

Annual Investment Strategy

Investment policy

The Department for Levelling Up, Housing and Communities (DLUHC) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals primarily 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 primarily covered in the separate Capital Strategy.

The Council's investment policy has regard to the DLUHC'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 2021 ("the CIPFA TM Code").

The Council's investment priorities will be Security first, Portfolio Liquidity second, 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. In the current economic climate, it is considered appropriate to keep investments short term (**less than 1 year**) to cover cash flow needs **and to have funds to reinvest for higher yield while interest rates continue to increase**. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 2 years with high credit rated financial institutions, as well as wider range fund options.

In accordance with the above guidance from the DLUHC 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.

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.

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 B1 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 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. (Non-specified investments which would be specified investments apart from originally being for a period longer than 12 months, will be classified as being specified once the remaining period to maturity falls to under twelve months.)

Investment instruments identified for use in the financial year are listed in appendix B1. Appendix B1 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 Link. 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 its 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 Link 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 the UK or 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 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

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

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.

The Bank Rate is currently 3.5% (January 2022) but is expected to rise regularly during this reporting period, **peaking towards the end of 2023/24** (as per Link Asset services), meaning that investments will generally be kept shorter so as to benefit from higher rates later on.

Bank Rate forecasts for financial year ends (March) are:

- **2022/23 4.25%**
- **2023/24 4.00%**
- **2024/25 3.00%**
- **2025/26 2.50%**

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about **six** months during each financial year are as follows:

- 2023/24 4.00%
- 2024/25 3.00%
- 2025/26 2.50%

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

Table 1

£'000	2022-23	2023-24	2024-25	2025-26
Principal sums invested > 364 or >365 days	7,500	5,000	5,000	5,000

This allows for £5m of investments longer than a year. No investment will be made without prior reference to Link Asset Services and confirmation that the cash is available for the recommended time period.

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 – up to £2m
- Liquid short term deposits of at least £5m available with a week’s notice.
- Weighted average life is expected to be less than 1 year to reflect the short term nature of current deposits. 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 Overnight SONIA compounded rate

In addition, that the security benchmark for each individual year is:

Table 2

	1 year	2 years	3 years
Maximum	0.06%	0.06%	0.08%

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 Link 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.

Non-Financial Investments

The Council's approach to non-financial investments is set out in section 4 of the Capital Strategy.