ADUR & WORTHING
COUNCILS

Joint Governance Committee
23 November, 2021

Joint Strategic Committee
7 December, 2021

Key Decision : No
Ward(s) Affected: All

MID YEAR REVIEW OF TREASURY MANAGEMENT 2021-22, ADUR DISTRICT COUNCIL AND WORTHING BOROUGH COUNCIL

REPORT BY THE DIRECTOR FOR DIGITAL, SUSTAINABILITY AND RESOURCES

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EXECUTIVE SUMMARY

1. PURPOSE

1.1 This report asks Members to note the Treasury Management mid-year performance for Adur and Worthing Councils at the 30 September 2021, as required by regulations issued under the Local Government Act 2003.

2. RECOMMENDATIONS

2.1 The Joint Governance Committee is recommended to note this report, including the recommendations for additions to the counterparties contained in section 4.3, and refer any comments or suggestions to the Joint Strategic Committee meeting on the 7th December 2021.

2.2 The Joint Governance Committee is recommended to note that the contract for Treasury advice is due for renewal on 1 April 2022 and the Chief Financial Officer will be re-procuring the contract.

2.3 The Joint Strategic Committee is recommended to note this report and approve the recommendations for additions to the counterparties contained in section 4.3.

2.4 The Joint Strategic Committee is recommended to note that the contract for Treasury advice is due for renewal on 1 April 2022 and the Chief Financial Officer will be re-procuring the contract.

3. CONTEXT

3.1 This report summarises the treasury management activities and portfolio for both Adur and Worthing Councils for the half year to 30 September 2021.

3.2 This is one of 3 treasury management reports that are required to be presented during the financial year (see Para. 4.1.3).

3.3 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. All local authorities are required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out our Capital Strategy was approved by the full Councils on 22nd July 2021 (Adur) and 20th July 2021 (Worthing).

3.4 Treasury Management

The Councils operate balanced budgets, which broadly means cash raised during the year will meet their cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Councils' capital plans. These capital plans provide a guide to the borrowing needs of the Councils, essentially the longer term cash flow planning to ensure the Councils can meet their capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

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

3.5 The Councils' Treasury Management Strategy and Annual Investment Strategy place the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Councils' priorities set out in Platforms for our Places.

4. ISSUES FOR CONSIDERATION

4.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Councils' treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Councils will seek to achieve those policies and objectives.

3. Receipt by the full Councils of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

4. Delegation by the Councils of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Councils of the role of scrutiny of treasury management strategy and policies to a specific named body. For these Councils the delegated bodies are the Joint Governance Committee and the Joint Strategic Committee.

4.2 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2021/22 financial year;

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;

- The Councils' capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Councils' investment portfolios for 2021/22;
- A review of the Councils' borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22

4.3 RECOMMENDED ADDITIONS/AMENDMENTS TO COUNTERPARTIES

4.3.1 The Councils have declared a climate emergency and Members have expressed their enthusiasm to improve the sustainability of the Councils' investments. Officers have been careful to avoid counterparties with direct connections to industries which would not comply with this aim, wherever possible, but in order to fulfil the investment security requirements and our counterparty limits, it is not always possible to avoid indirect connections. The Councils use Low Volatility Net Asset Value (LVNAV) money market funds to manage liquidity and these funds invest in a wide range of assets. HSBC is in the process of launching a new ESG (Environmental, Social and Governance) LVNAV money market fund that will be implementing a "Best in Class" strategy towards ESG investing. It is recommended that, subject to confirmation of AAA rating for the fund, the HSBC ESG Sterling Liquidity Fund is added to the funds currently used by the Councils.

4.3.2 As permitted under the Non-Specified Investments sections of the Treasury Management Strategy Statement, the Councils have placed fixed term deposits with the UK bank Standard Chartered, which currently has an A+ rating. It is recommended that Standard Chartered Bank is now added to the Specified Investments lists with a maximum investment limit of £3m.

4.3.3 For social policy purposes, the Councils both hold deferred shares in the local Credit Union, Boom. Boom has approached the Councils with a request to hold and invest some of Boom's funds in order to mitigate their treasury management investment risk. They may wish to deposit £1m-£2m with the Councils on a call basis, so would be satisfied with a soft interest rate, possibly linked to Bank Rate. This has the potential to benefit both parties because we are able to diversify the investment risk over a wider portfolio and the Councils will have a lower borrowing requirement, as long as the funds are held. The details are still under discussion, but it is recommended that the Councils add the option to invest on behalf of Boom to the approved investment and borrowing strategy.

4.3.4 Local Climate Bonds have been suggested as a means of raising funds for smaller sustainability projects, such as local solar farms. This was a

recommendation from the Climate Assembly and would allow local residents to invest securely in environmentally friendly initiatives. The bonds are promoted by the Green Finance Institute. Initial research has shown that other local authorities have used these bonds successfully. Therefore it is recommended that this option is added to the Councils' borrowing strategy. Full due diligence would be undertaken before committing to a bond.

4.3.5 The Councils have invested with the Local Authorities' Property Fund. The current investment limit is £3m per Council and it is recommended that the limit should be raised to £5m per Council for the purpose of setting aside long term funds for the repayment of debt.

5. THE ECONOMY AND INTEREST RATES

A commentary supplied by ***Link Treasury Services Ltd***, the professional consultants for the Councils' shared treasury management services, is included as an appendix to this report. The context is significant as it describes the backdrop against which treasury management activity has been undertaken during the year.

6. TREASURY MANAGEMENT STRATEGY STATEMENT and ANNUAL INVESTMENT STRATEGY UPDATE

6.1 The Treasury Management Strategy Statement (TMSS) for 2021/22 was noted by the Joint Governance Committee on the 26th January 2021 and approved by Adur Council on 18th February 2021 and by Worthing Council on 23rd February 2021.

6.2 There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

7. THE COUNCILS' CAPITAL POSITION (PRUDENTIAL INDICATORS)

This part of the report is structured to update:

- The Councils' capital expenditure plans
- How these plans are being financed
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow
- Compliance with the limits in place for borrowing activity

7.1 Prudential Indicator for Capital Expenditure

These tables show the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Adur District Council

	2021/22 Original Estimate	Actual at 30 Sept 2021	2021/22 Revised Estimate
	£m	£m	£m
HRA	18.956	2.183	25.666
Non HRA	9.447	1.758	10.270
Commercial property	20.000	0.000	0.000
Total capital expenditure	48.403	3.941	35.936

The change in the Adur revised capital expenditure estimate for the HRA is due mainly to reprofiling from 2020-21 caused by Covid-19 and additional safety works. The Council no longer plans to invest in property solely for commercial purposes due to changes in government guidance. £2m of the planned commercial property expenditure has been re-profiled to non HRA investment in local property for regeneration or service delivery.

Worthing Borough Council

	2021/22 Original Estimate	Actual at 30 Sept 2021	2021/22 Revised Estimate
	£m	£m	£m
Non HRA	16.550	11.811	52.355
Commercial property	0.000	0.000	0.000
Total capital expenditure	16.550	11.811	52.355

There have been various changes to the Worthing capital expenditure programme, which have been detailed in regular reports and are partly due to reprofiling of several schemes caused by Covid-19. Specific changes include:

- the inclusion of the budget for the purchase of the Teville Gate Development Site of £8.122m
- expenditure on the Worthing Integrated Care Centre of £15.156m
- £10m reprofiled from 2020/21 commercial property investment to investments in local property for regeneration or service provision
- £1.595m for refurbishment of the Town Hall for new ways of working.

7.2 **Changes to the Financing of the Capital Programme**

The tables below draw together the main strategy elements of the capital

expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the tables increases the underlying indebtedness of the Councils by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Adur District Council

	2021/22 Original Estimate	2021/22 Revised Estimate
	£m	£m
Total Capital Expenditure	48.403	35.936
Financed by:		
Capital receipts	1.799	1.519
Capital Grants & contributions	1.425	4.363
Reserves & revenue contributions	7.808	6.474
Total financing	11.032	12.356
Borrowing requirement	37.371	23.580

Worthing Borough Council

	2021/22 Original Estimate	2021/22 Revised Estimate
	£m	£m
Total Capital Expenditure	16.550	52.355
Financed by:		
Capital receipts	0.000	0.184
Capital grants & contributions	5.468	6.568
Reserves & revenue contributions	3.201	1.979
Total financing	8.669	8.731
Borrowing requirement	7.881	43.624

7.3 **Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary**

The tables below show the CFR, which is the underlying external need to incur borrowing to fund the capital programme. They also show the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator - Capital Financing Requirement

As explained above, the CFR forecasts change with the capital expenditure forecasts, to the extent that the expenditure is not funded. Due to the reprofiling of capital expenditure, partly due to Covid 19, the CFR is below the forecast for both Adur and Worthing.

Prudential Indicator - the Operational Boundary for external debt
Adur District Council

	2021/22 Original Estimate	Actual at 30 Sept 2021	2021/22 Revised Estimate
	£m	£m	£m
Prudential Indicator Capital Financing Requirement			
CFR - HRA	79.004	61.941	79.713
CFR – Non-HRA	158.544	108.173	112.363
Total CFR	237.548	170.114	192.076
Net movement in CFR	37.371	1.618	23.580
	Operational Boundary	**Actual Debt**	**Operational Boundary**
Borrowing	233.000	156.361	233.000
Other long term liabilities	1.000	0.000	1.000
Total debt	234.000	156.361	234.000

Worthing Borough Council

	2021/22 Original Estimate	Actual at 30 Sept 2021	2021/22 Revised Estimate
	£m	£m	£m
Prudential Indicator Capital Financing Requirement			
CFR - Non-HRA	191.619	144.564	179.256
Net movement in CFR	7.881	8.932	43.624
	Operational Boundary	**Actual Debt**	**Operational Boundary**
Borrowing re Worthing Homes	10.000	10.000	10.000
Borrowing re GB Met	5.000	4.625	5.000
Other Borrowing	177.000	124.926	177.000
Other long term liabilities	1.000	0.000	1.000
Total debt	193.000	139.551	193.000

7.4 Limits to Borrowing Activity: CFR and debt

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital investment purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the next two financial years. This allows some flexibility for limited early borrowing for future years. The Councils have approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. The Chief Financial Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

Adur District Council

	2021/22 Original Estimate	Actual debt at 30 Sept 2021	2021/22 Revised Estimate
	£m	£m	£m
Borrowing	232.332	156.361	178.323
Other long term liabilities	0.000	0.000	0.000
Total debt	232.332	156.361	178.323
CFR	237.548	170.114	192.076

Worthing Borough Council

	2021/22 Original Estimate	Actual debt at 30 Sept 2021	2021/22 Revised Estimate
	£m	£m	£m
Borrowing	190.902	139.551	174.243
Other long term liabilities	0.000	0.000	0.000
Total debt	190.902	139.551	174.243
CFR	191.619	144.564	179.256

7.5 Limits to Borrowing Activity: Authorised Limit and debt

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Adur District Council

	2021/22 Original Indicator	Actual debt at 30 Sept 2021	2021/22 Revised Indicator
Authorised Limit for external debt	**£m**	**£m**	**£m**
Borrowing	238.000	156.361	238.000
Other long term liabilities	1.000	0.000	1.000
Total	239.000	156.361	239.000

Worthing Borough Council

	2021/22 Original Indicator	Actual debt at 30 Sept 2021	2021/22 Revised Indicator
Authorised Limit for external debt	**£m**	**£m**	**£m**
Borrowing re Worthing Homes and GB Met	15.000	14.625	15.000
Other Borrowing	182.000	124.926	182.000
Other long term liabilities	1.000	0.000	1.000
Total	198.000	139.551	198.000

8 BORROWING

8.1 The Capital Financing Requirement (CFR) denotes the Councils' underlying need to borrow for capital purposes. If the CFR is positive the Councils may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. For both Adur and Worthing Councils capital expenditure in 2021/22 is funded from grants, capital receipts, contributions, reserves and revenue contributions as well as borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that any upside risk to gilt yields prevails..

8.2 Adur District Council's revised CFR forecast for 2021/22 is £192.076m. The relevant table in 7.4 shows the Council has borrowings of £156.361m at 30 September 2021 and has utilised £13.753m of cash flow funds in lieu of borrowing.

Worthing Borough Council's revised CFR for 2021/22 is £179.256m. The relevant table in 7.4 shows the Council has borrowings of £139.551m at 30 September 2021 and has utilised £5.013m of cash flow funds in lieu of borrowing.

8.3 Due to the overall financial position, the payments made on repayment loans and the underlying need to borrow for capital purposes, new external borrowing was undertaken as shown in the tables below. It is anticipated that further borrowing will be undertaken by both Councils during this financial year to fund capital expenditure and any debt refinancing needs. The capital programmes are being kept under regular review to assess progress and the associated need to finance the programme. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term. The Councils have made some use of short-term borrowing from other local authorities due to the low interest rates available.

Adur District Council – new loans

Lender	Principal	Type	Interest Rate	Maturity
Public Works Loans Board	£1.0m	Fixed interest rate	2.01%	08/07/2041

Worthing Borough Council – new loans

Lender	Principal	Type	Interest Rate	Maturity
Leicester City Council	£5m	Fixed interest rate	0.25%	18/08/2023

8.4 **PWLB maturity certainty rates (gilts plus 80bps) year to 30 September 2021**

Gilt yields and PWLB rates were on a falling trend between May and August. However they rose sharply towards the end of September. The 50-year PWLB target certainty rate for new long-term borrowing started in April at 1.90%, rose to 2.00% in May, fell back to 1.70% in August and has now returned to 2.00% at the end of September after the MPC meeting of 23rd September.

The current PWLB rates are set as margins over gilt yields as follows (100 basis points is equivalent to 1%):-

- **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 80 basis points (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60 basis points (G+60bps)

9.0 DEBT RESCHEDULING

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 for either Council.

10.0 COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

It is a statutory duty for the Councils to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2021, the Councils have operated within the treasury and prudential indicators set out in the Joint Treasury Management Strategy Statement for 2021/22. The Chief Financial Officer reports that no difficulties are envisaged for the current or future years in complying with the indicators.

All treasury management operations have also been conducted in full compliance with the Councils' Treasury Management Practices.

11.0 ANNUAL INVESTMENT STRATEGY

11.1 The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Adur Council on 18 February 2021 and by Worthing Council on 23 February 2021. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Councils' investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Councils will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity and with the Councils' risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions. The shared Treasury Service uses information supplied by the Treasury advisers, Link Asset Services, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

As shown by the interest rate forecasts in the Appendix, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020 until the MPC meeting on 24th September 2021 when 6 and 12 month rates rose in anticipation of Bank Rate going up in 2022. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before mid 2023, investment returns are expected to remain low.

This has had an impact on the income from our investment portfolios which has fallen substantially since 2019/20. Within the Medium Term Financial Strategy, the impact of these rates has added to the financial pressure the Councils are under although this pressure is offset by the low rates on the Councils' loans.

11.2 **Creditworthiness**

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 (the rating agency's view regarding the potential direction of a long term credit rating over the intermediate period - typically 6 months to 2 years). However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirements of the treasury management function except for the amendments recommended in section 4.3.

Credit Default Swap prices

Credit Default Swaps (CDS) are credit derivative contracts that enable investors to swap credit risk on a company with another counterparty. They are market indicators of credit risk. Although CDS prices for UK banks 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.**

11.3 **Investment balances**

The Councils occasionally lend funds to each other, for example when a competitive rate is available from another Local Authority, but that Authority wishes to lend a larger sum than Adur or Worthing need individually. In 2020 Worthing borrowed £5m from another Authority, of which £2.5m was lent onwards to Adur.

The average level of funds available for investment purposes during the half year for Adur was £14.8m and for Worthing was £17.1m, excluding long term loans to Adur District Council, Worthing Homes and GB Met College. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt and payment of grants and progress on the capital programme.

11.4 **Investment performance – Adur District Council**

The investment portfolio yield for the first 6 months of the year is 0.25% p.a. against the London Interbank Bid Rate benchmark rate (supplied by Link) of 0.07% for 12 month deposits. This rate excludes the £3m investment in the Local Authorities' Property Fund, which returned 3.46% p.a. over the 6

months. The portfolio is shown below. Adur District Council's budgeted investment return for 2021/22 for both the General Fund and the HRA is £135k and the current forecast will result in a small over achievement of about £6k. The interest payable budget is currently expected to underspend by £159k by the year end.

Investment portfolio – Adur District Council

Counterparty	Issue Date	Maturity Date	Principal	Interest Rate	Long Term Rating
CCLA MMF	n/a	n/a	£3,000,000	var	AAA
Close Brother Ltd	10.08.21	09.08.22	£1,000,000	0.45%	A-
Close Brothers Ltd	06.09.21	06.03.23	£1,000,000	0.60%	A-
Federated Investments MMF	n/a	n/a	£10,000	var	AAA
Goldman Sachs Int Bank	26.05.21	06.06.22	£1,000,000	0.32%	A+
Goldman Sachs Int Bank	19.05.21	21.02.22	£1,000,000	0.24%	A+
Goldman Sachs Int Bank	15.07.21	07.03.22	£1,000,000	0.19%	A+
Handelsbanken call account	n/a	n/a	£140,000	0.02%	AA
Handelsbanken 35 day notice	n/a	n/a	£2,000,000	0.05%	AA
Lloyds Bank call account	n/a	n/a	£660,000	0.01%	A+
Lloyds Bank 95 day notice	n/a	n/a	£10,000	0.05%	A+
Local Authority Property Fund	25.04.17	n/a	£3,000,000	var	n/a
Santander UK 95 day notice	n/a	n/a	£4,000,000	0.40%	A+
Standard Chartered Bank	16.06.21	28.03.22	£1,000,000	0.17%	A+
Boom Credit Union	06.03.15	n/a	£25,000	n/a	n/a
TOTAL			**£18,845,000**		

11.5 **Investment performance – Worthing Borough Council**

The investment portfolio yield for the first 6 months of the year is 0.28% p.a. against the London Interbank Bid Rate benchmark rate of 0.07% for 12 month deposits. The portfolio yield includes a £2.5m loan to Adur District Council but excludes the £1.5m investment in the Local Authorities' Property Fund, which returned 3.46% p.a. over the 6 months.

The Council has also made 2 loans which are treated as capital expenditure rather than treasury investments:

- £10m to Worthing Homes at 0.7% above the rate at which the funds were borrowed, generating £70k p.a. for the Council
- £5m repayment loan to GB Met College at 2% above the rate at which funds were borrowed; the balance is now £4.868m, which will generate £104k in 2021/22 for the Council.

Worthing Borough Council's budgeted investment income for 2021/22, excluding the Worthing Homes and GB Met loans, is £65k and the current forecast will result in an over achievement of about £40k, due to the substantial Covid grants still held by the Council, but due to be repaid to

Government in the near future. The use of internal borrowing and the reprofiling of the capital programme contribute to a saving in the interest payable budget which is currently expected to underspend by £304k by the year end.

Investment Portfolio - Worthing Borough Council

Counterparty	Issue Date	Maturity Date	Principal	Interest Rate	Long Term Rating
Adur District Council	30.06.20	30.06.22	£2,500,000	1.00%	n/a
CCLA MMF	n/a	n/a	£3,000,000	var	AAA
Close Bros	30.06.21	05.01.22	£1,000,000	0.25%	A-
Federated Investments MMF	n/a	n/a	£10,000	var	AAA
Goldman Sachs Int Bank	26.05.21	28.02.22	£2,000,000	0.26%	A+
Goldman Sachs Int Bank	02.06.21	07.03.22	£1,000,000	0.25%	A+
Handelsbanken call account	n/a	n/a	£2,000,000	0.02%	AA
Handelsbanken 35 day notice	n/a	n/a	£2,000,000	0.05%	AA
Invesco MMF	n/a	n/a	£10,000	var	AAA
Leeds Building Society	09.06.21	06.06.22	£1,000,000	0.15%	A-
Lloyds call account	n/a	n/a	£280,000	0.01%	A+
Lloyds 32 day notice	n/a	n/a	£10,000	0.03%	A+
Lloyds 95 day notice	n/a	n/a	£10,000	0.05%	A+
Santander 95 day notice	n/a	n/a	£4,000,000	0.40%	A+
Standard Chartered Bank	16.06.21	28.02.22	£2,000,000	0.16%	A+
Standard Chartered Bank	24.06.21	05.10.21	£1,000,000	0.09%	A+
Local Authority Property Fund	27.04.17	n/a	£1,500,000	var	n/a
Boom Credit Union	Various	n/a	£50,000	n/a	n/a
TOTAL			**£23,370,000**		

Investment Performance – Approved Limits

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the period ended 30 September 2021. The Local Authority Property Funds gave a briefing for Members on the 27th October 2021 to update them and answer any questions.

11.6 **Counterparty commitment to sustainability**

The Councils are committed to ethical investments and the use of counterparties which have appropriate sustainability, carbon reduction or ethical plans. There are links below to the plans or declarations of our current investment counterparties.

https://www.ccla.co.uk/our-policies/climate-change-and-investment-policy
https://www.closebrothers.com/sustainability-and-environment
https://www.federatedinvestors.com/resources/resource-centers/responsible-investing-center.do?hint=class
https://www.goldmansachs.com/investor-relations/corporate-governance/sustainability-reporting/

https://www.handelsbanken.com/en/sustainability/climate-impact
https://www.invesco.com/corporate/about-us/esg/environmental-sustainability
https://www.leedsbuildingsociety.co.uk/knowledge-base/members/continuing-to-reduce-our-carbon-footprint/
https://www.lloydsbankinggroup.com/our-group/responsible-business/financing-a-green-future-together/reducing-our-own-environmental-footprint/

https://www.santander.co.uk/assets/s3fs-public/documents/2019_santander_esg_supplement.pdf

https://www.sc.com/en/sustainability/?gclid=Cj0KCQjw18WKBhCUARIsAFiW7Jw9h9XtzcULNMBFfdOMiAEC0Lkjnwv5QBGzPyHH7ftV08AuVuZm3hYaAmJmEALw_wcB&gclsrc=aw.ds

12. ENGAGEMENT AND COMMUNICATION

12.1 The Adur and Worthing Councils' treasury management team provides treasury services to Mid Sussex District Council through a shared services arrangement (SSA). The SSA is provided under a Service Level Agreement that was renewed from 18th October 2019, and which defines the respective roles of the client and provider authorities for a period of three years.

12.2 The Adur and Worthing Councils' treasury management team has also provided treasury services to Arun District Council through a shared services arrangement (SSA) since 1st March 2021 under a Service Level Agreement which defines the respective roles of the client and provider authorities for a period of three years.

12.2 Information and advice is supplied throughout the year by Link Treasury Services Ltd, the professional consultants for the Councils' shared treasury management service. This contract is due to be re-procured for 1st April 2022.

13. FINANCIAL IMPLICATIONS

13.1 This report has no quantifiable additional financial implications to those outlined above. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget.

14. LEGAL IMPLICATIONS

14.1 The presentation of the Half Year Report is required by regulations issued under the Local Government Act 2003 to review the treasury management activities, the actual prudential indicators and the treasury related indicators for 2021/22.

Background Papers

Joint Treasury Management Strategy Statement and Annual Investment Strategy Report 2021/22 to 2023/24 (Adur Council 18 February 2021 and Worthing Council 23 February 2021)
Annual Joint In-House Treasury Management Operations Report 1 April 2020 – 31 March 2021 (Adur Council 28 October 2021, Worthing Council 19 October 2021)
Link Treasury Services Ltd Half Year Report Template 2021/22

Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA)
The Prudential Code for Capital Finance in Local Authorities (CIPFA)

SUSTAINABILITY & RISK ASSESSMENT

1. ECONOMIC

The treasury management function ensures that the Councils have sufficient liquidity to finance their day to day operations. Borrowing is arranged as required to fund the capital programmes. Available funds are invested according to the specified criteria to ensure security of the funds, liquidity and, after these considerations, to maximise the rate of return.

2. SOCIAL

2.1 Social Value

Matter considered and no issues identified.

2.2 Equality Issues

Matter considered and no issues identified.

2.3 Community Safety Issues (Section 17)

Matter considered and no issues identified.

2.4 Human Rights Issues

Matter considered and no issues identified.

3. ENVIRONMENTAL

Matter considered and no issues identified.

4. GOVERNANCE

4.1 The Councils' Treasury Management Strategy and Annual Investment Strategy places the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Council priorities.

4.2 The operation of the treasury management function is as approved by the Councils' Treasury Management Strategy and Annual Investment Strategy 2021/22 - 2023/24, submitted and approved before the commencement of the 2021/22 financial year.

4.3 In the current economic climate the security of investments is paramount, the management of which includes regular monitoring of the credit ratings and other incidental information relating to credit worthiness of the Councils' investment counterparties.

APPENDIX

*This commentary has been supplied by **Link Treasury Services Ltd**, the professional consultants for the Councils' shared treasury management services. The context is significant as it describes the backdrop against which treasury management activity has been undertaken during the year.*

Economics and interest rates

1. Economics update

MPC meeting 24th September 2021

- 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; two MPC member voted to stop these purchases now to leave total purchases £35bn short of the total target as they were concerned that this would add to inflationary pressures.

- There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey 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, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, **the MPC had been prepared to look through a temporary spike in inflation.**

- So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to **faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement;** this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

- Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

  The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

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

- **COVID-19 vaccines**. These have been the game changer which have enormously boosted confidence that **life in the UK could largely return to normal during the summer** after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

Globally, our views on economies are as follows: -

- **US.** See comments below on US treasury yields.

- **EU.** The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP 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. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.
  German general election. With the CDU/CSU and SDP both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SDP-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.

- **China**. 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. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, 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 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

- **Japan**. 2021 has been a patchy year in combating Covid. However, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.

- **World growth.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

Supply shortages. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

2 Interest rate forecasts

The Council's treasury advisor, Link Group, provided the following forecasts on 29th September 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View 29.9.21										
	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	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

Additional notes by Link on this forecast table: -

- LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.

The coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings.

As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23 and another increase to 0.50% in quarter 4 of 23/24 and a third one to 0.75% in quarter 4 of 2023/24.

Significant risks to the forecasts

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that supresses GDP growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding QE.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets e.g. in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market sell-offs on the general economy.
- Geo-political risks are widespread e.g. German general election in September 2021 produces an unstable coalition or minority government and a void in high-profile leadership in the EU when Angela Merkel steps down as Chancellor of Germany; on-going global power influence struggles between Russia/China/US.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

Forecasts for Bank Rate

Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC’s 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons: -

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
- Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. Then we have the Government's upcoming budget in October, which could also end up in reducing consumer spending power.
- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- There are 1.6 million people coming off furlough at the end of September; how many of those will not have jobs on 1st October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that there could be further nasty surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.

In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon - in line with what the new news is.

It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields
As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

There is likely to be **exceptional volatility and unpredictability in respect of gilt yields and PWLB rates** due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?

- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Gilt and treasury yields

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic party's determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the $900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American families plan over the next decade which are caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy had already been growing strongly during 2021.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
4. And the Fed was still providing monetary stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards the goal of reaching full employment". However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August

seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK. **As an average since 2011, there has been a 75% correlation between movements in 10 year treasury yields and 10 year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.**

There are also possible **DOWNSIDE RISKS** from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to keep an eye on.

The balance of risks to medium to long term PWLB rates: -

- There is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era – a fundamental shift in central bank monetary policy

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going <u>above</u> a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.

- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.

- ***<u>For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.</u>***
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.