

A summary of the strategy agreed for 2021/22 and the economic factors affecting this strategy

1. Background information

1.1 Full Council approved the annual Treasury Management Strategy report in February 2021, which sets out the proposed strategy for the year ahead. This strategy includes the limits and criteria for organisations to be used for the investment of cash surpluses and has to be approved by the Council.

1.2 This Council has always adopted a prudent approach to its investment strategy and in the last few years, there have been regular changes to the list of the approved organisations used for investment of surpluses. This list is regularly reviewed to ensure that the Council is able to invest in the best available rates consistent with low risk; the organisations are regularly monitored to ensure that their financial strength and low risk has been maintained.

1.3 The original strategy for 2021/22 was prepared within the context of the financial challenge being faced by the County Council over the Medium Term Financial Plan:

- Utilising long term cash balances as effectively as possible by investing in longer term instruments and/or using to fund borrowing to reduce borrowing costs;
- Ensuring the investment portfolio is working hard to maximise income by further use of alternative appropriate investment opportunities during 2021/22;
- Ensuring effective management of the borrowing portfolio by exploring rescheduling opportunities and identifying and exploiting the most cost effective ways of funding the Council's borrowing requirement.

1.4 At the same time, the Treasury Management Policy Statement was agreed as unchanged for 2021/22.

East Sussex County Council defined its treasury management activities as:

“The management of the organisation’s cash flows, its banking, money market and Capital market transactions (other than those of the Pension Fund) the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

The Council regards the successful identification, monitoring and management of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

This authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.”

2. Investment

2.1 When the strategy was agreed in February 2021, it emphasised the continued importance of credit quality. The Treasury Management Advisors Link Asset Services commented on short term interest rates, the UK economy, inflation, the outlook for long term interest rates and these factors were taken into account when setting the Strategy. The 2021/22 Investment Strategy was set in the context of diminishing returns and opportunities in the post Covid-19 pandemic economic environment.

2.2 During the period investments to other Local Authorities could secure an enhanced fixed level of return over traditional bank deposits with an increased level of credit security

2.3 Officers continue to monitor opportunities to invest in Environmental Social and Governance (ESG) products. In reality, the market for green and ESG investments is relatively immature, which reduces the ability to actively invest in products that support the Council's aspirations. However, research and the consideration of suitability of ESG investment products is ongoing.

2.4 This Council, in addition to other tools, uses 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, Moody's 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; and
- sovereign ratings to select counterparties from only the most creditworthy countries.

2.5 The strategy going forward was to continue with the policy of ensuring minimum risk, but was also intended to deliver secure investment income on the Councils cash balances.

2.6 As was clear from events globally and nationally since 2008, it is impossible in practical terms to eliminate all credit risk.

2.7 The strategy aimed to ensure that in the economic climate it was essential that a prudent approach was maintained. This would be achieved through investing with selected banks and funds which met the Council's rating criteria. The emphasis would continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield.

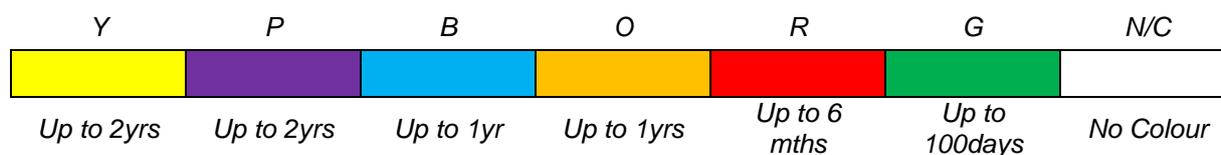
2.8 The Council's investment policy has regard to the Department for Levelling Up, Housing & Communities Guidance on Local Government Investments ("[the Guidance Guidance on local government investments.pdf \(publishing.service.gov.uk\)](https://www.publishing.service.gov.uk/guidance/guidance-on-local-government-investments.pdf)) and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Link Asset Services Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, and then return.

2.9 Investment instruments identified for use in the financial year are listed in section 3.2 and 4.1 under the 'Specified and Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

2.10 The weighted scoring system produces an end product of a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments, i.e., using counterparties within the following durational bands provided they have a minimum AA+ sovereign rating from three rating agencies:

- Yellow 2 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months

- Green 3 months
- No Colour, not to be used



2.11 The Link credit worthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue influence to just one agency's ratings.

2.12 Typically the minimum credit ratings criteria the Authority use, will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. 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.

All credit ratings will be monitored daily. The Authority is alerted to changes to ratings of all three agencies through its use of the Link Asset Services credit worthiness service.

- if a downgrade results in the counterparty or investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

2.13 The Link Asset Services methodology determines the maximum investment duration under the credit rating criteria. Key features of Link Asset Services credit rating policy are:

- a mathematical based scoring system is used taking ratings from all three credit rating agencies;
- negative and positive watches and outlooks used by the credit rating agencies form part of the input to determine a counterparty's time band (i.e. 3, 6, 9, 12 months etc.).
- CDS spreads are used in Link Asset Services creditworthiness service as it is accepted that credit rating agencies lag market events and thus do not provide investors with the most instantaneous and "up to date" picture of the credit quality of a particular institution. CDS spreads provide perceived market sentiment regarding the credit quality of an institution.
- After a score is generated from the inputs a maximum time limit (duration) is assigned and this is known as the Link Asset Services colour which is associated with a maximum suggested time boundary.

2.14 All of the investments were classified as Specified (i.e., investment is sterling denominated and has a maximum maturity of 1 year) and non-Specified Investments (i.e., any

other type of investment not defined as Specified). These investments were sterling investments for up to two years maturity with institutions deemed to be high credit quality or with the UK Government (Debt Management Account Deposit Facility). These were considered low risk assets where the possibility of loss of principal or investment income was small.

2.15 If investment instruments identified in the financial year under the 'Non-Specified and Specified' Investments categories were used, the Council funds would be invested as follows:

3. Specified Investments

3.1 An investment is a specified investment if all of the following apply:

- the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
- the investment is not a long term investment (i.e. up to 1 year);
- the making of the investment is not defined as Capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended];
- the investment is made with a body or in an investment scheme of high credit quality (see below) or with one of the following public-sector bodies:
 - The United Kingdom Government;
 - A local authority in England or Wales (as defined under section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; and
 - High credit quality is defined as a minimum credit rating as outlined in section 4.2 of this strategy.

3.2 The use of Specified Investments

Investment instruments identified for use in the financial year are as follows:

- The Table below set out the types of investments that fall into each category, counterparties available to the Council, and the limits placed on each of these. A detailed list of each investment type is available in the Treasury Management Practices guidance notes;
- all investments will be within the UK or AA+ sovereign rated countries.

Criteria for specified Investments:

| Counterparty | Country/ Domicile | Instrument | Min. Credit Criteria/LAS colour band | Max. Amount | Max. maturity period |
|------------------------------------------------------|----------------------|------------------------|--------------------------------------------|----------------|----------------------------|
| Debt Management and Deposit Facilities (DMADF) | UK | Term Deposits (TDs) | N/A | unlimited | 12 Months |
| Government Treasury bills | UK | TDs | UK Sovereign Rating | unlimited | 12 Months |
| UK Local Authorities | UK | TDs | UK Sovereign Rating | £60m | 12 Months |
| Banks – part nationalised | UK | ▪ TDs | N/A | £60m | 12 Months |

| Counterparty | Country/ Domicile | Instrument | Min. Credit Criteria/LAS colour band | Max. Amount | Max. maturity period |
|----------------------------------------------------|----------------------------------------------|-----------------------------------------------------------------------------------------------------------------|--------------------------------------------|----------------|----------------------------|
| | | <ul style="list-style-type: none"> ▪ Deposits on Notice ▪ Certificates of Deposit (CDs) | | | |
| Banks | UK | <ul style="list-style-type: none"> ▪ TDs ▪ Deposits on Notice ▪ CDs | Blue | £60m | 12 Months |
| | | | Orange | £60m | 12 Months |
| | | | Red | £60m | 6 Months |
| | | | Green | £60m | 100 Days |
| Building Societies | UK | <ul style="list-style-type: none"> ▪ TDs ▪ Deposits on Notice ▪ CDs | Blue | £60m | 12 Months |
| | | | Orange | £60m | 12 Months |
| | | | Red | £60m | 6 Months |
| | | | Green | £60m | 100 Days |
| Individual Money Market Funds (MMF) CNAV and LVNAV | UK/Ireland/ EU domiciled | AAA Rated Money Market Fund Rating | N/A | £60m | Liquid |
| VNAV MMF's and Ultra-Short Dated Bond Funds | UK/Ireland/EU domiciled | AAA Rated Bond Fund Fund Rating | N/A | £60m | Liquid |
| Banks – Non-UK | Those with sovereign rating of at least AA+* | <ul style="list-style-type: none"> ▪ TDs ▪ Deposits on Notice ▪ CDs | Blue | £60m | 12 Months |
| | | | Orange | £60m | 12 Months |
| | | | Red | £60m | 6 Months |
| | | | Green | £60m | 100 Days |

4. Non Specified Investments

4.1 Non-Specified investments are any other types of investment that are not defined as specified. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

| Counterparty | Minimum credit criteria | Maximum investments | Period |
|--------------------------|-------------------------|---------------------|-------------|
| UK Local Authorities** | Government Backed | £60m | 2 years |
| Corporate Bond Fund(s) | Investment Grade | £30m | 2 - 5 years |
| Pooled Property Fund(s) | N/A | £30m | 5+ years |
| Mixed Asset Fund(s) | Appropriate rating | £30m | 2 - 5 years |
| Short Dated Bond Fund(s) | N/A | £30m | 2 – 5 years |

** Local Authorities appear on both Specified and Non-specified investment list – an investment with a LA for up to a year is Specified, and between 1-2 years is Non-specified. The maximum amount that can be lent to any single Local Authority is £60m across both specified and Unspecified Investments

4.2 The maximum amount that can be invested will be monitored in relation to the Council surplus monies and the level of reserves. The approved counterparty list will be maintained by referring to an up-to-date credit rating agency reports, and the Council will liaise regularly with brokers for updates. Where Externally Managed Funds are not rated a selection process will evaluate relative risks & returns. Security of the council's money and fund volatility will be key measures of suitability. Counterparties may be added to or removed from the list only with the approval of the Chief Finance Officer.

5. The economy in 2021/22 – Commentary from Link Asset Services (Treasury Management Advisors) in April 2022

5.1 Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

5.2 The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, now that the CPI measure has already risen to 6.2% and is likely to exceed 8% in April.

5.3 Gilt yields fell towards the back end of 2021, but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

5.4 Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April utilities prices as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1st April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

5.5 Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for 18% of total world GDP (the USA accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy. In addition, after the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

5.6 Central banks' monetary policy. During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond

yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.