Appendix 3

TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY 2022/23

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 2021 CIPFA Prudential and Treasury Management 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 2022/23

The strategy for 2022/23 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, DLUHC MRP Guidance, the CIPFA Treasury Management Code and DLUHC 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 on 24 February 2022 and prior to this, 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 2022/23 – 2026/27

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 16 February 2022.

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	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000
Total	6,789	15,043	10,095	14,728	14,666	11,245	2,484

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	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000
Capital Receipts	65	24	0	0	0	0	0
Capital Grants and Contributions	3,518	11,526	9,939	14,578	14,363	11,030	2,080
Revenue / Reserves	3,206	3,493	156	150	303	215	404
Total	6,789	15,043	10,095	14,728	14,666	11,245	2,484
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.

	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000
Total CFR	11,261	11,165	11,069	10,973	10,877	10,787	10,713
Movement in CFR	-96	-96	-96	-96	-90	-74	-74

Movement in CFR represented by:							
	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000
MRP and other financing movements	96	96	96	96	90	74	74

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	2020/21 Actual £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000
Fund balances/ reserves	26,988	22,590	21,672	20,473	18,443	16,273	14,358
Capital receipts	823	704	704	704	704	704	704
Provisions	2,001	2,496	2,496	2,496	2,496	2,496	2,496
Other	0	0	0	0	0	0	0
Total core funds	29,812	25,790	24,872	23,673	21,643	19,473	17,558
Working capital*	3,023	3,023	3,023	3,023	3,023	3,023	3,023
Expected Investments	33,816	28,813	27,895	26,696	24,666	22,496	20,581

*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). DLUHC 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.

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 2021 and for the position as at 21 February 2021 are shown below for both borrowing and investments.

Treasury Portfolio				
Treasury Investments	**Actual**	**Actual**	**Current**	**Current**
	31/03/2021	**31/03/2021**	**21/02/2022**	**21/02/2022**
	£000	**%**	**£000**	**%**
Banks	23,124	70%	33,435	57%
Money Market Funds	10,000	30%	25,000	43%
Total Treasury Investments	**33,124**		**58,435**	
External Borrowing	-1,552		-1,552	
Net Treasury Investments	**31,572**		**56,883**	

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.

	2020/21 Actual £000	2021/22 Est. £000	2022/23 Est. £000	2023/24 Est. £000	2024/25 Est. £000	2025/26 Est. £000	2026/27 Est. £000
External Debt at 1 April	1,552	1,552	1,552	1,552	1,552	1,552	1,552
Expected change in External Debt	0	0	0	0	0	0	0
Other Long Term Liabilities (OLTL)	7	50	50	50	50	50	50
Expected change in OLTL	0	0	0	0	0	0	0
Actual Gross Debt at 31 March	1,559	1,602	1,602	1,602	1,602	1,602	1,602
Capital Financing Req.	11,261	11,165	11,069	10,973	10,877	10,787	10,713
Under/ (over) Borrowing	9,702	9,563	9,467	9,371	9,275	9,185	9,111

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 2022/23 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 16 February 2022 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**	**2022/23 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	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 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 %	PWLB Rates % as at December 2021			
		5 year	10 year	25 year	50 year
March 2022	0.50	1.50	1.70	1.90	1.70
June 2022	0.50	1.60	1.80	2.00	1.80
Sept 2022	0.50	1.60	1.80	2.10	1.90
Dec 2022	0.50	1.70	1.90	2.10	1.90
March 2023	0.50	1.80	1.90	2.20	2.00
June 2023	0.75	1.80	2.00	2.20	2.00
Sept 2023	0.75	1.80	2.00	2.20	2.00
Dec 2023	0.75	1.90	2.00	2.30	2.10
March 2024	1.00	1.90	2.10	2.30	2.10
June 2024	1.00	1.90	2.10	2.40	2.20
Sept 2024	1.00	1.90	2.10	2.40	2.20
Dec 2024	1.00	2.00	2.20	2.50	2.30
March 2025	1.25	2.00	2.30	2.50	2.30

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.

As shown in the forecast table above, the forecast for Bank Rate now includes three increases, one in June 2023 to 0.75%, March 2024 to 1.00% and, finally, one in March 2025 to 1.25%.

Gilt yields / PWLB rates

Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though 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 our 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 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. However, this was in addition to the $900bn support package already passed in December 2020. This was then followed by additional Democratic ambition to spend $1trn on infrastructure (which was eventually passed by both houses later in 2021) and an even larger sum on an American families plan over the next decade; this is still caught up in Democrat / Republican haggling.

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.

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. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases eventually needed to suppress inflation, are likely to be faster and stronger than Bank Rate increases in the UK. This is likely to put upward pressure on treasury yields which could then spill over into putting upward pressure on UK gilt yields.

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.

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 above 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.

Investment and borrowing rates

- Investment returns are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.

- 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.

- Borrowing for capital expenditure. Link's long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely 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 an authority is seeking to avoid a "cost of carry" but also wishes to mitigate future re-financing risk.

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 2022/23 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 of 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 that 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 Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) 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 treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.

The council’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 2021 (“the Code”)
- CIPFA Treasury Management Guidance Notes 2021

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 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 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, 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 part 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

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

CDS prices

Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

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
The current forecast shown in paragraph 3.3, includes a forecast for a first increase in Bank Rate in May 2022, though it could come in February.

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	
2022/23	1.00%
2023/24	1.25%
2024/25	1.25%
2025/26	1.25%
2026/27	1.25%
Long term later years	2.00%

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

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.

Annex 1
Approved Countries for Investments (as at 18/02/2022)

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
- Netherlands
- Singapore
- Sweden
- Switzerland
- U.S.A

AA+

- Canada
- Finland

AA

- United Arab Emirates
- France

AA-

- Belgium
- Qatar
- U.K.