Investment and Borrowing Strategy

The Councils Borrowing and Investment Position

1. The Council currently has no external borrowing as at 30 November 2016.

2. As at 30 November 2016 the Council held £83.1m of Investments. £81.1m of these are held to less than one year's maturity with the remainder held for longer than a year.

3. According to current cash flow forecasts, net investments are projected to be £61.6 million by 31 March 2017 and to £50.8 million by 31 March 2018.

4. The budget for investment income in 2017/18 is £521k, based on an average investment portfolio of £72.2 million at an interest rate of 0.70%. If actual levels of investments and borrowing, and actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Investment Strategy

5. The Council holds significant surplus funds, representing income received in advance of expenditure, plus balances and reserves. Both the CIPFA Code and the CLG Guidance require the Council 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**.

<u>Specified investments</u>

6. Specified investments are those expected to offer relatively high security and high liquidity, and can be entered into with the minimum of formalities. The CLG Guidance defines specified investments as those:

   - Denominated in pound sterling
   - Due to be repaid within 12 months of arrangement,
   - Not defined as capital expenditure by legislation, and
   - Invested with one of:
     - The UK Government
     - A UK local authority, parish council, or community council, or
     - A body or investment scheme of "high credit quality"

7. The Council defines the following as being of "high credit quality" for making specified investments, subject to the monetary and time limits shown.

Table 1.1 – Specified investment limits 2017/18

	Monetary limit
Banks and building societies (including Supranationals) holding long-term credit ratings[1] no lower than AA- or equivalent. (either UK based or domiciled in a country with a AA rating)	£6m each
Banks and building societies holding long-term credit ratings no lower than A or equivalent (either UK based or domiciled in a country with a AA rating)	£5m each
UK building societies holding a long-term credit rating no lower than A- or equivalent.	£4m
Other Financial institutions in which the UK government has a substantial financial stake in excess of 50% or is providing support subject to a notice period – for example the Council's banking services provider Natwest Plc.	£4m
Money market funds[1] holding credit ratings no lower than AAA	£7.5m per fund and £15m per fund administrator
UK Central Government (DMO DMADF and Gilts)	Unlimited
Supranationals	£5m each
UK Local Authorities[2]	£7.5m each

1 AS DEFINED IN THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) REGULATIONS 2003

2 AS DEFINED IN THE LOCAL GOVERNMENT ACT 2003

Change from 2016/17 Strategy – Limits for Banks and Building societies with a credit rating higher than BBB+ have been increased by £1m to ensure adequate avenues for placing cash without diluting the credit quality of the Council's counterparties. This action is in response to the cut in interest rates and a fall in demand for Local Authority deposits due to increased requirements for financial institutions to set aside corresponding capital against deposits.

8. Counterparties are only required to meet the minimum credit rating with one of the rating agencies and the Council will take the highest rating for investment purposes. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

9. Investments may not be restricted to banks and building society deposits, but may be made with any public or private sector organisation providing that it meets the credit rating criteria above. This reflects a lower likelihood that central government will support failing banks following new Bail in

Regulations, as well as the removal of restrictions on local authority purchases of corporate bonds.

10. The Council's revenue reserves available to cover investment losses are forecast to be £51.2 million at 31st March 2017. In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £7.5 million. This will be kept under regular review.

Building societies

11. The Council will restrict deposits to UK building societies that hold credit ratings of A- or above. The Council will not place deposits with Building Societies that are not rated by one or more the main Credit Rating Agencies.

Money market funds

12. Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council.

13. Individual Money Market Fund managers operate several different funds. These have different objectives but are essentially the same in nature in terms of diversification of underlying investments. Investments may be invested in more than one fund run by the same fund manager, with an overall limit of £15m per fund manager.

14. Funds that offer same-day liquidity and a constant net asset value will be used as an alternative to instant access call accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment period.

Collateralised investments

15. Where the Council makes an investment with an organisation that is secured on collateral in a third party (e.g. a reverse repo or a collateralised deposit), the time limit may be extended to match the limit given above for the third party. However, the investment will still count against the cash limit of the organisation receiving the funds.

Non-specified investments

16. Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any with low credit quality bodies nor any that are defined as capital expenditure by legislation, such as company shares.

17. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of

arrangement. The maximum duration of the investment will depend upon its lowest published long-term credit rating:

Table 1.2 – Non Specified Investment Criteria

Long-term credit rating	Time limit
AAA	5 years
AA+	4 years
AA	3 years
A+ to AA-	2 years

18. The time limit for long-term investments in UK local authorities will be three years and in UK government 25 years.

19. Long-term investments will be limited to £3m per organisation except the UK Government which will be unlimited and Local Authorities (as defined in the 2003 Local Government Act) which will be £7.5m individually. The combined value of short-term and long-term investments with any organisation will not exceed the limits for specified investments outlined above.

20. The total limit on long-term investments and non-specified investments is £40 million.

<u>Property Fund</u>

21. The Council has direct property investments within the Wycombe District Council area amounting to £104.95m at 31 March 2016.

22. As part of its Treasury Management Strategy, the Council may seek to invest in an indirect property fund. This would be managed by a fund manager and may invest in properties across the UK or internationally. The Council would hold a shareholding in the fund based on the value of its investment.

23. Property Funds in the UK can provide returns of 4-6% at present together with capital appreciation. This is considerably more than the average of 0.7% currently being achieved on the Council's treasury investments. However, capital values can go down as well as up. The investment would also be long term and there are potential entry and exit fees. The Council will not invest more than £7.5m in indirect property funds.

24. One further consideration is whether such an investment would be considered capital expenditure or not. The Authority will seek guidance on the status of any fund and due diligence will be undertaken by the Head of Finance and Commercial and the Portfolio Holder before any investment is made.

Other Consideration

25. The criteria for choosing counterparties set out above provide a sound approach to investment in “normal” market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions, the Chief Financial Officer will temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to “normal” conditions. Similarly the time periods for investments may be restricted.

26. In practice the strategy currently means that it is unlikely that any investments other than in local authorities and UK government will be longer than two years, as bank long term ratings have been reduced substantially over recent years.

Risk assessment and credit ratings

27. The Council uses long-term credit ratings from the three main rating agencies, Fitch Ratings Ltd, Moody’s Investors Service Inc, and Standard & Poor’s Financial Services LLC, to assess the risk of investment default. A counterparty needs to meet the minimum rating criteria from at least one of the rating agencies.

28. Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council’s credit rating criteria are set to ensure that it is very unlikely the Council will hold speculative grade investments, despite the possibility of repeated downgrades.

29. Credit ratings are obtained and monitored by the Council’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 above criteria then:

- no new investments will be made,
- any existing investments that can be recalled at no cost will be recalled, and
- full consideration will be given to the recall of any other existing investments.

30. Where a credit rating agency announces that it is actively reviewing an organisation’s credit ratings with a view to downgrading it (also known as “negative rating watch”) so that it is likely to fall below the above criteria, then the Head of Finance and Commercial will consider suspending any further investments pending the outcome of the rating agency review. If after taking advice from the Council’s Treasury Management Advisors he/she is satisfied that there is no implied increase risk of default from the Counterparty then the Counterparty will continue to be used subject to meeting all other elements of the Council’s Investment criteria.

31. If rising balances and/or falling credit ratings mean that insufficient banks of "high credit quality" are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office, for example.

<u>Other information on the security of investments</u>

32. The Council 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 banks and building societies, including credit default swap prices, financial statements and rating agency reports. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.

<u>Foreign countries</u>

33. Investments in foreign countries will be limited to those that hold an AAA, AA+ or AA, sovereign credit rating from all three major credit rating agencies, and to a maximum of £10 million per foreign country. Banks that are domiciled in one country but are owned in another country will need to meet the rating criteria of and will count against the limit for both countries. There is no limit on investments in the UK irrespective of the credit rating.

34. Investments in countries whose rating is not AAA will be limited to one year's duration. Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union

<u>Investment instruments</u>

35. Investments may be made using any of the following instruments:

- Interest paying bank accounts
- Fixed term deposits
- Call or notice deposits (where the Council can demand repayment)
- Certificates of deposit
- Treasury bills and gilts issued by the UK government
- Bonds issued by multilateral development banks (e.g. the EIB)
- Shares in money market funds
- Shares in Enhanced Cash Funds

36. Investments may be made at either a fixed rate of interest, or at a variable rate (which may or may not be linked to a market interest rate, such as LIBOR).

Liquidity management

37. The Council uses spreadsheets to forecast cash flow to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. The forecast allows for a cushion of between £5million and £7million to be held on instant access deposit at all times.

38. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

Planned investment strategy for 2017/18

39. The cash flow forecast will be used to divide surplus funds into three categories:

    - Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
    - Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned use of reserves, and a longer-term contingency
    - Long-term – cash not required to meet cash flows, and used primarily to generate investment income

40. Short-term funds are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash.

41. Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity, but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks, UK building societies and local authorities. A wide spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks; this may be achieved by the use of suitable medium-term money market funds. Deposits with lower credit quality names will be made for shorter periods only, while deposits with higher quality names can be made for longer durations.

42. Cash that is not required to meet any liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local authority services. Security remains important, as any losses from defaults will impact on the total return, but, fluctuations in price, and even occasional losses, can be managed over the long term within a diversified portfolio. Liquidity is of less concern, although it should still be

possible to sell investments, with due notice, if large spending commitments arise unexpectedly. The Council employs external fund managers that have the skills and resources to manage the risks inherent in a portfolio of long-term investments. This allows the Council to diversify into a wider range of instruments, including certificates of deposit, and gilts.

Borrowing Strategy

43. The Council had no external borrowing. However the Council has internally borrowed from existing balances to fund its capital programme. The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31 March 2017 is expected to be £7.3 million.

44. In addition, the Council may borrow for short periods of time (up to two weeks) to cover unexpected cash flow shortages, though because of its cash flow projections outlined above this should prove unnecessary.

Sources of borrowing

45. The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- Any institution approved for investments above
- Any other bank or building society approved by the Financial Services Authority

Debt Instruments

46. As an alternative to borrowing, the Council may finance capital expenditure and incur long-term liabilities by means of leases. However, there are no immediate plans to use this other than in respect of embedded leases within the Joint Waste Collection Contract.

Treasury Management Indicators

47. The Council measures its exposures to treasury management risks using the following indicators. The Council is asked to approve the following indicators:

Security: average credit rating

48. The Council is asked to adopt a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

Table 1.3 – Average Investment Credit Rating

	Target
Portfolio average credit rating	A

49. For the purpose of this indicator, unrated local authorities are assumed to hold an AA+ rating. *The target average credit rating of 'A' is unchanged from the 2015/16 strategy.*

Liquidity: cash available within three months

50. The Council is asked to adopt a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period. This target is set at a minimum of £5 million without temporary borrowing, and £7 million with temporary borrowing. This range has been increased to reflect the higher level of expenditure being paid on Major Projects.

Interest rate exposures

51. This limit is set to control the Council's exposure to interest rate risk. In order to keep as much flexibility as possible in the investment and borrowing strategies these have been kept deliberately high. It is extremely unlikely that borrowing will be fixed over the next three years, but this does allow for that possibility. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed is:

Table 1.4 Net Principal Borrowed Interest Rate Exposures

	2017/18	2018/19	2019/20
	£m	£m	£m
Upper limit on fixed interest rate exposures	5	5	5
Upper limit on variable interest rate exposures	5	5	5

52. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity structure of borrowing

53. This limit is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 1.5 – Fixed borrowing 'Upper' and 'Lower' Limits

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within five years	100%	0%
Five years and within 10 years	100%	0%

10 years and above	100%	0%

54. This indicator applies to the financial years 2016/17, 2017/18, and 2018/19. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. These limits provide flexibility should the Council decide to enter into any new borrowing.

Principal sums invested for periods longer than 364 days

55. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond one year will be:

Table 1.6 – Overall investment limits >1 year

	2017/18	2018/19	2019/20
Limit on principal invested beyond year end	£42m	£40m	£38m

Borrowing limits

56. The Council is being asked to approve these Prudential Indicators as part of the Prudential indicator report. These limits consist of a limit for external borrowing (loans) from third parties and 'Other Long Term Liabilities' which cover Finance Leases. This second element includes the Council's Financial Liabilities under the Waste Collection contract for both Vehicles and Bin Recepticles. These limits are unchanged from 2015/16.

Table 1.7 – Operational boundary

	2017/18	2018/19	2019/20
Operational boundary – borrowing	£10m	£10m	£10m
Operational boundary – other long-term liabilities	£8m	£8m	£8m
Operational boundary – TOTAL	£18m	£18m	£18m

Table 1.8 – Authorised limit for external debt

	2017/18	2018/19	2019/20
Authorised Limit – borrowing	£10m	£10m	£10m
Authorised Limit – other long-term liabilities	£9m	£9m	£9m
Authorised Limit – TOTAL	£19m	£19m	£19m

Other Matters

57. The CLG Investment Guidance requires the Council to note the following matters each year as part of the investment strategy:

<u>Treasury management advisers</u>

58. The Council is currently in contract with Capita Asset Services to provide advice and information relating to its investment and borrowing activities. However, responsibility for final decision making remains with the Council and its officers. The services received include:

- Advice and guidance on relevant policies, strategies, and reports
- Advice on investment decisions
- Notification of credit ratings and changes
- Other information on credit quality
- Advice on debt management decisions
- Accounting advice
- Reports on treasury performance
- Forecasts of interest rates, and
- Training courses

59. The quality of this service is controlled by half yearly review meetings.

<u>Investment Training</u>

60. The needs for training of the Council's treasury management staff in investment management are assessed periodically as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

61. Staff regularly attend training courses, seminars and conferences provided by Capita Asset Services and CIPFA.

<u>Investment of money borrowed in advance of need</u>

62. The Council could, from time to time, borrow in advance of spending need where this is expected to provide the best long term value for money. Since amounts borrowed would be invested until spent, the Council is aware that it would be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks would be managed as part of the Council's overall management of its treasury risks.

63. Any total amount borrowed would not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure would be expected to be two years, although the Council does not link particular loans with particular items of expenditure.