

**REPORT TO:** Executive Board

**DATE:** 26 June 2014

**REPORTING OFFICER:** Operational Director – Finance

**PORTFOLIO:** Resources

**TITLE:** Revised Treasury Management Investment Strategy 2014/15

**WARDS:** Borough-wide

## **1.0 PURPOSE OF REPORT**

1.1 The purpose of this report is to propose revisions to the Council's Treasury Management Investment Strategy for 2014/15 in respect of the approved counterparty list and limits, in line with advice from Capita Asset Services who are the Council's Treasury Management advisers.

**2.0 RECOMMENDATION: That the Council adopt the revised Treasury Management Investment Strategy and Counterparty List, as shown in the appendices.**

## **3.0 SUPPORTING INFORMATION**

3.1 The Treasury Management Strategy for 2014/15 was approved by Council on 5<sup>th</sup> March 2014. Included within the Strategy was an Investment Strategy which set out a specific list of investment counterparties and maximum limits the Council would invest with each.

3.2 The Council's treasury management advisers Capita Asset Services, have advised that the counterparty list is somewhat restrictive and therefore opportunities may be missed to utilise different counterparties whilst still maintaining the Council's prudent policy of prioritising security and liquidity over investment yield.

3.3 Rather than naming specific counterparties, they advise that the Council should maintain a counterparty list based upon specifying the type of institution which the Council will invest with, dependent upon the counterparty meeting a minimum credit rating. Research has identified that most other councils now have their counterparty list on this non-specific basis. A revised counterparty list on this basis is therefore shown in Appendix B.

3.4 The Council uses a creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from all three rating agencies; Fitch, Moody's and Standard and Poors.

- 3.5 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 weight to just one agency's ratings. The Council's creditworthiness policy is set out within the Treasury Management Investment Strategy which is shown in Appendix A.
- 3.6 It will be particularly important for the Council to have such improved flexibility regarding its counterparties, as opportunities are taken to borrow in preparation for the Council making its contribution to the Mersey Gateway construction costs.
- 3.7 The proposed revised Counterparty List and Treasury Management Investment Strategy for 2014/15 are shown in the appendices.

#### **4.0 POLICY IMPLICATIONS**

- 4.1 The successful delivery of the Treasury Management Investment Strategy will assist the Council in meeting its budget commitments.

#### **5.0 OTHER IMPLICATIONS**

- 5.1 None.

#### **6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES**

- 6.1 There are no direct implications, however, the Treasury Management Investment Strategy supports the revenue budget and delivery and achievement of all the Council's priorities.

#### **7.0 RISK ANALYSIS**

- 7.1 The Council operates its investment management activity within the approved code of practice and supporting documents. The aim at all times is to operate in an environment where risk is clearly identified and managed. This strategy sets out clear objectives within these guidelines.
- 7.2 Regular monitoring is undertaken during the year and reported on a quarterly basis to the Executive Board.

#### **8.0 EQUALITY AND DIVERSITY ISSUES**

- 8.1 None.

#### **9.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972**

- 9.1 There are no background papers under the meaning of the Act.

**2014/15 ANNUAL INVESTMENT STRATEGY**

- 1.1 The Council will have regard to CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:-
- (a) the security of capital
  - (b) the liquidity of its investments
- 1.2 The Council will also aim to achieve the optimum return (or yield) on its investments commensurate with proper levels of security and liquidity. The risk appetite of the Council is low in order to give priority to security of its investments.
- 1.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.
- 1.4 Investment instruments identified for use in the financial year are listed under the 'Specified' and 'Non-Specified' investments categories.

Specified v Non-Specified Investments

- 1.5 There have been an increasing number of innovative investment products being marketed over recent years. They have arisen due to the relatively low interest rate environment which has prevailed during this period. The initial guidance from the CLG focused on high security and more particularly credit risk. This approach however does not deal with market risk, which is the sudden adverse movement in interest rates. In some products this could lead to a significant diminution of the maturity value below that of the original sum invested.
- 1.6 Because of this it has been suggested that if any investment other than a straight cash deposit is envisaged, the following tests are applied;-
- 1. the working of the product is fully understood;
  - 2. the degree of risk exposure the product carries is identified;
  - 3. the level of risk fits within the parameters set by the authority;

4. the product complies with the CIPFA Code of Practice on Treasury Management (prime focus on security and best value applied to optimise returns).

1.7 The Council has previously used straightforward cash deposits, with both fixed and variable rates, but always with options to repay if the counterparty wanted to change the terms and agreement couldn't be reached. The issue therefore still boils down to credit risk and this is handled through the counterparty weighted rankings.

Specified Investments:

1.8 All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' credit quality where applicable (i.e. credit rated counterparties).

	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
UK Government Gilts	UK Only (AA)	In house
Bonds Issued by an Institution guaranteed by the UK government	UK Only (AA)	In house
Term Deposits – UK Government	--	In-house
Term Deposits – Other LAs	--	In-house
Term Deposits – UK Banks and Building Societies	Minimum credit rating of A or above	In-house
Term Deposits – Non UK Banks	Countries with a minimum sovereign rating of AAA	In-house
Certificate of Deposits	Minimum credit rating of A or above	In-house

If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

Non-Specified Investments:

1.9 A maximum of 30% will be held in aggregate in non-specified investments for 2-3 years and 60% for 1-2 years. This group can include non-credit rated organisations but with caution.

	Minimum Credit Criteria	Use	Max % of Total Investments	Max. Maturity Period
Term deposits – UK government (with maturities in excess of 1 year)	-	In-house	30% 60%	2-3 years 1-2 years
Term deposits – other LAs (with maturities in excess of 1 year)	-	In-house	30% 60%	2-3 years 1-2 years
Term deposits – UK banks and building societies (with maturities in excess of 1 year)	Minimum credit rating of A or above	In-house	30% 60%	2-3 years 1-2 years

### Investment Strategy

- 1.10 In-house funds: Investments will be made with reference to cash flow requirements and the outlook for short term interest rates (i.e. rates for investments up to 12 months).
- 1.11 The Council has avoided locking into longer term deals while investment rates are down at historically low levels, and has chosen instead to finance the capital programme by running down investment balances.
- 1.12 The interest rate outlook is particularly relevant to the performance of the Council's investment portfolio. The timing of any increase in investment rates will be subject to the speed of economic recovery.
- 1.13 The Council has placed much of its current portfolio into fixed rate, fixed period deals. The Council's policy will be to explore the availability of variable rate investments, whilst prioritising security and liquidity over yield in order to optimise a return commensurate with the principal invested. The Council will also continue to run down the level of investments, to reduce counterparty and interest rate exposure whilst waiting for the opportune time to borrow to fund its long term capital projects. This policy will minimise the impact of low investment rates.
- 1.14 For its cash flow generated balances, the Council will seek to utilise its business reserve account, Handelsbanken call account and short-dated deposits (1-3 months) in order to benefit from the compounding of interest.

### End of year Investment Report

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

## **CREDITWORTHINESS POLICY**

- 1.16 The Council uses the creditworthiness service provided by Capita Asset Services. This service 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:
  - credit watches and credit outlooks from credit rating agencies
  - Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
  - sovereign ratings to select counterparties from only the most creditworthy countries
- 1.17 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 code bands

which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments and are therefore referred to as durational bands

1.18 The selection of counterparties with a high level of creditworthiness will be achieved by selecting institutions down to a minimum durational band within Capita's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised/semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

1.19 All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Capita 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 against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

1.20 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on government support for banks and the credit ratings of that Government support.

## Appendix B

### Counterparty List and Limits for 2014/15

The table below shows the amount of Council Funds that can be invested with individual counterparties.

	Maximum Limit
	£m
UK Government	30.00
Nationalised and Part Nationalised Banks with a minimum rating of A	30.00
UK Banks/Building Societies with a minimum rating of AAA	30.00
UK Banks/Building Societies with a minimum rating of AA	20.00
UK Banks/Building Societies with a minimum rating of A	10.00
Foreign Banks in countries with a sovereign rating of AAA and;	
Minimum rating of AAA	20.00
Minimum rating of AA	10.00
Local Authorities	20.00

Note: No more than 25% of the total portfolio will be placed with any one institution, except where balances are held for cash-flow generated purposes.