Parish Councils: how should you invest your funds?

With market volatility continuing to fluctuate and short-term interest rates rapidly rising, it may be time to reassess your bank balances and short-term investments for security, liquidity and yield.

A looming recession means it is ever more crucial to ensure **security** of principal is maintained. One way this can be managed is to diversify funds across a number of counterparties to eliminate any sizeable losses. When investing with banks through either call accounts, notice accounts or fixed term deposits, it is important to identify whether your authority is covered by the Financial Services Compensation Scheme (FSCS).

Following discussions with Arlingclose, the FSCS extended its protections in 2015 to include 'small local authorities', which are described as authorities with an annual budget of less than €500,000 (currently £430,000 and updated annually on 3rd July). This means that authorities considered small are granted the same protections as individuals, and deposits of up to £85,000 per UK bank or building society are fully protected. Authorities covered by the scheme should have enough counterparties to ensure accounts do not exceed this limit.

For larger authorities, there is no FSCS protection and an investment strategy should be formed to help set formal criteria for investing. Not all banks run the same risks and, as investors of public money, you will want to ensure you are making your best effort to maximise security. The strategy should include minimum overall acceptable credit criteria as well as duration and monetary limits based on the type of approved counterparty and its creditworthiness. For councils with investments of over £100,000, an investment strategy prepared in line with government investment guidance is a legal requirement.

Maintaining an adequate level of **liquidity** is important to ensure there is funds available to draw down should unexpected costs arise. Keeping a proportion of your portfolio liquid can help avoid incurring expensive borrowing from external sources. Money Market Funds (MMFs) are a useful liquidity tool which also offer diversification.

A MMF is a pooled fund which invests in high credit quality, short-term debt instruments and typically offers daily liquidity. MMFs are actively managed by a fund manager and there are rigid guidelines regarding the makeup and transparency of the fund. For example, the fund must have a weighted average maturity of below 60 days and each holding is limited to no more than 5% of the fund. The principal objectives of a MMF are preservation of capital, high liquidity and competitive returns (or **yield**) commensurate with security and liquidity, aligning them closely with the requirements of the government investment guidance.

In the current high and rising interest rate environment, you also want to ensure you are not bypassing lost income from accounts still paying sub one percent returns. Generally, MMFs can react relatively quickly to rate rises as existing deposits roll off and it invests at higher rates. We have seen this recently with most funds paying close to the current Bank of England base rate.

To discuss our parish council investment advice, please contact the Arlingclose team at info@arlingclose.com