

Report to the Finance and Value for Money Overview and Scrutiny
Commission – 19th November 2021
Cabinet – 22nd November 2021

Wards: All

<p style="text-align: center;">TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY – MID YEAR REVIEW REPORT 2021/22</p>
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Report of the Director of Finance and Transformation (S151 Officer)

This item is not exempt
Therefore exempt reasons are not applicable

This is a Non-Key Decision

1. Purpose of the Report and Summary

- 1.1 To provide Members with an update on Treasury Management activity and performance in the first half of the financial year 2021/22, as required by the Council's Treasury Management Policy Statement.
- 1.2 The scope and content of this report are in line with the requirements of the Treasury Management Code of Practice and the Prudential Code for Capital Finance, and is therefore more detailed than standard committee reports.
- 1.3 A **Glossary of Terms** as shown at Appendix 5.

2. Executive Summary

- 2.1 Throughout the financial year 2021/22 Treasury Management officers have operated within the requirements and guidelines of the Prudential Code as laid down in the approved Treasury Management Strategy and Policy Statement, in terms of safeguarding the Council's investments whilst ensuring they remain accessible, liquid and generate a return as required to support the Council's Medium Term Financial Strategy (MTFS).
- 2.2 Performance for the financial year up to 30 September 2021 is currently forecast in line with budgeted levels. Officers are, however, monitoring forecasts very closely and continue to liaise with the Council's Treasury advisors, Link Asset Services – Treasury Solutions, in terms of ongoing borrowing assumptions, debt rescheduling and investment opportunities, with the view of identifying and realising revenue savings where possible against budgeted borrowing costs.

- 2.3 The investment returns for 2021/22 to 30 September are forecast to achieve budgeted levels. The security of funds is being maintained in these current volatile times, and performance and operation has continued to remain within the approved Prudential Indicator limits.
- 2.4 The revised Capital Programme was considered by Cabinet on the 25th October. The affordability prudential indicators have been reviewed and updated to reflect the latest capital expenditure forecasts and the current short term temporary borrowing strategy.

3. Recommendations

- 3.1 Members note the report; the investment returns achieved during 2021/22 and performance against the revised prudential indicators as shown at Appendix 1.
- 3.2 Members confirm that they remain content with the approved investment strategy as shown at Appendices 2 to 4.
- 3.3 Members note the revised Prudential Indicators as shown in Appendix 1 to reflect the latest capital expenditure and financing forecasts.

4. Reasons for Recommendations

- 4.1 As required by the Treasury Management Strategy Statement 2021/22 approved by Council in February 2021, delegation for considering the Mid-Year Review Report is to the Cabinet Executive Committee.

5. Impact on other Executive Committees (including Area Committees)

- 5.1 The report is an information only report with no impact on other Executive Committees.

6. Background

- 6.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.
- 6.2 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 the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

6.3 Accordingly, treasury management is defined as:

“The management of the local authority’s 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.”

7. Issues for Consideration

7.1 Reviewing the treasury activities of the Council for 2021/22 to date as compared to the Treasury Management Strategy approved by Council in February 2021, and with regards to the current treasury and economic environment.

8. Introduction

8.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised 2017).

8.2 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council’s treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the Council of an annual Treasury Management Strategy Statement (including the Annual Investment Strategy and Minimum Revenue Provision Policy) for the year ahead, a **Mid-Year Review Report** (this report) and an Annual Report (stewardship report) covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specified named body which in this Council is the Finance and Value for Money Overview and Scrutiny Commission.

8.3 The mid-year report has been prepared in compliance with CIPFA’s Code of Practice on Treasury Management (2017), and covers the following:

- An economic update for the first part of the 2021/22 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council’s capital expenditure, as set out in the Capital Strategy, and prudential indicators;

- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

9. CIPFA Consultation (stage 2)

- 9.1 CIPFA released a consultation on proposed changes to the current Treasury Management Code and Prudential Code in early 2021, it is due to complete in November 2021. The Treasury Management Code was last updated in 2017. Since then the landscape for public services has changed. The increasing profile of the role of treasury management as a result of the pandemic, the disciplines and skills required to meet the advances brought forward by issues such as the Markets in Financial Instruments Directive, known as MIFID II, and the increasing complexity of transactions in the sector all underline the importance of the Treasury Management Code and its guidance. In addition, the rise in commercial non-treasury investments is a contributing factor behind the need to strengthen its provisions to ensure that they are fit for the 21st century.
- 9.2 In response to the recommendation of the Public Accounts Committee and the substantial increase in commercial investment, CIPFA is also proposing to strengthen the provisions within the Prudential Code to ensure that the Code and its objectives continue to support borrowing and capital investment in the modern era and ensure risks taken with public money are robustly managed and taken appropriately.
- 9.3 The key areas the review is keen to strengthen include:
- Further strengthen provisions to state clearly, that borrowing for debt-for-yield investment is not permissible under the Prudential Code. While recognising that commercial activity is part of regeneration, it does not constitute the primary purpose of investment and unnecessary risk to public funds.
 - Any commercial investment undertaken should be consistent with statutory provisions, proportionate to service and revenue budgets and consistent with effective treasury management practice.
- 9.4 The growing trend in commercial investment was met with intervention from central government through changes to the PWLB lending terms. These revised lending terms came into force in November 2020, and in order for Local Authorities to continue to access PWLB loans, the following is now required:
- The PWLB will ask the finance director (s151 Officer) of the local authority to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years.
 - The PWLB will not lend to any local authority which plans to buy investment assets primarily for yield anywhere in their capital plans, regardless of whether the transaction would notionally be financed from a source other than the PWLB.

- When applying for a new loan, the local authority will be required to confirm that the plans they have submitted remain current and that the assurance that they do not intend to buy investment assets primarily for yield is still accurate.
- 9.5 Therefore if Councils continue to pursue 'Commercial Investments' then they will not be able to access low/discounted borrowing rates from the PWLB and the cost of borrowing to finance the Capital Strategy is likely to be significantly higher and will become an additional burden on their revenue budgets.
- 9.6 The Council continues not to pursue investment on commercial activity purely for yield purposes.
- 9.7 The Council will continue to adhere to the Treasury Management and Prudential Codes and review and update the Treasury Management Strategy following the consultation process which closes 16th November 2021 and any subsequent amendments to both Codes effective 1st April 2022.

10. **Economic Update**

- 10.1 The following paragraphs are designed to impart a degree of knowledge around factors impacting on the treasury management function at the Council. This environment is constantly changing, no more so than in recent years. Any significant issues that arise between the report being written and the actual committee date will be reported verbally.
- 10.2 **UK.**
- The Monetary Policy Committee (MPC) in September voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn.
 - However, there was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer.

- However, in September MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.
- Reflecting the change in MPC tone, the financial markets are now pricing in a first increase in Bank Rate from 0.10%.

10.3 US.

- Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. Recent fiscal stimulus packages have impacted the financial markets at a time in the US when: -
 - The economy is opening up as the pandemic recedes.
 - The economy had already been growing strongly during 2021.
 - It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
 - And the Fed was still providing monetary stimulus through monthly QE purchases.
- These factors could cause an excess of demand in the economy which could result in stronger and more sustained inflationary pressures in the US than in other western countries.
- In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation.
- As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory

as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK.

- As an average since 2011, there has been a 75% correlation between movements in 10 year treasury yields and 10 year gilt yields.

10.4 EU.

- After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2.2% which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitional after an initial burst through to around 4%, so it is unlikely to be raising rates for a considerable time.

Interest rate forecasts

10.5 The Council's treasury advisors, Link Asset Services, has provided the following forecast (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View		29.9.21									
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70	
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80	
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00	
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70	
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60	
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40	

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.*

10.6 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. As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 23/24 and a third one to 0.75% in quarter 4 of 23/24. However, there are significant uncertainties which will impact on the actual movement in rates including the path of the pandemic, vaccine development, Government policy regarding public spending and borrowing as well as international economic and political change.

10.7 Forecast for PWLB rates

As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US. However, the future of PWLB rate movements is unpredictable for the same reasons set out above which will impact on the base rate.

However, for local authorities, it is anticipated 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 has been in recovery.

11. **Treasury Management Strategy Statement and Annual Investment Strategy Update**

11.1 The Treasury Management Strategy Statement (TMSS) for 2021/22 was approved by Council on 25th February 2021.

11.2 There are no proposed policy changes to the TMSS, the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

12. **The Council's Capital Position (Prudential Indicators)**

12.1 This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicators for Capital Expenditure

12.2 In line with the requirements of the Prudential Code, Council on 25th February 2021 approved a range of Prudential Indicators for 2021/22 and future years, aimed at ensuring affordability of capital plans and effective treasury management.

12.3 The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Council on 25th February 2021. This revised capital expenditure programme is the subject of a separate report presented to Members on 25th October 2021.

Capital Expenditure by	2021/22	Current	2021/22
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Programme Theme	Original Estimate £m	Spend (30/9/21) £m	Revised Estimate £m
Adult Services and Public Health	0.00	0.041	0.041
Corporate Services	6.902	2.493	6.903
Culture, Leisure and Tourism	4.130	3.296	5.816
Economic Investment, Regeneration and Planning, Land and Property	7.053	3.012	9.232
Housing	10.590	4.380	12.111
Learning, Skills and Safeguarding Children	16.496	4.976	30.077
Neighbourhood, Communities and Environment	5.183	0.202	4.581
Operational Services	26.967	5.943	27.969
Hull World Class Visitor Destination	21.115	2.835	14.313
Non-HRA	98.436	27.178	111.043
HRA	59.668	10.668	46.467
Total	158.104	37.846	157.510

Changes to the Financing of the Capital Programme

12.4 The table below draws together the main strategy elements of the capital expenditure plans (above), a highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2021/22 Original Estimate £m	Current Position (30/09/21) £m	2021/22 Revised Estimate £m
Total spend	158.104	37.846	157.510
Financed by:			
Capital receipts	21.284		19.516
Capital grants	39.158		50.000
Capital reserves	28.417		28.417
Revenue	5.116		4.087
Total financing	93.975		102.020
Borrowing need	64.129		55.490

Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

- 12.5 The below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	690.004	681.430
CFR – housing	231.808	212.259
Total CFR	921.812	893.689
Net movement in CFR	41.231	32.465
Operational Boundary		
Borrowing	612.897	616.549
Change in Borrowing	64.129	55.490
10% Net Budget Requirement	34.227	34.227
Other long term liabilities*	169.233	170.034
Total	880.486	876.300

* - On balance sheet PFI schemes and finance leases.

Limits to Borrowing Activity

- 12.6 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2021/22 Original Estimate £m	Current Position £m	2021/22 Revised Estimate £m
Gross borrowing	677.026	593.091	672.039
Plus other long term liabilities*	169.233	170.034	170.034
Gross borrowing	846.259	763.125	842.073
CFR (year end position)	921.812	893.689	893.689

* - On balance sheet PFI schemes and finance leases.

- 12.7 The Director of Finance and Transformation reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.
- 12.8 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is

not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2021/22 Original Indicator £m	2021/22 Revised Indicator £m
Borrowing	677.026	672.039
Plus other long term liabilities*	169.233	170.034
10% Net Budget Requirement	34.227	34.227
Plus possible additional borrowing (grants/capital receipts)	60.442	69.516
Total	940.928	945.816

* - On balance sheet PFI schemes and finance leases.

13. Investment Portfolio 2021/22

13.1 In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

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, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

13.2 As set out in Section 9 (interest rates forecast), it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before the second half of 2023, investment returns are expected to remain low.

13.3 The Council held £39.735 million of investments as of 30 September 2021 (£51.300 million on 31 March 2021) and the investment portfolio yield for the first six months of the year is 0.01% against a benchmark of -0.08%.

13.4 A full list of investments held on 30th September 2021 is shown in Appendix 4.

13.5 The Director of Finance and Transformation confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.

- 13.6 The Council's budgeted investment return for 2021/22 (including dividends) is £0.550 million. Based on performance this is looking likely to outturn on target.

Investment Counterparty Criteria

- 13.7 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

14. Borrowing

14.1 The Council's revised capital financing requirement (CFR) for 2021/22 is £894 million. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 12.6 shows the Council has forecast gross borrowings of £842 million and has utilised cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

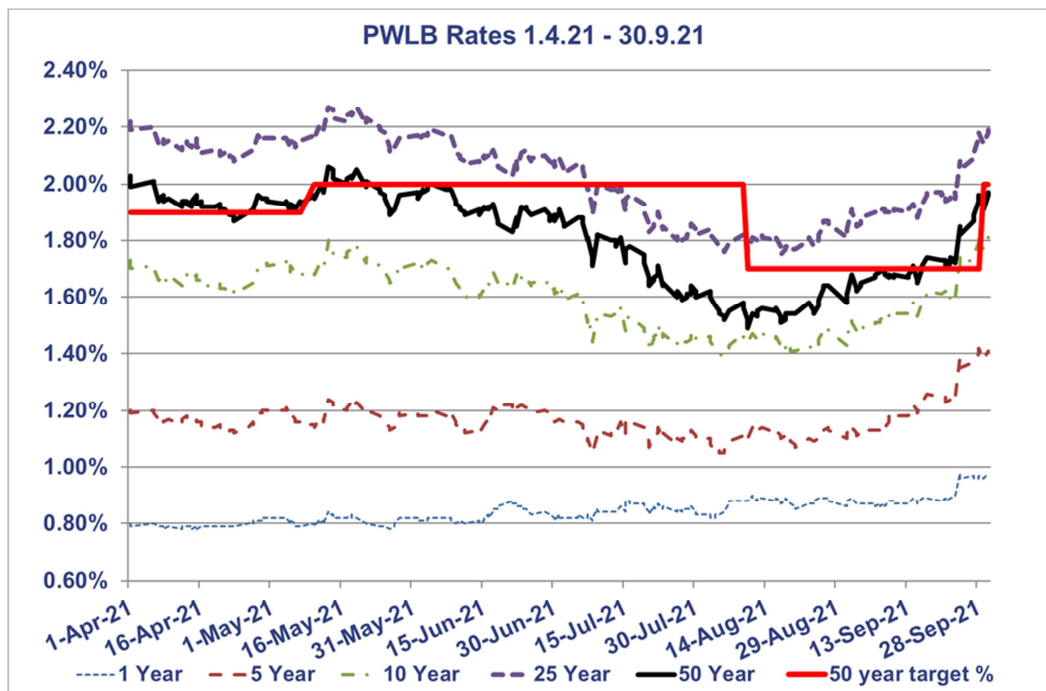
14.2 Due to the overall financial position and the underlying need to borrow for capital purposes (the CFR), new external borrowing of £92 million has been undertaken from the market on a temporary basis for periods of between 3 months and 1 year. New long term PWLB borrowing of £40M was taken, £30M at 1.61% for 49 years and £10M at 1.62 for 48 years. The capital programme is being kept under regular review due to the effects of coronavirus and shortages of materials and labour. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

14.3 During the first 6 months of the year a total of £152 million of debt has been repaid which was on a temporary basis and related to loans outstanding at the end of 2020/21.

14.4 It is anticipated that further short term borrowing will be undertaken during this financial year.

14.5 The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date.

PWLB certainty rates 1 April 2021 to 30 September 2021



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

14.6 Gilt yields and PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September.

14.7 The 50 year PWLB target certainty rate for new long-term borrowing started 2021/22 at 1.90%, rose to 2.00% in May, fell to 1.70% in August and returned to 2.00% at the end of September after the MPC meeting of 23rd September.

15. Debt Rescheduling

15.1 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

15.2 Any potential debt rescheduling opportunities are reviewed with the Council's external advisors.

16. Options and Risk Assessment

16.1 Although the content and criteria stated in the Treasury Management Strategy are statutory requirements, there are some options available to the Council in how this is managed, in terms of the following:

- Investment Options – alternative investment products, counterparties, limits and durations.
- Prudential Indicators – alternative limits for certain indicators, i.e., debt maturity profile, interest rate exposure.
- Minimum Revenue Provision – alternative options for the revenue charge.

16.2 The options proposed are based on the Council investing surplus monies with low risk counterparties in line with the Council's low risk appetite. This provides the Council with adequate liquidity and security of funds before considering investment return.

17. **Risk Assessment**

17.1 The main risks surrounding the Council's Treasury operations, mitigated through the Treasury Management Strategy and Investment Policy, are as follows:

- Prudential Indicator limits are breached – set and approved locally and regularly monitored as part of ongoing Treasury Management activity.
- Investments lost due to the inability of a Bank or Building Society to repay the loan – key criteria as part of the Creditworthiness Policy which ensures investments are made with only high credit quality counterparties for set durations.
- Too cautious an approach to investments could result in lower investment income being achieved – Investment Policy provides flexibility to use other non-specific investment products if it is considered prudent.

18. **Consultation**

18.1 This report is an information only report with no further consultation required.

19. **Comments of the Director of Legal Services and Partnerships (Monitoring Officer)**

19.1 The Director of Finance has a duty to report on the Council's financial position under the Local Government Finance Act 1992. The uncertainty of financial markets globally is noted, but the report is for information and raises no immediate legal issues. In considering the report and recommendations, Cabinet acts within the delegated authority from Council. The Local Government Act 2003 sets out the statutory framework for local authority finance, including power to borrow and invest, credit arrangements and how capital receipts may be used. Ss. 15 and 21 of the Act require the Council to follow such guidance and codes of practice in relation to accounting and other financial functions as may be published from time to time by the Secretary of State. The matters set out in the report would appear to comply with the CIPFA Code of Practice on Treasury Management adopted by the Council and is consistent with its own Treasury Management Strategy and Policy. [CA]

20. **Comments of the Director of Finance and Transformation (Section 151 Officer)**

20.1 The Director of Finance and Transformation (s151 Officer) is the author of this report.

21. Comments of the Assistant Director Human Resources and Organisation Development and Compliance with the Equality Duty

21.1 The Assistant Director HR & OD notes the update on Treasury Management activity and performance in accordance with the Council's Treasury Management Policy Statement. There are no staffing or equality duty implications arising for the Council from this report. (KM)

22. Comments of Overview and Scrutiny

22.1 This report is due to be considered by the Finance and Value for Money Overview and Scrutiny Commission at its meeting of 19 November 2021. Any comments or recommendations agreed by the Commission, will be submitted to Cabinet for consideration alongside the final report. Ref: Sc6544 [MK].

23. Comments of the Portfolio Holder for Strategic Finance

23.1 I welcome this update which confirms Treasury activity has been in line with policy. I would also highlight the planned changes in the Prudential Code outlined at paragraph 9, which relate to the tightening of the guidance and discouragement of investment purely for financial return in the light of damaging experiences at some authorities. This has not been the approach in Hull where the focus has been on investment to drive economic regeneration and employment in the City.

David Bell
Director of Finance and Transformation (S151 Officer)

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Officer Interests: None

Background documents: Borrowing and investment records
CIPFA Code of Practice on Treasury Management
Treasury Management Policy Statement (Council 25th February 2021)

Treasury Management – Mid-Year Review Report 2021/22

Implications Matrix

I have informed and sought advice from HR, Legal, Finance, Overview and Scrutiny and the Climate Change Advisor and any other key stakeholders i.e. Portfolio Holder, relevant Ward Members etc prior to submitting this report for official comments	Yes
I have considered whether this report requests a decision that is outside the Budget and Policy Framework approved by Council	Yes
Value for money considerations have been accounted for within the report	Yes
The report is approved by the relevant City Manager	Yes
I have included any procurement/commercial issues/implications within the report	n/a
I have considered the potential media interest in this report and liaised with the Media Team to ensure that they are briefed to respond to media interest.	Yes
I have included any equalities and diversity implications within the report and where necessary I have completed an Equalities Impact Assessment and the outcomes are included within the report	n/a
Any Health and Safety implications are included within the report	n/a
Any human rights implications are included within the report	n/a
I have included any community safety implications and paid regard to Section 17 of the Crime and Disorder Act within the report	n/a
I have liaised with the Climate Change Advisor and any environmental and climate change issues/sustainability implications are included within the report	n/a
I have included information about how this report contributes to the City Plan/ Area priorities within the report	n/a

1.1 **Affordability of Capital Plans**

(a) Indicator 1 – Capital Expenditure

“The local authority will make reasonable estimates of the total capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. These prudential indicators will be referred to as estimates of capital expenditure and shall be expressed in the following manner:

Estimate of total capital expenditure to be incurred in years 1, 2 and 3 (and 4 etc if applicable)” **(paragraph 47 of the code)**

This details the Council’s capital spending plans over the next 3 years and reports on the outturn from the previous financial year. These estimates are reporting decisions agreed previously in the Capital Programme report; there is no subjectivity to this indicator. These estimates are also in line with the Capital Programme Monitoring report considered by Cabinet on 25th October 2021.

	2020/21	2021/22	2022/23	2023/24
	£'000	£'000	£'000	£'000
	Actual	Estimate	Estimate	Estimate
General Fund	92.997	111.043	108.932	21.730
HRA	32.316	46.467	73.270	43.983
Total	125.313	157.510	182.202	65.713

(b) Indicator 2 – Ratio of Financing Costs to Net Revenue Stream

“The local authority will estimate for the forthcoming financial year and the following two financial years the ratio of financing costs to net revenue stream. This prudential indicator shall be referred to as estimates of the ratio of financing costs to net revenue stream and shall be expressed in the following manner:

Estimates of financing costs / estimate of net revenue stream * 100 %

For years 1, 2 and 3“(paragraph 38 of the code)

Shows the revenue costs (the capital financing costs less investment income earned) associated with funding previous and future capital spending, as a percentage of total revenue spending. Again, as in the previous indicator the estimates that populate this table have been agreed by Committee, either through the Revenue Budget setting report or in the Medium Term Financial Strategy (MTFS) and are not subjective.

	2020/21	2021/22	2022/23	2023/24
	%	%	%	%
	Actual	Estimate	Estimate	Estimate
General Fund	1.7	3.7	3.8	3.9
HRA	31.17	49.1	54.2	46.1

(c) Indicator 3 – Capital Financing Requirement

“The local authority will make reasonable estimates of the total of the capital financing requirement at the end of the forthcoming financial year and the following two years. These prudential indicators will be referred to as the estimates of capital financing requirement and shall be expressed as follows: Estimate of capital financing requirements as at the end of years 1, 2 and 3”
(paragraph 50 of the code)

The Capital Financing Requirement (CFR) measures the Council’s underlying need to borrow for a capital purpose i.e. that element of previous and proposed capital spending which has been / will be funded from borrowing. In order to ensure borrowing is maintained within sustainable limits, the Prudential Code requires that net external borrowing does not exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. The Director of Finance and Transformation can confirm that this requirement will be met.

	2021/22	2022/23	2023/24
	£'000	£'000	£'000
	Estimate	Estimate	Estimate
General Fund	681.430	723.060	713.166
HRA	212.259	241.233	247.613
Total	893.689	964.293	960.779
Borrowing	842.073	931.863	948.049

At the end of 2021/22 long term borrowing is forecast to be £51 million below the capital financing requirement which is acceptable.

(d) Indicator 4 – Incremental impact of Capital Investment Decisions on Council Tax and Housing Rents

“The local authority will

- (i) forecast the total budgetary requirements for the authority based on no changes to the capital programme
- (ii) forecast the total budgetary requirements for the authority with the changes proposed to the capital programme included in the calculation
- (iii) take the difference between (i) and (ii) and calculate the addition or reduction to the council tax that would result.

This calculation shall be undertaken for the forthcoming year and the following two financial years or longer timeframe if required to capture the full effect of capital investment decision. This prudential indicator will be referred to as estimates of the impact of the new capital investment decisions on the Council Tax and shall be expressed in the following manner:

£xx.xx **(Paragraph 39 of the code)**

The rules are the same for the Housing revenue account but show the effect on weekly rents.

The indicator seeks to demonstrate the additional costs, to be funded from the Council Tax and Housing Rents, of the Council’s capital spending plans.

These estimates are in line with the Capital Programme Monitoring report considered by Cabinet on 25th October 2021.

	2021/22	2022/23	2023/24
	£	£	£
	Estimate	Estimate	Estimate
General Fund (Council Tax)	3.52	11.20	16.10
HRA (average weekly rent)	0.10	0.92	1.21

1.2 **Treasury Management**

(a) Indicator 5 – Authorised Limit for External Debt

“The local authority will set for the forthcoming financial year and the following two financial years an authorised limit for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities. This prudential indicator will be referred to as the authorised limit and shall be expressed in the following manner:

Authorised limit for external debt = authorised limit for borrowing + authorised limit for other long term liabilities

For years 1, 2 and 3.” **(Paragraph 54 of the code)**

With regard to external debt the Council is required to identify limits consistent with the Revenue Budget and Capital Programme. The Authorised Limit is based on a prudent, but not worse case scenario, with additional headroom to allow for unusual cash movements. The authorised limit will be the statutory limit determined under Section 3 (1) of the Local Government Act 2003.

The indicator is calculated by taking the results from indicator six, Operational boundary for external debt, plus the amount of capital spend forecast to be financed from grants and capital receipts. This would cover the unlikely event of contractually committed spend not being financed from grants or capital receipts as planned and having to be financed from borrowing.

	2021/22	2022/23	2023/24
	£'000	£'000	£'000
Operational debt indicator (indicator 6)	876.300	965.320	982.154
Possible additional capital spend financed from borrowing (grants/capital receipts not received)	69.516	42.431	17.040
Total Amount	945.816	1,007.751	999.194
Rounded for indicator	946.000	1,008.000	999.000

Actual external debt stands at £763 million as at September 2021, which is well within the Authorised Limit for 2021/22.

(b) Indicator 6 – Operational Boundary for External Debt

“The local authority will also set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities. This prudential indicator will be referred to as the operational boundary and shall be expressed in the following manner:
 Operational boundary for external debt = operational boundary for borrowing + operational boundary for other long term liabilities.
 For years 1, 2 and 3.” **(Paragraph 55 of the code)**

The Operational Boundary for external debt is based on the same estimates which underpin the Authorised Limit but does not include the additional headroom included within the Authorised Limit. The Operational Boundary provides an important tool for in year monitoring.

The code goes on to say “It will probably not be significant if the operational boundary is breached temporarily on occasions due to variations in cashflow. However, a sustained or regular trend above the operational boundary would be significant and should lead to further investigation and action as appropriate.”

The Operational Limit for external debt has been calculated as the current amount of debt, plus additional borrowing, plus ten per cent of the year’s net revenue budget for cash flow purposes in the event of expenditure being higher than income at points during the year.

	2021/22	2022/23	2023/24
	£'000	£'000	£'000
	Estimate	Estimate	Estimate
Debt	616.549	672.039	762.888
Other Liabilities	170.034	168.975	167.881
10% Net budget requirement	34.227	33.457	34.105
Additional Borrowing	55.490	90.849	17.280
Calculated Operational Limit	876.300	965.320	982.154
Rounded for indicator	876.000	965.000	982.000

Actual external debt stands at £763 million as at September 2021, which is well within the Authorised Limit for 2021/22.

(c) Indicator 7 – Fixed and Variable Rate Exposure

“The local authority will set for the forthcoming financial year the following two financial year’s upper limits to its exposure to the effects of changes in interest rates. These prudential indicators will relate to both fixed interest rates and variable interest rates and be referred to respectively as the upper limits on fixed interest rates and variable interest rate exposures.

The upper limits on fixed interest rates and variable interest rates exposures may be expressed either as absolute amounts or as percentages. They may be related either to the authority’s net interest on, or to its net principal sum outstanding on, its borrowings / investments.” **(Paragraph 67 and 68)**

The indicator seeks to ensure that the Council limits its exposure to the risk of interest rate changes and the consequent impact on the

investment income and interest payments on loans, by restricting the proportion of variable rate borrowing.

	2021/22 Estimate	2021/22 Actual to Sept	2022/23 Estimate	2023/24 Estimate
	%	%	%	%
Fixed Rate – Upper Limit	90	89.71	90	90
Fixed Rate – Lower Limit	25		25	25
Variable Rate – Upper Limit	75	10.29	75	75
Variable Rate – Lower Limit	10		10	10

(d) Indicator 8 – Upper and Lower Limits for the maturity structure of borrowings

“The local authority will set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of its borrowings. The prudential indicators will be referred to as the upper and lower limits respectively for the maturity structure of borrowing and shall be calculated as follows:

Amount of projected borrowing maturing in each period expressed as a percentage of total projected borrowing.

Where the periods in question are

- Under 12 months
- 12 months and within 24 months
- 24 months and within 5 years
- 5 years and within 10 years
- 10 years and above”

(paragraph 74 of the code)

The indicator also seeks to ensure the Council controls its exposure to the risk of interest rate changes by limiting the proportion of debt maturing in any single period. Ordinarily debt is replaced on maturity and therefore it is important that the Council is not forced to replace a large proportion of loans at a time of relatively high interest rates.

	Actual as at 30/09/21	Upper Limit	Lower Limit
	%	%	%
Under 12 Months	35.76	35	0
12 months and within 24 months	4.62	30	0
24 months and within 5 years	9.40	50	0
5 years and within 10 years	10.89	75	0
10 years and above	39.33	90	0

(e) Indicator 9 – Upper limit for maturity structure of investments

“Where a local authority invests, or plans to invest, for periods longer than 364 days, the local authority will set an upper limit for each forward financial year period for the maturing of such investments. These prudential indicators will be referred to as prudential limits for principal sums invested for periods longer than 364 days and shall be calculated as follows:

Total principal invested to final maturities beyond the period end.”

(paragraph 77 of the code)

Under the Prudential Regime Councils are free to invest for periods of greater than 1 year. This indicator sets restrictions on the proportion of investments committed for longer periods in order to limit the risks associated with being unable to meet unexpected cash flows and/or being able to take advantage of future increases in interest rates.

	Actual as at 30/09/21	Upper Limit
	%	%
Under 12 Months	100	100
12 months and within 24 months	-	25
24 months and within 3 years	-	20
3 years and within 4 years	-	15
4 years and within 5 years	-	10
5 years and above	-	10

Annual Investment Strategy 2021/22**1. Changes to Credit Rating Methodology – Link Asset Services**

- 1.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.
- 1.2 In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.
- 1.3 The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.
- 1.4 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

2. Investment Policy

- 2.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments (the Guidance) and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA TM Code). The Council's investment priorities will be security first, liquidity second, then return (yield).
- 2.2 In accordance with guidance from CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Capita ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.
- 2.3 Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.
- 2.4 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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 this end 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. This is fully integrated into the credit methodology provided by the advisors, Link Asset Services in producing its colour codings which show the varying degrees of suggested creditworthiness.
- 2.5 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.
- 2.6 The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.
- 2.7 The intention of the strategy is to provide security of investment and minimisation of risk.

- 2.8 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;
 - 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.
- 2.9 The investment instruments identified for use in the financial year 2021/22 are set out at Appendix 2 under the 'Specified' and 'Non-Specified' Investments categories. Organisations to which the Council will lend and associated counterparty limits are detailed at Appendix 3.

Creditworthiness Policy

- 2.10 The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:
- Credit watches and credit outlooks from credit rating agencies;
 - Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
 - Sovereign ratings to select counterparties from only the most creditworthy countries.
- 2.11 Credit Default Swap (CDS) is a contract between two counterparties, which basically gives protection, or insurance, in case of credit default. The payments involved in the contract are based on a spread currently traded in the market. The spread of CDS indicates the market perception of the likelihood of a credit event or default occurring. The higher the spread the more likely the market considers an event of default will occur.
- 2.12 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:
- Blue - 1 year (only applies to nationalised or semi-nationalised UK banks)
 - Orange - 1 year
 - Red - 6 months
 - Green - 100 days
 - No colour not to be used

- 2.13 Link Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.
- 2.14 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
- 2.15 All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service.
- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
 - In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
- 2.16 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government.
- 2.17 If financial institutions are upgraded in rating and therefore meet the Council's criteria as defined, then committee approval will be sought prior to inclusion on the counterparty list.

Country Limits

- 2.18 The Council has determined that it will only use approved counterparties from the UK only.

Investment Counterparty Selection Criteria

- 2.19 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.
- 2.20 The Director of Finance and Transformation 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.
- 2.21 The minimum rating criteria use 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, then the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.
- 2.22 Credit rating information is supplied by Link Asset Services, the Council's treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer 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 considered for suspension from use, with all others being reviewed in light of market conditions.
- 2.23 On occasions 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.
- 2.24 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is as follows:
- Banks 1 – a good credit quality – the Council will only use banks/building societies which are UK banks only and have, as a minimum, the following Fitch credit ratings:
 - Banks 1 – a good credit quality – the Council will only use banks which hold a minimum rating of:
 - Short term – F1
 - Long term – A-
 - Banks 2 – part nationalised UK bank – Royal Bank of Scotland. This bank can be included if it continues to be part nationalised or it meets the rating in Banks 1 above.

- Banks 3 – The Council’s own banker (Natwest Bank) 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 ratings for banks as outlined above.
- Money Market Funds – AAA rating.
- Enhanced Money Market Funds – AAA rating.
- UK Government (DMADF)
- Local authorities.

Group Considerations

- 2.25 Due care will be taken will be taken to consider the group exposure of the Council’s investments. In addition, limits in place above will apply to a group of companies.

Use of Additional Information other than Credit Ratings

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

Time and Monetary Limits Applying to Investments

2.27 The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover specified and non-specified investments):

	<i>Fitch Long Term Rating (minimum)</i>	<i>Fitch Short Term Rating (minimum)</i>	<i>Money Limit</i>	<i>Time Limit</i>
Banks 1 category high quality	AA-	F1+	£15 million	1 yr
Banks 1 category medium quality	A	F1	£7.5 million	1 yr
Banks 1 category lower quality	A-	F1	£5 million	1 yr
Banks 2 category – part nationalised – high quality	AA-	F1+	£20 million	1 yr
Banks 2 category – part nationalised – medium quality	A	F1	£10 million	1 yr
Banks 2 category – part nationalised – low quality	A-	F1	£7.5 million	1 yr
Limit 3 category – Council's banker (not meeting Banks 1)	N/A	N/A	£2.5 million	1 day
UK Government (DMADF)	N/A	N/A	Unlimited	6 mths
Local authorities	N/A	N/A	£15 million	1 yr
Money Market Funds	AAA		£15 million	liquid

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

Credit and Counterparty Risk Management – Specified and Non-Specified Investments and Limits (Treasury Management Practice (TMP1))

1. Specified and Non-Specified Investments

- 1.1 Specified investments are investments denominated in sterling, do not exceed 364 days in term, do not involve the acquisition of share or loan capital, are made with the UK Government or a local authority, or with a body or investment scheme meeting the minimum ‘high’ credit quality criteria where applicable. Non-specified investments are anything that does not satisfy the specified investment criteria, i.e. investments with a maturity of greater than 1 year.
- 1.2 Importantly the acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as ‘non-specified investments’. As a result no such investment instruments, such as equities, are included within this Appendix.

Specified Investments

	Minimum ‘High’ Credit Criteria	Use
Term deposits – banks	Short-term F1, Long-term A-	In-house
Term deposits – building societies	Short-term F1, Long-term A-	In-house
Term deposits – local authorities	--	In-house
Term deposits – UK part nationalised banks	Short-term F1, Long-term A-	In-house
UK Government support to the banking sector	UK Sovereign Rating	In-house
Debt Management Agency Deposit Facility (DMADF)– UK Government	UK Sovereign Rating	In-house
Money Market Funds	AAA	In-house

- 1.3 Accounting treatment of investments – the accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, Treasury Officers in consultation with Sector will review the accounting implications of any new transactions before they are undertaken.

Non-specified Investments

Maturities of ANY period (not applicable for 2021/22 Investment Strategy)

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits with unrated counterparties	Market Capitalisation above £500m	In-house	Nil - no longer applicable	Nil – no longer applicable

Maturities in excess of 1 year (not applicable for 2021/22 Investment Strategy)

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – banks	Short-term F1, Long-term A+	In-house	Nil - no longer applicable	Nil - no longer applicable
Term deposits – local authorities	--	In-house	Nil - no longer applicable	Nil - no longer applicable

Approved Organisations for on-lending Of Surplus Funds

Note – the organisations listed below currently meet the specified criteria as per the Investment Policy of the above report.

UK Banks (Maximum Investment Period of up to 1 year)

	Approved Investment Limit (max)	Proposed Investment Limit (max)	Current Investment Limit **	Investment (as at 30/9/21)
Santander UK plc	£15m	£15m	Nil	-
Barclays Bank plc	£15m	£15m	£7.5m	-
Clydesdale Bank (trading as Yorkshire Bank)	£15m	£15m	Nil	-
HSBC Bank plc	£15m	£15m	£15m	-
Lloyds Banking Group inc: *	£20m	£20m	£10m	-
Lloyds TSB Bank plc				-
Bank of Scotland plc				-
Royal Bank of Scotland Group inc: *	£20m	£20m	£2.5m	-
Royal Bank of Scotland				-
NatWest Bank plc				£0.235m
Ulster Bank Ltd (not used)				-

Note * - The increased limits are based on Lloyds and RBS being part-nationalised therefore carrying additional UK Government security.

Note **: The current investment limits above reflect the action taken as per the creditworthiness criteria included in the Investment Policy stated at paragraph 2.27 of Appendix 2 in the above report. Current investment limits have been reduced due to the wholesale downgrade of ratings of some of the above organisations.

UK Building Societies (Maximum Investment Period of up to 1 year)

	Approved Investment Limit (max)	Proposed Investment Limit (max)	Current Investment Limit **	Investment (at 30/9/21)
Coventry Building Society	£15m	£15m	£7.5m	-
Nationwide Building Society	£15m	£15m	£7.5m	-
Leeds Building Society	£15m	£15m	£5m	-
Skipton Building Society	£15m	£15m	£5m	-
Yorkshire Building Society	£15m	£15m	£5m	-

Other (Maximum Investment Period of up to 1 year)

	Approved Investment Limit	Proposed Investment Limit	Current Investment Limit	Investment (at 30/9/21)
Any Local Authority	£15m (each)	£15m (each)	£15m (each)	-
Debt Management Agency Deposit Facility (DMADF) ***	Unlimited	Unlimited	Unlimited	-
Money Market Funds	£15m (each)	£15m (each)	£15m (each)	£39.5m

Note *** - The unlimited investment limit for the DMADF is based on the current uncertainties within the banking sector, and if further bank failures occur, this account would provide for the security of the Council's cash surpluses.

GLOSSARY OF TERMS

Base Rate	Minimum lending rate of a bank or financial institution in the UK determined by the Bank of England.
Basis Point	1/100 th of 1%, i.e. 0.01%.
Call Account	Deposits/investments placed with a bank or other financial institutions which are available immediately, i.e. no advance notice is required.
Capital Expenditure	Expenditure on the acquisition of fixed assets which has a long term value to the Council (e.g. the purchase of land, erection of buildings), or expenditure that adds to the value of these assets and not just maintains their existing value.
Capital Financing Requirement (CFR)	The total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. This is the cumulative total of the Council's borrowing need.
Capital Grants	Monies provided to local authorities, usually from Government departments, for capital expenditure only.
Capital Receipts	These are proceeds from the sale of capital assets such as land or property. These receipts can be used to fund the capital programme but are <u>not</u> available to support the Revenue Budget.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender or borrower). In the Council's case this generally relates to a bank or building society.
Credit Default Swap	This provides protection (insurance) to a financial institution following a loan or investment against any potential default, i.e. protection against non-repayment of loan or investment.
Credit Outlook	A formal indication by a credit rating agency that it anticipates a change in a particular credit rating of a bank or other financial institution at some time in the foreseeable future.
Credit Rating	An assessment of the creditworthiness of a bank or other financial institution, made by a credit rating agency, i.e. Fitch, Moody's and Standard & Poor's.
Credit Rating Agency	Independent organisations that assess the credit quality of corporate and government debt. The main agencies are Moody's, Standard & Poor's and Fitch.
Credit Watch	Attached to a bank or other financial institution in which a downgrading or upgrading of the credit rating could be imminent.
Creditworthiness	A measure of the ability and the willingness of a bank or other financial institution to honour their financial obligations.

Debt Cap	A limit set on the council housing borrowing requirement for each local authority.
Debt Rescheduling	Refinancing of current debt/loans to generate revenue savings if rates are favourable.
Investment Instrument	Investment options available to local authorities, i.e. fixed term deposits, notice accounts.
Liquidity	The ability to convert an asset (investment) easily into cash quickly without affecting the asset's price or value.
Maturity	The end date of a loan, borrowing, investment or other form of capital financing.
Minimum Revenue Provision (MRP)	Local authorities are required each year to set aside some of their revenues as provision for debt repayment. The provision (revenue charge) is in respect of capital expenditure financed by borrowing.
Money Market	Consists of financial institutions (e.g. banks and building societies) and dealers in money and credit.
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments.
Non-Specified Investments	Anything that does not satisfy the specific investment criteria, i.e. investments with a term of greater than 1 year.
Notice Account	Deposits/investments placed with a bank or other financial institutions which are available at notice, i.e. 15/30 day notice to withdraw is required.
PFI	Private Finance Initiative – a Government initiative in which private sector companies usually design, build and operate a public facility for a set period of time, often 25 years.
Prudential and Treasury Indicators <i>(see below for description of each indicator)</i>	As required by The Prudential Code, requires local authorities to self regulate the affordability, prudence and sustainability of their capital plans, buy setting estimates and limits, and publishing actuals, for a range of indicators.
Prudential Borrowing	Permissible borrowing within defined affordable limits.
Prudential Code (CIPFA)	Local Authorities determine their own programmes of capital investment in fixed assets that are central to the delivery of quality local public services. The Prudential Code has been developed as a professional code of practice to support them in taking these decisions. The Prudential Code underpins the overall system of capital finance. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable.
PWLB	Public Works Loans Board – a statutory body operating within the Debt Management Office of the HM Treasury and is responsible for lending money to local authorities and other prescribed bodies.

Risk Appetite	The level of risk Local Authorities wish to take in the lending of surplus monies. The Council operates a low risk appetite, i.e. only investing with low risk counterparties, where the security and liquidity of cash are more important than yield (return).
Specified Investments	Investments that are made in sterling, do not exceed 364 days in term, do not involve the acquisition of share or loan capital, are made with the UK Government or a local authority, or with a financial institution and meet the minimum credit criteria.
Treasury Management Code of Practice (CIPFA)	Provides Local Authorities with standards and guidance to support and underpin their overall Treasury Management activities.
Yield (Return)	The return on an investor's capital investment. The higher the yield the higher the risk of the capital invested.

Prudential and Treasury Indicators	
Affordability of Capital Plans:	
Indicator 1 – Capital Expenditure	This details the Council's approved capital spending plans for the next 3 years and reports on the outturn from the previous financial year. These estimates are reporting decisions agreed previously in the Capital Programme report, and therefore there is no subjectivity to this indicator.
Indicator 2 - Ratio of Financing Costs to Net Review Stream	This shows the revenue costs (the capital financing costs less investment income earned) as a percentage of the total revenue budget. There is a separate calculation for the General Fund and the HRA. Again, these estimates have been agreed by Committee through the Revenue Budget setting report or in the Medium Term Financial Strategy.
Indicator 3 – Capital Financing Requirement (CFR)	The CFR measures the Council's overall borrowing requirement for capital purposes, i.e. that element of previous and proposed capital spending which has been/will be funded from borrowing. The Prudential Code requires that net external borrowing does not exceed the CFR.
Indicator 4 – Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rents	This indicator seeks to demonstrate the additional costs, to be funded from the Council Tax and Housing Rent of the Council's capital spending plans, i.e. the capital plans to be funded from borrowing. These estimates are in line with the General Fund and HRA Revenue Budget setting reports.
Treasury Management	
Indicator 5 – Authorised Limit for External Debt	The Council is required to set external borrowing limits consistent with the Revenue Budget and Capital Programme. The Authorised Limit is based on a prudent limit, with additional headroom to allow for unusual cash movements.

Indicator 6 – Operational Boundary for External Debt	<p>The Operational Boundary is based on the same estimates as the Authorised Limit but does not include any additional headroom. The Operational Boundary is the current debt plus additional planned borrowing, plus 10% of next years revenue budget for cash flow purposes.</p>
Indicator 7 – Fixed and Variable Interest Rate Exposure	<p>This indicator seeks to ensure that the Council limits its exposure to the risk of interest rate changes and the subsequent impact of such changes on the interest payments on loans (a revenue expense), by restricting the proportion of variable rate borrowing.</p>
Indicator 8 – Upper and Lower Limits for the maturity structure of borrowings	<p>This indicator also seeks to ensure the Council controls its exposure to the risk of interest rate changes by limiting the proportion of debt due to be repaid in any one year. Debt is ordinarily replaced on maturity and therefore it is important that the Council is not forced to replace a large proportion of loans at a time of relatively high interest rates (aimed at mitigating any potential impact on the revenue budget).</p>
Indicator 9 – Upper Limit for the maturity structure of Investments	<p>Under the Prudential Code councils are free to invest for periods of greater than 1 year. This indicator sets restrictions on the proportion of investments committed for longer periods in order to limit the risks associated with being unable to meet unexpected cash flows and/or being able to take advantage of future increases in interest rates.</p>