

**TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT
STRATEGY 2021/22**

1. Introduction

1.1 Background

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

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

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

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."

This authority has not engaged in any commercial investments and has no non-treasury investments.

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management (updated 2018) Codes require all local authorities to prepare a capital strategy report which will 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 associated risk is managed
- The implication for future sustainability

The aim of this capital strategy is to ensure that all elected members on full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.2.2 Treasury Management Reporting

The council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

a. Prudential and treasury indicators and treasury strategy
(this report) – The first, and most important report is forward looking and covers:

- The capital plans (including prudential indicators);
- A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- The treasury management strategy, (how the investments and borrowing are to be organised) including treasury indicators; and
- An investment strategy (the parameters on how investments are to be managed).

b. A 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.

c. An annual treasury report – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.2.3 Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the council. This role is undertaken by the Overview and Scrutiny Committee.

1.3 Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

1.3.1 Capital issues

- The capital expenditure plans and the associated prudential indicators;
- The minimum revenue provision (MRP) policy.

1.3.2 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, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

1.4 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. All members were invited to attend a Treasury Management training session delivered by our Treasury Management Consultants prior to the council meeting on 9 January 2020 and further training was given to Overview and Scrutiny Committee on 18 January 2021.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The council uses Link Group, Treasury Solutions Ltd as its external treasury management advisors.

The council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The council will ensure that the terms of their

appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

2. **The Capital Prudential Indicators 2021/22 – 2025/26**

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. The Prudential Indicators, capital expenditure plans and how these plans are being financed by capital or revenue resources were approved by Cabinet at its meeting on 17 February 2021.

2.1 **Capital Expenditure**

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

Capital Expenditure	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000
Total	5,979	11,763	2,743	2,843	2,197	2,136	2,048

Other long-term liabilities – The above financing need excludes other long-term liabilities, such as PFI and leasing arrangement that already include borrowing instruments (not currently applicable to Wyre).

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of Capital Expenditure	2019/20 Actual £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000
Capital Receipts	11	88	0	0	0	0	0
Capital Grants and Contributions	4,455	8,189	2,349	2,688	2,048	1,833	1,833
Revenue / Reserves	1,513	3,486	278	61	151	303	303
Total	5,979	11,763	2,743	2,843	2,197	2,136	2,048
Net Financing need for the Year	0	0	0	0	0	0	0

2.2

The council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the council's indebtedness and so its underlying borrowing need. Any capital expenditure above, 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 minimum revenue provision (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.

The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the council is not required to separately borrow for these schemes. The council does not currently have any such schemes within the CFR.

	2019/20 Actual £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Total CFR	11,261	11,165	11,069	10,973	10,877	10,787	10,707
Movement in CFR	-96	-96	-96	-96	-96	-90	-80

Movement in CFR represented by:							
	2019/20 Actual £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
MRP and other financing movements	96	96	96	96	96	90	80

2.3

Core funds and 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.

Year End Resources	2019/20 Actual £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Fund balances/ reserves	26,803	27,594	23,390	21,699	19,324	16,777	14,192
Capital receipts	781	693	693	693	693	693	693
Provisions	3,210	2,366	2,892	2,892	2,892	2,892	2,892
Other	0	0	0	0	0	0	0
Total core funds	30,794	30,653	26,975	25,284	22,909	20,362	17,777
Working capital*	3,023	3,023	3,023	3,023	3,023	3,023	3,023
Expected Investments	33,816	33,675	29,997	28,306	25,931	23,384	20,799

*Working capital balances shown are estimated year-end; these may be higher mid-year.

2.4 Minimum Revenue Provision Policy Statement

The council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision – MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision – VRP). MHCLG regulations have been issued which require the full council to approve an MRP Statement in advance of each year. The council is recommended to approve the MRP Statement at Appendix 4.

2.5 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the council's overall finances.

%	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
Ratios	-0.39	0.50	0.97	0.52	0.52	0.46	0.37

2.6 Control of Interest Rate Exposure

Please see following paragraphs 3.3, 3.4 and 4.4.

3. Borrowing

The capital expenditure plans set out in Section 2 provide details of the service activity of the council. The treasury management function ensures that the council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require,

the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

- 3.1** The overall treasury management portfolio as at 31 March 2020 and for the position as at 4 February 2021 are shown below for both borrowing and investments.

Treasury Portfolio				
Treasury Investments	Actual	Actual	Current	Current
	31/03/2020	31/03/2020	04/02/2021	04/02/2021
	£000	%	£000	%
Banks	17,271	70%	25,411	51%
Money Market Funds	7,500	30%	23,961	49%
Total Treasury Investments	24,771		49,372	
External Borrowing	-1,552		-1,552	
Net Treasury Investments	23,219		47,820	

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

	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
External Debt	£000	£000	£000	£000	£000	£000	£000
Debt at 1 April	1,552	1,552	1,552	1,552	1,552	1,552	1,552
Expected change in Debt	0	0	0	0	0	0	0
Other Long Term Liabilities (OLTL)	7	7	50	50	50	50	50
Expected change in OLTL	0	0	0	0	0	0	0
Actual Gross Debt at 31 March	1,559	1,559	1,602	1,602	1,602	1,602	1,602
Capital Financing Requirement	11,261	11,165	11,069	10,973	10,877	10,787	10,707
Under/(over) Borrowing	9,702	9,606	9,467	9,371	9,275	9,185	9,105

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

The Corporate Director of Resources reports that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 **Treasury Indicators: Limits to Borrowing Activity**

The council is required to approve an 'authorised limit' and an 'operational boundary' for external debt. The Treasury Management indicators were approved by Cabinet at its meeting 17 February 2021 alongside the prudential indicators, capital expenditure plans and how these plans are being financed by capital or revenue resources.

The operational boundary. This 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.

Operational boundary	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000
Debt	13,452	13,452	13,452	13,452	13,452	13,452
Other long term liabilities	7	50	50	50	50	50
Total	13,459	13,502	13,502	13,502	13,502	13,502

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

1. 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 council's plans, or those of a specific council, although this power has not yet been exercised.
2. The council is asked to approve the following authorised limit:

Authorised limit	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000
Debt	20,000	20,000	20,000	20,000	20,000	20,000
Other long term liabilities	0	100	100	100	100	100
Total	20,000	20,100	20,100	20,100	20,100	20,100

3.3

Prospects for Interest Rates

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

Annual Average % as at the quarter ending:	Bank Rate %	PWL B Rates % as at February 2021			
		5 year	10 year	25 year	50 year
March 2021	0.10	0.90	1.30	1.90	1.70
June 2021	0.10	0.90	1.30	1.90	1.70
Sept 2021	0.10	0.90	1.30	1.90	1.70
Dec 2021	0.10	0.90	1.30	1.90	1.70
March 2022	0.10	1.00	1.40	2.00	1.80
June 2022	0.10	1.00	1.40	2.00	1.80
Sept 2022	0.10	1.10	1.50	2.10	1.90
Dec 2022	0.10	1.10	1.50	2.10	1.90
March 2023	0.10	1.10	1.50	2.10	1.90
June 2023	0.10	1.20	1.60	2.20	2.00
Sept 2023	0.10	1.20	1.60	2.20	2.00
Dec 2023	0.10	1.20	1.60	2.20	2.00
March 2024	0.10	1.20	1.60	2.20	2.00

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 16th December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and,

therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20: as this has now occurred, these forecasts do not need to be revised.

Gilt yields / PWLB rates

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

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the

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

Investment and borrowing rates

- Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following two years.
- 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: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- Borrowing for capital expenditure. As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

3.4

Borrowing Strategy

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Corporate Director of Resources 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 portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to Council at the next available opportunity.

The council doesn't have any plans in the short to medium term to undertake any further borrowing.

3.5 Policy on borrowing in advance of need

The council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the council can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of PWLB rates over gilt yields was reduced by 100 bps in November 2020.

3.7 New Financial institutions as a source of borrowing and/or types of borrowing

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

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

4. Annual Investment Strategy

4.1 Investment policy – management of risk

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

- MHCLG'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 council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs.

The above guidance from the MHCLG 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 council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
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. Types of investment instruments identified for use in the financial year are listed in Treasury Management Practices (TMP) Schedule 1 under the 'specified' and 'non-specified' investment categories.
5. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
6. Transaction limits are set for each type of investment in 4.2.

7. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 4.3).
8. This authority has engaged external consultants (see paragraph 1.5) 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.
9. All investments will be denominated in sterling.
10. As a result of the change in accounting standards for 2020/21 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [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 31.3.23.

However, 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 (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year

The above criteria are unchanged from last year.

4.2

Creditworthiness Policy

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

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

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

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

Organisation	Minimum credit criteria / colour band	Max. Amount per Institution	Max. maturity Period
Term deposits with UK Clearing Banks and UK Building Societies	Purple Blue Orange Red Green	£6m or ** £6m or ** £6m or ** £6m or ** £6m or **	Up to 2 years Up to 1 year* Up to 1 year Up to 6 months Up to 100 days
Term deposits with Other Banks	Orange Red Green	£6m or ** £6m or ** £6m or **	Up to 1 year Up to 6 months Up to 100 days
Certificates of Deposit with UK Clearing Banks and UK Building Societies	Purple Blue Orange Red Green	£6m or ** £6m or ** £6m or ** £6m or ** £6m or **	Up to 2 years Up to 1 year* Up to 1 year Up to 6 months Up to 100 days
UK Local Authorities	Yellow	£6m or ** £6m or **	Up to 5 years Up to 1 year
Ultra-Short Dated Bond with credit score of 1.25	Dark Pink / AAA	£6m or **	liquid
Ultra-Short Dated Bond with credit score of 1.5	Light Pink / AAA	£6m or **	liquid
Money Market Funds - CNAV, LVNAV or VNAV	AAA	£6m or **	liquid

*Part nationalised banks.

** £6m or 20% of investment balance per individual counterparty or 25% per whole counterparty group whichever is higher.

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

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

All credit ratings will be monitored weekly. The council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

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

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

Creditworthiness

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on actual levels of credit losses.

(Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating

adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the UK banking sector to “somewhat less than £80bn”. It stated that in its assessment, “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.

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

4.3 Country limits

The council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Annex 1. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 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

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

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):

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

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

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

Negative investment rates

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

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over

accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

4.5 Investment treasury indicator

There are currently no plans for funds to be invested for a period greater than 364 days. These limits are set with regard to the councils 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. For its cash flow generated balances, the council will seek to utilise its instant access and notice accounts, money market funds, short dated deposits (overnight to 100 days) and 6 month deposits in order to benefit from compounding of interest. This council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID (London Interbank Bid Rate).

4.6 End of year investment report

At the end of the financial year, the council will report on its investment activity as part of its Annual Treasury Report.

4.7 Non-treasury investments

This council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries and investment property portfolios. This council does not currently have any such investments. However it will ensure that all of its investments are covered in the capital programme, investment strategy or equivalent and will set out, where relevant, the council's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that of treasury management. The council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the council's risk exposure where applicable.

Approved Countries for Investments (as at 20/01/21)

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

Based on lowest available rating

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

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