APPENDIX E: Treasury Management Strategy Statement and Annual Investment Strategy 2018/19

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 to do so, any debt previously drawn may be restructured to meet council risk or cost objectives.

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. "

1.2 Reporting requirements

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

Prudential and Treasury Indicators and Treasury Strategy (This report) - The first, and most important report 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 borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A Mid Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are required to be adequateley scrutinised before being recommended to the Council.

1.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 covers two main areas:

Capital Issues

- the capital plans and the prudential indicators;
- the MRP policy.

Treasury Management Issues

- the current treasury position;
- treasury indicators which will 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
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, CIPFA Prudential Code, CLG MRP Guidance, CIPFA Treasury Management Code and the CLG 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. The training needs of treasury management officers are periodically reviewed.

1.5 Treasury Management Consultants

The council uses Link Asset Services, Treasury Solutions 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 our external service providers.

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 2018/19 – 2021/22

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

Details of how these plans are used to achieve the core vision of the council are reported separately as part of the council's Capital Strategy (Appendix G).

A list of approved capital schemes and projects are also reported separately within the council's Capital Programme (Appendix F).

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. The table below also summarises how these plans are being financed by capital and revenue resources. Any shortfall in resources results in a requirement for this to be financed by additional borrowing.

Members are asked to approve the capital expenditure forecasts:

	2016/17 Actual £'m	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m
Capital Expenditure						
General Fund	65.108	41.202	51.727	11.214	11.214	11.214
HRA	48.186	54.571	62.294	64.824	47.633	47.286
Total	**113.294**	**95.773**	**114.021**	**76.038**	**58.847**	**58.500**
Resourced by:						
Capital Receipts	12.432	12.585	12.522	10.428	10.466	8.535
Capital Grants & Contributions	53.990	31.003	41.295	8.394	8.394	8.394
Revenue	41.048	29.257	21.106	26.210	13.572	13.979
Capital Expenditure Financed from Borrowing	**5.824**	**22.928**	**39.098**	**31.006**	**26.415**	**27.592**

The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

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, 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 borrowing need in line with each assets life and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities such as PFI schemes and finance leases. Whilst these increases the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. The council currently has £89.078m of such schemes within the CFR as at 31 March 2017.

The council is asked to approve the CFR projections below:

	2016/17 Actual £'m	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m
Capital Financing Requirement (CFR)						
General Fund	339.197	335.773	320.724	300.383	280.207	255.748
HRA	428.154	426.205	448.441	479.682	492.078	505.891
Total CFR @ 31 March	**767.351**	**761.978**	**769.165**	**780.065**	**772.285**	**761.639**
Movement in CFR		**-5.373**	**7.187**	**10.900**	**-7.780**	**-10.646**
Movement Represented by:						
Capital expenditure to be financed from borrowing		22.928	39.098	31.006	26.415	27.592
Less MRP/VRP and other financing movements *		-28.301	-31.911	-20.106	-34.195	-38.238
Movement in CFR		**-5.373**	**7.187**	**10.900**	**-7.780**	**-10.646**

* Includes PFI annual principal repayments

2.3 Minimum Revenue Provision (MRP) 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).

CLG Regulations have been issued which 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. The council is recommended to approve the following MRP Statement;

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Average Asset Life method** - MRP will be based on the total average estimated life of assets held by the authority. This replaces the previous methodology that provided for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Individual Asset Life Method -** MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This provides for a reduction in the borrowing need over the assets' life.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement to make a charge for depreciation.

Annual principal repayments included in PFI schemes or finance leases are applied as MRP.

West Midlands Combined Authority: Collective Investment Fund
The agreed Combined Authority Devolution Deal proposes the establishment of a Collective Investment Fund to support investment in the region. It is possible that some of this investment may be delivered by individual districts, and funded from prudential borrowing.

MRP on capitalised loan advances to other organisations or individuals will not be required. Instead, the capital receipts arising from the capitalised loan repayments will be used as provision to repay debt. However, revenue MRP contributions would still be required equal to the amount of any impairment of the loan advanced.

MRP on investments in Equities will be made on an annuity profile over 20 years, as recommended by Government guidance.

2.4 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.

	2016/17 Actual £'m	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m
Balances	139.091	139.000	139.000	139.000	139.000	139.000
Specific reserves	22.805	20.000	20.000	20.000	20.000	20.000
Capital Receipts Unapplied	7.863	7.000	7.000	7.000	7.000	7.000
Capital Grants Unapplied	15.665	15.000	15.000	15.000	15.000	15.000
Provision	12.692	10.000	10.000	10.000	10.000	10.000
Collection Fund	-2.420	0.000	0.000	0.000	0.000	0.000
Total Core Funds	**195.696**	**191.000**	**191.000**	**191.000**	**191.000**	**191.000**
Net Working capital *	104.589	100.000	100.000	100.000	100.000	100.000
Expected investments	38.250	25.000	25.000	25.000	25.000	25.000

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

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. The council is asked to approve the following indicator:

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.

	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
General Fund	6.14%	6.20%	6.82%	6.52%	5.72%	5.71%
HRA	26.39%	26.24%	29.47%	18.81%	30.96%	30.99%

The estimates of financing costs include current commitments and the proposals in this budget report.

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. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The council's actual treasury portfolio position at 31 March 2017, along with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2016/17 Actual £'m	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m
External Debt as at 1 April	482.768	468.393	468.393	475.580	486.480	486.480
Expected change in Debt	0.000	0.000	7.187	10.900	0.000	0.000
Other Long Term Liabilities (OLTL)*	93.052	89.078	84.193	80.099	75.545	71.310
Expected change in OLTL	-3.974	-4.885	-4.094	-4.554	-4.235	-3.243
External Debt as at 31 March	**571.846**	**552.586**	**555.679**	**562.025**	**557.790**	**554.547**
Capital Financing Requirement	**767.351**	**761.978**	**769.165**	**780.065**	**772.285**	**761.639**
Under / (Over) Borrowing	**195.505**	**209.392**	**213.486**	**218.040**	**214.495**	**207.092**

Within the 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 2018/19 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 purposes.

The Section 151 Officer 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 Operational Boundary is the limit beyond which external debt would not normally be 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.

	2016/17 Actual £'m	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m
External Debt	482.768	468.393	475.580	486.480	486.480	486.480
Other Long Term Liabilities*	89.078	84.193	80.099	75.545	71.310	68.067
Operational Boundary	**571.846**	**552.586**	**555.679**	**562.025**	**557.790**	**554.547**

The Authorised Limit for external debt is a further key prudential indicator, which represents control over the maximum level of debt. This represents a 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 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 council is asked to approve the following Authorised Limit:

	2016/17 Actual £'m	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m
External Debt	678.273	677.785	689.066	704.520	700.975	693.572
Other Long Term Liabilities*	89.078	84.193	80.099	75.545	71.310	68.067
Authorised Limit	**767.351**	**761.978**	**769.165**	**780.065**	**772.285**	**761.639**

The council is also limited to a maximum HRA CFR through the HRA self-financing regime which is built into the total reported Authorised Limit. This limit is currently £426.205m.

3.3 Prospects for Interest Rates

The council has appointed Link Asset Services 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 on interest rates over the next few years.

	Bank Rate	PWLB Borrowing Rates % (including certainty rate adjustment)		
	%	5 year	25 year	50 year
Dec-17	0.50	1.50	2.80	2.50
Mar-18	0.50	1.60	2.90	2.60
Jun-18	0.50	1.60	3.00	2.70
Sep-18	0.50	1.70	3.00	2.80
Dec-18	0.75	1.80	3.10	2.90
Mar-19	0.75	1.80	3.10	2.90
Jun-19	0.75	1.90	3.20	3.00
Sep-19	0.75	1.90	3.20	3.00
Dec-19	1.00	2.00	3.30	3.10
Mar-20	1.00	2.10	3.40	3.20
Jun-20	1.00	2.10	3.50	3.30
Sep-20	1.25	2.20	3.50	3.30
Dec-20	1.25	2.30	3.60	3.40
Mar-21	1.25	2.30	3.60	3.40

A more comprehensive list of these rates is detailed in Appendix 1.

Link Asset Services have also provided a detailed analysis of the economic background for the UK and the rest of the world which is given as Appendix 2 to this report. However, their general comments are as follows:

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.

- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

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 2018/19 treasury operations. The Section 151 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 long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and 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 the appropriate decision making body at the next available opportunity.

Treasury Management Limits on Activity
There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments; this is set at 1/3 of the fixed interest rate limit.
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates; this is set to the Authorised limit.
  A note on both limits set for variable and fixed, the combined borrowed limit will not exceed the set Authorised limit.
- Maturity structure of borrowing. These gross limits are set to reduce the council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The council is asked to approve the following treasury indicators and limits:

	2017/18 £'m	2018/19 £'m	2019/20 £'m
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	761.978	769.165	780.065
Limits on variable interest rates based on net debt	253.993	256.388	260.022
Maturity Structure of fixed interest rate borrowing 2017/18			
		Lower	**Upper**
Under 12 months		0%	20%
12 months to 2 years		0%	20%
2 years to 5 years		0%	25%
5 years to 10 years		0%	50%
10 years and above		10%	90%

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.

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 20% of the expected increase in borrowing need (CFR) over a three year planning period

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

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
-

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to council at the earliest meeting following its action.

4. Annual Investment Strategy

4.1 Investment Policy

The council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA and in order to minimise the risk to investments, the council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Further, the council's officers recognise that ratings should 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.

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

Investment instruments identified for use in the financial year are listed in appendix 3 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the council's Treasury Management Practices.

4.2 Creditworthiness policy

The primary principle governing the council'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 council 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 council's prudential indicators covering the maximum principal sums invested.

The Section 151 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 council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services, our treasury consultants, 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 a possible long term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum council criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) are:

- Banks 1 - good credit quality **–** the council will only use banks which have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
    i. Short term - F1, P-1, A-1 respectively
    ii. Long term – A-, A1 and A- respectively
- Banks 2 – Part nationalised UK banks – These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Building societies - The council will use all societies which meet the above criteria.
- Money Market Funds – AAA rated money market funds
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions
- Building Schools for the Future Local Education Partnership
- Sandwell Inspired Partnership Services

A limit will be applied to the use of Non-Specified investments, further details can be found at appendix 3.

Use of additional information other than credit ratings
Additional requirements under the Code require the council to supplement credit rating information. Whilst the above criteria relies 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 time and monetary limits for institutions on the council's counterparty list are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 category high quality	**AA-**	**£30m**	**3yrs**
Banks 1 category medium quality	**A-**	**£10m**	**364 days**
Limit 3 category – council's banker (not meeting Banks 1)	**-**	**£15m**	**1 day**
Other institutions limit	**-**	**£10m**	**364 days**
DMADF	**AAA**	**unlimited**	**6 months**
Money market Funds	**AAA**	**£10m**	**liquid**

The proposed criteria for Specified and Non-Specified investments are shown in appendix 3 for approval.

4.3 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).

Investment returns expectations
Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next eight years are as follows:

2017/18 0.40%
2018/19 0.60%
2019/20 0.90%
2020/21 1.25%
2021/22 1.50%
2022/23 1.75%
2023/24 2.00%
Later years 2.75%

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

WM Combined Authority
The Council will be prepared to lend to the Combined Authority. Such lending may be as part of arrangements agreed with the Combined Authority and other constituent authorities.

Investment treasury indicator and limit
These are the total principal funds invested for greater than 364 days. These limits are set with regard to the council'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.

The council is asked to approve the treasury indicator and limit:

Maximum principal sums invested > 364 days			
	2017/18	**2018/19**	**2019/20**
Principal sums invested > 364 days	£30m	£30m	£30m

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

4.4 Investment Risk Benchmarking
These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

Security - The council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.03% historic risk of default when compared to the whole portfolio.

Liquidity – the council seeks to maintain:
- Bank overdraft - £2m
- Liquid short term deposits of at least £20m available with a week's notice.

Yield - Local measures of yield benchmarks are:
- Investments – internal returns above the 7 day LIBID rate
- Investments – external fund managers – returns 110% above 7 day compound LIBID.

The current LIBID benchmarks are reported below; please note that these rates are variable and change daily. They are linked to current market conditions and may go up or down as those conditions change.

% Benchmarks	7 Day	1 Month	3 Month	6 Month	12 Month
Benchmark Return (LIBID Uncompounded)	0.36%	0.37%	0.40%	0.45%	0.64%

4.5 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.

APPENDIX 1: Interest Rate Forecasts 2018 – 2021

Link Asset Services Interest Rate View	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
3 Month LIBID	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.00%	1.20%	1.20%	1.20%
6 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.60%
5yr PWLB Rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB Rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB Rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate													
Link Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
Capital Economics	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.00%	2.25%	2.25%	-
5yr PWLB Rate													
Link Asset Services	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
Capital Economics	1.70%	1.90%	2.10%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.65%	2.65%	2.90%	-
10yr PWLB Rate													
Link Asset Services	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
Capital Economics	2.20%	2.40%	2.60%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	3.05%	3.05%	3.30%	-
25yr PWLB Rate													
Link Asset Services	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.60%	2.90%	3.10%	3.30%	3.30%	3.30%	3.35%	3.35%	3.35%	3.60%	3.60%	3.80%	-
50yr PWLB Rate													
Link Asset Services	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

APPENDIX 2 Economic Background

1.1 APPENDIX: Economic Background

GLOBAL OUTLOOK. World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

In addition, **inflation prospects are generally muted** and it is particularly notable that **wage inflation** has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this? The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the **fourth industrial revolution.**

KEY RISKS - central bank monetary policy measures
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking too rapid and too strong action, or, alternatively, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the **low level of productivity growth**, which may be the main driver for increases in wages; and **decreasing consumer disposable income,** which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

A further question that has come to the fore is whether **an inflation target for central banks of 2%**, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

- Some economists favour a shift to a **lower inflation target of 1%** to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply 'look through' tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.
- However, other economists would argue for a **shift *UP* in the inflation target to 3%** in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should **target financial market stability**. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that **other non-financial asset prices**, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

UK. After the UK surprised on the upside with strong economic growth in 2016, **growth in 2017 has been disappointingly weak**; quarter 1 came in at only +0.3%

(+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the **Monetary Policy Committee, (MPC), meeting of 14 September 2017** managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that **the amount of spare capacity in the economy was significantly diminishing** towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

It is also worth noting the **contradiction within the Bank of England** between action in 2016 and in 2017 **by two of its committees**. After the shock result of the EU referendum, the **Monetary Policy Committee (MPC)** voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was *because* the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the **Financial Policy Committee (FPC)** of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that **some consumers may have over extended their borrowing** and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

EZ. Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

USA. Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.2%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and four increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

JAPAN. GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

Appendix 3 - Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The CLG issued Investment Guidance in 2010, and this forms the structure of the council's policy below. These guidelines do not apply to either trust funds or pension funds that 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. In accordance with the Code, the Section 151 Officer has produced its Treasury Management Practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the council will use. These are high security (i.e. high credit rating, although this is defined by the council, and no guidelines are

given), and high liquidity investments in sterling and with a maturity of no more than a year.

- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the council is:

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

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality such as a bank or building society. This covers bodies with a minimum short term rating of A (or equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is as per the Investment Counter Party and Liquidity Framework.

Non-Specified Investments – Are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
a.	**Supranational Bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds -** These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. National Rail, the Guaranteed Export Finance Company {GEFCO})	30%

	The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	
b.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	30%
c.	**The council's own banker** if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£15m
d.	Any **bank or building society** that has a minimum long term credit rating of AA-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	3 Years and £30m
e.	**Building Schools for the Future Local Education Partnership.** Whilst this is not a usual investment counter party, the council is likely to invest a small amount as part of the wider Building Schools for the Future project. As this institution is not credit rated it falls under the Non-specified criteria.	£1m
f.	**Sandwell Inspired Partnership Services.** Whilst this is not a usual investment counter party, the council is likely to invest a small amount for the organisation to be use as working capital in its infancy. As this institution is not credit rated it falls under the Non-specified criteria.	£1.2m

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services 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 Section 151 Officer and if required new counterparties which meet the criteria will be added to the list.