

## APPENDIX C

### Annual Investment Strategy 2023/24

#### 1. Annual Investment Strategy

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

- 1.1.1 The Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG) and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets and service investments, are covered in the Capital Strategy, (a separate report).
- 1.1.2 The Council’s investment policy has regard to the following: -
- DLUHC’s Guidance on Local Government Investments (“the Guidance”)
  - CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 (“the Code”)
  - CIPFA Treasury Management Guidance Notes 2021
- 1.1.3 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 within the Council’s risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.
- 1.1.4 The above guidance from the DLUHC 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 or have less than a year left to run to maturity if originally they were originally classified as being non-specified investments solely due to the maturity period exceeding one year.
  - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by Members and officers before being authorised for use.
5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being £6.86 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 Council 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 advisers**, to provide expert treasury management 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. As a result of the change in accounting standards for 2022/23 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 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 23). At the current juncture it has not been determined whether a further extension to the over-ride will be agreed by Government.
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. The Council currently holds £1.5m in the CCLA Property Fund and £2m in the CCLA Diversified Income Fund.

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.

## 1.2 Creditworthiness Policy

1.2.1 This Council applies the creditworthiness service provided by Link Group. 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 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 on a real-time basis. The Council is alerted to changes to ratings of all three agencies through its use of the 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 Senior Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. 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 5 years	Up to 5 years	Up to 5 years	Up to 2 years	Up to 1 year	Up to 1 year	Up to 6 months	Up to 100 days	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 held for up to 7 years
CCLA Diversified Income Fund	Not credit rated	£2m	No fixed maturity date but will generally be held for 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	nil	N/A
Loan capital in a body corporate	N/A	£0.36 million	N/A

## Creditworthiness

- 1.2.7 Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. Accordingly, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK.
- 1.2.8 **CDS prices.** Although bank CDS prices (these are market indicators of credit risk) spiked upwards during the days of the Truss/Kwarteng government, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Authority has access to this information via its Link-provided Passport portal.

### 1.3 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 £6.86 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.
- 1.3.2 **Loans.** In accordance with the Statutory Guidance on Local Government Investments, a local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth.

The Council can make such loans whilst continuing to have regard to this guidance, subject to the following requirements of the Council's strategy, being:-

- i) Total financial exposure to these type of loans is proportionate;
- ii) The Council uses an allowed “expected credit loss” model for loans and receivables as set out in International Financial Reporting Standard (IFRS) 9 Financial Instruments as adopted by proper practices to measure the credit risk of its loan portfolio;
- iii) The appropriate credit control arrangements to recover overdue repayments are in place; and
- iv) The local authority has formally agreed the total level of loans by type that it is willing to make and the total loan book is within the self-assessed limit.

## 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. The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate peaking in the first half of 2023 and possibly reducing as early as the latter part of 2023 so an agile investment strategy would be appropriate to optimise returns.

1.4.2 Accordingly, 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.

1.4.3 **Investment Returns Expectations.** The current forecast includes a forecast for Bank Rate to reach 4.5% in Q2 2023.

1.4.4 **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.

1.4.5 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>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>
Principal sums invested for longer than 365 days	£3,500,000	£3,500,000	£3,500,000
Current investments as at 31.01.23 in excess of 1 year maturing in each year*	£3,500,000	£3,500,000	£3,500,000

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

1.4.6 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.

1.4.7 The Council's investments are predominantly sterling-denominated term deposits. These are not long-term investments that are specifically used by financial institutions to "on-finance" projects, but used as part of day-to-day cash flow balances. The Council also does not make equity investments in financial institutions.

#### **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 the Sterling Overnight Interbank Average rate (SONIA).

#### **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	£6,000,000 per fund	Liquid
Ultra Short Dated Bond Funds	AAA	£6,000,000	Liquid
Local authorities	Yellow	£6,000,000 per institution	12 months
Term deposits with banks and building societies	Blue	£6,000,000 per institution (£7,000,000 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.

The limits shown below for share capital and loan capital are the maximum limits for this investment type.

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
Property Investment Funds – CCLA	N/A	£1,500,000	No fixed maturity date but will generally be up to 7 years
Diversified Income Fund – CCLA	N/A	£2,000,000	No fixed maturity date but will generally be up to 7 years
UK Government Gilts	Yellow	£3,000,000	5 Years
Share capital in a body corporate (See note 1 and note 2 below)	N/A	nil	N/A
Loan capital in a body corporate (See note 1 and note 2 below)	N/A	£360,000	N/A
<b>TOTAL</b>		<b>£6,860,000</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 Executive report on 28 January 2021 set out the details of a secured loan of up to £360,000 for seven years for a housing project.

### 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 and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Group credit worthiness service.

***Although the countries listed below are eligible for Investment as their credit rating is AA- or higher, the Council mainly invests with Banks or Building Societies within the UK.***

#### ***Based on lowest available rating***

##### AAA

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

##### AA+

- Canada
- Finland
- U.S.A.

##### AA

- Abu Dhabi (UAE)
- France

##### AA-

- Belgium
- Qatar
- U.K