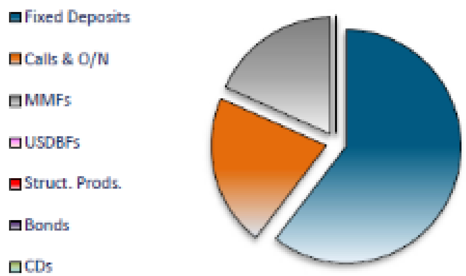
The following three pages present an extract, with glossary, of the Council’s treasury benchmarking report as at 30 June 2021.

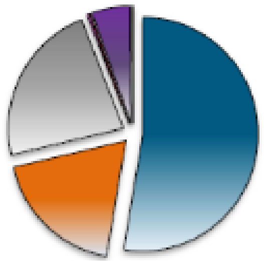
London Borough Of Lewisham

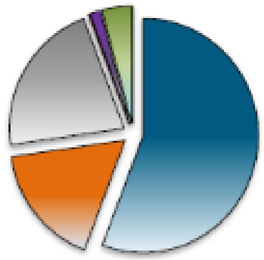
Summary Sheet

	London Borough Of Lewisham	Benchmakring Group 2 (15)	London (19)
		Basic Portfolio Characteristics	
WARoR	0.13%	0.27%	0.24%
WAM	114	95	87
WATT	166	206	187
WA Credit Risk	3.86	2.81	2.80
Model WARoR	0.18%	0.26%	0.23%
Difference	-0.05%	0.01%	0.01%
Model Band	0.14% - 0.22%	0.21% - 0.30%	0.19% - 0.28%
Performance	Below	Inline	Inline

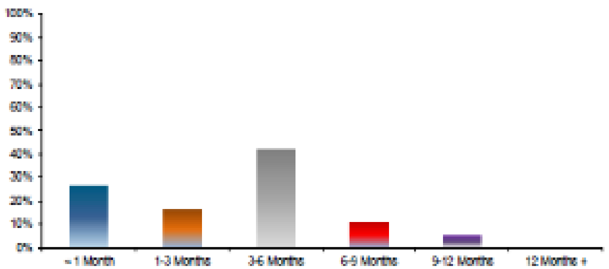
Asset Breakdown

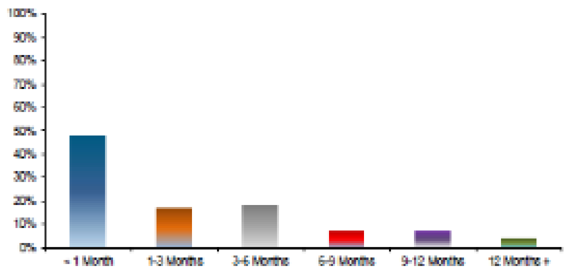


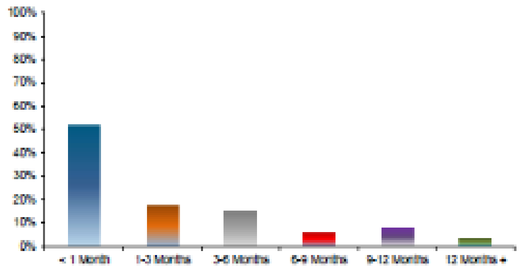




Maturity Profiles







London Borough Of Lewisham

Peer Comparison

	London Borough Of Lewisham	Benchmakring Group 2 (15)		London (19)		Population Average (212)	
Basic Characteristics							
Principal	£426,563,000	£247,970,574		£204,483,115		£99,774,978	
WARoR	0.13%	0.27%		0.24%		0.17%	
WAM	114	95		87		69	
WATT	166	206		187		127	
WA Credit Risk	3.86	2.81		2.80		2.97	
Portfolio Breakdown							
Fixed Deposits	60.48%	52.67%	14	55.76%	17	39.21%	170
Calls & O/N	21.10%	18.71%	12	17.00%	15	31.89%	191
MMFs	18.42%	22.66%	14	21.49%	14	25.28%	153
USDBFs	0.00%	0.33%	1	0.00%	0	1.13%	17
Struct. Prods.	0.00%	0.13%	1	0.10%	1	0.12%	3
Bonds	0.00%	5.40%	2	1.50%	1	0.77%	11
CDs	0.00%	0.11%	1	4.16%	1	1.59%	19
Institution Breakdown							
Banks	79.71%	45.65%	15	43.92%	18	46.20%	201
Building Socs.	0.00%	3.86%	4	5.14%	5	4.80%	57
Government	1.88%	26.25%	11	27.90%	13	21.89%	127
MMFs	18.42%	22.66%	14	22.05%	15	25.32%	154
USDBFs	0.00%	0.33%	1	0.00%	0	1.13%	17
MLDBs	0.00%	0.00%	0	0.00%	0	0.02%	1
Other	0.00%	1.25%	2	0.99%	2	0.64%	13
Domestic/Foreign Exposure							
Domestic	48.76%	68.25%	15	70.50%	19	70.00%	205
Foreign	32.82%	8.75%	9	7.44%	10	3.52%	47
MMFs	18.42%	22.66%	14	22.05%	15	25.35%	154
USDBFs	0.00%	0.33%	1	0.00%	0	1.13%	17
Maturity Structure							
< 1 Month	26.62%	47.67%		51.70%		58.68%	
1-3 Months	15.94%	16.76%		17.50%		13.83%	
3-6 Months	42.20%	18.04%		14.46%		16.65%	
6-9 Months	10.55%	6.81%		5.79%		5.12%	
9-12 Months	4.69%	6.85%		7.50%		3.73%	
12 Months +	0.00%	3.88%		3.06%		2.00%	

Definitions

WARoR	Weighted Average Rate of Return	This is the average annualised rate of return weighted by the principal amount in each rate.
WAM	Weighted Average Time to Maturity	This is the average time, in days, till the portfolio matures, weighted by principal amount.
WATT	Weighted Average Total Time	This is the average time, in days, that deposits are lent out for, weighted by principal amount.
WA Risk	Weighted Average Credit Risk Number	Each institution is assigned a colour corresponding to a suggested duration using Link Asset Services' Suggested Credit Methodology 1 = Yellow; 1.25 = Pink 1; 1.5 = Pink 2, 2 = Purple; 3 = Blue; 4 = Orange; 5 = Red; 6 = Green; 7 = No Colour
Model WARoR	Model Weighted Average Rate of Return	This is the WARoR that the model produces by taking into account the risks inherent in the portfolio.
Difference	Difference	This is the difference between the actual WARoR and the model WARoR; Actual WARoR minus Model WARoR.

APPENDIX 4: Economic Update from Link Asset Services

UK Economy

1.1 On 5th August, the Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; only one MPC member voted to stop these purchases now to leave total purchases at £45bn short of the total target.

1.2 Although MPC decisions have very much unchanged over the last year, there was a major shift from indicating no expected tightening any time soon to now flagging up that interest rate increases were on the horizon. There was a disagreement among MPC members, some of whom felt that the forward guidance that the MPC won't tighten policy until inflation "is achieving the 2% inflation target sustainably", had already been met. Although other MPC members did not agree with them, they all did agree that "some modest tightening of monetary policy over the forecast period was likely to be necessary to be consistent with meeting the inflation target sustainably in the medium term".

1.3 The MPC was more upbeat in its new 2-3 year forecasts so whereas they had expected unemployment to peak at 5.4% in Q3, the MPC now thought that the peak had already passed. It is noted that the recent spread of the Delta variant has damaged growth over the last couple of months and has set back recovery to pre-pandemic level of economic activity until probably October.

1.4 The review of the Bank of England monetary policy has now been completed and it will start to tighten monetary policy by:

- Placing the focus on raising Bank Rate as "the active instrument in most circumstances"
- Raising Bank Rate to 0.50% (1.50% previously), before starting on reducing its holdings.
- Once Bank Rate is at 0.50%, it would stop reinvesting maturing gilts.
- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

1.5 The MPC did not give any indication on when it would start raising Bank Rate. Inflation is currently expected to peak at 4% during 2021. The key issue then is whether this is going to be transitory inflation or whether it will morph into inflation which will bust the MPC's 2% target on an ongoing basis.

1.6 Governor of Bank of England said; "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, the MPC is worried that labour shortages will push up wage growth by more than it expected and that, as a result, CPI inflation will stay above the 2% target for longer.

1.7 This then raises the issue as to whether the million or so workers who left the UK during the pandemic, will come back to the UK and help to relieve wage inflation pressures. It is also unknown how trade with the EU will evolve once the pandemic distortions have dissipated, now that the UK no longer has tariff free access to EU markets.

1.8 At present, the MPC's forecasts are showing inflation close to, but just below, it's 2% target in 2 to 3 years' time. The initial surge in inflation in 2021 and 2022 is due to a combination of base effects, one off energy price increases and a release of pent-up demand hitting supply constraints. However, these effects will gradually subside or fall out of the calculation of inflation.

1.9 The issue for the MPC will, therefore, turn into a question of when the elimination of spare capacity in the economy takes over as being the main driver to push inflation upwards and this could then mean that the MPC will not start tightening policy until 2023. The MPC sets its policy as wanting to see inflation coming in sustainably over 2% to counteract periods when inflation was below 2%. While financial markets have been pricing in a hike in Bank Rate to 0.25% by mid-2022, and to 0.50% by the end of 2022, they appear to be getting ahead of themselves. In the view of Link Asset Services, the first increase to 0.25% will be unlikely to come until Q2 2023 and the second to 0.50% until Q1 2024. The second increase would then open the way for the Bank to cease reinvesting maturing bonds sometime during 2024.

USA Economy

1.10 Since the Democrats won the elections in late 2020 and gained control of both Congress and the Senate, (although power is more limited in the latter), they have passed a $1.9trn (8.8% of GDP) stimulus package in March 2021 on top of the $900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly to hit the target of giving a first jab to over half of the population within the President's first 100 days, will promote a rapid easing of restrictions and strong economic recovery during 2021. The Democrats have also recently passed a $1trn fiscal stimulus package aimed at renewing infrastructure over the next decade. Although this package is longer-term, it would also help economic recovery in the near-term.

1.11 In the Fed's June meeting, it stuck to its line that it expects strong economic growth this year to have only a transitory impact on inflation which is being temporarily boosted by base effects, spikes in reopening inflation and supply shortages. The big surprise was the extent of the upward shift in the "dot plot" of interest rate projections: having previously expected no hikes until 2024 at the earliest, most officials now anticipate two in 2023, with 7 out of 18 expecting to raise rates next year. This was a first indication that there was rising concern about the risks around inflationary pressures building up on a more ongoing basis and is somewhat hard to reconcile to the words around inflation pressures being only transitory.

Eurozone Economy

1.12 The slow rollout of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2% which is likely to continue into Q3, though some countries more dependent on tourism may struggle. There is little sign that underlying inflationary pressures are building to cause the European Central Bank any concern.

China Economy

1.13 After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. Policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth.

1.14 China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2021. However, the pace of economic growth will fall back after this initial surge of recover from the pandemic. China is also now struggling to contain the spread of the Delta variant through sharp local lockdowns which will damage economic growth. These are also questions as to how effective Chinese vaccines are proving.

Japan Economy

1.15 After declaring a second state emergency on 7th January, which depressed growth in Q1 2021, the economy was expected to make a strong recover to pre-pandemic GDP levels in the rest of the year as the slow rollout of vaccines eventually gathers momentum. However, the Delta variant has now raised questions as to whether lockdowns will be needed to contain it and to protect the health service from being overwhelmed.

Global Growth Prospects

1.16 World growth was in recession in 2020 but recovered during 2021. 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.

Gilt Yields/PWLB Rates

1.17 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 heightened expectations 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.

1.18 While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets. Over the year prior to the coronavirus crisis, this resulted in many bond yields up to 10 years turning negative in the Eurozone. In addition, there was, at times, an inversion of bond yields in the US whereby 10 year yields fell below shorter-term yields. In the past, this has been a precursor of a recession.

1.19 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 initially spiked upwards in March, yields fell sharply in response to major western central banks taking rapid policy action to deal with excessive stress in financial markets during March and starting massive quantitative easing driven purchases of government bonds: these actions also acted to put downward pressure on government bond yields at a time when there was 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.

1.20 At the start of 2021, all gilt yields from 1 to 8 years were negative: however, since then all gilt yields have become positive and have risen sharply, especially in medium and longer-term periods. The main driver of these increases has been investors becoming progressively more concerned at the way that inflation has risen sharply in major western economies during 2021, and further increases in inflation are expected. There is also much investor concern that the US Fed is taking a too laid back view that this inflation is purely transitory and that it will subside without the need for the Fed to take any action to tighten monetary policy; this could mean that rates will need to rise faster and sharper if inflation were to get out of control.

1.21 The current PWLB rates are set as margins over gilt yields 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)

As the interest forecast table for PWLB certainty rates, (gilts plus 80bps), above shows, there is likely to be little upward movement in PWLB rates over the next three years as the Bank of England is not expected to raise Bank Rate above 0.25% during that period as inflation is not expected to be sustainably over 2%.

Creditworthiness

1.22 Significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

1.23 Although CDS prices (these are market indicators of credit risk) for banks (including those from the UK) spiked at the outset of the pandemic in 2020, they have subsequently returned to near pre-pandemic levels. However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

Debt Rescheduling

1.24 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

APPENDIX 5: Approved Countries for Investment

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 have banks operating in sterling markets which have credit ratings of green or above in the Link Group creditworthiness service.

AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- USA

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Hong Kong
- Qatar
- U.K.

APPENDIX 6: Requirement of the CIPFA Treasury Management Code of Practice

<u>Treasury Management Scheme of Delegation</u>

(i) Full Council

- budget consideration and approval;
- approval of annual Treasury Management Strategy;
- approval of/amendments to the organisation's adopted clauses and treasury management policy statement.

(ii) Public Accounts Committee

- receiving and reviewing reports on treasury management policies, practices and activities.

<u>The Treasury Management Role of the Section 151 Officer</u>

The S151 (responsible) officer has responsibility for:

- recommending treasury management policies 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;
- approval of the division of responsibilities;
- approving the organisation's treasury management practices;
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;
- ensuring that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources;
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision to Members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that Members are adequately informed and understand the risk exposures taken on by an authority; and
- ensuring that the authority has adequate expertise, either in-house or externally, to carry out the above.