TREASURY MANAGEMENT STRATEGY STATEMENT 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.

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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

Capital Strategy

The CIPFA 2017 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 the associated risk is managed
- the implications for future financial sustainability

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

The capital strategy is included as a separate document within the budget report.

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) –** This will provide members with an outline of how investments and borrowings are to be organised in coming years, including an Investment Strategy and relevant indicators.

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.

The above reports are required to be adequately scrutinised before being recommended to the council. This role is undertaken by the Budget and Corporate Scrutiny Management Board.

1.3 Treasury Management Strategy for 2022/23

The strategy for 2022/23 covers two main areas:

Capital Issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (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, MHCLG MRP Guidance, CIPFA Treasury Management Code and the MHCLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. An overview of treasury management training was undertaken by the Budget and Corporate Scrutiny Management Board in December 2018 and further training for members will arranged for June 2022.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury Management Consultants

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

The council understands that responsibility for treasury management decisions remains with the organization 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 – 2025/26

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

2.1 Capital Expenditure and Financing

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. Members are asked to approve the capital expenditure forecasts:

	2020/21 Actual £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m	2025/26 Estimate £'m
Capital Expenditure						
General Fund	82.301	83.055	48.839	12.331	12.414	12.414
HRA	50.315	67.376	69.511	45.612	45.612	45.612
Total	**132.616**	**150.431**	**118.350**	**57.943**	**58.026**	**58.026**

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

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.

	2020/21 Actual £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m	2025/26 Estimate £'m
Resourced by:						
Capital Receipts	18.869	25.255	8.496	7.299	7.351	7.419
Capital Grants & Contributions	58.737	55.387	22.036	8.394	8.394	8.394
Revenue	24.107	23.730	19.415	13.979	13.979	13.979
Capital Expenditure Financed from Borrowing	**30.903**	**46.059**	**68.403**	**28.271**	**28.302**	**28.234**

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 increase 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 £74.308m of such schemes within the CFR as at 31 March 2020.

The council is asked to approve the CFR projections below:

	2020/21 Actual £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m	2025/26 Estimate £'m
Capital Financing Requirement (CFR)						
General Fund	326.457	317.837	317.436	298.510	279.165	259.822
HRA	468.374	497.324	540.238	560.482	580.692	600.701
Total CFR @ 31 March	**794.831**	**815.161**	**857.674**	**858.992**	**859.857**	**860.523**
Movement in CFR		**20.330**	**42.513**	**1.318**	**0.865**	**0.666**
Movement Represented by:						
Capital expenditure to be financed from borrowing		46.059	68.403	28.271	28.302	28.234
Less MRP/VRP and other financing movements *		-25.729	-25.890	-26.953	-27.437	-27.568
Movement in CFR		**20.330**	**42.513**	**1.318**	**0.865**	**0.666**

* Includes PFI annual principal repayments

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.

	2020/21 Actual £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m	2025/26 Estimate £'m
Balances	98.516	107.000	87.000	77.000	77.000	77.000
Specific reserves	137.834	114.000	99.000	89.000	79.000	69.000
Capital Receipts Unapplied	15.083	15.000	10.000	5.000	5.000	5.000
Capital Grants Unapplied	2.790	3.000	3.000	3.000	3.000	3.000
Con Adv & Borrowing	17.982	15.000	15.000	15.000	15.000	15.000
Collection Fund	-41.588	0.000	0.000	0.000	0.000	0.000
Total Core Funds	**230.617**	**254.000**	**214.000**	**189.000**	**179.000**	**169.000**
Net Working capital *	73.026	25.000	25.000	25.000	25.000	25.000
Expected investments	37.319	40.000	23.000	23.000	23.000	23.000

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

2.4 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).

MHCLG 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.

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.

A change introduced by the revised DLUHC MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. For this sum to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2021 the total VRP overpayments made by the General Fund account was £5.423m.

2.5 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.

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 Current Portfolio Position

The overall treasury management portfolio as at 31 March 2021 and for the positiion as 31 December 2021 are shown below for both borrowing and investments:

Treasury Portfolio				
	Actual 31/03/2021 £'000	Actual 31/03/2021 %	Current 31/12/2021 £'000	Current 31/12/2021 %
Treasury Investments				
Banks	556	1%	8,731	10%
Temporary Deposits	0	0%	0	0%
Money Market Funds	36,500	98%	74,800	89%
Local Authorities	0	0%	0	0%
6 Towns Credit Union	250	1%	250	0%
Total Managed In House	**37,306**	**100%**	**83,781**	**100%**
Total Treasury Investments	**37,306**	**100%**	**83,781**	**100%**
Treasury External Borrowing				
Local Authorities	10,046	2%	9,905	2%
PWLB	324,288	67%	305,060	63%
LOBO's	82,000	17%	82,000	17%
Market Fixed Loan	10,000	2%	10,000	2%
Temporary Loans	52,344	11%	72,403	15%
Soft Loans	2,915	1%	2,510	1%
Total External Borrowing	**481,593**	**100%**	**481,879**	**100%**
Net Treasury Investments/(Borrowing)	**(444,287)**		**(398,098)**	

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 £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m	2025/26 Estimate £'m
External Debt as at 1 April	481.593	490.964	511.294	553.806	555.124	555.989
Expected change in Debt	2.571	20.330	42.513	1.318	0.865	0.666
Other Long Term Liabilities (OLTL)*	74.308	68.289	66.057	62.774	58.718	54.393
Expected change in OLTL	-4.613	-3.638	-3.283	-4.056	-4.325	-4.599
External Debt as at 31 March	**553.859**	**575.945**	**616.581**	**613.842**	**610.382**	**606.449**
Capital Financing Requirement	**794.831**	**815.161**	**857.674**	**858.992**	**859.857**	**860.523**
Under / (Over) Borrowing	**240.972**	**239.216**	**241.093**	**245.150**	**249.475**	**254.074**

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

Director of Finance (Section 151 Officer) confirms that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view considers current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary

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 and the ability to fund under-borrowing by other cash resources.

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
External Debt	484.164	511.294	553.807	555.124	555.989	556.655
Other Long Term Liabilities*	69.695	64.651	62.774	58.718	54.393	49.794
Operational Boundary	**553.859**	**575.945**	**616.581**	**613.842**	**610.382**	**606.449**

The Authorised Limit

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

	2019/20 Actual £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m	2023/24 Estimate £'m	2024/25 Estimate £'m
External Debt	725.136	750.510	794.900	800.274	805.464	810.729
Other Long Term Liabilities*	69.695	64.651	62.774	58.718	54.393	49.794
Authorised Limit	**794.831**	**815.161**	**857.674**	**858.992**	**859.857**	**860.523**

The HRA CFR is built into the total reported Authorised Limit, this revised limit is currently £815.161m; the UK Government announced that there would be a policy change which led, in October 2018, to the HRA debt cap being abolished. The HRA therefore, are no longer restricted to a debt ceiling however, although the debt cap has now been lifted, the HRA will still follow the principals of the Prudential Code; (as a result will still use the CFR as their ultimate debt ceiling).

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. Link provided the following forecasts on 20 December 2021, these are forecasts for certainty rates, gilt yields plus 80 bps.

	Bank Rate	**PWLB Borrowing Rates % (including certainty rate adjustment)**		
	%	**5 year**	**25 year**	**50 year**
Dec-21	0.25	1.40	1.80	1.50
Mar-22	0.25	1.50	1.90	1.70
Jun-22	0.50	1.50	2.00	1.80
Sep-22	0.50	1.60	2.10	1.90
Dec-22	0.50	1.60	2.10	1.90
Mar-23	0.75	1.70	2.20	2.00
Jun-23	0.75	1.80	2.20	2.00
Sep-23	0.75	1.80	2.20	2.00
Dec-23	0.75	1.80	2.30	2.10
Mar-24	1.00	1.90	2.30	2.10
Jun-24	1.00	1.90	2.40	2.20
Sep-24	1.00	1.90	2.40	2.20
Dec-24	1.00	2.00	2.50	2.30
Mar-25	1.25	2.00	2.50	2.30

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

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 the Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16 December 2021.

As shown in the forecast table above, the forecast for the Bank Rate now includes four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and finally one in quarter 1 of 2025 to 1.25%.

- Investment returns are expected to improve in 2022/23 however, while markets are pricing in a series of Bank Rate hikes, actual 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.

- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and any rundown on reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

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 Director of Finance (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 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 the appropriate decision making body at the next available opportunity.

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 Finance 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

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.

If rescheduling was done, it will be reported to the council at the earliest meeting following its action.

3.7 New Financial Institutions (as a source of borrowing or types of borrowing)

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both 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 authorites (primarily shorter dated maturities out to 3 years or so – still cheaper than the certainty rate)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid “cost of carry” or to achieve recfinancing certainty over the next few years)

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

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, (a separate report).

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 2017 (“the Code”)

- CIPFA Treasury Management Guidance Notes 2018

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

The above guidance from the DLUHC and CIPFA place 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 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 banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Appendix 3 under the categories of 'specified' and 'non-specified' investments.

   - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.

   - **Non-specified investments** are those with less high credit quality, may be for periods more than one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18-month deposit would still be non-specified even if it has only 11 months left until maturity.

5. **Non-specified investments limit**. The council has determined that it will limit the maximum total exposure to non-specified investments as being 30% of the total investment portfolio.

6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in section 4.2.

7. **Transaction limits** are set for each type of investment in section 4.2.

8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.4).

9. Investments will only be placed with counterparties form countries with a specified minimum **sovereign rating**, (see paragraph 4.3).

10. 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.

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

12. As a result of the change in accounting standards for 2022/23 under IFRS 9**,** this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.

13. If considering ‘Property Funds’ or other ‘Diversified Income Funds’ in the future, the council may look to use externally appointed fund managers.

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.

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 Director of Finance (Section 151 Officer) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit then 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 Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of 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) is:

- Banks 1 - good credit quality – the council will only use banks which:
  i. are UK banks and/or
  ii. are non-UK and domiciled in a country which has a minimum sovereign long-term rating of AA-

  and 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 – Royal Bank of Scotland ringfenced operations. These banks can be included provided they continue to be part nationalised or 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 invested.

- Bank subsidiary and treasury operation. The council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

- Building societies - The council will use all societies which meet the above criteria.

- Money Market Funds (MMFs) CNAV – AAA rated money market funds.

- Money Market Funds (MMFs) LVNAV – AAA rated money market funds.

- Money Market Funds (MMFs) VNAV – AAA rated money market funds.

- Ultra-Short Dated Bond Funds with a credit rating of at least – AAA

- UK Government (including gilts, Treasury Bills and the DMADF)

- Local authorities, parish councils etc

- Supranational institutions

- Property Funds.

- Building Schools for the Future Local Education Partnership

- Sandwell Inspired Partnership Services

- Sandwell Children's Trust

- West Midlands Fire & Rescue Authority

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 rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments

The 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 (CNAV)	AAA	£20m	Liquid
Money market Funds (LVNAV)	AAA	£20m	Liquid
Money market Funds (VNAV)	AAA	£10m	1yr plus
Ultra-Short Dated Bond Funds	AAA	£10m	1yr plus
Local authorities	-	£10m	364 days
Property Funds	-	£10m	10yrs plus

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

Creditworthiness

Significant levels of downgrades to short-term 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 ot outlooks however, as economies are beginning to reopen, there have been some instances of previous lowering of outlooks being reversed.

CDC 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. That being said, 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 the 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 Other limits

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

a) **Non-specified investment limit.** The council has determined that it will limit the maximum total exposure of treasury management investments to non-specified investments as being 30% of the total investment portfolio.

b) **Country limit.** 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, will be added to or deducted from, by officers should ratings change in accordance with this policy.

c) **Other limits.** In addition:

- no more than 20% will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

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 the 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	Now	Previously
2022/23	0.50%	0.50%
2023/24	0.75%	0.75%
2024/25	1.00%	1.00%
2025/26	1.25%	1.25%
Long term later years	2.00%	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.

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 365 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			
	2022/23	**2023/24**	**2024/25**
Principal sums invested > 365 days	£30m	£30m	£30m

4.5 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:

- 0.00% 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 £21m available with a week's notice.

Yield - Local measures of yield benchmarks are:

- Investments – internal returns above the over-night SONIA compounded rate

The current SONIA 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	Over-Night	1 Month	3 Month	6 Month	12 Month
Benchmark Return (SONIA compounded)	0.06%	0.07%	0.10%	0.18%	0.35%

Note: This benchmark is an average risk of default measure and would not constitute an expectation of loss against a particular investment.

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 External Fund Manager

£74.8m of the council's funds is externally managed on a discretionary/pooled basis by the following:

- Aberdeen Standard Liquidity Fund (Lux) – Sterling Fund (Class 1)
- Aviva Investors Sterling Liquidity Fund (Class 3)
- BlackRock Institutional Sterling Liquidity Fund (Heritage)
- BNP Paribas Insticash Sterling (Institutional)
- CCLA – The Public Sector Deposit Fund (Class 4)
- Federated Short-Term Sterling Prime Fund (Class 3)
- Fidelity Institutional Liquidity Sterling Fund (Class A)
- Invesco Sterling Liquidity Portfolio (Institutional)

The council's external fund managers will comply with the Annual Investment Strategy. The agreements between the council and the fund managers additional stipulate guidelines on duration and other limits in order to contain and control risk.

The council fully appreciates the importance of monitoring the activity and resultant performance of its appointed external fund managers. In order to aid this assessment, the council is provided with a suite of regular reporting from its managers via both the Institutional Cash Distributions (ICD) Portal and the fund managers themselves.

In additional to formal reports, the council also meets the representatives of the fund managers on an annual basis. These meetings allow for additional scrutiny of the manager's activity as well as discussions on the outlook for the fund as well as wider markets.

5 TREASURY INDICATORS 2022/23 – 2025/26

5.1 Affordability Prudential Indicators

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.

	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
General Fund	5.53%	6.55%	5.15%	4.70%	4.45%	4.19%
HRA	22.63%	21.69%	21.91%	22.28%	22.33%	22.20%

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

HRA Ratios

	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
HRA Debt (£m)	353.950	336.868	327.801	316.413	308.913	303.626
HRA Revenues (£m)	130.290	132.381	135.351	136.538	136.538	136.538
Ratio of Debt to Revenues (%)	2.72%	2.54%	2.42%	2.32%	2.26%	2.22%

	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
HRA Debt (£m)	353.950	336.868	327.801	316.413	308.913	303.626
Number of HRA Dwellings	28,292	28,142	27,992	27,842	27,692	27,542
Debt Per Dwelling (£m)	12.511	11.970	11.711	11.365	11.155	11.024

5.2 Maturity Structure of Borrowing

Maturity structure of borrowing. These gross limits are set to reduce the council's exposure to large fixed rate sums falling due to refinancing and are required for upper and lower limits.

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

Maturity Structure of Fixed Interest Rate Borrowing 2021/22		
	Lower %	**Upper %**
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	20%
5 years to 10 years	0%	20%
10 years to 20 years	0%	20%
20 years to 30 years	0%	30%
30 years to 40 years	0%	40%
40 years to 50 years	0%	50%
50 years plus	0%	90%

Maturity Structure of Variable Interest Rate Borrowing 2021/22		
	Lower %	**Upper %**
Under 12 months	0%	5%
12 months to 2 years	0%	5%
2 years to 5 years	0%	5%
5 years to 10 years	0%	5%
10 years to 20 years	0%	5%
20 years to 30 years	0%	10%
30 years to 40 years	0%	10%
40 years to 50 years	0%	10%
50 years plus	0%	10%

APPENDIX 1: Interest Rate Forecasts

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. Link provided the following forecasts on 20th December 2021. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View 20.12.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

Additional notes by Link on this forecast table:-

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

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 four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

Significant risks to the forecasts

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns. 25% of the population not being vaccinated is also a significant risk to the NHS being overwhelmed and lockdowns being the only remaining option.

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.

- **The Monetary Policy Committee** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **The Monetary Policy Committee** tightens monetary policy too late to ward off building inflationary pressures.

- **The Government** acts too quickly to cut expenditure to balance the national budget.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Longer term US treasury yields** rise strongly and pull gilt yields up higher than forecast.

- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.

- **Geopolitical risks,** for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

The balance of risks to the UK economy: -

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

Forecasts for Bank Rate

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.

- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.

- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?

- Rising gas and electricity prices in October and next April and increase in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.

- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?

- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.

- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.

- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

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

It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

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 <u>UPWARD RISK</u> 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 family plan over the next decade; this is still caught up in Democrat / Republican haggling. FFinancial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme had enabled a rapid opening up of the economy during 2021.
2. The economy was growing strongly during the first half of 2021 although it has weakened overall during the second half.

3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing substantial stimulus through monthly QE purchases during 2021.

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

At its 3rd November Fed meeting, the Fed decided to make a start on tapering its $120bn per month of QE purchases so that they ended next June. However, at its **15th December meeting** it doubled the pace of tapering so that they will end all purchases in February. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that Treasury yields will rise over the taper period and after the taper ends, all other things being equal. The Fed also forecast that it expected there would be three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy.

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

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

- How strongly will changes in gilt yields be correlated to changes in US treasury yields (see below). Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?

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

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.

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

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

A new era for local authority investing
– a fundamental shift in central bank monetary policy

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

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.

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

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.

- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The current margins over gilt yields are as follows: -.

    - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
    - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
    - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

- **Borrowing for capital expenditure.** Our long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As 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, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing if an authority is seeking to avoid a “cost of carry” but also wishes to mitigate future re-financing risk.

- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a *cost of carry*, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances.

APPENDIX 2: Economic Background

COVID-19 vaccines.

These were the game changer during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, the bursting onto the scene of the Omicron mutation at the end of November, rendered the initial two doses of all vaccines largely ineffective in preventing infection. This has dashed such hopes and raises the spectre again that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that this mutation is very fast spreading with the potential for total case numbers to double every two to three days, although it possibly may not cause so much severe illness as previous mutations. Rather than go for full lockdowns which heavily damage the economy, the government strategy this time is focusing on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection, as a booster has been shown to restore a high percentage of immunity to Omicron to those who have had two vaccinations. There is now a race on between how quickly boosters can be given to limit the spread of Omicron, and how quickly will hospitals fill up and potentially be unable to cope. In the meantime, workers have been requested to work from home and restrictions have been placed on large indoor gatherings and hospitality venues. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in sectors like restaurants, travel, tourism and hotels which had been hit hard during 2021, but could now be hit hard again by either, or both, of government restrictions and/or consumer reluctance to leave home. Growth will also be lower due to people being ill and not working, similar to the pingdemic in July. The economy, therefore, faces significant headwinds although some sectors have learned how to cope well with Covid. However, the biggest impact on growth would come from another lockdown if that happened. The big question remains as to whether any further mutations of this virus could develop which render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- In December, the Bank of England became the first major western central bank to put interest rates up in this upswing in the current business cycle in western economies as recovery progresses from the Covid recession of 2020.
- The next increase in Bank Rate could be in February or May, dependent on how severe an impact there is from Omicron.

- If there are lockdowns in January, this could pose a barrier for the MPC to putting Bank Rate up again as early as 3rd February.
- With inflation expected to peak at around 6% in April, the MPC may want to be seen to be active in taking action to counter inflation on 5th May, the release date for its Quarterly Monetary Policy Report.
- The December 2021 MPC meeting was more concerned with combating inflation over the medium term than supporting economic growth in the short term.
- Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022.
- However, the MPC will want to normalise Bank Rate over the next three years so that it has its main monetary policy tool ready to use in time for the next down-turn; all rates under 2% are providing stimulus to economic growth.
- We have put year end 0.25% increases into Q1 of each financial year from 2023 to recognise this upward bias in Bank Rate - but the actual timing in each year is difficult to predict.
- Covid remains a major potential downside threat in all three years as we ARE likely to get further mutations.
- How quickly can science come up with a mutation proof vaccine, or other treatment, – and for them to be widely administered around the world?
- Purchases of gilts under QE ended in December. Note that when Bank Rate reaches 0.50%, the MPC has said it will start running down its stock of QE.

MPC MEETING 16H DECEMBER 2021

- The Monetary Policy Committee (MPC) voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.

- The MPC disappointed financial markets by not raising Bank Rate at its November meeting. Until Omicron burst on the scene, most forecasters, therefore, viewed a Bank Rate increase as being near certain at this December meeting due to the way that inflationary pressures have been comprehensively building in both producer and consumer prices, and in wage rates. However, at the November meeting, the MPC decided it wanted to have assurance that the labour market would get over the end of the furlough scheme on 30th September without unemployment increasing sharply; their decision was, therefore, to wait until statistics were available to show how the economy had fared at this time.

- **On 10th December we learnt of the disappointing 0.1% m/m rise in GDP** in October which suggested that economic growth had already slowed to a crawl even before the Omicron variant was discovered in late November. Early evidence suggests growth in November might have been marginally better. Nonetheless, at such low rates of growth, the government's "Plan B" COVID-19 restrictions could cause the economy to contract in December.

- **On 14th December, the labour market statistics** for the three months to October and the single month of October were released. The fallout after the furlough scheme was smaller and shorter than the Bank of England had feared. The single-month data were more informative and showed that LFS employment fell by 240,000, unemployment increased by 75,000 and the unemployment rate rose from 3.9% in September to 4.2%. However, the weekly data suggested this didn't last long as unemployment was falling again by the end of October. What's more, the 49,700 fall in the claimant count and the 257,000 rise in the PAYE measure of company payrolls suggests that the labour market strengthened again in November. The other side of the coin was a further rise in the number of vacancies from 1.182m to a record 1.219m in the three months to November which suggests that the supply of labour is struggling to keep up with demand, although the single-month figure for November fell for the first time since February, from 1.307m to 1.227m.

- These figures by themselves, would probably have been enough to give the MPC the assurance that it could press ahead to raise Bank Rate at this December meeting. However, the advent of Omicron potentially threw a spanner into the works as it poses a major headwind to the economy which, of itself, will help to cool the economy. The financial markets, therefore, swung round to expecting no change in Bank Rate.

- **On 15th December we had the CPI inflation** figure for November which spiked up further from 4.2% to 5.1%, confirming again how inflationary pressures have been building sharply. However, Omicron also caused a sharp fall in world oil and other commodity prices; (gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies).

- **Other elements of inflation are also transitory** e.g., prices of goods being forced up by supply shortages, and shortages of shipping containers due to ports being clogged have caused huge increases in shipping costs. But these issues are likely to clear during 2022, and then prices will subside back to more normal levels. Gas prices and electricity prices will also fall back once winter is passed and demand for these falls away.

- Although it is possible that the Government could step in with some **fiscal support for the economy**, the huge cost of such support to date is likely to pose a barrier to incurring further major economy wide expenditure unless it is very limited and targeted on narrow sectors like hospitality, (as announced just before Christmas). The Government may well, therefore, effectively leave it to the MPC, and to monetary policy, to support economic growth – but at a time when the threat posed by rising inflation is near to peaking!

- This is the adverse set of factors against which the MPC had to decide on Bank Rate. For the second month in a row, the MPC blind-sided financial markets, this time with a **surprise increase in Bank Rate from 0.10% to 0.25%.** What's more, the hawkish tone of comments indicated that the MPC is now concerned that inflationary pressures are indeed building and need concerted action by the MPC to counter. This indicates that there will be more increases to come with financial markets predicting 1% by the end of 2022. The 8-1 vote to raise the rate shows that there is firm agreement that inflation now poses a threat, especially after the CPI figure hit a 10-year high this week. The MPC commented that “there has been significant upside news” and that “there were some signs of greater persistence in domestic costs and price pressures”.

- On the other hand, it did also comment that **“the Omicron variant is likely to weigh on near-term activity”.** But it stressed that at the November meeting it had said it would raise rates if the economy evolved as it expected and that now “these conditions had been met”. It also appeared more worried about the possible boost to inflation form Omicron itself. It said that “the current position of the global and UK economies was materially different compared with prior to the onset of the pandemic, including elevated levels of consumer price inflation”. It also noted the possibility that renewed social distancing would boost demand for goods again, (as demand for services would fall), meaning “global price pressures might persist for longer”. (Recent news is that the largest port in the world in China has come down with an Omicron outbreak which is not only affecting the port but also factories in the region.)

- On top of that, there were no references this month to inflation being expected to be below the **2% target in two years’ time,** which at November’s meeting the MPC referenced to suggest the markets had gone too far in expecting interest rates to rise to over 1.00% by the end of the year.

- These comments indicate that there has been a material reappraisal by the MPC of the inflationary pressures since their last meeting and the Bank also increased its forecast for inflation to peak at 6% next April, rather than at 5% as of a month ago. However, as the Bank retained its guidance that only **a “modest tightening”** in policy will be required, it cannot be thinking that it will need to increase interest rates that much more. A typical policy tightening cycle has usually involved rates rising by 0.25% four times in a year. “Modest” seems slower than that. As such, the Bank could be thinking about raising interest rates two- or three-times next year to 0.75% or 1.00%.

- In as much as a considerable part of the inflationary pressures at the current time are indeed **transitory,** and will naturally subside, and since economic growth is likely to be weak over the next few months, this would appear to indicate that this tightening cycle is likely to be comparatively short.

- As for the timing of the next increase in Bank Rate, the MPC dropped the comment from November’s statement that Bank Rate would be raised “in the coming months”. That may imply another rise is unlikely at the next meeting in February and that May is more likely. However, much could depend on how adversely, or not, the economy is affected by Omicron in the run up to the next meeting on 3rd February. Once 0.50% is reached, the

Bank would act to start shrinking its stock of QE, (gilts purchased by the Bank would not be replaced when they mature).

- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
    - Raising Bank Rate as "the active instrument in most circumstances".
    - Raising Bank Rate to 0.50% before starting on reducing its holdings.
    - Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
    - Once Bank Rate had risen to at least 1%, it would start selling its holdings.

- **US.** Shortages of goods and intermediate goods like semi-conductors, have been fuelling increases in prices and reducing economic growth potential. In November, **CPI inflation hit a near 40-year record level of 6.8%** but with energy prices then falling sharply, this is probably the peak. The biggest problem for the Fed is the mounting evidence of a strong pick-up in cyclical price pressures e.g., in rent which has hit a decade high.
- **Shortages of labour** have also been driving up wage rates sharply; this also poses a considerable threat to feeding back into producer prices and then into consumer prices inflation. It now also appears that there has been a sustained drop in the labour force which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023 while core inflation is likely to remain elevated at around 3% in both years instead of declining back to the Fed's 2% central target.
- Inflation hitting 6.8% and the feed through into second round effects, meant that it was near certain that the **Fed's meeting of 15th December** would take aggressive action against inflation. Accordingly, the rate of tapering of monthly $120bn QE purchases announced at its November 3rd meeting. was doubled so that all purchases would now finish in February 2022. In addition, Fed officials had started discussions on running down the stock of QE held by the Fed. Fed officials also expected three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy. The first increase could come as soon as March 2022 as the chairman of the Fed stated his view that the economy had made rapid progress to achieving the other goal of the Fed – "maximum employment". The Fed forecast that inflation would fall from an average of 5.3% in 2021 to 2.6% in 2023, still above its target of 2% and both figures significantly up from previous forecasts. What was also significant was that this month the Fed dropped its description of the current level of inflation as being "transitory" and instead referred to "elevated levels" of inflation: the statement also dropped most of the language around the flexible average inflation target, with inflation now described as having exceeded 2 percent "for some time". It did not see Omicron as being a major impediment to the need to take action now to curtail the level of inflationary pressures that have built up, although Fed officials did note that it has the potential to exacerbate supply chain problems and add to price pressures.

  See also comments in paragraph 3.3 under PWLB rates and gilt yields.

- **EU.** The slow role out of vaccines initially delayed **economic recovery** in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery was then within 0.5% of its pre Covid size. However, the arrival of Omicron is now a major headwind to growth in quarter 4 and the expected downturn into weak growth could well turn negative, with the outlook for the first two months of 2022 expected to continue to be very weak.
- **November's inflation figures** breakdown shows that the increase in price pressures is not just due to high energy costs and global demand-supply imbalances for durable goods as services inflation also rose. Headline inflation reached 4.9% in November, with over half of that due to energy. However, oil and gas prices are expected to fall after the winter and so energy inflation is expected to plummet in 2022. Core goods inflation rose to 2.4% in November, its second highest ever level, and is likely to remain high for some time as it will take a long time for the inflationary impact of global imbalances in the demand and supply of durable goods to disappear. Price pressures also increased in the services sector, but wage growth remains subdued and there are no signs of a trend of faster wage growth which might lead to *persistently* higher services inflation - which would get the ECB concerned. The upshot is that the euro-zone is set for a prolonged period of inflation being above the ECB's target of 2% and it is likely to average 3% in 2022, in line with the ECB's latest projection.
- **ECB tapering.** The ECB has joined with the Fed by also announcing at its meeting on 16th December that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases for over half of next year. However, as inflation will fall back sharply during 2022, it is likely that it will leave its central rate below zero, (currently -0.50%), over the next two years. The main struggle that the ECB has had in recent years is that inflation has been doggedly anaemic in sticking below the ECB's target rate despite all its major programmes of monetary easing by cutting rates into negative territory and providing QE support.
- The ECB will now also need to consider the impact of **Omicron** on the economy, and it stated at its December meeting that it is prepared to provide further QE support if the pandemic causes bond yield spreads of peripheral countries, (compared to the yields of northern EU countries), to rise. However, that is the only reason it will support peripheral yields, so this support is limited in its scope.
- The EU has entered a **period of political uncertainty** where a new German government formed of a coalition of three parties with Olaf Scholz replacing Angela Merkel as Chancellor in December 2021, will need to find its feet both within the EU and in the three parties successfully working together. In France there is a presidential election coming up in April 2022 followed by the legislative election in June. In addition, Italy needs to elect a new president in January with Prime Minister Draghi being a favourite due to having suitable gravitas for this post. However, if he switched office, there is a significant risk that the current government coalition could collapse. That could then cause differentials between Italian and German bonds to widen when 2022 will also see a gradual

running down of ECB support for the bonds of weaker countries within the EU. These political uncertainties could have repercussions on economies and on Brexit issues.

- **CHINA.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of **2020**; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021.
- However, the pace of economic growth has now fallen back in **2021** after this initial surge of recovery from the pandemic and looks likely to be particularly weak in 2022. China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. Chinese consumers are also being very wary about leaving home and so spending money on services. However, with Omicron having now spread to China, and being much more easily transmissible, this strategy of sharp local lockdowns to stop the virus may not prove so successful in future. In addition, the current pace of providing boosters at 100 billion per month will leave much of the 1.4 billion population exposed to Omicron, and any further mutations, for a considerable time. The **People's Bank of China** made a start in December 2021 on cutting its key interest rate marginally to stimulate economic growth. However, after credit has already expanded by around 25% in just the last two years, it will probably leave the heavy lifting in supporting growth to fiscal stimulus by central and local government.
- Supply shortages, especially of coal for power generation, were causing widespread power cuts to industry during the second half of 2021 and so a sharp disruptive impact on some sectors of the economy. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

- **JAPAN.** 2021 has been a patchy year in combating Covid. However, recent business surveys indicate that the economy has been rebounding rapidly in 2021 once the bulk of the population had been double vaccinated and new virus cases had plunged. However, Omicron could reverse this initial success in combating Covid.
- The Bank of Japan is continuing its **very loose monetary policy** but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was actually negative in July. New Prime Minister Kishida, having won the November general election, brought in a supplementary budget to boost growth, but it is unlikely to have a major effect.

- **WORLD GROWTH.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum in the second half of the year, though overall growth for the year is expected to be about 6% and to be around 4-5% in 2022. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. While headline inflation will fall sharply, core inflation will probably not fall as quickly as central bankers would hope. It is likely that we are heading into a period where there will be a **reversal of world globalisation** and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

- **SUPPLY SHORTAGES**. The pandemic and extreme weather events, followed by a major surge in demand after lockdowns ended, have been highly disruptive of extended worldwide supply chains. Major queues of ships unable to unload their goods at ports in New York, California and China built up rapidly during quarters 2 and 3 of 2021 but then halved during quarter 4. Such issues have led to a misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. The latest additional disruption has been a shortage of coal in China leading to power cuts focused primarily on producers (rather than consumers), i.e., this will further aggravate shortages in meeting demand for goods. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods available to purchase.

APPENDIX 3: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The DLUHC issued Investment Guidance in 2018 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. 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 Director of Finance (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 number 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. 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, housing association, 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.).	30%

	(b) A financial institution that is guaranteed by the United Kingdom Government (e.g. National Rail, the Guaranteed Export Finance Company {GEFCO}) 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 minimized 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
g.	**Bond funds** this Authority will seek further advice on the appropriateness and associated risks with investments in these categories.	£10.0m
h.	**Property funds** the use of these instruments can be deemed to be capital expenditure and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using.	£10.0m (10 years plus)

This Authority will seek further advice on the appropriateness and associated risks with investments in these categories.

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 Director of Finance (Section 151 Officer) and if required new counterparties which meet the criteria will be added to the list.

Use of External Fund Managers – It is the council's policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investment categories and are contractually committed to keep to the council's investment strategy.

The council fully appreciates the importance of monitoring the activity and resultant performance of its appointed external fund managers. To aid this assessment, the council is provided with a suite of reporting from its managers. This includes access to funds via the ICD Portal, containing fact sheets, fund performance reviews, daily interest rate sheets, daily access to the council's investment activity and interest accrued reports.