

## APPENDIX C

### Annual Investment Strategy 2020/21

#### 1. Annual Investment Strategy

##### 1.1 Investment Policy – Management of Risk

- 1.1.1 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).
- 1.1.2 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
- 1.1.3 The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return).
- 1.1.4 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 and defines its risk appetite 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.
  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 C1 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 as being £30.5 million of the total investment portfolio, (see Appendix C1).
6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 1.2.6.
7. **Transaction limits** are set for each type of investment in 1.2.6.
8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 1.4.6).
9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 1.3.1).
10. This authority has engaged **external consultants**, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
11. All investments will be denominated in **sterling**.
12. **Statutory override on pooled investments.** As a result of the change in accounting standards for 2018/19 under IFRS 9, the Ministry for Housing, Communities and Local Government (MHCLG) agreed 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 commencing from April 2018. The Council will use the statutory override to account for any changes in the fair value on its pooled investments. For the Council's Money Market Fund investments, the change in fair value was immaterial in 2018/19.

**13. Investments in equity instruments designated at fair value through other comprehensive income.** Upon transition to IFRS9 – Financial Instruments on 1 April 2018, the Council elected to designate the CCLA Property Fund investment (£0.5m) and the CCLA Diversified Income Fund (£1m) as fair value through other comprehensive income. These investments are eligible for the election because they meet the definition of equity instruments in paragraph 11 of IAS32 and are neither held for trading (the Council holds this investment as a long term strategic investment) nor contingent consideration recognised by an acquirer in a business combination to which IFRS3 applies. They are not considered to be puttable instruments because the Council does not have a contractual right to put the instrument back to the issuer for cash.

1.1.5 However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 1.5.1). Regular monitoring of investment performance will be carried out during the year.

1.1.6 The above criteria are unchanged from last year.

## **1.2 Creditworthiness Policy**

1.2.1 This 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, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- “watches” and “outlooks” from credit rating agencies;
- CDS spreads that may give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

1.2.2 This modelling approach combines credit ratings, and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product of this 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 suggested duration for investments. The Council will, therefore, use counterparties within the following durational bands:

- Yellow 5 years \*
- Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple 2 years
- 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

1.2.3 The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

1.2.4 Typically, the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1 and a long term rating of 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.

1.2.5 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' 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 spreads against the iTraxx European Financials 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.

1.2.6 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, as well as information on any external support for banks to help support its decision making process.

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	<b>Minimum credit criteria/colour band</b>	<b>Limit per institution Max % of total investments</b>	<b>Maximum maturity</b>
DMADF	n/a	100%	6 months
Money Market Funds	AAA	£6m	Daily liquidity
Cash Plus Funds/ Ultra short bond funds	AAA, AA	£6m	T+1 to T+4
CCLA Local Authorities Property Fund	Not credit rated	£1.5m	No fixed maturity date but will generally be up to 7 years
CCLA Diversified Income Fund	Not credit rated	£2m	No fixed maturity date but will generally be up to 7 years
Local Authorities	Yellow	£6 million per institution	5 years
Unsecured investments with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£6m (£7m for Lloyds plc)	Up to 5 years Up to 2 years Up to 1 years Up to 1 years Up to 6 months Up to 100 days Not for use
Share capital in a body corporate	N/A	£12 million	N/A
Loan capital in a body corporate	N/A	£12 million	N/A

### 1.2.7 UK Banks – Ring Fencing

1.2.8 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

1.2.9 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

1.2.10 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

### 1.3 Country Limits

1.3.1 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 as being £30.5 million of the total investment portfolio.

b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of AA-** (see Appendix C2).

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

- no more than £6 million will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

## 1.4 Investment Strategy

1.4.1 **In-house Funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

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

### 1.4.2 Investment Returns Expectations

1.4.3 Due to the current Coronavirus pandemic, there are no short term interest rate predictions currently available. On Thursday 19<sup>th</sup> March, the Bank's Monetary Policy Committee cut rates from 0.25% to 0.1%. This takes the base rate to its lowest-ever level.

1.4.5 **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

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

<b>Upper limit for principal sums invested for longer than 365 days</b>			
<b>£m</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>
Principal sums invested for longer than 365 days	£3.5	£3.5	£3.5
Current investments as at 31.01.20 in excess of 1 year maturing in each year*	£3.5	£3.5	£3.5

*\*Monies already invested in the CCLA Property Fund (£1.5 million) and the CCLA Diversified Income Fund (£2 million)*

1.4.7 For its cash flow generated balances, the Council will seek to utilise its money market funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.

**1.5 Investment Performance / Risk Benchmarking**

1.5.1 The 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 rate.

**1.6 End of Year Investment Report**

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



## APPENDIX C1

### Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

#### Specified Investments

All such investments will be sterling denominated, with **maturities up to a maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable.

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	100%	6 months
Money Market Funds	AAA	£6 million per fund	Liquid
Ultra Short Dated Bond Funds	AAA	£6 million	Liquid
Local authorities	Yellow	£6 million per institution	12 months
Term deposits with banks and building societies	Blue	£6 million per institution (£7 million for Lloyds)	Up to 1 Year
	Orange		Up to 1 Year
	Red		Up to 6 months
	Green		Up to 100 days
	No Colour		Not for use

## Non-Specified Investments

Investment instruments 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. The Council's CCLA Property Fund investment (£1.5m) and CCLA Diversified Income Fund investment (£2m) are the only investment types that the Council has which meets the definition of a non-specified investment.

In December 2019, the Investment Strategy for 2019/20 was revised to include share capital for the purchase of shares in a Special Purpose Vehicle (SPV), so as to own, operate or invest in renewable energy. This was approved by Council on 19<sup>th</sup> December 2019 (Minute 53/19). The limits shown below for share capital and loan capital are the maximum limits for this investment type.

	<b>Minimum credit criteria / colour band</b>	<b>Max % of total investments/ £ limit per institution</b>	<b>Max. maturity period</b>
Property Investment Funds – CCLA	N/A	£1.5 million	No fixed maturity date but will generally be up to 7 years
Diversified Income Fund – CCLA	N/A	£2 million	No fixed maturity date but will generally be up to 7 years
UK Government Gilts	Yellow	£3 million	5 Years
Share capital in a body corporate (See note 1 and note 2 below)	N/A	£12 million	N/A
Loan capital in a body corporate (See note 1 and note 2 below)	N/A	£12 million	N/A
<b>TOTAL</b>		<b>£30.5 million</b>	

NOTE 1. The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies. The Council will seek further advice on the appropriateness and associated risks with investments in these categories.

NOTE 2. The Council is currently undertaking due diligence work on the opportunity for the Council to purchase shares in a Special Purpose Vehicle (SPV) so as to own, operate or invest in renewable energy generation. This business case would also involve the Council entering into a loan in 2020/21 at a commercial rate with the Special Purpose Vehicle.

### APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

#### *Based on lowest available rating*

##### AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

##### AA+

- Finland
- U.S.A.

##### AA

- Abu Dhabi (UAE)
- Hong Kong
- France
- U.K.

##### AA-

- Belgium
- Qatar