ANNEX 1

TREASURY MANAGEMENT STRATEGY STATEMENT

Minimum Revenue Provision Policy Statement

Annual Treasury Investment Strategy

January 2022

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1. INTRODUCTION

1.1 Background

CIPFA defines treasury management as:

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

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

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

The contribution that treasury management makes to the authority's financial health is critical, as the balance of debt and investment operations ensure liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue expenditure or for larger capital projects. The treasury function seeks to balance interest costs on debt and investment income from cash deposits. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

While any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are reported separately from day to day treasury management activities.

Objectives: the Treasury Management Strategy has the following objectives:

- To consider and effectively address the risks associated with Treasury Management activity;
- To optimise the flow of cash through the organisation in order to maximise the potential for using it to earn investment income for the Council, and where required limit the borrowing costs for the Authority;
- To optimise the returns from investments while meeting the overriding need to protect the capital sum and ensure that the cash is available when the Council requires it;

- To align investments in relation to cash flow, within statutory constraints, in order to increase investment returns in future years;
- To optimise the revenue costs of undertaking all treasury activities;
- To monitor and review significant changes in the pattern of cash movements and interest rate movements and react accordingly; and
- To incorporate any changes to the Treasury Management Code of Practice and the Prudential Code that will affect effective treasury management.

1.2 Reporting Requirements

Capital Investment Strategy: The CIPFA 2021 Prudential and Treasury Management Codes require all local authorities to prepare, a Capital Investment Strategy, which provide the following:

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

The aim of the Capital Investment Strategy is to ensure that all elected Members on the Council fully understand the overall long-term policy objectives and resulting Capital Investment Strategy requirements, governance procedures and risk appetite.

The 2022/23 Capital Investment Strategy was reported to Executive in July 2021; the next update is due to be reported in summer 2022.

Treasury Management Reporting: The Council is required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

(i) Treasury Management Strategy and Prudential Indicators (this report) - the first, and most important, report is forward-looking and covers:
   - Capital Plans including the Prudential Indicators and the Capital Financing Requirement (CFR);
   - the Minimum Revenue Provision (MRP) Policy, demonstrating how residual capital expenditure is charged to revenue over time; and
   - the Treasury Investment Strategy, describing the parameters for how investments are to be managed.

(ii) Mid-Year Treasury Management Report – this is primarily a progress report and will update Members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

(iii) Annual Treasury Outturn Report – this is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the Strategy.

1.3 Scrutiny

All Treasury Management reports must be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

1.4 Treasury Management Strategy for 2022/23

The strategy for 2022/23 covers two main areas:

(i) Capital Issues
- the capital expenditure plans and the associated prudential indicators; and
- the MRP policy.

(ii) Treasury management issues
- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

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

1.5 Treasury Management Training

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. A briefing for members was conducted with the Council's Treasury Advisors (LINK Group) in March 2022 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed. They take up opportunities to attend training courses and are expected to meet their Continued Professional Development (CPD) requirement.

1.6 Treasury Management Consultants

The authority employs LINK Group, as its external treasury management advisors.

It is important to recognise that responsibility for treasury management decisions remains with the authority at all times and to ensure that undue reliance is not placed upon the services of external service providers. All treasury management decisions are undertaken with regard to all available information, including, but not solely, the external advisers.

It is also important to ensure that the terms of the advisors' appointment and the methods by which their value is assessed are properly agreed and documented and subjected to regular review.

2. CAPITAL PRUDENTIAL INDICATORS

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

2.1 Capital Expenditure Plans

The first **Prudential Indicator** is a summary of the authority's capital expenditure plans which are the key driver of treasury management activity.

The following capital expenditure forecasts were included in the Budget 2022/23 budget report to Executive on 27 January 2022 and Members are asked to approve the capital expenditure forecasts:

Table 1: CAPITAL EXPENDITURE TO BE FINANCED	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual £m	Estimate £m	Estimate £m	Estimate £m	Estimate £m
People Services	8.333	5.523	11.875	1.425	1.425
Place Services	15.887	20.039	16.742	0.874	0.991
Organisation Services	1.541	0.562	5.436	1.862	1.746
Total	**25.761**	**26.124**	**34.053**	**4.161**	**4.162**

The Council does not currently have any planned Capital Programme expenditure which is solely for investment purposes.

Other Long-Term Liabilities: the introduction of IFRS16 may change some of the Prudential Indicators due to additional lease liabilities being recognised on the balance sheet. CIPFA is currently consulting on options for delaying implementation of IFRS16 to 2023/24.

Capital Financing: the table below summarises the above capital expenditure plans and how they are to be financed through use of capital or revenue resources. Any shortfall of resources results in a borrowing requirement.

Table 2: CAPITAL FINANCING PLANS	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual £m	Estimate £m	Estimate £m	Estimate £m	Estimate £m
Capital Grants / Contributions	1.843	1.660	1.247	1.247	1.247
Capital Receipts	4.403	4.402	26.778	-	-
Revenue	-	-	-	-	-
Capital Reserves	-	7.000	-	-	-
External Funding	**6.246**	**13.062**	**28.025**	**1.247**	**1.247**
Net borrowing need - General Fund (Core)	19.515	13.062	6.028	2.914	2.915
Net financing need for the year	**19.515**	**13.062**	**6.028**	**2.914**	**2.915**

2.2 Borrowing Need (the Capital Financing Requirement)

The second **Prudential Indicator** is the authority's Capital Financing Requirement (CFR).

The CFR is the total of historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of indebtedness and so its underlying borrowing need. Any capital expenditure which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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

Council is recommended to approve the CFR projections below:

Table 3: MOVEMENT IN THE CAPITAL FINANCING REQUIREMENT	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual £m	Estimate £m	Estimate £m	Estimate £m	Estimate £m
Closing CFR	**50.326**	**62.874**	**68.236**	**70.412**	**72.549**
Movement in CFR	**19.221**	**12.548**	**5.362**	**2.176**	**2.137**
Movement in CFR represented by:					
Net financing need for the year (above)	19.515	13.062	6.028	2.914	2.915
Less MRP/VRP and other financing movements	(0.294)	(0.514)	(0.666)	(0.738)	(0.778)
Movement in CFR	**19.221**	**12.548**	**5.362**	**2.176**	**2.137**

2.3 Core Funds and Expected Investment Balances

Expected Investment Balances: The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Table 4: EXPECTED BALANCES TO INVEST OR FUND CAPITAL	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
General Fund Balance	3.246	3.000	3.000	3.000	3.000
Earmarked Reserves	36.044	33.767	30.000	30.000	30.000
Capital Receipts/Grants	15.698	15.698	15.000	15.000	15.000
Provisions	181	181	181	181	181

Table 4: EXPECTED BALANCES TO INVEST OR FUND CAPITAL	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Revenue Grants	-	-	-	-	-
Total Core funds - General Fund	**55.169**	**52.646**	**48.181**	**48.181**	**48.181**
Working Capital[1]	7.000	7.000	7.000	7.000	7.000
Under / (Over) Borrowing[2]	41.326	25.874	24.236	21.412	21.549
Expected Investments	**6.843**	**19.772**	**16.945**	**19.769**	**19.632**

1. Working capital balances shown are estimated year-end; these may be higher mid-year
2. This table has been prepared on the basis that the current level of under borrowing is sustained across the period.

2.4 Liability Benchmark

A new requirement under the Treasury Management Code 2021 is to publish a liability benchmark for a minimum of 10 years in chart format, with material differences between the liability benchmark and actual loans explained. This will be developed for inclusion in the 2023/24 Strategy.

2.5 Minimum Revenue Provision (MRP) Policy Statement

Local Authorities have a duty to *"determine for the current financial year an amount of MRP which it considers prudent".* In principle councils must arrange for debt liabilities to be repaid over a period commensurate with asset lives.

The authority is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the MRP). It is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

DLUHC guidance require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

Council is recommended to approve the following MRP Statement for 2022/23:

> From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the Minimum Revenue Policy will be the Asset life method – MRP will be based on the estimated life of the assets, in accordance with the guidance and will be set aside in the year after the asset becomes operational. This will be a combination of the annuity method and straight line method:
>
> - Operational land and buildings - 50 years annuity method;
> - Investment Properties - 50 years annuity method;
> - General Fund Housing - 50 years annuity method;
> - Infrastructure - 50 years straight line method;
> - Plant and Equipment- 30 years straight line method;

- Investment in share capital – 20 years straight line method;
- ICT- 5 years straight line method; and
- Vehicles - 8 years straight line method.

MRP on Capital Loans and Share Capital: Under local authority capital accounting regulations loans to third parties for capital purposes and share capital are deemed to be capital expenditure of the authority. The authority has made loans to its companies (Greensand Holdings Limited and Horley Business Park Development LLP).

The CFR includes the value of the loans and investments (share capital). Funds repaid by the companies are classed as capital receipts and offset against the CFR.

A recently-published Government consultation document on MRP is proposing a requirement that MRP is set aside to repay the debt liability for this type of loan in the interim period. Depending on the outcome of the consultation the policy on MRP may have to be revised for 2023/24 if these proposals go ahead. They are not expected to be retrospective.

MRP Overpayments: DLUHC Guidance includes the provision that any MRP charges made over the statutory minimum may be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed, the MRP policy must disclose the cumulative overpayment made each year. At 31 March 2022 the cumulative voluntary overpayments by this authority were forecast to be £nil.

3. BORROWING

3.1 External Debt

Borrowing Strategy: the capital expenditure plans at Section 2 provide a summary of the service activity of the Council.

The treasury management function ensures that the authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to fund service activity and the Capital Investment Strategy. This will involve both the organisation of cash flows and, where capital plans require, the organisation of appropriate borrowing facilities. The Treasury Management Strategy covers the relevant treasury/prudential indicators, current and projected debt positions and the annual Treasury Investment Strategy.

3.2 Current Portfolio Position

The treasury management portfolio position at 31 March and at 31 December is set out below:

Table 5: INVESTMENT PORTFOLIO	Actual 31/03/2021 £m	%	Actual 31/12/2021 £m	%
Treasury Investments				
Cash at Bank	12.469	25.7%	22.559	42.1%
Building Societies - unrated	13.000	26.8%	10.000	18.7%
Building Societies - rated	-	-	-	-
Local Authorities	-	-	-	-
DMADF (HM Treasury)	-	-	-	-
Money Market Funds	23.000	47.5%	21.000	39.2%
Certificates of Deposit	-	-	-	-
Total Managed In-House	48.469	100%	53.559	100%
Bond Funds	-	-	-	-
Property Funds	-	-	-	-
Total Managed Externally	0	0%	0	0%
Total Treasury Investments	**48.469**	**100%**	**53.559**	**100%**
Treasury External Borrowing				
Local Authorities	9.000	100%	-	-
PWLB	-	-	-	-
Total External Borrowing	**9.000**	**100%**	**0**	**0%**
Net Treasury Investments / (Borrowing)	**39.469**	**-**	**53.559**	**-**

The total CFR at the table below is based upon the total approved capital programme expenditure as reported to Executive and Council as part of budget setting. The authority has no external borrowing at present.

The table below sets out the **Prudential Indicator** for gross debt compared to the underlying capital borrowing need (the CFR), highlighting any over- or under-borrowing. Borrowing is forecast based on the approved capital programme rather than the capital expenditure forecast and will be revised at the year-end in line with the actual expenditure outturn.

Table 6: CUMULATIVE EXTERNAL DEBT	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Debt at 1 April	14.000	9.000	37.000	44.000	49.000
Expected Change in Debt	(5.000)	28.000	7.000	5.000	2.000
Other Long-Term Liabilities	-	-	-	-	-
Expected Change in Other Long-Term Liabilities	-	-	-	-	-
Gross Debt at 31 March	**9.000**	**37.000**	**44.000**	**49.000**	**51.000**
The Capital Financing Requirement (CFR)	50.326	62.874	68.236	70.412	72.549
Under/ (Over) Borrowing	**41.326**	**25.874**	**24.236**	**21.412**	**21.549**

3.3 Treasury Indicators: Limits to Borrowing Activity

Within the range of prudential indicators there are a number of key indicators to ensure that the authority operates within well-defined limits.

One of these is that the authority needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimate for any additional CFR for the current and following two years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative reasons.

The Chief Financial Officer reports that the authority complied with this prudential indicator in the current year and does not envisage difficulties in future. This opinion takes into account current commitments, existing plans and the approved budget.

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

The recommended **Operational Boundary** is based on the forecast maximum CFR over the Capital Programme period 2022/23 to 2026/27 (details above) plus the forecast value of leases under IFRS16.

Council is recommended to approve the following Operational Boundary for 2022/23:

Table 7: OPERATIONAL BOUNDARY	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Estimate £m	**Estimate £m**	**Estimate £m**	**Estimate £m**
Borrowing - General	63.000	68.500	70.500	73.000
Other long term liabilities	500	500	500	500
Operational Boundary	**63.500**	**69.000**	**71.000**	**73.500**

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

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

The recommended **Authorised Limit** is set £10M above the Operational Boundary to provide sufficient headroom to allow borrowing for any unforeseen circumstances.

Council is recommended to approve the following Authorised Limit for 2022/23:

Table 8: AUTHORISED LIMIT	**2021/22**	**2022/23**	**2023/24**	**2024/25**
	Estimate £m	**Estimate £m**	**Estimate £m**	**Estimate £m**
Borrowing - General	73.000	78.500	80.500	83.000
Other long term liabilities	500	500	500	500
Authorised Limit	**73.500**	**79.000**	**81.000**	**83.500**

3.4 Prospects for Interest Rates

Part of LINK Group's service as the authority's treasury advisor is to assist the in-house treasury team in formulating a view on interest rates. LINK Group provided the following forecasts on 7 February 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View 7.2.22	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month av. earnings	0.80	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month av. earnings	1.00	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month av. earnings	1.40	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40

Further commentary from LINK Group is provided at Appendix 5.2.

3.5 Borrowing Strategy

The authority continues to maintain an under-borrowed position. This means that the capital borrowing need (the CFR), has not been funded with loan debt because cash supporting the authority's reserves, balances and cash flow has been used as a temporary measure.

This strategy is prudent as investment returns on balances are low and counterparty risk is a factor that needs to be considered.

Against this background, and the risks within the economic forecast, caution will continue to be exercised for treasury management operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.
- if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the borrowing position will be re-appraised. Most likely, fixed rate funding will be drawn while interest rates are lower than they are projected to be in the next few years.

Any decisions on borrowing will be reported to the appropriate decision making body at the next available opportunity as part of regular in-year treasury management reporting.

3.6 Policy on Borrowing in Advance of Need

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

3.7 Approved Sources of Long- and Short-term Borrowing

Access may be limited due to the authority's quantum of borrowing relative to the minimum loan required by some of these instruments.

On Balance Sheet	Fixed	Variable
PWLB	●	●

Municipal Bonds Agency	●	●
Other local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	-	-
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	-
Local authority bills	●	●
Overdraft	-	●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	-
Medium Term Notes	●	-
Finance leases	●	●

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

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

The revised Prudential Code states (at paragraph 51) that in order to comply with the Code, an authority must not borrow to invest primarily for financial return. Paragraph 53confirms that '…*Authorities with existing commercial investments (including property) are not required by this Code to sell these investments. Such authorities may carry out prudent active management and rebalancing of their portfolios. However, authorities that have an expected need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual treasury management or investment strategies. The reviews should evaluate whether to meet expected borrowing needs by taking new borrowing or by repaying investments, based on a financial appraisal that takes account of financial implications and risk reduction benefits. Authorities with commercial land and property may also invest in maximising its value, including repair, renewal and updating of the properties….'.*

The authority is not planning to purchase any new investment assets primarily for yield within the next three years so has full access to PWLB borrowing.

The PWLB has also recently increased the settlement period for taking up new loans from 3 to 5 working days to provide more time to check borrowing applications made by local authorities for compliance with their arrangements. Additionally, in a move to protect the PWLB from negative interest rates, the minimum interest rate for PWLB loans has been set at 0.01%. These changes are not expected to have any material impact on this authority's borrowing plans.

4. INVESTMENT

4.1 Annual Treasury Investment Strategy

The Government (DLUHC) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Investment Strategy (a separate report).

The authority's investment policy has regard to the following:

- DLUHC's Guidance on Local Government Investments ('the Guidance')
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ('the Code')
- CIPFA Treasury Management Guidance Notes 2018

The authority's investment priorities remain security first, portfolio liquidity second and then yield (return). The aim is to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity and with the authority's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the authority will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

4.2 Investment Policy – Management of Risk

The guidance from DLUHC and CIPFA places a high priority on the management of risk.

DLUHC and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the in-house treasury management team). Non-financial investments, essentially the purchase of income yielding assets and service investments, are covered in the Capital Investment Strategy (a separate report).

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

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

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political

environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the authority will engage with its treasury advisors to maintain a monitor on market pricing such as **“credit default swaps”** and overlay that information on top of the credit ratings.

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

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use:

   - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if they were originally classified as being non-specified investments solely due to the maturity period exceeding one year; and

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

5. **Non-specified and loan investment limits.** The authority has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of 40%.

6. **Lending limits**, (amounts and maturity), for each counterparty will be set.

7. **Transaction limits** are set for each type of investment.

8. This authority will set a limit for its investments which are invested for **longer than 365 days**.

9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**.

10. This authority has engaged **external consultants** to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

11. All investments will be denominated in **sterling**.

12. As a result of the change in accounting standards for 2022/23 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and

resultant charges at the end of the year to the General Fund. In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending March 2023.

This authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Creditworthiness Policy: the primary principle governing the authority'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 authority 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. This is set out in the specified and non-specified investment sections below; 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 authority's prudential indicators covering the maximum principal sums invested.

The Chief Financial Officer 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 that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the authority may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by LINK Group, the authority's treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating 'Watches' (notification of a likely change), rating 'Outlooks' (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur, and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for achieving a pool of high-quality investment counterparties, (for both specified and non-specified investments) are set out below. The authority uses credit ratings and other market intelligence to access the credit quality of any potential counterparty.

The authority sets limits as to the minimum level of credit rating that it will accept for any individual counterparty. The current minimum levels are set out at Appendix 5.3.

Use of additional information, other than credit ratings: additional requirements under the Code require the authority to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments: the authority sets a maximum exposure level, expressed in '£' that can be invested with any one organisation. The current limits are set out at Appendix 5.3.

UK banks – ring-fencing: the largest UK banks, (those with more than £25bn of retail and/or Small and Medium-sized Enterprise (SME) deposits), were required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019; known as 'ring-fencing'. Ring-fencing mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and 'riskier' activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The authority continues to assess the newly-formed entities in the same way that it does others. Those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Other Limits

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

Non-specified investment limit: the authority has determined that it will limit the maximum total exposure to non-specified investments as being 40% of the total investment portfolio.

Country limit: the authority has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Other limits. In addition:

- no more than 10% will be placed with any non-UK country at any time; and

- limits in place above will apply to a group of companies.

4.4 Treasury Investment Strategy

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

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations: LINK Group's current forecast includes a forecast for Bank Rate to reach 1.25% by December 2022. The budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year are as follows:

Table 9: AVERAGE EARNINGS IN EACH YEAR	Now	Previously
2022/23	0.20%	0.10%
2023/24	0.20%	0.10%
2024/25	0.20%	0.10%
2025/26	0.20%	0.10%
Years 6 to 10	0.20%	0.10%
Years 10+	0.20%	0.10%

For its cash flow-generated balances, the authority will seek to utilise business reserve, instant access and notice accounts, pooled investments (such as money market funds) and short-dated deposits (overnight to 100 days), in order to benefit from the compounding of interest.

Investment treasury indicator and limit: total principal funds invested for greater than 1 year. These limits are set with regard to the authority's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

Council is recommended to approve the following **Prudential Indicator and Limit**:

Table 10: UPPER LIMIT FOR PRINCIPAL SUMS INVESTED FOR LONGER THAN 365 DAYS	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m
Principal sums invested for longer than 365 days	20.0	20.0	20.0	20.0

Table 10: UPPER LIMIT FOR PRINCIPAL SUMS INVESTED FOR LONGER THAN 365 DAYS	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m
Current investments as at 31.12.21 in excess of 365 days maturing in each year	£nil			

Policy on Use of Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the authority is exposed to.

Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Investment Performance/Risk Benchmarking: To date the authority has used the 7-Day LIBID (London Inter Bank Bid Rate) as an investment benchmark to assess the performance of its investment portfolio.

Publication of LIBOR (London Inter Bank Bid Rate) figures (and related LIBID calculations) ceased at the close of 2021 and the replacement is SONIA (Sterling Overnight Index Average) the risk-free rate for sterling markets administered by the Bank of England. SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

End of Year Investment Report: At the end of the financial year, the authority will report on its investment activity as part of its Annual Treasury Report.

External Fund Managers: External fund managers (where employed) will comply with the Annual Treasury Investment Strategy. The agreement(s) between the authority and the fund manager(s) will stipulate guidelines and duration and other limits in order

to contain and control risk. The authority does not currently employ external fund managers.

5. APPENDICES

5.1 Capital, Prudential and Treasury Indicators

5.2 Interest Rate Forecasts & Economic Background – LINK Group

5.3 Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

5.4 Investment Portfolio at 31.12.21

5.5 Approved Countries for Investment

5.6 Treasury Management Scheme of Delegation

5.7 Treasury Management Role of the Section 151 Officer

5.8 Treasury Management Risk Assessment

Appendix 5.1

Capital, Prudential and Treasury Indicators

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

Capital Expenditure
Council is asked to approve the **Prudential Indicator** for Capital Expenditure:

Table 11: CAPITAL EXPENDITURE TO BE FINANCED	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual £m	Estimate £m	Estimate £m	Estimate £m	Estimate £m
People Services	8.333	5.523	11.875	1.425	1.425
Place Services	15.887	20.039	16.742	0.874	0.991
Organisation Services	1.541	0.562	5.436	1.862	1.746
Total	**25.761**	**26.124**	**34.053**	**4.161**	**4.162**

Affordability Prudential Indicators: The previous section covers the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are also required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the authority's overall finances.

Ratio of financing costs to net revenue stream: this indicator identifies the trend in the cost of capital, (borrowing and other long-term obligation costs net of investment income), against the net revenue stream.

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs.

The financing costs are the interest payable on borrowing, finance lease or other long-term liabilities and the amount defined by statute which needs to be charged to revenue to reflect the repayment of the principal element of borrowing. Any additional payments in excess of the statutory amount or the cost of early repayment or rescheduling of debt would be included within the financing cost. Financing costs are expressed net of investment income.

The Medium Term Financial Plan has already been adopted and within it the Chief Financial Officer has highlighted that there are funding gaps in future years. The investment in corporate initiatives and regeneration is intended to make up part of that gap.

The table below highlights the risk to the net budget requirement of not achieving any planned income streams – the top line represents the increasing percentage of net budget requirement which would be needed to service debt if none of the existing investment income were received. The lower line represents the percentage of net

budget requirement which would be needed to service debt even if existing investment income streams deliver as currently planned.

Council is asked to approve the affordability **Prudential Indicator**:

Table 12: RATIO OF FINANCING COSTS TO NET REVENUE BUDGET	2020/21	2021/22	2022/23	2023/24	2024/25
	Actual	Estimate	Estimate	Estimate	Estimate
Gross cost of borrowing as % of net budget requirement	2.4%	7.9%	8.9%	9.1%	9.2%
Net cost of borrowing including investment income as % of net budget requirement	(3.5%)	0.9%	3.8%	4.2%	4.4%

The estimates of financing costs include current commitments and the proposals in the 2022/23 Budget Report.

Maturity Structure Of Borrowing: these gross limits are set to reduce the authority's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Council is required to approve the following **Treasury Indicators and Limits**:

Table 13: MATURITY STRUCTURE OF BORROWING 2022/23		
Fixed & Variable Rate Borrowing	**Lower**	**Upper**
Under 12 months	100%	
12 months to 2 years		
2 years to 5 years		
5 years to 10 years		
10 years to 20 years		
20 years to 30 years		
30 years to 40 years		
40 years to 50 years		

The authority does not currently have any external borrowing; the limit will be reviewed and refined as borrowing takes place.

Appendix 5.2:

Interest Rate Forecasts & Economic Background – LINK Group

INTEREST RATE FORECASTS

Over the last two years, 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 until raising it to 0.25% at its meeting on 16th December 2021 and then to 0.50% at its meeting of 4th February 2022.

As shown in the forecast table above, the forecast for Bank Rate now includes a further three increases of 0.25% in March, May and November 2022 to end at 1.25%.

Significant risks to the forecasts

- ***Mutations*** *of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns.*
- ***Labour and supply shortages*** *prove more enduring and disruptive and depress economic activity.*
- ***The Monetary Policy Committee*** *acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.*
- ***The Monetary Policy Committee*** *tightens monetary policy too late to ward off building inflationary pressures.*
- ***The Government*** *acts too quickly to cut expenditure to balance the national budget.*
- ***UK / EU trade arrangements*** *– if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.*
- ***Longer term US treasury yields*** *rise strongly and pull gilt yields up higher than forecast.*
- ***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 selloffs on the general economy.*
- ***Geopolitical risks,*** *for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.*

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 risks from Covid and its variants - both domestically and their potential effects worldwide.*

Forecasts for Bank Rate

The Monetary Policy Committee is now very concerned at the way that forecasts for inflation have had to be repeatedly increased within a matter of just a few months. Combating this rising tide of inflation is now its number one priority and the 5-4 vote marginally approving only a 0.25% increase on 4th February rather than a 0.50% increase, indicates it is now determined to push up Bank Rate quickly. A further increase of 0.25% is therefore probable for March, and again in May, followed possibly by a final one in November. However, data between now and November could shift these timings or add to or subtract from the number of increases.

However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- *We do not know whether there will be further mutations of Covid and how severe they may be, nor how rapidly scientific advances may be made in combating them.*
- *The economy was running out of steam during the second half of 2021 and Omicron will mean that economic growth in quarter 1 of 2022 is likely to be flat, though on the rise towards the end of the quarter as the economy recovers. However, 54% energy cap cost increases from April, together with 1.25% extra employee national insurance, food inflation around 5% and council tax likely to rise in the region of 5% too - these increases are going to hit lower income families hard despite some limited assistance from the Chancellor to postpone the full impact of rising energy costs.*
- *Consumers are estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above increases. But most of those holdings are held*

by more affluent people whereas poorer people already spend nearly all their income before these increases hit and have few financial reserves.

- *These increases are already highly disinflationary; inflation will also be on a gradual path down after April so that raises a question as to whether the MPC may shift into protecting economic growth by November, i.e., it is more debatable as to whether they will deliver another increase then.*
- *The BIG ISSUE – will the current spike in inflation lead to a second-round effect in terms of labour demanding higher wages, (and/or lots of people getting higher wages by changing job)?*
- *If the labour market remains very tight during 2022, then wage inflation poses a greater threat to overall inflation being higher for longer, and the MPC may then feel it needs to take more action.*
- *If the UK were to invoke article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this would have the potential to end up in a no-deal Brexit.*

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

Forecasts for PWLB rates and gilt and treasury yields

Gilt yields. *Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. Our forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.*

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on gilt yields. ***As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for medium to longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.***

US treasury yields. *During the first part of 2021, 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. This was in addition to the $900bn support package previously passed in December 2020. Financial markets were alarmed that all this stimulus was happening at a time when: -*

1. *A fast vaccination programme roll-out had enabled a rapid opening up of the economy during 2021.*
2. *The economy was growing strongly during the first half of 2021 although it has weakened during the second half.*
3. *It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.*
4. *And the Fed was still providing substantial stimulus through monthly QE purchases during 2021.*

It was not much of a surprise that a combination of these factors would eventually cause an excess of demand in the economy which generated strong inflationary pressures. This has eventually been recognised by the Fed at its recent December meeting with an aggressive response to damp inflation down during 2022 and 2023.

- ***At its 3rd November Fed meeting****, the Fed decided to make a start on tapering its $120bn per month of QE purchases so that they ended next June. However, at its* ***15th December meeting*** *it doubled the pace of tapering so that they will end all purchases in February. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that treasury yields will rise over the taper period, all other things being equal.*
- *It also forecast that it expected there would be three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024. This would take rates back above 2% to a neutral level for monetary policy. It also gave up on calling the sharp rise in inflation as being 'transitory'.*
- *At its* ***26th January meeting****, the Fed became even more hawkish following inflation rising sharply even further. It indicated that rates would begin to rise very soon, i.e., it implied at its March meeting it would increase rates and start to run down its holdings of QE purchases. It also appears likely that the Fed could take action to force longer term treasury yields up by prioritising selling holdings of its longer bonds as yields at this end have been stubbornly low despite rising inflation risks. The low level of longer dated yields is a particular concern for the Fed because it is a key channel through which tighter monetary policy is meant to transmit to broader financial conditions,*

particularly in the US where long rates are a key driver of household and corporate borrowing costs.

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 monitor.*

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 (see below). As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising higher in the US than in the UK; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two 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 and enduring will inflationary pressures turn out to be in both the US and the UK, and so impact treasury and gilt yields?*
- ***Will the major western central banks implement their previously stated new average or sustainable level inflation monetary policies when inflation has now burst through all previous forecasts and far exceeded their target levels? Or are they going to effectively revert to their previous approach of prioritising focusing on pushing inflation back down and accepting that economic growth will be very much a secondary priority - until inflation is back down to target levels or below?***
- *How well will central banks manage the running down of their stock 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?*
- *If Russia were to invade Ukraine, this would be likely to cause short term volatility in financial markets, but it would not be expected to have a significant impact beyond that.*

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the 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 Russia, China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

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 for local authority investing
– 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%' before starting on raising Bank Rate and the ECB now has a similar policy.*
- ***For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising 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.***
- *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 once economies recover from the various disruptions caused by the pandemic.*
- *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.*

Investment and borrowing rates

- ***Investment returns*** *have started improving in the second half of 21/22 and are expected to improve further during 22/23 as the MPC progressively increases Bank Rate.*
- ***Borrowing interest rates*** *fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.*
- *On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The current margins over gilt yields are as follows:-*
  - ***PWLB Standard Rate*** *is gilt plus 100 basis points (G+100bps)*
  - ***PWLB Certainty Rate*** *is gilt plus 80 basis points (G+80bps)*
  - ***PWLB HRA Standard Rate*** *is gilt plus 100 basis points (G+100bps)*
  - ***PWLB HRA Certainty Rate*** *is gilt plus 80bps (G+80bps)*
  - ***Local Infrastructure Rate*** *is gilt plus 60bps (G+60bps)*
- ***Borrowing for capital expenditure.*** *Our long-term (beyond 10 years) forecast for Bank Rate is 2.00%. As nearly all PWLB certainty rates are now above this level, borrowing strategy will need to be reviewed, especially as the maturity curve has flattened out considerably. Better value can be obtained at the very short and at the longer end of the curve and longer-term rates are still at historically low levels. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing if a client is seeking to avoid a "cost of carry" but also wishes to mitigate future re-financing risk.*

ECONOMIC *BACKGROUND*

COVID-19 and vaccines.

These were the game changer during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, the bursting onto the scene of the Omicron mutation at the end of November, rendered the initial two doses of all vaccines largely ineffective in preventing infection. This dashed such hopes and raised major concerns that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that although this mutation is very fast spreading, it does not cause severe illness in fully vaccinated people. Rather than go for full lockdowns which heavily damage the economy, the government strategy this time focused on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection., It also placed restrictions on large indoor gatherings and hospitality venues over Christmas and into January and requested workers to work from home. This hit sectors like restaurants, travel, tourism and hotels hard which had already been hit hard during 2021.Economic growth will also have been lower due to people being ill and not working, similar to the pingdemic in July. The economy, therefore, faces significant headwinds in early 2022 although some sectors have learned how to cope well with Covid. The big question still remains as to whether any further mutations of this virus could

develop which render all 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 until tweaked vaccines become widely available.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- *The threat from Omicron was a wild card causing huge national concern at the time of December's MPC meeting; now it is seen as a vanquished foe disappearing in the rear-view mirror.*
- *The MPC shifted up a gear last week in raising Bank Rate by another 0.25% and narrowly avoiding making it a 0.50% increase by a 5-4 voting margin.*
- *Our forecast now expects the MPC to deliver another 0.25% increase in March; their position appears to be to go for sharp increases to get the job done and dusted.*
- *The March increase is likely to be followed by an increase to 1.0% in May and then to 1.25% in November.*
- *The MPC is currently much more heavily focused on combating inflation than on protecting economic growth.*
- *However, 54% energy cap cost increases from April, together with 1.25% extra employee national insurance, food inflation around 5% and council tax likely to rise in the region of 5% too - these increases are going to hit lower income families hard despite some limited assistance from the Chancellor to postpone the full impact of rising energy costs.*
- *Consumers are estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above increases. But most of those holdings are held by more affluent people whereas poorer people already spend nearly all their income before these increases hit and have few financial reserves.*
- *The increases are already highly disinflationary; inflation will also be on a gradual path down after April so that raises a question as to whether the MPC may shift into protecting economic growth by November, i.e., it is more debatable as to whether they will deliver another increase then.*
- *The BIG ISSUE – will the current spike in inflation lead to a second-round effect in terms of labour demanding higher wages, (and/or lots of people getting higher wages by changing job)?*
- *If the labour market remains very tight during 2022, then wage inflation poses a greater threat to overall inflation being higher for longer, and the MPC may then feel it needs to take more action.*

PWLB RATES

- *The yield curve has flattened out considerably.*
- *We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate.*
- *It is difficult to say currently what effect the Bank of England starting to sell gilts will have on gilt yields once Bank Rate rises to 1%: it is likely to act cautiously as it has already started on not refinancing maturing debt. A passive process of not refinancing maturing debt could begin in March when the 4% 2022 gilt matures; the Bank owns £25bn of this issuance. A pure roll-off of the £875bn gilt portfolio by not refinancing bonds as they mature, would see the holdings fall to about £415bn by 2031, which would be about equal to the Bank's pre-pandemic holding. Last August, the Bank said it would not actively sell gilts until the "Bank Rate had risen to at least 1%" and, "depending on economic circumstances at the time."*
- *It is possible that Bank Rate will not rise above 1% as the MPC could shift to relying on quantitative tightening (QT) to do the further work of taking steam out of the economy and reducing inflationary pressures.*
- *Increases in US treasury yields over the next few years could add upside pressure on gilt yields though, more recently, gilts have been much more correlated to movements in bund yields than treasury yields.*

MPC MEETING 4TH FEBRUARY 2022

- *After the Bank of England became the first major western central bank to put interest rates up in this upswing in December, it has quickly followed up its first 0.15% rise by another 0.25% rise to 0.50%, in the second of what is very likely to be a series of increases during 2022.*
- *The Monetary Policy Committee voted by a majority of 5-4 to increase Bank Rate by 25bps to 0.5% with the minority preferring to increase Bank Rate by 50bps to 0.75%. The Committee also voted unanimously for the following: -*
    - *to reduce the £875n stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets.*

  - *to begin to reduce the £20bn stock of sterling non-financial investment-grade corporate bond purchases by ceasing to reinvest maturing assets and by a programme of corporate bond sales to be completed no earlier than towards the end of 2023.*
- *The Bank again sharply increased its forecast for inflation – to now reach a peak of 7.25% in April, well above its 2% target.*
- *The Bank estimated that UK GDP rose by 1.1% in quarter 4 of 2021 but, because of the effect of Omicron, GDP would be flat in quarter 1, but with the economy recovering during February and March. Due to the hit to households' real incomes from higher inflation, it revised down its GDP growth forecast for 2022 from 3.75% to 3.25%.*
- *The Bank is concerned at how tight the labour market is with vacancies at near record levels and a general shortage of workers - who are in a very favourable position to increase earnings by changing job.*
- *As in the December 2021 MPC meeting, the MPC was more concerned with combating inflation over the medium term than supporting economic growth in the short term. However, what was notable was the Bank's forecast for inflation: based on the markets' expectations that Bank Rate will rise to 1.50% by mid-2023, it forecast inflation to be only 1.6% in three years' time. In addition, if energy prices beyond the next six months fell as the futures market suggests, the Bank said CPI inflation in three years' time would be even lower at 1.25%. With calculations of inflation, the key point to keep in mind is that it is the rate of change in prices – not the level – that matters. Accordingly, even if oil and natural gas prices remain flat at their current elevated level, energy's contribution to headline inflation will drop back over the course of this year. That means the current energy contribution to CPI inflation, of 2% to 3%, will gradually fade over the next year.*
- *So the message to take away from the Bank's forecast is that they do not expect Bank Rate to rise to 1.5% in order to hit their target of CPI inflation of 2%. The immediate issue is with four members having voted for a 0.50% increase in February, it would only take one member more for there to be another 0.25% increase at the March meeting.*
- ***The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative tightening) holdings of bonds is as follows: -*
  1. *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.*

OUR FORECASTS

a. Bank Rate

- *Covid remains a major potential downside threat as we are most likely to get further mutations. However, their severity and impact could vary widely, depending on vaccine effectiveness and how broadly it is administered.*
- *If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.*

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

b. PWLB rates and gilt and treasury yields

***Gilt yields.** Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. Our forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period*
While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on gilt yields. ***As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for medium to longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.***
***US treasury yields.** During the first part of 2021, 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. This was in addition to the $900bn support package previously passed in December 2020. Financial markets were alarmed that all this stimulus was happening at a time when: -*

1. *A fast vaccination programme roll-out had enabled a rapid opening up of the economy during 2021.*
2. *The economy was growing strongly during the first half of 2021 although it has weakened during the second half.*
3. *It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.*
4. *And the Fed was still providing substantial stimulus through monthly QE purchases during 2021.*

It was not much of a surprise that a combination of these factors would eventually cause an excess of demand in the economy which generated strong inflationary pressures. This has eventually been recognised by the Fed at its recent December meeting with an aggressive response to damp inflation down during 2022 and 2023.

- ***At its 3rd November Fed meeting**, the Fed decided to make a start on tapering its $120bn per month of QE purchases so that they ended next June. However, at its **15th December meeting** it doubled the pace of tapering so that they will end all purchases in February. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that treasury yields will rise over the taper period, all other things being equal.*
- *It also forecast that it expected there would be three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024. This would take rates back above 2% to a neutral level for monetary policy. It also gave up on calling the sharp rise in inflation as being 'transitory'.*
- *At its **26th January meeting**, the Fed became even more hawkish following inflation rising sharply even further. It indicated that rates would begin to rise very soon, i.e., it implied at its March meeting it would increase rates and start to run down its holdings of QE purchases. It also appears likely that the Fed could take action to force longer term treasury yields up by prioritising selling holdings of its longer bonds as yields at this end have been stubbornly low despite rising inflation risks. The low level of longer dated yields is a particular concern for the Fed because it is a key channel through which tighter monetary policy is meant to transmit to broader financial conditions, particularly in the US where long rates are a key driver of household and corporate borrowing costs.*

*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 monitor.*

Globally, our views are as follows: -

- ***EU.** The ECB joined with the Fed by announcing on **16th December** that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases during the first half of 2022. The ECB did not change its rate at its **3rd February** meeting, but it was clearly shocked by the increase in inflation to 5.1% in January. The President of the ECB, Christine Lagarde, hinted in the press conference after the meeting that the ECB may accelerate monetary tightening before long and she hinted that asset purchases could be reduced more quickly than implied by the previous guidance. She also refused to reaffirm officials' previous assessment that interest rate hikes in 2022 are "very unlikely". It, therefore, now looks likely that all three major western central banks will be raising rates this year in the face of sharp increases in inflation - which is looking increasingly likely to be stubbornly high and for much longer than the previous oft repeated 'transitory' descriptions implied.*
- ***China.** The pace of economic growth has now fallen back after the initial surge of recovery from the **pandemic** and China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. However, with Omicron having now spread to China, and being much more easily transmissible, lockdown strategies may not prove so successful in future. To boost flagging economic growth, The People's Bank of China cut its key interest rate in December 2021.*

- ***Japan.*** *2021 was a patchy year in combating Covid. However, recent business surveys indicate that the economy is rebounding rapidly now that the bulk of the population is fully vaccinated, and new virus* ***cases*** *have plunged. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back towards its target of 2% any time soon.*
- ***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, followed by a major surge in demand after lockdowns ended, have* ***been*** *highly disruptive of extended worldwide supply chains. Major queues of ships unable to unload their goods at ports in New York, California and China built up rapidly during quarters 2 and 3 of 2021 but then halved during quarter 4. Such issues have led to a misdistribution 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. The latest additional disruption has been a shortage of coal in China leading to power cuts focused primarily on producers (rather than consumers), i.e., this will further aggravate shortages in meeting demand for goods. 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 available to purchase.*

The balance of risks to the UK economy: -

- *The overall balance of risks to economic growth in the UK is now to the downside.*

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

- ***Mutations*** *of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed or unable to be administered fast enough to stop the NHS being overwhelmed.*
- ***Labour and supply shortages*** *prove more enduring and disruptive and depress economic activity.*
- ***Bank of England*** *acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.*
- ***The Government*** *acts too quickly to increase taxes and/or cut expenditure to balance the national budget.*
- ***UK / EU trade arrangements*** *– if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.*
- ***Geopolitical risks,*** *for example in Ukraine/Russia, Iran, China, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows. If Russia were to invade Ukraine, this would be likely to cause short term volatility in financial markets, but it would not be expected to have a significant impact beyond that.*

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

- *The* ***Bank of England is too slow*** *in its pace and strength of increases in Bank Rate and, therefore, allows* ***inflationary*** *pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.*
- *Longer term US treasury yields rise strongly and pull gilt yields up higher than forecast.*

LINK Group
February 2022

Appendix 5.3:

Treasury Management Practice (TMP1)
Credit and Counterparty Risk Management

DLUHC issued Investment Guidance in 2018, and this forms the structure of the authority's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective, the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the code on 9 April 2020 and will apply its principles to all investment activity. In accordance with the Code, the Chief Financial Officer has produced treasury management practices (TMPs). This part, TMP 1(1), covering Investment Counterparty Policy requires approval each year.

Annual Treasury Investment Strategy: the key requirements of both the Code and the investment guidance are to set an annual Treasury Investment Strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of 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 Authority will use. These are high security (i.e. high credit rating, although this is defined by the Authority, 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 value/categories that can be held at any time.

Strategy Guidelines: the main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments: DLUHC Investment Guidance states that an investment is a specified investment if all of the following apply:

- The investment is denominated in sterling and any payments or repayments in the respect of the investment are payable only in sterling;
- The investment is not a long term investment. This means that the local authority has contractual right to repayment within 12 months, either because that is the expiry term of the investment or through a nonconditional option;
- The making of the investment is not defined as capital expenditure by virtue of Regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended];

- The investment is made with a body or in an investment scheme described as high quality or with one of the following bodies:

  (i) The United Kingdom Government;

  (ii) A local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; or

  (iii) A parish council or community council.

This Authority defines high credit quality as counterparties having a minimum credit rating of:

- Short term: F1/A-1/P-1 (which equates to the long term ratings of A/A/A2)
- Building Societies regulated by the Prudential Regulation Authority and has a minimum of a £1billion asset base
- MMFs rated AAA

The Authority will operate to the following limits in relation to specified investments, where:

- Short Term – less than or equal to 12 months
- Medium Term – More than 12 months and up to and including 3 years
- Long Term – over 3 years and up to 5 years

Table 14: COUNTERPARTY LIST			**Credit Rating & Duration**			
			Fitch	**Standard & Poor**	**Moody's**	**Comments**
The Council's own banker for day to day banking transactional purposes.	If the main bank maintains the following criteria	Short-Term	F1	A-1	P-1	• £20M with the bank or counterparties within their group
The Council's own banker for day to day banking transactional purposes.	If the main bank falls below the following criteria, in this case balances will be minimised in both monetary size and time invested.	Short-Term	F1	A-1	P-1	• £7m
UK Banks	Covers UK Retail & Clearing Banks	Short-Term	F1	A-1	P-1	• £10m with any individual counterparty

Table 14: COUNTERPARTY LIST			Credit Rating & Duration			
			Fitch	**Standard & Poor**	**Moody's**	**Comments**
UK Banks	Covers UK Retail & Clearing Banks	Medium-Term	A+	A+	A1	• £10m with any individual counterparty
UK Banks	Covers UK Retail & Clearing Banks	Long-Term	AA-	AA-	Aa3	• £10m with any individual counterparty
Non-UK domiciled Banks	Non-UK Banks must be domiciled in a country which has a minimum sovereign long-Term rating of 'AA-'	Short-Term	F1	A-1	P-1	• £5m with any individual counterparty
		Medium - Term	A+	A+	A1	• £10m
		Long-Term	AA-	AA-	Aa3	• £10m
Building societies	The Council will use all societies which meet the following criteria	Regulated by the Prudential Regulation Authority ***and*** has a minimum of a £1billion asset base				• £10m with any individual counterparty • Up to and incl. 3 years.
Money Market Funds (MMFs)	Constant Net Asset Value (CNAV)	Short-Term	AAA	AAA	Aaa	• £10m with any individual counterparty
Money Market Funds (MMFs)	Low-Volatility Net Asset Value (LVNAV)	Short-Term	AAA	AAA	Aaa	• £10m with any individual counterparty
Money Market Funds (MMFs)	Variable Net Asset value (VNAV)	Short-Term	AAA	AAA	Aaa	• £10m with any individual counterparty
UK Government (including gilts, Treasury Bills and the DMADF)	No credit rating - UK Government guarantee	N/A	N/A	N/A		• Unlimited • To maturity
Local authorities, parish councils etc.	No credit rating - UK government guarantee	N/A	N/A	N/A		• £10m with any individual counterparty • Up to and incl. 5 years
Supranational institutions (e.g. European Investment Bank or World Bank)	The Council will use supranational institutions which meet the following criteria:	Short-Term	F1	A-1	P-1	• £10m with any individual counterparty

Non-Specified Investments: these are any other type of investment (i.e. not defined as specified above) over 365 days or those outside the criteria above where additional due diligence would be required.

Monitoring of Investment Counterparties: the credit rating of counterparties will be monitored regularly. The Authority receives credit rating information (changes, rating watches and rating outlooks) from LINK Group as and when ratings change, and

counterparties are checked 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. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Financial Officer, and if required new counterparties which meet the criteria will be added to the list.

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 Authority is protected from any adverse revenue impact, which may arise from these differences, the treasury team will review the accounting implications of new transactions before they are undertaken.

Appendix 5.4

Investment Portfolio at 31.12.21

Table 15: INVESTMENT PORTFOLIO - DETAILS	Actual 31/03/2021 £m	%	Current 31/12/2021 £m	%
Treasury Investments				
Cash at Bank – Lloyds Bank	12.469	25.7%	11.759	22.0%
Cash at Bank - Bank of Scotland	-	-	0.800	1.5%
Cash at Bank - Santander	-	-	10.000	18.7%
Building Societies - unrated - Principality Building Society	13.000	26.8%	10.000	18.7%
Building Societies - rated	-	-	-	-
Local Authorities	-	-	-	-
DMADF (HM Treasury)	-	-	-	-
Money Market Funds - Aberdeen Liquidity Fund	5.000	10.3%	10.000	18.7%
Money Market Funds - Black Rock ICS GBP LVNAV Heritage	5.000	10.3%	1.000	1.9%
Money Market Funds - Federated Hermes Short-Term GBP Prime Class 3	5.000	10.3%	-	-
Money Market Funds - GS Sterling Liquid Reserve	5.000	10.3%	-	-
Money Market Funds - LGIM Sterling Liquidity 4	3.000	6.2%	-	-
Money Market Funds - Morgan Stanley GBP Liquidity Institutional	-	-	10.000	18.7%
Certificates of Deposit	-	-	-	-
Total Managed In-House	**48.469**	**100.0%**	**53.559**	**100.0%**
Bond Funds	-	-	-	-
Property Funds	-	-	-	-
Total Managed Externally	-	-	-	-
Total Treasury Investments	**48.469**	**100.0%**	**53.559**	**100.0%**
Treasury External Borrowing				
Local Authorities - Portsmouth City Council	5.000	56%	-	-
Local Authorities - Elmbridge Borough Council	4.000	44%	-	-
PWLB	0	0%	-	-
Total External Borrowing	**9.000**	**100.0%**	-	-
Net Treasury Investments / (Borrowing)	**39.469**	**-**	**53.559**	**-**

Appendix 5.5

Approved Countries for Investment

This list is based on those countries which have sovereign ratings of AAA or higher (based on the lowest rating from Fitch, Moody's and S&P) and also [except - at the time of writing - for Norway and Luxembourg] have banks operating in sterling markets which have credit ratings of green or above in LINK Group's credit worthiness reports.

Based on lowest available rating

AAA

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

This list may change during the year

Appendix 5.6

Treasury Management Scheme of Delegation

Council

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

Executive

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

Audit Committee

- scrutinising treasury reports and making recommendations to the Executive.

Appendix 5.7

Treasury Management Role of the Section 151 Officer

The Section 151 Officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a Capital Investment Strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the Capital Investment 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
- ensure 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
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following:

    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*

Appendix 5.8

Treasury Management Risk Assessment

Table 16: TREASURY MANAGEMENT RISK ASSESSMENT			
Risk	**Impact**	**Likelihood**	**Mitigation actions/controls included within the Treasury Management Strategy**
Interest Rate Risk Rates varying significantly compared to forecast.	High	Medium	With a forecast increasing borrowing requirement rising interest rates would be detrimental. The Council would need to consider taking out fixed borrowing to help mitigate this risk and/or use further internal borrowing if resources are available. Falling interest rates would be broadly beneficial given the increasing borrowing requirement.
Market Risk Adverse market fluctuations affect value of investment capital.	Medium	Low	Limits are placed on the value of principal sums that are invested.
Credit Risk Risk to repayment of capital	High	Medium	The Council's investment policy restricts counterparties to those of the highest quality and security.
Liquidity Risk Risk that cash will not be available when needed.	Medium	Medium	The Council's investment portfolio is structured to reflect future liquidity needs. Temporary borrowing is available to meet short term liquidity issues.
Liquidity Risk Changes to Capital Programme forecasts and/or revenue streams	High	Medium	Cash flows are calculated weekly and regular projections are made to identify changes to the Council's funding requirements. Prudential borrowing to support capital expenditure can be used for schemes expected to provide a financial benefit to the Council. There may be some slippage in capital expenditure between years and the impacts are monitored.