

### Annual Investment Strategy

#### Investment policy

The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

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 this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in appendix B1 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices as set out in Appendix B2.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments identified for use in the financial year are listed in appendix B1 under the 'specified' and 'non-specified' investments categories. This repeats the tables shown under Appendix B2 TMP4[4]. Counterparty limits will be as set through the Council's treasury management practices as set out in Appendix B2.

#### Creditworthiness policy

This Council applies the creditworthiness service provided by Capita 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;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years \*
- 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

*\*Please note: the yellow colour category is for UK Government debt, or it's equivalent, constant Net Asset Value money market funds and collateralised deposits where the collateral is UK Government debt.*

How the above translates into actual counterparties is shown in Appendix B2 (shown separately for approval at Appendix B1).

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

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.

All credit ratings will be monitored on an ongoing basis and 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 benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

This Council will place reliance on the use of this external service but it will in addition use market data and market information, information on any external support for banks to help support its decision making.

### **Country and sector limits**

The Council has determined (at Council 8th October 2015) that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. The individual counterparty must also have a minimum credit rating of AA-. (The minimum credit rating does not apply to UK counterparties). The list of countries that qualify using this credit criteria as at the date of this report are shown

in Appendix D. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

### Investment strategy

Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

	<b>Now</b>
2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

### Capita comment (as at 16/11/2016)

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

**Investment treasury indicator and limit** – total principal funds invested for greater than 364 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.

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

Table 1

<b>Maximum principal sums invested &gt; 364 days</b>				
<b>£m</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>
Principal sums invested > 364 days	£16m	£5m*	£0m	£0m

\*This allows for one investment longer than a year. No investment will be made without prior reference to Capita Asset Services and confirmation that the cash is available for the recommended time period.

For its cash flow generated balances, the Council will seek to utilise its instant access and notice accounts, and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

### **Investment risk benchmarking**

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.08% historic risk of default when compared to the whole portfolio

Liquidity – in respect of this the Council seeks to maintain:

- Bank overdraft - £0.250m
- Liquid short term deposits of at least £5m available with a month's notice.
- Weighted average life is expected to be less than 1 year to reflect the short term nature of current deposits. However, this is not a benchmark but is measured and reported for information and will be subject to change as opportunities for longer term deposits in line with our counterparty list arise.

Yield – local measures of yield benchmarks are:

- Investments – internal returns above the 3 month LIBID rate

And in addition that the security benchmark for each individual year is:

Table 2

	1 year	2 years	3 years
<b>Maximum</b>	<b>0.06%</b>	<b>0.06%</b>	<b>0.08%</b>

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment. These percentages are reviewed by Capita Asset Services and if there is any change to the maximum risk percentages, these will be updated and reported accordingly.

### **End of year investment report**

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