Council	Agenda Item 102
24th March 2016	Brighton & Hove City Council

Subject:		**Annual Investment Strategy 2016/17**	
Date of Meeting:		**24 March 2016** 17 March 2016 – Policy & Resources	
Report of:		**Acting Director Finance & Resources**	
Contact Officer:	**Name:**	**James Hengeveld**	**Tel: 29-1242**
	Email:	**james.hengeveld@brighton-hove.gov.uk**	
Ward(s) affected:		**All**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The Local Government Act 2003 introduced a prudential capital finance system whereby levels of borrowing and investments are decided locally by each council.

1.2 Guidance issued under the Act requires a local authority to approve an annual investment strategy which gives priority to security and liquidity and requires the council to set out:

- its policy on determining the credit-worthiness of its investment counterparties and the frequency at which such determinations are monitored;
- its policy on holding investment instruments other than deposits held in financial institutions or government bodies;
- its policy on determining the maximum periods for which funds may be invested;
- its policy on the minimum level of investments to be held at any one time.

2. RECOMMENDATIONS:

2.1 That Policy & Resources Committee recommend to full Council the approval of the Annual Investment Strategy 2016/17 as set out in Appendix 1 to this report.

3. CONTEXT/ BACKGROUND INFORMATION

3.1 The Annual Investment Strategy (AIS) for 2016/17 is set out in Appendix 1 to this report and covers investments made by the in-house treasury team and the council's external cash manager. The council currently uses a cash manager to take advantage of investment opportunities in specialist markets not covered by the in-house team, such as government stock. The AIS gives priority to security and liquidity.

3.2 Security is achieved by:

- selecting only those institutions that meet stringent credit rating criteria or, in the case of non-rated UK building societies, have a substantial asset base, and;

- limiting the amount invested with any one institution.

3.3 The council uses independent credit rating agencies to assess the creditworthiness of investment counterparties. Aside from some specific exemptions (as set out in 1.3.3 of Appendix 1), the AIS 2016/17 continues with the policy of assessing creditworthiness by applying the lowest rating issued by the three main rating agencies – Fitch, Moody's and Standard & Poor's. In the majority of cases the ratings issued by the three agencies are aligned but this is not always the case.

3.4 Rating criteria are only one factor taken into account in determining investment counterparties. Other factors such as counterparty Credit Default Swap prices, credit watches and outlooks and articles in the financial press will continue to be monitored. Action will be taken where it is felt the risk attached to a particular counterparty has or is likely to worsen. Action will include the temporary suspension of a counterparty if considered appropriate.

3.5 Liquidity is achieved by limiting the maximum period for investment and matching investment periods to cash flow requirements.

Changes to the Annual Investment Strategy 2016/17

Review of externally managed investments

3.6 In 2006 the council appointed a cash manager to manage £25m of funds on its behalf. The performance of the cash manager fund has exceeded the benchmark in 2015/16, but fund performance has dropped compared to previous years and has been below the performance of the in-house team. Officers therefore consider it prudent to review the continued management of these funds. Officers have explored a number of options in consultation with the council's treasury advisors which prioritise the security of the authority's monies whilst obtaining a yield which is in line with the council's appetite for risk.

3.7 Initial groundwork has shortlisted a number of options to be explored further including managing some or all of these funds in-house. As a result, it is recommended that:

- The list of permitted investment instruments be extended to allow the council to take advantage of investment instruments which it has the authority to enter into under statute but which have not previously been utilised. These are listed in the section 3.8.
- The investment counterparty limits are increased to enable the in-house team to invest any additional funds effectively.

Permitted types of Investment Instruments

3.8 Section 5 of the Annual Investment Strategy (Appendix 1) outlines the permitted instruments in which the in-house treasury team can invest. The permitted instruments has been expanded to include the following:

- Property Funds
- Corporate Bonds
- Bond Funds

3.9 These instruments will only be utilised following a thorough due diligence process supported by the council's treasury advisors. This process will set out in detail the potential risks and rewards and include a report to the Member Budget Review Group.

Increase in counterparty investment limits

3.10 The borrowing strategy adopted following the economic downturn was to use reserves to reduce borrowing (i.e. under borrowing). This strategy reduced counterparty risk whilst reducing borrowing costs with minimal loss of investment interest. Due to the expected reduction of certain reserves over the next 4 years the strategy was amended in 2015/16. Borrowing of £15.000m was entered into in this financial year to take advantage of exceptionally low long term borrowing rates and thereby reduce the council's under borrowing position. Any new borrowing, unless immediately spent, increases the council's balances available for investment.

3.11 Additionally, the council's average investment balances have increased from £68.516m in 2012/13 to £79.458m in 2015/16 to date. Consequently, the counterparty limits in tables 3 & 4 in appendix 1 have been extended to ensure sufficient capacity within the strategy for the council to accommodate this increase in investments and ensure investments remain with high quality counterparties.

3.12 Increasing counterparty limits presents a possible risk of having an investment portfolio which is too concentrated over a small number of institutions. To ensure the risk of this is mitigated, the proportion of the portfolio invested in an individual counterparty has been reduced to 25% of the relevant sector under 1.3.1 of appendix 1.

Investments held with the council's banking provider

3.13 Currently the council assesses Lloyds Bank in the same way that other banks are assessed. Under the 2015/16 limits this allows investments with Lloyds of £10m for up to 1 year. The 2015/16 AIS was amended and approved by full Council on 16 July 2015 and one of the amendments was to allow an "operational limit" with Lloyds Bank. This change allows up to £2.000m of cash to remain in the council's current account overnight, thereby allowing the Treasury Team to manage the council's cash as efficiently as possible.

3.14 After discussions with our advisers it is recommended that the investment limit with Lloyds Bank is increased by £5m to reflect the fact that Lloyds provide banking services to the council. This will assist with day to day investment decisions and provide an opportunity to support a new low risk investment product recently introduced by Lloyds which provides loans to local businesses.

3.15 Officers will monitor Lloyds Bank and consider the factors outlined above in paragraphs 3.3 & 3.4 to ensure a supplementary investment limit remains appropriate. The additional £5.000m lending limit will be reviewed and action may be taken if deemed appropriate. Action taken may include the temporary suspension of the additional investment limit if there is any evidence of deterioration of the bank's financial position. Furthermore, risk will be managed through the amendment to maximum exposure to one counterparty as outlined above in paragraph 3.12.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report sets out the council's annual investment strategy for the year commencing 1 April 2016. The AIS continues with the strong emphasis on risk management and liquidity, two cornerstones to the draft guidance issued by the Secretary of State and the impact these have on investment performance.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted in the drafting of this report.

6. CONCLUSION

6.1 The 2010 investment guidance requires that local authorities produce an investment strategy to be approved and amended by full Council. This report fulfils that requirement

7. FINANCIAL & OTHER IMPLICATIONS:

<u>Financial Implications:</u>

7.1 The financial implications arising from the AIS have been included in the Financing Costs budget for 2016/17.

Finance Officer Consulted: James Hengeveld Date: 24/02/16

<u>Legal Implications:</u>

7.2 The legal framework for the council's Annual Investment Strategy is Part 1, chapter 1, of the Local Government Act 2003, and associated statutory guidance.

It is a legal requirement for the Annual Investment Strategy to be approved by full Council. It is the role of the Policy & Resources Committee to formulate the strategy prior to consideration by full Council.

Lawyer Consulted: Elizabeth Culbert Date: 25/02/16

<u>Equalities Implications:</u>

7.3 No equalities impacts have been identified in relation to this report.

<u>Sustainability Implications:</u>

7.4 The council's ethical investment statement requests that institutions apply council deposits in a socially responsible manner. Ethical options were considered in the report to 12 July 2012 Policy & Resources Committee

Any Other Significant Implications:

.

Risk & Opportunity Management Implications:

7.5 The investment guidance issued under the 2003 Act requires the council to assess credit worthiness by reference to an independent rating agency. The AIS 2016/17 will use the ratings assigned by Fitch, Moody's and Standard & Poor's.

7.6 The ratings provide an opinion on the relative ability of an institution to meet financial commitments, such as interest, preferred dividends, repayment of principal, insurance claims or counterparty obligations. The council uses credit ratings as an indication of the likelihood of receiving its money back in accordance with the terms of the investment. Other sources of information are also used to supplement that provided by the rating agencies.

7.7 The minimum ratings set out in the AIS have the following meaning:

	Generic criteria	Fitch	Moody's	Standard & Poor's
For investment up to 1 year				
Short-term	Good capacity for timely payment of financial commitments. Where the credit risk is particularly good, a "+" is added to the assigned rating by Fitch and S&P	F2	P-2	A-2
For investment in excess of 1 year				
Long-term	Strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	BBB	Baa	BBB

7.8 Investment risk is managed by selecting only institutions that meet the council's stringent credit rating criteria. Liquidity risk is managed by applying maximum investment periods to institutions.

SUPPORTING DOCUMENTATION

Appendices:

1. Annual Investment Strategy 2015/16 including the counterparty list in schedule 1.

Documents in Members' Rooms

None

Background Documents

1. Guidance issued by the secretary of State under Section 15(1)(a) of the Local Government Act 2003 effective from 1 April 2010

2. The Prudential Code for Capital Finance in Local Authorities published by CIPFA – fully revised third edition 2011