

# **TREASURY MANAGEMENT POLICY STATEMENT FOR 2021/22 INCLUDING:**

- **TREASURY MANAGEMENT STRATEGY**
- **ANNUAL INVESTMENT STRATEGY**

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## 1. INTRODUCTION

### 1.1 Background

- 1.1.1 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 risk appetite, providing adequate liquidity initially before considering investment return.
- 1.1.2 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, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.1.3 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.
- 1.1.4 Whilst any commercial initiatives or loans to third parties will affect 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.
- 1.1.5 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

*“The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”*

## 1.2 Reporting requirements

### 1.2.1 Capital Strategy

The revised CIPFA 2017 Prudential and Treasury Management Codes require 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 fully understand the overall long-term policy objectives and resulting capital strategy requirements and governance procedures.

This Capital Strategy (reported elsewhere on the Cabinet Agenda for 9 March 2021) 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, as distinct from the policy on commercial investments usually driven by expenditure on an asset. The Capital Strategy will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The debt payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

Where a physical asset is being bought, details of market research, advisers used, ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the Capital Strategy.

To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

### 1.2.2 Treasury Management reporting

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

- a. **Treasury Indicators and Treasury Strategy** (this report) - The first, and most important report is forward looking and covers:
  - 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).
- b. **A Mid-year Treasury Management report** – This is primarily a progress report and will update members on the treasury management position, amending prudential and treasury management indicators as necessary, and revising any policies if required. In addition, the Governance and Audit and Standards Committee will receive quarterly update reports.
- c. **An Annual Treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

### 1.2.3 Scrutiny

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

In addition, the Governance and Audit and Standards Committee receives quarterly treasury management monitoring reports.

The Chief Executive, the Leader of the City Council and the Chair of the Governance and Audit and Standards Committee will be informed of any variances from the Treasury Management Policy when they become apparent, and the Leader of the City Council will be consulted on remedial action.

### **1.3 Treasury Management Strategy for 2021/22**

The strategy for 2021/22 covers:

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

### **1.4 Treasury Management Staff**

1.4.1 The treasury management function is undertaken by the Director of Finance and Resources (Section 151 Officer). This includes (i) investing surplus funds in accordance with the approved Annual Investment Strategy; (ii) borrowing to finance short term cash deficits and capital payments from any reputable source within the authorised limit for external debt; (iii) rescheduling debt in order to even the maturity profile or to achieve revenue savings and; (iv) to buy and sell foreign currency and hedge against currency movements to fulfil contracts priced in or indexed against foreign currencies. The Director of Finance and Resources will have the power to delegate authority to undertake these functions to relevant officers including the Deputy Director of Finance and Section 151 Officer, the Finance Manager (Technical and Financial Planning), the Treasury Manager and various back up cash dealers drawn from the Finance Directorate. The Director of Finance and Resources (Section 151 Officer), the Deputy Director of Finance and Section 151 Officer, and the Finance Manager (Technical and Financial Planning) are all qualified Chartered Public Finance Accountants.

### **1.5 Treasury Management Consultants**

1.5.1 The Council uses "Link Asset Services, Treasury Solutions" as its external treasury management advisors.

1.5.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including from, but not solely, our treasury advisers.

1.5.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

- 1.5.4 The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties. The commercial type investments require specialist advisers, and the Council uses Avison Young in relation to this activity.

## 2. THE CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2025/26

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

### 2.1 Capital expenditure

The capital programme approved by the City Council on 11 February 2021 can be summarised in table A as follows:

<b>Table A</b>	<b>2019/20 Actual</b>	<b>2020/21 Revised Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>	<b>2025/26 Estimate</b>
	£m	£m	£m	£m	£m	£m	£m
Investment Properties	12	11	-	-	-	-	-
Other Non - Housing Revenue Account (HRA)	219	204	211	108	66	39	37
<b>Sub - Total</b>	<b>231</b>	<b>215</b>	<b>211</b>	<b>108</b>	<b>66</b>	<b>39</b>	<b>37</b>
Housing Revenue Account (HRA)	25	50	71	56	52	49	31
<b>Total</b>	<b>256</b>	<b>265</b>	<b>282</b>	<b>164</b>	<b>118</b>	<b>88</b>	<b>68</b>
<b>Element financed from borrowing</b>	<b>177</b>	<b>56</b>	<b>110</b>	<b>53</b>	<b>26</b>	<b>27</b>	<b>-</b>

Capital expenditure on commercial activities / non-financial investments including investment properties is entirely financed from borrowing.

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

2.2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and therefore its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital funding resource, will increase the CFR.

2.2.2 The CFR does not increase indefinitely, and is reduced by the minimum revenue provision (MRP) which is a statutory annual revenue charge that reduces the indebtedness broadly in line with each assets life, thus the economic consumption of capital assets as they are used is charged to the Council's Revenue Budget.

2.2.3 The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, or lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £62m of such schemes within the CFR.

The projected CFR is shown below:

<b>Table B</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>	<b>2025/26 Estimate</b>
<b>Capital Financing Requirement (£m)</b>							
Investment Properties	160	171	171	171	171	171	171
Other Non - Housing Revenue Account (HRA)	461	474	549	568	567	569	561
<b>Sub - Total</b>	<b>621</b>	<b>645</b>	<b>720</b>	<b>739</b>	<b>738</b>	<b>740</b>	<b>732</b>
Housing Revenue Account (HRA)	178	200	224	244	261	275	272
<b>Total CFR</b>	<b>799</b>	<b>845</b>	<b>944</b>	<b>983</b>	<b>999</b>	<b>1,015</b>	<b>1,004</b>
<b>Movement in CFR</b>	<b>172</b>	<b>46</b>	<b>99</b>	<b>39</b>	<b>16</b>	<b>16</b>	<b>(11)</b>

<b>Movement in CFR represented by (£m)</b>							
Net financing need for the year (above)	177	56	110	53	26	27	-
Less MRP	(5)	(10)	(11)	(14)	(10)	(11)	(11)
<b>Movement in CFR</b>	<b>172</b>	<b>46</b>	<b>99</b>	<b>39</b>	<b>16</b>	<b>16</b>	<b>(11)</b>

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 2.1 and the details above demonstrate the scope of this activity and, by approving these sums; consider the scale proportionate to the Authority's remaining activity.

## 2.3 Core funds and expected investment balances

2.3.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

<b>Table C Year End Resources £m</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>	<b>2025/26 Estimate</b>
Fund balances / reserves	244	268	230	205	200	194	191
Capital grants unapplied	58	58	58	58	58	58	58
Capital receipts	17	19	21	23	25	27	29
Provisions	13	13	13	13	13	13	13
Other	29	29	29	29	29	29	29
<b>Total core funds</b>	<b>361</b>	<b>387</b>	<b>351</b>	<b>328</b>	<b>325</b>	<b>321</b>	<b>320</b>
Working capital*	67	67	67	67	67	67	67
Over / (under) borrowing - see overleaf	(36)	(67)	(182)	(236)	(264)	(294)	(294)
<b>Expected investments</b>	<b>392</b>	<b>387</b>	<b>236</b>	<b>159</b>	<b>128</b>	<b>94</b>	<b>93</b>

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

### 3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

#### 3.1 Current borrowing position

3.1.1 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

<b>Table D</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>	<b>2025/26 Estimate</b>
<b>External Debt (£m)</b>							
Debt at 1 <sup>st</sup> April	590	701	721	711	701	692	683
Expected change in Debt	111	20	(10)	(10)	(9)	(9)	(9)
Other long-term liabilities (OLTL) at 1 <sup>st</sup> April	66	62	57	51	46	43	38
Expected change in OLTL	(4)	(5)	(6)	(5)	(3)	(5)	(2)
<b>Actual gross debt at 31 March</b>	<b>763</b>	<b>778</b>	<b>762</b>	<b>747</b>	<b>735</b>	<b>721</b>	<b>710</b>
<b>The Capital Financing Requirement</b>	<b>799</b>	<b>845</b>	<b>944</b>	<b>983</b>	<b>999</b>	<b>1,015</b>	<b>1,004</b>
Over / (under) borrowing	(36)	(67)	(182)	(236)	(264)	(294)	(294)

Within the above figures the level of debt relating to commercial activities / non-financial investment is:

<b>Table E</b>	<b>2019/20 Actual</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>	<b>2025/26 Estimate</b>
<b>External Debt for investment properties</b>							
Actual debt at 31 March £m	160	171	171	171	171	171	171
Percentage of total external debt %	21%	22%	23%	23%	24%	24%	25%

- 3.1.2 Within the range of prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.
- 3.1.3 The Director of Finance and Resources (Section 151 Officer) reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and proposals in the budget.

### 3.2 Treasury Indicators: limits to borrowing activity

- 3.2.1 **The operational boundary.** This is the limit, set as part of the capital programme, 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 of other cash resources (as described in Table B).

<b>Table F</b>	<b>2020/21 Estimate (£m)</b>	<b>2021/22 Estimate (£m)</b>	<b>2022/23 Estimate (£m)</b>	<b>2023/24 Estimate (£m)</b>	<b>2024/25 Estimate (£m)</b>	<b>2025/26 Estimate (£m)</b>
Commercial activities/ non-financial investments	160	171	171	171	171	171
Other Debt	629	723	766	786	805	808
Other long term liabilities	57	51	46	42	38	35
<b>Total</b>	<b>846</b>	<b>945</b>	<b>983</b>	<b>999</b>	<b>1,014</b>	<b>1,014</b>

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

<b>Table G</b>	<b>2020/21 Estimate (£m)</b>	<b>2021/22 Estimate (£m)</b>	<b>2022/23 Estimate (£m)</b>	<b>2023/24 Estimate (£m)</b>	<b>2024/25 Estimate (£m)</b>	<b>2025/26 Estimate (£m)</b>
Commercial activities/ non-financial investments	160	171	171	171	171	171
Other Debt	647	742	785	805	825	828
Other long term liabilities	57	51	46	42	38	35
<b>Total</b>	<b>864</b>	<b>964</b>	<b>1,002</b>	<b>1,018</b>	<b>1,034</b>	<b>1,034</b>

### 3.3 Prospects for interest rates

3.3.1 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 27<sup>th</sup> November 2020. However, following the conclusion of the review of PWLB margins over gilt yields on 25<sup>th</sup> November 2020, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps:

Link Group Interest Rate View		9.11.20													
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20															
	Dec-20	Mar-21	Jun-21	Sep-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	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00	
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30	
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80	
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60	

3.3.2 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5<sup>th</sup> November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

### 3.4 Bond yields / Public Works Loans Board (PWLB) rates.

3.4.1 There was much speculation during the second half of 2019 that bond markets were in a bubble, which was driving bond prices up, and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be

expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

3.4.2 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

3.4.3 As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geopolitical, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9<sup>th</sup> November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

### 3.5 Investment and borrowing rates

3.5.1 **Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

3.5.2 **Borrowing interest rates** fell to historically very low rates because of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019 required an initial major rethink of local authority treasury management strategy and risk management. It also introduced the following rates for borrowing for different types of capital expenditure:

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

3.5.3 However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. Because of these increases in margins, the Council has only borrowed for HRA financing so far in 2020/21.

3.5.4 On 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% 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 new margins over gilt yields are as follows:

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

3.5.5 **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows.

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

### 3.6 Borrowing strategy and risk appetite

3.6.1 It is often possible to borrow money short term at lower rates than it is possible to borrow long term. This often leaves the Council with two choices:

- Borrowing at either short term or variable interest rates. This would often enable the Council to borrow relatively cheaply, but the Council would need to accept that its borrowing costs might be volatile, as it exposes the Council to the benefits and dis-benefits of interest rate movements that can give rise to budget variances. This is a major risk when interest rates are expected to increase.
- Borrowing long term at fixed rates. This provides stable and predictable revenue costs of borrowing. Fixed interest rates avoid the risk of budget variances caused by interest rate movements but prevent the council from benefiting from falling interest rates on its borrowing. There is a risk that the Council could become locked into relatively high rates of interest if interest rates fall.

3.6.2 The Council attaches a high priority to a stable and predictable revenue cost of borrowing in the long term. This reflects the fact that debt servicing represents 18.9% of the General Fund net revenue budget and 7.0% of the HRA net revenue budget.

3.6.3 The Council's objective in relation to debt is as follows:

- To borrow as cheaply as possible for the long-term at a fixed rate

This means that the Council is not totally risk averse, and the Council may borrow either short term or at variable rates if long-term interest rates are expected to fall.

Treasury management staff will act flexibly to actively manage treasury risks within the scope of the Council's treasury management policy and strategy.

### 3.7 Policy on borrowing in advance of need

- 3.7.1 Section 12 of the Local Government Act 2003 gives a local authority the power to invest for “any purpose relevant to its functions under any enactment or for the prudent management of its financial affairs”. While the speculative procedure of borrowing purely to invest at a profit is clearly unlawful, there is no legal obstacle to the temporary investment of funds borrowed for the purpose of funding capital expenditure incurred in the reasonably near future.
- 3.7.2 Borrowing in advance of need may enable the City Council to obtain cheaper loans than those available at the time when expenditure is incurred, although the consequent investment of funds borrowed in advance of need does expose the City Council to credit risk. The interest payable on funds borrowed in advance of need is likely to exceed the interest earned on the investment of those funds in the current economic climate. The Council may determine to borrow in advance of need in circumstances where it is reasonably expected that the total cost of borrowing over the whole life of the loan in present value terms is lower by borrowing in advance of need.

### 3.8 Debt rescheduling

- 3.8.1 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as PWLB new borrowing rates exceed PWLB premature debt repayment rates by around 0.80%.

### 3.9 Approved Sources of Long and Short Term Borrowing

	Fixed	Variable
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)		●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Internal (capital receipts & revenue balances)	n/a	n/a
Finance leases	●	●

### **3.10 Apportionment of Borrowing Costs to the Housing Revenue Account (HRA)**

3.10.1 From 2020/21 the Council will operate two loans pools for the purposes of apportioning borrowing costs to the HRA.

3.10.2 The first loans pool will consist of all the Council's loans taken out prior to 2020/21 for both General Fund and HRA purposes. The Council will continue to operate this loans pool and apportion costs according to locally established principles. The principles upon which the apportionment of borrowing costs should be based are as follows:

- The apportionment is broadly equitable between the HRA and the General Fund, and is detrimental to neither;
- The loans portfolio is managed in the best interests of the whole authority;

3.10.3 It is recommended that a second loans pool is established in 2020/21 consisting of the three £20m loans that were taken from the PWLB at the HRA Certainty Rate which was 1.0% below the PWLB General Fund Certainty Rate. The borrowing costs on these loans will be charged to the HRA in their entirety.

3.10.4 From 25 November 2020 the PWLB General Fund Certainty Rate was reduced by 1.0%, thereby removing the differential between the General Fund and HRA PWLB rates. Any future borrowing will therefore be included in the first loans pool covering both the HRA and the General Fund.

## 4. ANNUAL INVESTMENT STRATEGY

### 4.1 Investment policy – management of risk

4.1.1 The 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).

4.1.2 The Council’s investment policy has regard to the following:

- MHCLG’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

4.1.3 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. 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.

4.1.4 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk that is measured by the following means:

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings including outlooks and credit watches.
2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.
3. **Other information** sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 5.2 under the categories of ‘specified’ and ‘non-specified’ investments.
  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments to £200m, (see paragraph 4.3).
  6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
  7. This authority will set a limit for its investments that are invested for **longer than 365 days**, (see paragraph 4.7).
  8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).
  9. This authority places **sector and geographical limits** on its investment portfolio in order to avoid the concentration of risk, (Appendix 5.3).
  10. Because of the change in accounting standards for 2020/21 under IFRS 9, this authority will consider the implications of investment instruments, which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, (MHCLG), concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.

## 4.2 Creditworthiness policy

- 4.2.1 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.
- 4.2.2 The Director of Finance and Resources (Section 151 Officer) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality that the Council may use, rather than defining what types of investment instruments are to be used.

- 4.2.3 Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
- 4.2.4 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 double A sovereign Long Term ratingand have, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where rated):
    - i. Short Term - F1, P-2, or A-2
    - ii. Long Term – A-
  - Banks 2 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
  - Banks 3 - Secured lending to banks partly owned by the City Council.
  - Building societies. The Council will use all societies which:
    - i. Meet the ratings for Banks 1 outlined above or;
    - ii. Have assets in excess of £350m;or meet both criteria.
  - Money Market Funds (MMFs)
  - UK Government (including gilts, Treasury Bills and the DMADF)
  - Local authorities
  - Housing associations. In addition to ratings from the credit agencies, housing associations will only receive investments if they have a viability rating of V1 and a governance rating of G1 from Homes England.
  - Supranational institutions that meet the ratings for banks outlined above
  - Corporate Bonds. The Council will invest in corporate bonds which:
    - i. Meet the ratings for Banks 1 outlined above or;
    - ii. Have a credit rating of BBB+ or;
    - iii. Have a credit rating of BBB- but form part of a portfolio managed by professional fund managers
  - Universities that meet the ratings for Banks 1 outlined above

- Pooled investment vehicles including equity funds, property funds, corporate bond funds and multi asset funds
- Subsidiary companies of the City Council

A limit of £200m will be applied to the use of non-specified investments

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

4.2.6 **Time limits** are applied to most investment categories to limit credit risk as the longer the duration of an investment is, the more time there is for the credit quality of the counter party to deteriorate. There are no time limits applied to corporate bonds managed by a professional fund manager, pooled investment vehicles, and subsidiary companies of the Council. Corporate bonds can be sold if there is a need to disinvest and a professional fund manager will have more resources to assess credit quality. Investments in pooled investment vehicles often do not have a predetermined maturity; the Council would withdraw its investment at the appropriate time. The Council controls its subsidiary companies and therefore is in a position to have a considerable influence on their credit quality.

4.2.7 **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):

<b>Table H</b>	<b>Fitch Long term Rating (or equivalent)</b>	<b>Money Limit</b>	<b>Time Limit</b>
Banks 1 highest quality	AA-	£26m	6yrs
Banks 1 higher quality	A+	£20m	6yrs
Banks 1 medium quality	A	£15m	6yrs
Banks 1 lower quality	A-	£10m	6yrs
Banks 2 the Council's own banker if the criteria for Banks 1 is not met	-	Minimised	Minimised
Banks 3 partly owned by the Council	-	£10m	5yrs
UK Government including DMADF	UK sovereign rating	unlimited	6yrs
Local authorities	N/A	£30m	6yrs
Housing associations higher quality	AA-	£30m	10yrs
Housing associations lower quality	A-	£20m	10yrs
Corporate bonds purchased by City Council but not meeting criteria for Banks 1 above	BBB+	£7m	365 days
Corporate bonds managed by a professional fund manager	BBB-	£0.32m per bond up to a limit of £8m	Unlimited
Pooled investment vehicles	-	£50m	Unlimited
Subsidiary companies of the Council	-	£30m	Unlimited
	<b>Fund rating</b>	<b>Money Limit</b>	<b>Time Limit</b>
Money Market Funds	AAA	£26m	liquid
Enhanced Money Market Funds	AA	£20m	liquid

4.2.8 The proposed criteria for specified and non-specified investments are shown in Appendix 5.2 for approval.

### 4.3 Other limits

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

- a) **Non-specified investment limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments to £200m.
- b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of double A** from Fitch or equivalent.
- c) **Other limits.** In addition:
  - limits in place above will apply to a group of companies;
  - sector and geographic limits will be monitored regularly for appropriateness.

### 4.4 Environmental, Social and Governance Factors

4.4.1 The Council will seek to move towards investments that improve the environment, bring wider social benefits, and are with organisations with good governance.

4.4.2 The Council will avoid investments in fossil fuel extraction unless they are making substantial investment into renewable energy technologies as part of a strategy to move to becoming a clean energy supplier.

4.4.3 The Council will give weight to the environmental, social and governance elements of credit ratings in making investment decisions, provided that the overall risk profile of the investment portfolio (including liquidity risk) is not compromised, and that decisions remain consistent with responsible financial management and stewardship.

### 4.5 Investment Strategy and Risk Appetite Statement

4.5.1 All the investment guidance available, both statutory and from the Chartered Institute of Public Finance and Accountancy (CIPFA), makes it clear that all investing must follow SLY principles - security, liquidity, yield. In accordance with the guidance issued, the Council's first priority in investing is security, followed by liquidity. After these priorities are met, the Council will seek to maximise yields. The Council will consider the environmental and social implications of its investments once SLY principles have been met.

- 4.5.2 The Council's objectives in relation to investment can accordingly be stated as follows:

*Sums are invested with a diversified range of counter parties using the maximum range of financial instruments\* consistent with a low risk of the capital sum being diminished through movements in market prices.*

\* Financial instruments include term deposits, certificates of deposits, corporate bonds, money market funds, structured notes and shares in pooled investment funds

- 4.5.3 This means that the Council is not totally risk averse. Treasury management staff have the capability to actively manage treasury risks within the scope of the Council's treasury management policy and strategy.
- 4.5.4 In particular, when investing surplus cash, the Council will not necessarily limit itself to making deposits with the UK Government and local authorities, but may invest in other bodies including unrated building societies, Registered Social Landlords (RSLs), universities and corporate bonds. The Council may invest surplus funds through tradable instruments such as treasury bills, gilts, certificates of deposit, corporate bonds, covered bonds and repos / reverse repos.
- 4.5.5 The Council will invest its surplus cash to provide sufficient liquidity to meet its cash flow needs, but is mindful that the value of its investments will fall in real terms unless investment returns are at least equal to inflation. In order to earn investment returns in excess of inflation on as much of its surplus cash as possible, the Council will invest as much as it can in longer-term higher yielding investments whilst maintaining sufficient liquidity to meet its cash flow needs.
- 4.5.6 The Council may invest in lower risk structured investment products that follow the developed equity and other market indices where movements in prices may diminish the capital sum invested. These investments, and indeed any other investment, could also be diminished if the counter party defaults. Although the Council only invests in counter parties offering good credit quality, the credit quality of an investment counter party can decline during the life of the investment. This is particularly the case with long-term investments.
- 4.5.7 The Council may invest in externally managed pooled investment vehicles such as corporate bond funds, equity funds, property funds and multi asset funds, if the Council has cash for a term that is sufficient to cover cyclical movements in prices.
- 4.5.8 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed:
- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall, consideration will be given to locking in higher rates currently obtainable, for longer periods.

#### 4.6 Investment return expectations.

4.6.1 The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population.

4.6.2 There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter-term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations.

#### 4.7 Investment treasury indicator and limit - total principal funds invested for greater than 365 days.

4.7.1 These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

4.7.2 The Council is asked to approve the following treasury indicator and limit:

<b>Table I - Upper limit for principal sums invested for longer than 365 days</b>			
	<b>2022</b>	<b>2023</b>	<b>2024</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Current investments as at 31 March in excess of 1 year maturing in each year	200	134	103

#### 4.8 Investment performance

4.8.1 This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 1, 3, 6 or 12 month LIBID. 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.

#### 4.9 End of year investment report

4.9.1 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

## **5. APPENDICES**

### **5.1 Maturity structure of borrowing**

### **5.2 Credit and counterparty risk management**

### **5.3 Sector and Geographic Investment Limits**

**APPENDIX 5.1****Maturity Structure of Borrowing**

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large 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:

<b>Table J</b>		
<b>Maturity structure of fixed interest rate borrowing 2020/21</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	10%
5 years to 10 years	0%	20%
10 years to 20 years	0%	30%
20 years to 30 years	0%	40%
30 years to 40 years	0%	40%
40 years to 50 years	0%	50%
<b>Maturity structure of variable interest rate borrowing 2020/21</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	10%
5 years to 10 years	0%	20%
10 years to 20 years	0%	30%
20 years to 30 years	0%	40%
30 years to 40 years	0%	40%
40 years to 50 years	0%	40%

**APPENDIX 5.2****CREDIT AND COUNTERPARTY RISK MANAGEMENT**

The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Council's policy below.

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. This Council has adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Director of Finance and Resources (Section 151 Officer) has produced its treasury management practices (TMPs).

**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 amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

**Strategy Guidelines** – The main strategy guidelines are contained in the body of the Treasury Strategy Statement.

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

1. The UK Government (such as the Debt Management Office deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Bonds issued by supranational banks of less than one year's duration.
3. A local authority, housing association or university.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. This covers pooled

investment vehicles, such as money market funds, rated AA by Standard and Poor's, Moody's and / or Fitch rating agencies.

5. A body that is considered of a high credit quality (such as a bank or building society) with a minimum Short Term rating of A-2 / P-2 / F1 as rated by Standard and Poor's, Moody's and / 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 contained in Table H.

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

	<b>Non Specified Investment Category</b>	<b>Limit £</b>
a.	<p><b>Supranational bonds greater than 1 year to maturity</b></p> <p><b>(a) Multilateral development bank bonds with a AAA long-term rating</b> - 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.). However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p> <p><b>(b) A financial institution that is guaranteed by the United Kingdom Government</b> (e.g. National Rail)</p> <p>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. 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.</p>	<p><b>£26m for up to 6 years</b></p> <p><b>£26m for up to 6 years</b></p>
b.	<p><b>Gilt edged securities</b> 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.</p>	<p><b>Unlimited investments for up to 6 years</b></p>
c.	<p><b>The Council's own banker</b> if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.</p>	<p><b>£10m for up to 1 day</b></p>
d.	<p><b>Building societies not meeting the basic security requirements under the specified investments.</b> The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies that have a minimum asset size of £350m.</p>	<p><b>£6m for up to 2 years</b></p>
e.	<p>All <b>banks and building societies</b> that have 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).</p>	<p><b>Up to £26m (depending on credit quality)for up to 6 years</b></p>

	<b>Non Specified Investment Category</b>	<b>Limit £</b>
f.	<b>Loan capital</b> in a body corporate with a credit rating of at least BBB+. This will enable investments to be made in large commercial companies such as British Telecom. A short-term investment in a BBB+ rated counterparty may be less likely to default than a long-term investment with an A- rated counterparty.	<b>£7m for 365 days</b>
g.	<b>Corporate bonds</b> bought on the Council's behalf by professional fund managers who will target an average credit rating of at least BBB+ for the corporate bond fund. The average credit rating of the corporate bond fund may fall to BBB if there was a downgrade to a single issue or a broad downgrade. We would not want the fund manager to be a forced seller in this situation. If this situation arises, a strategy will be agreed with the fund manager to return the average rating of the portfolio to BBB+.	<b>£8m for an unlimited duration</b>
h.	<b>Pooled investment vehicles including equity funds, property funds and multi asset funds</b> with the potential to generate returns in excess of inflation and thus maintain the value of the principal invested in real terms. The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Local Authority Accounting requires movements in the market value of pooled investments to be charged to General Fund balances.	<b>£50m for an unlimited duration</b>
i.	<b>Subsidiary companies of the Council.</b> In particular, funds could be invested to facilitate the establishment of a subsidiary company to develop housing in the greater Portsmouth area on a commercial basis.	<b>£30m for an unlimited duration</b>
j.	<b>Banks partly owned by the City Council.</b> The Council is an equity shareholder in Hampshire Community Bank (HCB). Purchasing bonds in HCB would contribute to the regeneration of Hampshire and offer interest of up to 3.5%. Investing in HCB carries greater risk than the other approved investments contained in the Council's Annual Investment Strategy, as HCB is a new entity that is in the process of developing its business, and currently has neither a banking license nor a credit rating. However, HCB will be able to offer assets as security to cover a bond. These assets would consist of loans of the highest credit quality to the small and medium enterprise (SME) sector. The loan assets offered as security would pass to the Council in the event of HCB defaulting.	<b>£10m for 5 years</b>

**The monitoring of investment counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked. 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.

**APPENDIX 5.3****SECTOR AND GEOGRAPHIC INVESTMENT LIMITS****Sector Investment Limits**

AA money market funds offer security and same day access. By aggregating investments they can also invest in financial institutions that may not be interested in the relatively small sums that the Council can invest. Although AA money market funds are well diversified in their investments, there is a risk that more than one fund could have investments with the same bank or that the Council may also have invested funds in the same bank as a money market fund. Therefore it is proposed that the Council should aim to have no more than £80m invested in money market funds.

Most building society lending is secured against residential properties. If property prices fall there may be inadequate security to support building societies lending giving rise to a systemic risk.

As RSL's offer one principal service and their assets principally consist of residential properties, excessive investments in RSLs would also expose the Council to a systemic risk.

Excessive investments in investment products tracking equity, property or other markets could also expose the Council to a systemic risk.

In order to minimise systemic credit risk in any sector the following limits will be applied:

Money market funds	£80m
Building societies	£155m
Registered Social Landlords	£80m
Investments tracking the equity, property or other markets	£70m

**Geographic Investment Limits**

In order to minimise systemic credit risk in any region, the following limits will be applied to the geographic areas where investments can be made in foreign countries.

Asia & Australia	£80m
Americas	£80m
Eurozone	£60m
Continental Europe outside the Eurozone	£60m