
ANNUAL INVESTMENT STRATEGY 2004/05

**Responsible Cabinet Member(s) – Councillor Don Bristow,
Resource Management Portfolio**

Responsible Director(s) – Paul Wildsmith, Director of Corporate Services

Purpose of Report

1. This report requests Cabinet to review and approve the Annual Investment Strategy section of the Treasury management Strategy for 2004/05.

Summary

2. This is a statutory report that requests the Council to approve an Annual Investment Strategy. New, Office of the Deputy Prime Minister (ODPM), guidance from 1st April 2004 allows an increased number of investment vehicles and permits local authorities to invest for periods greater than 364 days. Investments should be categorised between specified and non- specified investments, both types of investment would normally be included in a strategy. This report requests the approval of both specified and non specified investments within our Strategy and seeks to extend the period which investments can be made from 364 days up to 5 years.

Information and Analysis

Background

3. Members will recall that an Interim Investment Strategy was approved by Council as part of the Treasury Management Strategy along with the Prudential Indicators for 2004/05 on 10th March 2004. The Interim Investment Strategy was produced because at that time, the final outcome of the new investment guidelines from the Office of the Deputy Prime Minister (ODPM) were not known. This new Guidance was produced to coincide with the introduction of the Prudential Code and the new freedoms that this brings with it. The new investment guidelines are now finalised and were issued on 12th March 2004. This report seeks to amend the Annual Investment Strategy part of that document, the Borrowing and Debt Strategy will remain as approved by Council on 10th March 2004.

New Guidance on Local Government Investments

4. The new guidelines show greater flexibility than the current regulations and allow Local Authorities to invest in different investment vehicles and for longer periods. At the moment investments are limited to less than one year.

5. The new vehicles that Local Authorities are allowed to invest in are as follows :-
 - (a) Bonds and gilts with a maturity of more than one year.
 - (b) a financial institution that is guaranteed by the UK Government e.g. The Guaranteed Export Finance Company.
 - (c) Share Capital or loan capital in a body corporate (this type of investment would be deemed as capital expenditure and as such will be an application of spending resources)
6. The guidance advises that investment should be categorised in 2 ways , those which are Specified and those which are Non Specified.
7. Specified investments are:-
 - (a) Deposits with the UK Government
 - (b) Supranational bonds
 - (c) Investments with another local authority, parish council or community council
 - (d) Money Market Funds
 - (e) Banks or Building Societies with a high credit rating

All of which would have an investment period of less than one year
8. Non Specified Investments include
 - (a) Supranational Bonds with a maturity of greater than one year
 - (b) Gilts edged securities with a maturity of more than one year
 - (c) Credit rated Banks or Building Society deposits for more than one year
 - (d) Unrated Building Societies (these deposits would be less than one year)

Share Capital or Loan Capital in a body corporate

With the exception of unrated building societies all of these investments can be for more than one year.
9. Having reviewed the new guidance it is proposed that the Council continues to invest in fixed or variable Sterling Deposits but a proportion of which will be invested in periods of longer than one year.
10. The other investment vehicles have been discounted at this time for the following reason. Gilts, bonds and share/loan Capital require a level of expertise that can only be found by using Fund Managers. The level of core investments that the authority predicts over the Medium Term Financial Plan is approximately £15m per annum. This figure is borderline as regard to whether it would be advantageous in terms of the return on the investments to employ fund managers to manage those investments. After taking into account fees charged and returns likely, it is felt that these investments would be better managed in house. Although this aspect of the Strategy would need to be revisited should circumstances change.
11. The Treasury Management Policy requires an annual strategy to be reported to Cabinet/Council outlining the expected treasury activity for the forthcoming 3 years. Two further reports are produced, one mid-year reporting on activity part way through the year and the other after the year-end to report on actual activity for the year. The Annual Report

for 2003/04 appears later on this meeting's agenda.

Annual Investment Strategy 2004/05

12. The key requirements of both the Code and the investment guidance are to set an annual investment strategy, covering the identification and approval of the following:-
 - (a) The strategy guidelines for decision making on investments, particularly non-specified investments.
 - (b) The principles to be used to determine the maximum periods for which funds can be committed.
 - (c) Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year. This will need to define broad categories of investment and the regularity of monitoring.
 - (d) Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.
13. It should be noted that the nature of the change to specified/non specified split should not be confused with approved/non-approved under the old system. Specified and non-specified are both approved under the new guidance and both should normally form part of the council's policy.
14. Throughout this Strategy the investments that will be used are Sterling fixed term or variable deposits of up to 5 years with Banks, Building Societies, UK Government and other local authorities.

Strategy Guidelines

15. The main principle governing the Council's investment criteria is the security and liquidity of its investments before yield, although the yield or return on the investment will be a consideration, subject to adequate security and liquidity. After this main principle the Council will ensure
 - (a) It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators which have been reported separately. This is set out in Liquidity of Investments below.
 - (b) It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
 - (c) The Director of Corporate Services will maintain a counterparty list in compliance with these criteria and will revise the criteria and submit it to Council for approval as necessary. The current proposed criteria are shown below for approval.

Liquidity of Investments

16. The Council will carefully balance the use of specified investments and non-specified investments into the future to ensure there is appropriate operational liquidity. In the normal course of the council's cash flow operations it is expected that both specified and non specified investments will be utilised for the control of liquidity as both categories allow for short term investments.
17. The use of longer term instruments (greater than one year from inception to repayment) will fall in the non-specified investment category. These instruments will only be used where the council's liquidity requirements are safeguarded. An estimate of long term investments was included in the report on the Prudential Indicators approved by Council on 10th March 2004 The following estimates for long term investments were included for the next three years 2004/05 £16.9m, 2005/06 £15.7m and 2006/07 £16.2m.

Specified Investments

18. These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the council has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. These would include investments with:-
 - (a) The UK Government (such as the Debt Management Office, UK Treasury Bills or gilts).
 - (b) Supranational bonds.
 - (c) A local authority, parish council or community council.
 - (d) An investment scheme that has been awarded a high credit rating by a credit rating agency. This covers money market funds rated by Standard and Poors, Moody's or Fitch rating agencies
 - (e) A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society) This covers bodies with a minimum rating of :-
 - (i) Short Term Rating- F1 (or equivalent) from Fitch, Moody's or Standard & Poors
 - (ii) Long Term Rating- A or equivalent from Fitch, Moody's or Standard & Poors
 - (iii) Individual / Financial Strength Rating – C from Fitch or Moody's Support Rating – 3 from Fitch
19. Within these bodies and in accordance with the code, the Council has set additional criteria to set the time limit and amount of monies which will be invested.

Non-Specified Investments

20. Non-specified investments are any type of other investment not defined as Specified and will include any investments for more than one year. These would include :-

- (a) Building Societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.
- (b) Any Bank or Building Society that has a minimum long term credit rating of A or equivalent for Fitch or Moody', for deposits with a maturity of greater than one year. This would include forward deals in excess of one year from inception to repayment.

21. The table below shows the minimum credit rating (or asset size, relating to Building Society's) required for inclusion on the Council counterparty list.

Type	Fitch				Moody's			Asset Size
	Short Term	Long Term	Ind.	Support	Short Term	Long Term	Financial Strength	
Bank	F1	A-	C	3				-
MMF	AAA				AAA			-
DMADF	-				-			-
Building Society (1)					P-1	A3	C	-
Building Society (2)	-	-	-	-	-	-	-	>£1bn

22. This table shows investment time limits categorised between specified and non specified investments

	Fitch				Moody's			Asset Size	
Type	Short Term	Long Term	Ind	Support	Short Term	Long Term	Financial Strength		Time Limit
Specified									
Bank / Building Society	F1	-	-	-	P-1				1 year
Building Society					P-2				9 months
MMF	AAA							-	1 year
DMADF	-				-			-	1 year
Non-Specified									
Un-rated BS	-	-	-	-	-	-	-	>£1bn	6 months
Long term Bank / BS	F1	A-	C	3	P-1	A3	C		2 years
	F1	AA-	B	2	P-1	Aa3	B		4 years
	F1	AAA	B	1	P-1	Aaa	B		5 years

The Monitoring of Investment Counterparties

23. The credit rating of counterparties is monitored regularly. The Council receives credit rating advice from its advisers, Butlers, on a daily basis as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria, or those on the minimum criteria placed on negative Creditwatch, will be removed from the list immediately by the Director of Corporate Services, and if required new counterparties which meet the criteria will be added to the list.

Outcome of Consultation

24. This report was presented to Resources Scrutiny Committee on 29th June 2004 and it resolved that Cabinet be advised that it endorsed the Annual Investment Strategy 2004/05.

Legal Implications

25. This report has been considered by the Borough Solicitor for legal implications in accordance with the Council's approved procedures. There are no issues which the Borough Solicitor considers need to be brought to the specific attention of Members, other than those highlighted in the report.

Section 17 of the Crime and Disorder Act 1998

26. The contents of this report have been considered in the context of the requirements placed on the Council by Section 17 of the Crime and Disorder Act 1998, namely, the duty on the Council to exercise its functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area. It is not considered that the contents of this report have any such effect.

Council Policy Framework

27. The issues contained within this report require approval by Council.

Decision Deadline

28. For the purpose of the 'call-in' procedure this does not represent an urgent matter

Key Decisions

29. In accordance with this Council's Constitution this item has been advertised in the forward plan as a key Decision as it contains a major financial decision.

Recommendation

30. It is recommended that Cabinet endorse the Annual Investment Strategy 2004/05 and forward it on the Council for their approval.

Reasons

31. The recommendations are supported by the following reasons :-
- (a) In order to comply with the CIPFA Treasury Management in the Public Services: Code of Practice
 - (b) To approve a framework for Officers to work within when making investment decisions

Paul Wildsmith
Director of Corporate Services

Background Papers

Local Government Investments
Guidance under Section 15(1)(a) of the Local Government Act 2003

Elaine Hufford Extension 2324