APPENDIX 1

The Annual Investment Strategy 2022/23

1. Background

1.1 The Council will adhere to the Local Government Investment (Scotland) Regulations 2010 (the Regulations), the CIPFA Prudential Code and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Code") which was revised in 2017.

1.2 Both the Regulations and the CIPFA Code 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. The Council'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 of receiving very low interest rates on investments. Where balances are invested for more than one year, the council will endeavour to achieve a total return that is at least equal to the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

1.3 The Annual Investment Strategy covers:

- Creditworthiness Policy
- Investment Strategy
- Permitted Investments
- Non Treasury Investments

2. Creditworthiness Policy

2.1 The Council's creditworthiness policy has been formulated after consultation with Arlingclose, the Council's treasury advisers.

2.2 In addition to credit ratings provided by the three main credit rating agencies; Fitch, Moodys and Standard & Poor, the following tools are used to assess credit risk:

- Sovereign support mechanisms
- Credit default swaps (where quoted)
- Share prices (where available)
- Corporate developments, news articles, market sentiment and momentum

2.3 The Chief Financial Officer maintains a counterparty list in compliance with the minimum criteria detailed in 2.4 which is submitted to the Council for approval as necessary. All credit ratings are monitored on an ongoing basis and the counterparty list is amended to reflect any changes. The current Counterparty List is shown as **APPENDIX 2**.

2.4 The current minimum criteria was approved by Full Council on 27 February 2019 (Para 5 refers) and it is not proposed to alter these.

The Council's minimum criteria are:

- Banks – the Council will use banks which have at least the following Fitch or equivalent ratings.

    - Long Term: BBB+

- Building Societies – the Council will include Societies which meet the criteria for Banks outlined above.

- Money Market Funds – Long Term: AAAmmf (Fitch) or equivalent.

2.5 The Council banks with Bank of Scotland and at the current time it meets the minimum credit criteria. However, if the credit rating falls below the Council's minimum criteria, Bank of Scotland will continue to be used for short-term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

3. Investment Strategy

3.1 The Local Government Investments (Scotland) Regulations 2010 states that Local Authorities are required to adopt a strategy that identifies the different types of treasury risk for the type of investments utilised. A local authority may invest money for any purpose relevant to its functions under any enactment, or for the purposes of prudent management of its financial affairs. Such investments or types of investments are defined as permitted investments. The risks that these investments are exposed to are credit or security risk (of default); liquidity risk (risk of committing funds to longer term investments); and market risk (effect of market prices on investment value).

3.2 The primary principle governing the Council's investment criteria is the security of capital and liquidity of its investments. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

3.3 The Council's in-house managed funds are mainly derived through cash-flow and the balance on the General Reserve. Investments will accordingly be made with reference to the Council's cash flow requirements and the outlook for short-term interest rates.

3.4 Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved. Therefore a maximum deposit of £5 million can be placed with any one institution at any one time, with the exception of the Council's Bankers when the limit is £10 million.

3.5 Given the Council's requirement for sufficient liquidity for cash flow purposes, the investment strategy continues to focus on the utilisation of an unsecured call account with Council's Banker and money market funds as they offer the best return for investments with instant access.

4. Permitted Investments

4.1 The Council will undertake the most appropriate form of investments in keeping with investment objectives, income and risk management requirements and prudential indicators. The Council may invest its surplus funds with any of the counterparty types in the table detailed in paragraph 4.4 below, subject to the limits shown and ensuring that the Council's environmental and social criteria are met.

4.2 The permitted investments identified for the Council's use are as follows:

- **Debt Management Agency Deposit Facility (DMADF).** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the UK Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. The longest term deposit that can be made with the DMADF is 6 months.

- **Bank (Unsecured).** These are account deposits, certificates of deposit and senior unsecured bonds with banks and building societies. These investments are subject to the risk of credit loss via a bail-in should a bank be failing or likely to fail. Diversifying investments is crucial to managing bail-in risk in addition to determining proportionate counterparty maturity limits. Should the Council's current bank, Bank of Scotland, be rated less than BBB+, investments with them will be restricted to overnight deposits.

- **Banks (Secured).** These are covered bonds, reverse purchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means they are exempt from bail-in.

- **Money Market Funds (MMFs).** MMFs are pooled funds that invest in short-term debt instruments. They provide the benefits of a pooled investment, as investors can participate in a more widely diversified portfolio than they could do individually. Due to the high level of expertise of the fund managers and the very large amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification, very low or no volatility and competitive rates of return.

- **Securities Issued or Guaranteed by Governments**

  a) **Treasury Bills.** These are short-term bills (up to 12 months) issued by the Government and therefore are backed by the sovereign rating of the UK. An advantage compared to a time deposit in the DMADF is that they can be sold if there is a need to access cash at any point in time. However there is a spread between purchase and sale prices so early sales may incur a net cost which would result in a fall in the nominal value of the instrument.

  b) **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK.

- **Lending to other Local Authorities.** Lending to other local authorities will normally be in the form of fixed term deposits for periods up to one year.

4.3 All investments in the table at 4.4 are subject to the following risks:-

1. **Credit and Counter-Party Risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the Council, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the Council's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have a very high level of creditworthiness. Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur.

2. **Liquidity Risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero. In this strategy, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. However while some forms of investment e.g. gilts or corporate bonds can usually be sold immediately if the need arises, there are two caveats: (a) cash may not be available until a settlement date up to three days after the sale and (b) there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer. The column in the table below at section 4.4 headed as 'market risk' will show each investment instrument as being instant access; sale T+1 = transaction date plus one business day before you get the cash, or term i.e. money is locked in until an agreed maturity date.

3. **Market Risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

4. **Interest Rate Risk**: this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances, against which the Council has failed to protect itself adequately. The Council has set

limits for its fixed and variable rate exposure in its previously agreed Treasury Indicators.

5. **Legal and Regulatory Risk:** this is the risk that the Council or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the Council suffers losses accordingly.

6. **Bail-In Risk:** this is the risk, arising from the EU Bank Recovery and Resolution Directive which has been implemented in the UK, that a Bank's creditors and depositors are forced to bear some of the burden of rescuing a failing Bank.

4.4 The following table provides details of the proposed investment limits and maturity periods for Permitted Investments:

	Minimum Credit Criteria (Fitch or Equivalent)	**Liquidity risk**	**Market risk**	**Bail-In Risk**	**Maximum Value of investments**	**Maximum maturity period**
Debt Management Agency Deposit Facility or successor	n/a	term	no	n/a	No Limit	6 months
Term Deposits: Local Authorities	n/a	term	no	n/a	£5m	364 Days
Banks (Unsecured)	Long-Term: BBB+	Instant*	no	yes	£5m (£10m Council's own Bank)	n/a
Banks (Secured)	Long-Term: BBB+	term	no	no	£5m (£10m Council's own Bank)	3 months
Money Market Funds	AAAmmf	instant	no	n/a	0.5% of Money Market Fund size Government Money Market Funds – 2% of Fund size	n/a
Treasury Bills	UK Sovereign Rating	Sale T+1	No (If held to maturity)	n/a	No Limit	12 months
UK Government Gilts	UK Sovereign Rating	Sale T+1	No (If held to maturity)	n/a	No Limit	12 months

***The only investment of this type used is a Call Account with the Council's own Bank.**

4.5 Controls on Treasury Risks

1. **Credit and Counter-Party Risk:** the Council has set minimum credit criteria to determine which counterparties are of high creditworthiness to enable investments to be made safely.

2. **Liquidity Risk:** the Council has cash flow forecasting models to enable it to determine how long investments can be made for and how much can be invested.

3. **Market Risk:** the Council does not directly purchase and/or account for investment instruments which are subject to market risk in terms of fluctuation in their value. If this position changes, instruments exposed to market risk will initially be purchased and held with the intention to hold them until maturity, thus mitigating market risk.

4. **Interest Rate Risk**: the Council manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with minimising risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.

5. **Legal and Regulatory Risk:** the Council will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

6. **Bail-In Risk:** The Council will diversify investments to manage this risk. Any investments subject to the risk of bail-in are restricted to overnight deposits with the Council's own Bank (Call Account).

4.6 Unlimited Investments

4.6.1 The Regulations state that the Council can deem an investment as being 'unlimited' in terms of the maximum amount of the total portfolio that can be put into that type of investment but an explanation must be given for using that category.

4.6.2 The Council has only given the UK Government (Debt Management Agency Deposit Facility, Treasury Bills and Gilts) an unlimited category. This is considered to be the lowest risk form of investment available to local authorities.

5. Non Treasury Investments

5.1 Investments defined in the regulations include the acquisition of properties, share or loan capital. These types of investments may have originally been made for service or policy reasons or for treasury management purposes. Should the Council make an investment which is not listed as a permitted investment, that investment will not be made in accordance with the Consent of Ministers and as such will be *ultra vires.* The exception to this is where the Council makes a financial transaction that relies on separate legislative powers such as loans to third parties.

5.2 General powers to borrow and lend money are conferred by S165 of the Local Government etc (Scotland) Act 1994 and ensuing regulations. Specific regulations for loans to third parties by local authorities are contained in the Housing (Scotland) Act 1987, the Housing (Scotland) Act 2006 and the general power to advance well-being contained in the Local Government in Scotland Act 2003 at section 20. The inclusion of loans to third parties as part of the investments of the Council is to identify the value of local authority monies utilised in this way, monies which would otherwise be available for general investment and give rise to investment income.

5.3 The following table provides a summary of the Councils Non-Treasury Investments at 31 March 2021 and the maximum value of investments that the Council will hold.

	Actual Value at 31 March 2021 £m	**Max Value of Investments £m**
Investment Property * - Council	£0.862m	£10m
Share Holdings - Council	Note **	£0.1m
Loans to 3rd Parties Market Rate - Council	£0.403m	£2.0m
Loans to 3rd parties – Below Market Rate - Council	£0.019m	£0.5m
Investment Property * - Common Good Funds	£2.334m	£12m
Share Holdings - Common Good Funds	Nil	Nil
Loans to 3rd Parties Market Rate – Common Good Funds	Nil	£0.5m
Loans to 3rd parties – Below Market Rate – Common Good Funds	Nil	Nil
Investment Property * - Trust Funds	£0.080m	£1.0m
Share/ Unit Trust Holdings – Trust Funds	£2.863m	£3.5m

Notes

* Investment Properties have been categorised using IFRS guidelines and include both properties acquired for capital appreciation and income generation.

** Although the Council has the following share holdings no value has been attached to them in its current Balance Sheet due to the fact that the Council has no exposure to commercial risk and the Council has not passed on control of any of its assets.

1) 20.44% of total share capital in The Grampian Venture Capital Fund Limited

6. End of Year Investment Report

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