APPENDIX 4

Treasury Management Strategy Statement

1 Background

1.1 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.

1.2 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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 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.

1.4 The Chartered Institute of Public Finance Accountants (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."

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

Reporting Requirements – Capital Strategy

1.6 The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2022-23, all local authorities to prepare an additional report, 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 understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. Full Council approved its current Capital Strategy on 7th December 2021.

This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset.

Reporting Requirements – Treasury Management

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

I. **A treasury strategy including Prudential and Treasury indicators** (this report) - The first, and most important report covers:

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

II. **A Mid-year Treasury Management Report** – this will update the Council with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury activity is meeting the strategy or whether any policies require revision.

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

1.8 The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

1.9 CIPFA published revised codes on 20th December 2021, Treasury Management Code and Prudential Code with formal adoption not until the 2023/24 financial year. In addition, the Department for Levelling Up, Housing and Communities are currently conducting a consultation on amending Minimum Revenue Provision Rules with effect from 1st April 2023 that could possibly have a negative revenue impact for the authority if implemented.

Further details of these changes are set out in Annex 4.

2 Treasury Management Strategy for 2022/23

2.1 The Treasury Management Strategy for 2022/23 covers two main areas:

Capital Issues

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

Treasury Management Issues

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

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

2.3 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. Treasury Management training was provided in July 2021 with further training to planned in 2022.

2.4 The training needs of treasury management officers are periodically reviewed.

2.5 The Council uses Link Group, Treasury solutions as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

2.6 The Council 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.

2.7 The scope of investments within the Council's Treasury operations include the placing of residual cash from the Council's functions in various products such as fixed term deposits, call accounts and money market with a variety of finanical institutions.

3 The Capital Prudential Indicators 2022/23 – 2026/27

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

Capital expenditure

3.2 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The table also summarises how the capital expenditure plans are being financed. Any shortfall of resources results in a borrowing need. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £m	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Non-HRA	126	147	168	140	84	40	27
Non – HRA*1	-	-	16	22	20	17	11
HRA	39	53	123	194	165	110	94
Total	**165**	**200**	**307**	**356**	**269**	**167**	**132**
Financed by:							
Capital receipts	35	48	83	63	34	24	11
Capital grants	74	60	82	55	48	16	13
HRA Self financing	22	29	30	32	33	34	35
Revenue	4	3	34	40	1	1	-
Net financing need for year	**30**	**60**	**78**	**166**	**153**	**92**	**73**

*1 Schemes pending subject to business case development

Note, the table above exclude arrangements such as service-concession contracts such as PFI and leasing that have their own financing / borrowing facilities.

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

3.3 The Capital Financing Requirement (CFR) is 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 underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

3.4 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 asset's life.

3.5 The CFR includes any long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £133m of such schemes within the CFR.

3.6 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	2026/27 Estimate £m
CFR – non housing	508	564	629	675	701	709	713
CFR – PFI/Lease schemes	133	124	116	107	98	89	80
CFR – housing	245	245	249	356	468	537	591
Total CFR	**886**	**933**	**994**	**1,138**	**1,267**	**1,335**	**1,384**
Movement in CFR	**16**	**47**	**61**	**144**	**129**	**68**	**49**

Net financing need for year	30	60	78	166	153	92	73
Less MRP & other financing	(14)	(13)	(17)	(22)	(24)	(24)	(24)
Movement in CFR	**16**	**47**	**61**	**144**	**129**	**68**	**49**

Minimum Revenue Provision (MRP) policy statement

3.7 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 allowed to undertake additional voluntary provision (VRP).

3.8 The Department for Levelling Up, Housing and Communities (DLUHC) have issued Regulations 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 and capital expenditure incurred on or after that date which forms part of its Supported Capital Expenditure - The MRP policy will be based on the pre 2007/08 borrowing and post supported borrowing at 2% fixed so that the whole debt is repaid after 50 years.

Note a change in policy approved by Full Council on 13th December 2016 amended the rate that is used to calculate MRP from 4% reducing balance to 2% straight line as this is better aligned to the average lives of the authority's assets and results with the debt being fully repaid. This means that the authority has overprovided during the period 1st April 2008 through to 31st March 2016. The Council has reduced it's MRP provision in 2017/18 through to 2021/22 and will reduce it's MRP further, over an adequate timeframe (a further 1 year) to recover this overprovision while also ensuring a prudent annual provision is maintained.

This additional reduction in MRP will be set aside to reserves to ensure the Council maintains reasonable provision as mitigation for financial risks outlined in the main body of the report. It is estimated that for 2022/23 £4.1m of this overprovided MRP will be made available to supplement general reserves.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be the Asset life method – MRP will be based on the estimated life of *the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction);*

Any loan or investment to an organisation defined as capital expenditure will not attract MRP. The original capital expenditure will be met from the capital receipt on the maturity of the loan/investment.

Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, as justified by the circumstances of the case, as determined by the Chief Finance Officer.

These options provide for a reduction in the borrowing need over approximately the asset's life.

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

3.10 Repayments included in annual PFI or finance leases are applied as MRP.

Affordability prudential indicator

3.11 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicator:

3.12 **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 %	2026/27 Estimate %
General Fund	6.9	6.7	7.5	9.1	9.2	9.3	8.9
HRA	8.8	9.1	8.2	8.4	9.8	10.9	12.4

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

4 Borrowing

4.1 The capital expenditure plans set out in Section 3 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

Current and projected portfolio position

4.2 The Council's treasury portfolio position at 31 March 2021, with forward projections are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement), 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	2026/27 Estimate £m
External Debt 1 April	461	451	451	516	716	896	1,006
Expected change in debt	(10)	-	65	200	180	110	53
Other long-term liabilities	141	133	124	116	107	98	89
Expected change in other long-term liabilities	(8)	(9)	(8)	(9)	(9)	(9)	(9)
Debt Administered on behalf of the Unitary authorities	(39)	(37)	(36)	(35)	(33)	(32)	(31)
Actual gross debt 31 March	**545**	**538**	**596**	**788**	**961**	**1,063**	**1,108**
Capital Financing Requirement	**886**	**933**	**994**	**1,138**	**1,267**	**1,335**	**1,384**
Under borrowing	**(341)**	**(395)**	**(398)**	**(350)**	**(306)**	**(272)**	**(276)**

Gross Debt and the Capital Financing Requirement

4.3 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes or speculative purposes.

4.4 The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: limits to borrowing activity

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

Currently the operational boundary is planned to be lower than the CFR as the Council is utilising other cash resources to support the financing of the capital programme, also commonly known as internal borrowing.

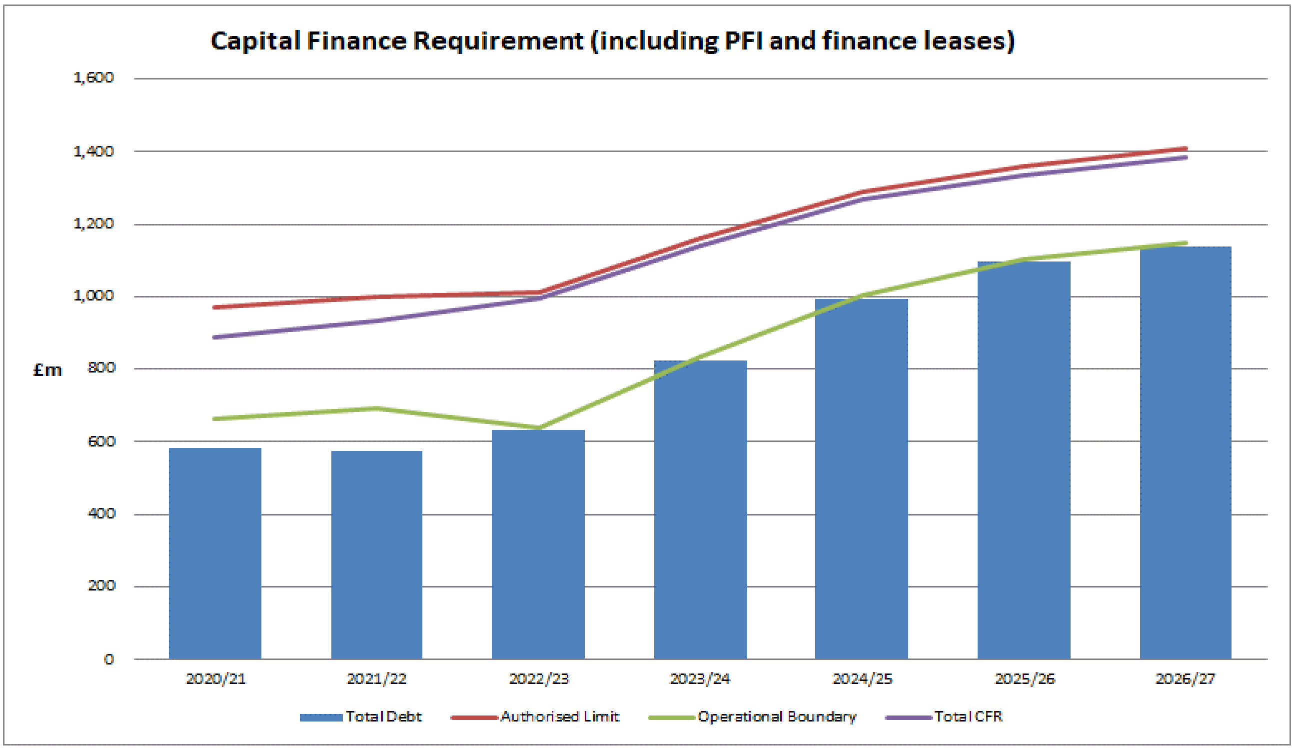
	2021/22 Approved £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Debt	561	516	716	896	1,006	1,059
Other long-term liabilities	133	124	116	107	98	89
Total	**693**	**640**	**832**	**1,003**	**1,104**	**1,148**

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

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

	2021/22 Approved £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Total	**1,000**	**1,010**	**1,160**	**1,290**	**1,360**	**1,410**

The graph below shows the above projections in one chart to assist with presenting this information.



Prospects for interest rates

4.7 The Council has appointed a treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their view.

Period	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)			
		5 year	10 Year	25 year	50 year
Mar 2022	0.25	1.50	1.70	1.90	1.70
Mar 2023	0.75	1.70	1.90	2.20	2.00
Mar 2024	1.00	1.90	2.10	2.30	2.10
Mar 2025	1.25	2.00	2.30	2.50	2.30

Over the last two years, the coronavirus outbreak has done significant 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 the following increases, quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and quarter 1 of 2025 to 1.25%. With the high level of uncertainty prevailing on several different fronts, we expect these forecasts to be revised.

The forecast for PWLB borrowing rates show a general upward trend across all maturity bands over the next three years. There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates from numerous factors. The balance of risks to medium to long term PWLB rates are to the upside.

There are significant risks to these forecasts as set out in Annex 2 – Economic Forecast and Interest Rate forecast.

- **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 the 25th November 2020 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 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 Council can now borrow from the PWLB at - gilt plus 80 basis points.

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.

The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

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

There are also alternative sources of long-term borrowing available, besides PWLB if an authority is seeking to avoid a "cost of carry" but also wishes to mitigate future re-financing risk, and these sources will be considered.

Borrowing Strategy

4.8 Based on current cash flow forecasts, it is estimated that the Council will have a net borrowing requirement of £608m over the MTFS period. The most significant consideration from a treasury management perspective is the timing and duration of that borrowing. Should the financial environment change and borrowing is deemed advantageous the Council will seek to borrow long-term loans below a "target rate" of 2.00% and short-term to medium term loans below a "target rate" of 1.75%.

4.9 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 an issue that needs to be considered.

4.10 Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Chief Finance 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.

4.11 Any decisions will be reported to the appropriate decision making body at the next available opportunity.

- Long-term and short-term fixed interest rates are expected to rise “marginally” over the medium term. The Chief Finance Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.
- The option of postponing borrowing and running down investment balances strategy has been applied in 2022/23. This approach will continue until balances are reduced to adequate liquidity requirements unless it was felt that there was a significant risk of a sharp rise in interest rates.
- The Councils borrowing strategy will consider new borrowing in the following ways:
  - The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase, be it marginally, over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years;
  - PWLB loans for up to 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing, which will spread debt maturities away from a concentration in the longer dated debt that the Council holds;
  - PWLB loans in excess of 10 years where rates are considered to be low and offer the Council the opportunity to lock into low value long-term finance;
  - Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio;
  - Long term borrowing from the Municipal Bond Agency if available and appropriate and rates are lower than those offered by the Public Works Loan Board (PWLB).
  - Short to medium funding from local authorities and financial institutions at rates lower than the PWLB

4.12 The authority is planning net borrowing of £65m over the period as set out in table 4.2, to finance the expected Prudential Borrowing requirement of £78m as set out in table 3.2 as set out in the Capital programme. The reduced borrowing of £13m partly reflects the cash set-aside for the repayment of debt, also known as Minimum Revenue Provision (MRP). The most efficient arrangement is for MRP to be used to reduce the new long term debt expected to be required. This ensures that MRP is utilised and does not accumulate as cash on the balance sheet, and reduces the expected level of debt. Alternatively MRP could be used to repay existing debt, but this would be at considerable cost in the current interest rate environment.

The level of borrowing will ensure the authority will maintain adequate liquidy levels as set out in the strategy.

4.13 The Council will seek to undertake temporary borrowing (less than one year) loans to cover day-to-day cashflow requirements as and when required. Such a decision will be based on the availability of and access to cash in deposit accounts and money market funds to cover the cashflow requirement, whilst also considering the most efficient method for the authority.

4.14 Temporary borrowing will also be considered when the draw down deadline for a deposit account for same day transfer has passed, thus resulting in borrowing cash from the money markets.

4.15 The Chief Finance Officer will be kept informed of the temporary loans outstanding on a monthly basis and reviewed at the regular Treasury Management Group meeting.

Policy on borrowing in advance of need

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

4.17 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.

Debt Rescheduling

4.18 As the yield curve is relatively flat there is limited opportunities to generate savings by switching from long term debt to short term debt. In addition, rescheduling of our PWLB loans is unlikely to occur due how the repayment penalties and discounts are calculated. Any savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

4.19 The reasons for any rescheduling to take place will include:

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

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

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

Zero Carbon initiatives

4.22 The capital strategy references the council being able to:

explore zero carbon initiatives funded through Community Municipal Investments or Retail Bonds upto a maximum exposure in such investments of £2m. The exposure to such initiatives would be included within the General Fund capital financing costs exposure of a maximum 10% of the net revenue budget.

4.23 If such an opportunity arose the council would explore the zero carbon initiative in accordance with this strategy.

5 Annual Investment Strategy

Investment policy

5.1 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 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).

5.2 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 36 months with high credit rated financial institutions, as well as wider range fund options.

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

- Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- **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.
- **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- The Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Annex 3 under the categories of 'specified' and 'non-specified' investments. Counterparty limits will be as set through the Council's treasury management practices – schedules using the parameters below
  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.
- Counterparty lending limits (amounts and maturity) will be set using the investment criteria below.

Creditworthiness policy

5.3 The primary principle governing the Council's investment criteria is the security of its investments, whilst liquidity and the yield 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.

5.4 The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

5.5 The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are considered before making investment decisions.

5.6 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 (or equivalent)
  ii. Long term – A- (or equivalent)
- **Banks 2** – Part nationalised UK banks – Royal Bank of Scotland ring-fenced operations. This bank can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- **Banks 3** – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

- **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 ratings for banks outlined above.
- **Money market funds (CNAV Constant Net Asset Value)** – AAA rated (sterling)
- **Money Market Funds (LVNAV Low Volatility Net Asset Value)** – AAA rated (sterling)
- **Money Market Funds (VNAV Variable Net Asset Value)** – AAA rated (sterling)
- **Ultra-Short dated Bond Funds with a volatility rating of S1+**
- **UK Government** (including gilts and the DMADF)
- **Local authorities, parish councils etc**
- **Supranational institutions**
- **Council owned subsidiaries**. The Council invests in wholly owned Council subsidiaries. Depending on the nature of the investment this will either be classified as a Service investment or a Treasury investment. Service investments fall outside the scope of the specified/ non specified categories and currently investments of this type are classified as service investments.

A limit of £100m will be applied to the use of non-specified investments

Country and sector considerations

5.7 Due care will be taken to consider the country, group and sector exposure of the Council's investments. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). In addition:

- no more than 25% 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.

5.8 **Use of additional information other than credit ratings.** Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision. This additional market information (for example Credit Default Swaps (CDS), negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments.

5.9 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	Money Limit	Time Limit

	(or equivalent)		
Banks 1 - higher quality	*AAA*	£50m	5 Years
Banks 1 - medium quality	*AA-*	£20m	3 Years
Banks 1 - lower quality	*A-*	£10m	1 Year
Banks 2 – part-nationalised	N/A	£10m	1 Year
Limit 3 category – Council's banker (not meeting Banks 1/2)	-	£100k	Liquid
Other institutions limit*	-	£50m	5 Years
DMADF	UK Sovereign rating	unlimited	1 Year
Local authorities	-	£40m	5years
Money market funds (MMF) (Including CNAV, LVNAV & VNAV)	AAA	£40m	liquid

**The Other Institution Limit will be for Gilt and Supranational investments*

The proposed criteria for specified and non-specified investments are shown in Annex 3 for approval.

5.10 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 fluctuations of the cash flows, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

5.11 **Investment return expectations.**

The current forecast shown in Annex 2 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, (based on a first increase in Bank Rate in quarter 2 of 2022), are as follows (the long term forecast is for periods over 10 years in the future):

- 2022/23 0.50%
- 2023/24 0.75%
- 2024/25 1.00%
- 2025/26 1.25%

- 2026/27 1.50%
- Long term later years 2.00%

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, with further details set out in Annex 2.

Treasury management limits on activity

5.12 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
- The Council is asked to approve the following treasury indicators and limits;

	2022/23	2023/24	2024/25 & Beyond
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%
Maturity structure of fixed interest rate borrowing 2022/23			
		Lower	**Upper**
Under 12 months		0%	30%
12 months to 2 years		0%	40%
2 years to 5 years		0%	40%
5 years to 10 years		0%	50%
10 years and above		25%	100%

Investment treasury indicator and limit

5.13 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.

Maximum principal sums invested > 365 days			
£m	**2022/23**	**2023/24**	**2024/25 & Beyond**
Principal sums invested > 364 days	£100m	£100m	£100m

5.14 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.

Ethical & Equitable Investment Policy

5.15 The councils current Ethical Investment Policy was approved by Cabinet on the 15th December 2011 (updated 2015). In summary it states the City Council will not knowingly invest in organisations whose activities include practices which directly pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the mission and values of the City Council.

5.16 During 2021/22 the council has reviewed its policy and, subject to Cabinet approval on 18th January 2022, will adopt its new Ethical and Equitable Investment Policy. This new policy will replace the existing policy, and form part of the Treasury Management Strategy that is to be approved by Council in February 2022. The key changes to be included in the new policy are the council taking a more proactive approach to ethical investment and a widening of the policy to promote an equitable approach to investment across all communities in Bristol. It should be noted a core element of the new policy continues to be the application of statutory guidance relating to treasury management funds.

Investment Risk Benchmarking

5.17 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 and 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.

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

- 0.00% (AAA rated) to 0.04% (A rated) historic risk of default when compared to the whole portfolio.

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft - £500k.
- Liquid short-term deposits of at least £40m available within a rolling three-month period.

- Weighted average life benchmark is expected to be a minimum of a day with a maximum of 1 year.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7-day SONIA compounded rate (Sterling Overnight Interbank Average) .

And in addition, that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.04%**	**0.13%**	**0.23%**	**0.33%**	**0.46%**

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

The Council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors in determining suitable replacement investment benchmark(s) ahead of this cessation and will report back to members accordingly.

Annexes

Annex 1 - Treasury Management Policy Statement

Annex 2 – Economic Background / Interest Rate Forecast

Annex 3 – TMP1 Credit and Counterparty risk management

Annex 4 - Changes to Codes of Practice and Minimum Revenue Provision Consultation

Annex 5 – Ethical and Equitable Investment Policy (Adoption subject to approval at January 2022 cabinet)

Annex 1

Treasury Management Policy Statement

1. The Council defines its treasury management activities as follows:

   The management of the Council'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.

2. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council, and any financial instruments entered into to manage these risks.

3. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

4. The Council's high-level policies for borrowing and investments are:

   - The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken, and the type of borrowing should allow the Council transparency and control over its debt
   - The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

Annex 2

Interest Rate Forecast / Economic Background

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
Bank Rate														
Link	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
Capital Economics	0.25	0.25	0.50	0.75	0.75	0.75	0.75	1.00	1.00	-	-	-	-	-
5yr PWLB Rate														
Link	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
Capital Economics	1.40	1.40	1.50	1.50	1.60	1.70	1.70	1.80	1.90	-	-	-	-	-
10yr PWLB Rate														
Link	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
Capital Economics	1.60	1.60	1.70	1.70	1.80	1.80	1.90	2.00	2.00	-	-	-	-	-
25yr PWLB Rate														
Link	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
Capital Economics	1.80	1.80	1.90	1.90	2.00	2.10	2.10	2.20	2.30	-	-	-	-	-
50yr PWLB Rate														
Link	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
Capital Economics	1.40	1.50	1.60	1.70	1.80	1.90	2.00	2.20	2.30	-	-	-	-	-

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, the forecasts are based on expected average earnings by local authorities for 3 to 12 months.

The 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 significant 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 the following increases, quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and quarter 1 of 2025 to 1.25%. With the high level of uncertainty prevailing on several different fronts, we expect these forecasts to be revised.

- **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. With the introduction of Omicron poses 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 reduction?

  Rising gas and electricity prices in October and next April and increases 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.

However, consumers are holding £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. In addition job 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 Covid mutations 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 forecasts to be revised.

  It should also be noted 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 remove 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, there has been a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.

  While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in

America could have on our gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

US treasury yields. During the first part of 2021, the US agreed a fiscal boost of $1.9trn (equivalent to 8.8% of GDP) for the US economy as a recovery package from the Covid pandemic that unsettled financial markets. However, this was in addition to the $900bn support package already passed in December 2020. This was then followed by additional $1trn package on infrastructure, and an even larger sum on the proposed "American families plan" over the next decade. Financial markets were alarmed that all this stimulus was happening at a time when: -

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

It was not 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 Federal Reserve at its December meeting with an response to damp inflation down during 2022 and 2023.

At its 3rd November Federal Reserve meeting, they decided to start on tapering its $120bn per month of Quantitative Easing 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. The Federal Reserve 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 large 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 could be invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down.

- 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 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 Federal Reserve take action to counter increasing treasury yields if they rise beyond a yet unspecified level?

  - Would the Monetary Policy Committee 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 reaction in financial markets as happened in the 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 Federal Reserve 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 "feed" 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, 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 Federal Reserve, the Bank of England and the European Central Bank, to "tolerate" a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US, before consideration would be given to increasing rates.

  The Federal Reserve 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 European Central Bank 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.

ECONOMIC BACKGROUND

COVID-19 vaccines.

The vaccines raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, with the Omicron mutation at the end of November, dashed these hopes and the possibility of a fourth wave.

To prevent any further 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.

As at the end of December 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 therefore be lower and the economy faces headwinds although some sectors have learned how to cope well with Covid. The biggest impact on growth coming from another lockdown.

The big question still remains as to whether any further mutations of this virus could develop which render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

In December, the Bank of England became the first major western central bank to put interest rates up. 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 Monetary Policy Committee 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 as rates under 2% are providing stimulus to economic growth.

There are 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.

Purchases of gilts under Quantitative Easing ended in December. Note that when Bank Rate reaches 0.50%, the MPC has said it will start running down its stock of Quantitative Easing.

MPC MEETING 16TH 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 variant was discovered, 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 see the impact on labour market following the end of the furlough scheme on 30th September; their decision was, therefore, to wait until statistics were available to show how the economy had fared at this time.

The hawkish tone of comments indicated that the MPC is concerned that inflationary pressures are building and need action 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. 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”.

The MPC do not expect Inflation to be below the 2% target in two years’ time and also increased its forecast for inflation to peak at 6% in April rather than at 5%. However, it should be noted that they retained its guidance that only a “modest tightening” in policy will be required, as such can expect rates rising slowly, two or three times next year to 0.75% / 1.00%.

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.

SUPPLY SHORTAGES. The pandemic and the global 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 built up rapidly during quarters 2 and 3 of 2021. 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 disrupt shortages in meeting demand for goods. Many western countries are also having difficulty in filling job vacancies. It is expected that these issues will be gradually be resolved, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods available to purchase.

Annex 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 which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective, the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The Council has adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Chief Finance 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 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. They also include investments which were originally classed as being non-specified investments, but which would have been classified as specified investments apart from originally being for a period longer than 12 months once the remaining period to maturity falls to under twelve months. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, 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. For this category this covers bodies with a minimum short-term rating of A- (or the 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. These criteria are set out below: -

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 higher quality	*AAA*	£50m	5 Years
Banks 1 medium quality	*AA-*	£20m	3 Years
Banks 1 lower quality	*A-*	£10m	1 Year
Banks 2 – part nationalised	N/A	£10m	1 Year
Limit 3 category – Council's banker (not meeting Banks 1/2)	-	£100k	Liquid
Other institutions limit*	-	£50m	5 Year
DMADF	AAA	unlimited	5 Years
Local authorities	-	£40m	5 Years
Money market funds (Including CNAV, LVNAV & VNAV)	AAA	£40m	Liquid

**The Other Institution Limit will be for Gilt and Supranational investments*

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 are limited to an overall exposure of £100m and would include any sterling investments with:

	Non-Specified Investment Category	Limit (£ or %)
a.	**Supranational bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. National Rail) The 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.	AAA long term ratings £50m
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.	£50m
c.	**The Council's own banker** if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	Minimal
d.	Any **bank or building society** that has a minimum long-term credit rating of A-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£40m
e.	Any **non-rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to: • Parent company guarantee • Parent company to be a UK institution.	£10m
f.	**Share capital** in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. **Loan capital** in a body corporate. There is a higher risk of loss with these types of instruments.	£10m
g.	**Share capital to Council owned companies** – The use of these instruments will be deemed to be capital expenditure,	£70m

	and as such will be an application (spending) of capital resources. **Loan capital** to Council owned companies	
h.	**Bond funds** – There is a high risk of loss with this type of instrument.	£10m
i.	**Pooled property funds** – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. The key exception to this is an investment in the CCLA Local Authorities Property Fund. This Authority will seek guidance on the status of any fund it may consider using The authority has invested £10m in a Property Fund (Cabinet 03/11/15 & 19/09/17) to support Homelessness in Bristol.	£50m
j.	**Property funds managed by a wholly owned Council subsidiary**– The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources.	£50m

In respect of category f, and h, these will only be considered after obtaining external advice and subsequent member approval.

Council owned companies

The Council has purchased share capital / provided loans to wholly owned Council subsidiaries. These are classified as service investment's, rather than treasury management investment's, and are therefore outside the specified / non specified 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 Group as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Finance Officer, and if required new counterparties which meet the criteria will be added to the list.

Changes to Codes of Practice and Minimum Revenue Provision Consultation

2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact on future TMSS/AIS reports and the risk management framework

CIPFA published the revised codes on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year.

The revised codes will have the following implications:

- a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;
- address Environmental, Social and Governance (ESG) issues within the Capital Strategy;
- require implementation of a policy to review commercial property;
- create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);
- ensure that any long term treasury investment is supported by a business model;
- amendment to Treasury Management Practice Statement 1 to address ESG policy within the treasury management risk framework;
- amendment to the knowledge and skills register for individuals involved in the treasury management function;
- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

In addition, all investments and investment income must be attributed to one of the following three purposes: -

Treasury management

Arising from the organisation’s cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

Service delivery

Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".

Commercial return

Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e. that 'losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not borrow to invest primarily for financial return.

As this Treasury Management Strategy Statement and Annual Investment Strategy deals soley with treasury management investments, the categories of service delivery and commercial investments will be dealt with as part of the Capital Strategy report.

Members will be updated during the next financial year on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 Treasury Management Strategy report.

Minimum Revenue Provision (MRP) consultation

In addition the DLUHC is currently conducting a consultation on amending the MRP rules for England that will also come into effect, if agreed, on the 1st April 2023. Members will be briefed on the outcome of this consulation but it could have a negative revenue impact for capital loans to third parties, thus making it more .