Investment Strategy 2016-17

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £9.6 million and £95.1 million. It is anticipated that balances will be lower next year as debt is repaid. The impact on the value of cash balances from capital expenditure and the timing of any associated debt financing are uncertain.

Objectives: Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving unsuitably low investment income.

Strategy: Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2016/17. The majority of the Authorities surplus cash is currently invested in short-term unsecured bank deposits, bank CDs and money market funds. These investments are exposed to bank bail in risk. To reduce the exposure to unsecured bank deposits, the counterparty policy has been expanded to include quasi government institutions; Supranational banks. Covered bonds are now identified separately from unsecured bank deposits as these deposits are of lower risk being both secured on collateral and possessing a bank issuer guarantee. During 2015 the Council commenced using treasury bills and certificates of deposits (CDs). The latter provides access to a greater range of counterparties who do not take fixed terms deposits e.g. overseas banks. This diversification has enabled the limit per counterparty for individual banks to be reduced from £20 million to £10 million. Similarly for local authority deposits the maximum exposure is halved to £15 million. These changes also reflect the anticipation that cash balances will remain at or below recent levels as part of the policy to minimise new long term borrowing.

Credit Scoring: Arlingclose, the Council's treasury management advisers, has a way of scoring the level of credit risk the Council is taking. This measure scores credit risk on a scale of 0 to 10 on both a value weighted and a time weighted basis and the table below demonstrates how to interpret the scores:

Above target	AAA to AA+	Score 0 - 2
Target score	AA to A+	Score 3 - 5
Below target	Below A+	Score over 5

The quarterly scores during 2015-16 have been within the range 2.70 to 5.63, which is partially outside of the target score following the reduction in Barclay's credit rating. Action was taken during October to return to within the target. For the next three years the target will remain 3 to 5.

Specified and Non-specified Investments: Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Instruments proposed for the Council's use within its investment strategy are contained in Annex 4, which also explains the meaning of these terms. The list of proposed counterparties is shown in Annex 5. In keeping with the strategy of maintaining high quality counterparties, at least 50% of all investments will be specified investments.

Although cash balances will be low at certain times, there tends to remain a core balance that is capable of being invested for more than twelve months. On occasions investments with a maturity of slightly in excess of 12 months can offer exceptional good value. For this reason, the strategy allows a maximum of £10 million to be invested for over 12 months but less than 24 months. The Chief Financial Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Investment activity will be reported to Corporate Committee as part of the quarterly reports.

Credit Rating: Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then no new investments will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Liquidity Management: The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments.

Counterparty Policy

The investment instruments identified for use in 2015-16 are listed in the table. Each investment type is classified as either 'Specified' or 'Non – Specified' investment categories. Specified investments are considered low risk and relate to funds invested for up to one year. Only those investments with a credit rating of at least AA- are considered as specified. Non-specified investments normally offer the prospect of higher returns but carry higher risk and may have a maturity beyond one year. At least 50% of investments held will be specified. All investments are sterling denominated.

As discussed in the borrowing strategy the plan during 2016-17 is to rely on short term debt and minimise cash balances. This will lead to a high proportion short dated and tradable instruments e.g. money market funds, T-bills, CDs and DMO within the cash portfolio to cover liquidity needs.

Investments do not include capital expenditure as defined under section 25(1) (d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

Minimum Credit Quality & diversification Limits

For credit rated counterparties, the minimum criteria will be the lowest equivalent long-term ratings assigned by Fitch, Moody's and Standard & Poor's (where assigned) as below:

Long-term minimum: A- (Fitch); A3 (Moody's); A- (S&P)

The Council will also take into account the range of information on investment counterparties detailed in 'other information' section above.

The limits stated in the table below will apply across the total portfolio operated by the Council and so incorporate both Council and Pension Fund specific investments. The limits for the period of investment are the maximum for the categories of counterparties. Lower operational limits will apply if recommended following a review of creditworthiness. Operationally a limit will be applied to the amount invested in any MMF of no more than 2.0% of the Money Market Fund's total assets.

Non UK Banks

The use of non-UK banks was suspended pre April 2015. Six countries retain AAA ratings from all three rating agencies – Australia, Canada, Denmark, Germany, Singapore, Sweden and Switzerland. Within these countries twelve banks meet the AA- or better criteria mentioned above and these have been included as eligible counterparties (annex 5). Using the highest quality overseas banks will both improve the overall security of the investment portfolio and enable greater diversification.

Maturities Guidance

At present maturities have been kept to less than 12 months reflecting the expectation that cash balances will be maintained at low levels. However, there remains a core cash balance that persists over time. Longer maturities attract higher returns at present to compensate for illiquidity and the prospect of increased base rates in future. The strategy has been revised to permit a maximum of £10 million to be invested between 12 – 24 months.

Institution Type	Minimum Credit Rating	Maximum Counterparty Limit	Maximum Period of Investment	Specified / Unspecified
Debt Management Office	UK Government	No limit	364 days	specified
Gilts, Treasury Bill & Repos	UK Government	No limit £10 million	364 days 24 months	Specified non-specified
Supra-national Banks & European Agency	AA-	£10 million £5 million	364 days 24 months	specified non-specified
Covered Bonds issued by UK Banks	Bond AA+ / counterparty A- Bond AA+ / Counterparty BBB+ Bond AA+ / counterparty A-	£5 million per bond, £20 million aggregate £5 million per bond, £10 million aggregate £5 million per bond, £10 million aggregate	364 days 364 days 24 months	Specified Non-specified non-Specified
UK Local Authority Deposits	n/a	£15 million per counterparty £5 million per counterparty	364 days 24 months	specified non-specified
UK & AAA country Banks - term deposits, CDs and call accounts	AA- AA- A-	£10 million per bank or banking group £5 million per bank or banking group £5 million per bank or banking group	364 days 24 months 364 days	specified non-specified non-specified
Constant Net Asset Value Money Market Funds (MMFs), UK / Ireland / Luxembourg domiciled Variable NAV Enhanced Cash Funds, UK/Ireland/Luxembourg domiciled	AAA AAA	£10 million per MMF. Aggregate £50 million. £5m per ECF. Group limit £15m	daily liquidity Minimum Weekly Redemption	specified non-specified

Additional Details on Types of Investments

Banks and Building Society Deposits, Call Accounts and Certificates of Deposit: These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Banks Covered Bonds: These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in.

Money Market and Enhanced Cash Funds: Shares in diversified investment vehicles consisting of time deposits, call accounts, CDs etc with banks and financial institutions. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while Enhanced Cash Funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

ANNEX 5

Lending List of counterparties for investments

This is the proposed list of bank counterparties which the Council can lend to, providing the counterparties meet the requirements set out in Annex 4 at the time of investment. The list will be kept under constant review and counterparties removed if the process described in the investment strategy raises any concerns about their credit worthiness. In addition to the counterparties listed below, UK government, local authorities, money market funds and enhanced cash funds are included in annex 4.

Instrument		Country/ Domicile	Counterparty	Arlingclose Suggested max maturity
Supranational Banks			European Bank for Reconstruction and Development	24 months
			European Investment Bank	24 months
			Inter-American Development Bank	24 months
			International Bank for Reconstruction & Development	24 months
UK Banks and Building Societies- Term Deposits, Call Accounts & CDs		UK	HSBC Bank Plc	13 months
		UK	Standard Chartered Bank	6 months
		UK	Barclays Bank Plc	100 days
		UK	Lloyds Banking Group including Bank of Scotland	13 months
		UK	Santander UK	6 months
		UK	Nationwide Building Society	6 months
		UK	Coventry Building Society	6 months
Non-UK Banks - Term Deposits, Call Accounts and CDs		Australia	Australia & New Zealand Banking Group	6 months
		Australia	National Australian Bank	6 months
		Australia	Commonwealth Bank of Australia	6 months
	new	Australia	Westpac Banking Group	6 months
	new	Canada	Bank of Montreal	13 months
	new	Canada	Royal Bank of Canada	13 months
	new	Canada	Toronto-Dominion Bank	13 months
	new	Singapore	DBS Bank	13 months
	new	Singapore	Overseas-Chinese Banking Corp	13 months
	new	Singapore	United Overseas Bank	13 months
		Sweden	Nordea Bank	13 months
		Sweden	Svenska Handelsbanken	13 months
Covered Bonds issued by UK Banks & Building Soc		UK	UK Banks and Buildings societies listed above.	24 months
			Royal Bank of Scotland	24 months

NB: max maturity capped at 24 months.

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Compared with last year, no counterparties have been deleted and no UK banks added. The four supranational banks are new additions. All are AAA rated by the three rating agencies. These banks raise funds via CDs. The Arlingclose support maximum maturities of up to 5 years for AAA rated supranational banks.

Eight overseas banks have been added to the counterparty list. All are rated AA- or better by all three rating agencies. These banks rarely take deposits in the UK but can be accessed through CDs. There are currently no overseas banks in the portfolio. In addition to the limits set out in annex 4, a limit of £5 million per bank and £10 million per Non-UK country will be applied.

Investments in covered bonds are limited to UK banks and building societies. In addition to those banks and building societies eligible for unsecured deposits, Royal Bank of Scotland has been added for covered deposits. Covered deposits offer additional default protection due to the provision of collateral as security.

The counterparty list excludes MMF and ECF's as the name of the fund reflects the fund manager not the quality of the underlying holdings. Selection of MMFs and ECFs will be based on the criteria set of in Annex 4. The limit for any single MMF is £20 million and each ECF is £5 million.

Should Arlingclose reduce the maximum recommended maturity guidance for any bank, this will be reflected in the portfolio.