

### Annual Investment Strategy for Treasury Investments 2022/23

This report details the Council's **Investment Policy** for its Treasury Investments for 2022/23 and has regard to the following:

- MHCLG's Guidance on Local Government Investments 2018.
- CIPFA Treasury Management Code of Practice and Guidance Notes 2017 and 2021.

The Government extended the meaning of 'investments' in their Guidance in 2018 to include both **financial (treasury related)** and **non-financial (non-treasury related)** investments. The revised CIPFA Treasury Management Code, issued in December 2021, further breaks down investments made into 3 purposes namely, treasury management, service delivery or commercial return. This Annual Investment Strategy applies to the Council's **treasury related investments only**. The investment strategy dealing with the Council's non-treasury related investments and loans is included in the Capital Strategy which is considered along with the Council Budget for 2022/2023.

The above guidance from MHCLG and CIPFA place a high priority on the management of risk when making investments. The **risk appetite** of the Council for its treasury investments is **low**, its priorities being **security first, liquidity second and then return**. The intention of the Treasury Strategy is to provide security of investment and minimisation of risk.

This prudent approach to risk is defined by the Council by using the following means:

- **Minimum acceptable credit criteria** – applied to generate a list of highly creditworthy investment counterparties. This also enables diversification and this avoidance of concentration risk. Key Ratings used to monitor counterparties are the **short term** and **long-term** ratings from credit rating agencies.
- **Other Information sources** – continual assessment of financial sector in relation to economic and political environments in which Counterparties operate using the following sources:
  - ~ 'Credit default swap' pricing.
  - ~ Financial press / Internet.
  - ~ Share price websites.

The Secretary of State, within the MHCLG Guidance, has defined investments into two categories as follows:

- **Specified Investments** - Investments of no more than one year with a high level of credit quality.
- **Non-Specified investments - Investments** that are more complex, longer than one year, or with a lower credit quality that results in higher risk than Specified Investments.

The Council has determined its Specified and Non-Specified Investments for 2022/23 as shown in the table below:

| Characteristics/Type                                                                                                                                                                                                                                                                                                                               | Counterparty Categories                                                                                                                                                                                                                                                                                                                                                            |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Specified Investments</b>                                                                                                                                                                                                                                                                                                                       |                                                                                                                                                                                                                                                                                                                                                                                    |
| <ul style="list-style-type: none"> <li>• Sterling deposits.</li> <li>• Up to and including one year.</li> <li>• Offering high security / high yield.</li> <li>• Fixed, callable or forward term deposits as appropriate<sup>1</sup>, Certificates of Deposit, Treasury/ Local Authority Bills, Dated Bonds and Repo.</li> </ul>                    | <ul style="list-style-type: none"> <li>• UK Government/ Supranational/ Multilateral Development Banks.</li> <li>• Local Authorities.</li> <li>• Bodies or Investment Schemes meeting the Councils <b>minimum acceptable credit rating criteria for Specified Investments</b> (Includes Banks, Building Societies, Corporates, and Money Market Funds CNAV, LVNAV).</li> </ul>      |
| Characteristics/Type                                                                                                                                                                                                                                                                                                                               | Counterparty Categories                                                                                                                                                                                                                                                                                                                                                            |
| <b>Non-Specified Investments</b>                                                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                                                                                                                    |
| <ul style="list-style-type: none"> <li>• Sterling deposits.</li> <li>• Period greater than 12 months up to a maximum of 2 years.</li> <li>• Higher risk than Specified Investments.</li> <li>• Fixed, callable or forward term deposits as appropriate, Certificates of Deposit, Treasury/ Local Authority Bills, Dated Bonds and Repo.</li> </ul> | <ul style="list-style-type: none"> <li>• UK Government/ Supranational/ Multilateral Development Banks.</li> <li>• Local Authorities.</li> <li>• Bodies or Investment Schemes meeting the Councils <b>minimum acceptable credit rating criteria for Non-Specified Investments</b> (Includes Banks, Building Societies, Corporates and Enhanced Money Market Funds VNAV).</li> </ul> |

### Creditworthiness Policy

The Council uses the **creditworthiness service** provided by Link Asset Services Ltd, its treasury management advisor, to assess the risk level of its Counterparties. This service has been progressively enhanced and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

<sup>1</sup> Fixed Deposit : Investment fixed for specific term at specific rate.

Callable Deposit : Investment whereby borrower has option to pay back deposit at specific intervals.

Forward Deposit : Investment whereby period, rate and amount are agreed in advance of a future date. The forward period plus the deal period to be within the maturity limit allowed.

- Credit watches and credit outlooks from credit rating agencies.
- Credit default swap (CDS) spreads to give early warning of likely changes in credit ratings.

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a **weighted scoring system** for which the result is a series of **colour coded bands** which indicate the relative creditworthiness of counterparties.

Limits for amount and duration of investment are then assigned to each colour banding. Maximum amount limits have been assigned to different levels of balances which enable the Council to be more risk sensitive to both falling and increasing balances going forward. Details can be seen in the table below:

| Link Weighted Colour Band        | Maximum Duration | Maximum Amount Based on Average Cash Balance of Up To: |       |       |       |
|----------------------------------|------------------|--------------------------------------------------------|-------|-------|-------|
|                                  |                  | £450m                                                  | £300m | £200m | £100m |
| <b>Specified Investments</b>     |                  |                                                        |       |       |       |
| Blue*                            | 1 Year           | £50m                                                   | £50m  | £40m  | £25m  |
| Orange                           | 1 Year           | £30m                                                   | £25m  | £20m  | £15m  |
| Red                              | 6 Months         | £25m                                                   | £20m  | £15m  | £10m  |
| Green                            | 100 Days         | £20m                                                   | £15m  | £10m  | £5m   |
| <b>Non Specified Investments</b> |                  |                                                        |       |       |       |
| Purple                           | 2 Years          | £30m                                                   | £25m  | £25m  | £15m  |
| Yellow**                         | 2 Years          | £30m                                                   | £25m  | £20m  | £15m  |

\* Nationalised/ Part Nationalised UK Banks

\*\* MMF's/ Government/ Local Government

| <b>Minimum Credit Rating Criteria</b> |       |                  |         |
|---------------------------------------|-------|------------------|---------|
| Any Two of Three                      | Fitch | Standard & Poors | Moody's |
| <b>Sovereign</b>                      | AA-   | AA-              | Aa3     |
| <b>Long Term</b>                      | A     | A                | A2      |
| <b>Money Market Funds</b>             | AAA   | AAAm             | Aaa/MR1 |

#### **Additional Minimum Rating Criteria/Limits in Place**

In addition to the Link's creditworthiness recommendations, the Council has also set **further minimum credit requirements** that restrict the number of acceptable counterparties further to meet its low risk appetite. (See previous table and below).

- **A minimum Sovereign (Country) Rating from a minimum of two rating agencies of AA-.\***
- **A minimum Long Term Rating from a minimum of two rating agencies of A or equivalent.\*\***
- **A limit of a maximum of no more than 20% of total investments to be placed with any one bank/group, corporate or building society sector - to ensure diversification of investments. (With exception of Part UK Nationalised Banks\*\*\* which are deemed to bear same low risk as UK Government).**

#### \*Sovereign Rating

Credit Rating Agencies have removed the effect of Sovereign Support from an entities individual rating. This now makes it more important to focus solely on the ratings of an entity itself within an investment strategy. A minimum Sovereign limit of AA- is in line with Link's creditworthiness policy and will allow greater depth and diversification to the Council's Counterparty list, while still maintaining the tenets of security and liquidity.

#### \*\* Long Term Rating

The definition of an A rating is 'High Credit quality with low expectation of credit risk, with a strong capacity for timely payment of financial commitments'. Ratings can also be assigned a "+" or "-" to denote the relative status within a rating category, but the category still has the same definition regardless of a "+" or "-". For reference, Link's credit worthiness matrix uses a minimum Long Term Rating level of A-.

#### \*\*\* Nationalised or semi nationalised UK Banks:-

As a result of the banking crisis which started in 2008, Governments across the world had to inject capital directly into banks to support their capital ratios and to avoid failure of financial institutions. Several banks were nationalised or part nationalised in this way.

These nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by Councils to identify banks which are of high credit worthiness. As they are no longer separate institutions in their own right, their individual ratings, which assess their stand-alone financial strength, are impaired. However, it is considered that institutions that have been nationalised or part nationalised effectively take on the creditworthiness of the Government itself and as such UK nationalised or semi nationalised banks are included within the Council's acceptable investment criteria and will continue to do so as long as they remain semi nationalised. At the time of writing, the only UK Bank falling into this category is now the Royal Bank of Scotland Group, which includes National Westminster Bank.

#### Barclays Bank plc

Barclays Bank plc is the Council's banker at present and therefore the Council have an intra-day financial exposure to Barclays Bank on a daily basis. This intra-day exposure will not be included with limits set for Barclays as part of the Annual Investment Strategy. When it is not financially viable to make an investment, a cash balance will be left at the bank overnight, so long as Barclays Bank remains on Link's recommended Counterparty list.

## **Authorised Lending List**

The Executive Director of Resources has delegated responsibility to produce an ‘**Approved Lending List**’ of acceptable counterparties to whom the Council will lend its surplus cash and this is derived from the credit criteria above.

**Annex G** shows this Lending List as at 1<sup>st</sup> April 2022 together with definitions of credit ratings, watches and credit default swaps. The limits on the Lending List are set in ranges depending on the level of average cash investment balance.

## **Monitoring**

The credit ratings of counterparties are monitored on an ongoing basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link 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 CDS prices of Counterparties against the iTraxx benchmark<sup>2</sup> and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or suspension from the Council’s lending list.

The Council is satisfied that this service gives an improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources. However sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and other market information, from various sources such as the internet, portals, brokers, government, CIPFA etc.

## **Additions to Non-Specified Investment List**

Proposals to invest in any other non-specified investment will be referred to the Executive Director of Resources for approval after first seeking the advice of the Council's treasury advisors, Link Asset Services Ltd. If approved by the Executive Director, a recommendation for the change to the Annual Investment Strategy will be sought from the Executive Councillor for Resources, Communications and Commissioning.

## **Liquidity of Treasury Investments**

Prudential Code Indicator (No 11) sets a voluntary total limit for investments over 365 days at any one time as **£40 million**, see Annex C. This limit reflects a prudent proportion of the Council’s estimated level of core cash balances available to invest for longer periods. The Executive Councillor for Resources, Communications and Commissioning will be informed on any occasion when investments are lent for over 12 months.

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<sup>2</sup> iTraxx Senior Financials Index that measures the “average” level of the most liquid financial CDS prices in the CDS market.

In determining the amount of funds that can prudently be committed for more than 12 months, consideration will be given to the following factors:

- Long Term Cash Flow Forecasts of the Council and Balance Sheet Review - 3 years ahead showing:
  - Projected core cash balances over the term of proposed investment.
  - Foreseeable spending needs over the term of proposed investment.
  - Level of provision for contingencies.
  - Acceptable level of reserves.