

# Executive

## INVESTMENT STRATEGY

6 July, 2009

### Report of Strategic Director for Customer Service and Resources

#### Purpose

This report sets out the revised investment Strategy for treasury operations for 2009/10 and replaces the strategy approved by the Executive on 2<sup>nd</sup> March 2009. As with the originally approved documents the attached fulfil the Council's requirement under the Local Government Act 2003 and guidance subsequently issued by the Office of the Deputy Prime Minister (now CLG) in March 2004, to prepare an annual investment strategy.

Whilst the formal regulatory framework has not changed and the Council's consistent compliance has not been compromised in any regard, a substantial amount of further guidance alongside the approval of a new medium term financial strategy has emerged since the approval of the current strategy earlier in the year.

The revised strategy attached has been formulated with due regard to:

- The guidance issued by CIPFA entitled 'Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes';
- The findings contained in the report issued by the Audit Commission in March 2009 entitled 'Risk and return, English local authorities and the Icelandic banks'; and
- The Council's own Medium Term Financial Strategy (MTFS) approved by the Executive on 6<sup>th</sup> April 2009.
- The Select Committee report on Local Authority Investments 11 June 2009

This report is public

#### Recommendations

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The Executive is recommended:

- (1) to recommend to Council approval of the revised Investment Strategy 2009/2010.

## Executive Summary

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1.1 The highest standard of stewardship of public funds remains of the utmost importance to the Council. The combined effects of the turbulence in the financial markets associated with the banking crises and the unprecedented fall in interest rates impact directly on the Council's investment strategy: The former driving a re-iteration of the Council's main priority to protect the security of funds. The latter driving a change in the Council's medium term financial strategy to reduce vulnerability to movements in interest rates by eliminating dependency on investment income to support revenue funding.

1.2 In March 2009, as part of our on-going commitment to regular review and maintaining best practice the Executive supported an independent review of the investment strategy. The Portfolio Holder for Resources and the Strategic Director for Customer Service and Resources commissioned Price Waterhouse Coopers (PWC) to undertake the review.

1.3 The process involved consultation with a wide range of Members and Senior Officers covering the full range of Treasury activities in order to establish views and synchronise the parameters of the strategy accordingly. The review covered all aspects of the investment strategy and in the light of recent guidance referenced above, gave particular regard to the following specific aspects:

Ownership and accountability; risk appetite; the monitoring of performance and compliance; the role of the external advisors, the in house team and the external fund managers; the nature of the investment instruments ; the counterparty criteria; the use of credit reference agencies and the management of working capital.

1.4 The assessment of risk appetite was the main driver of the emerging priorities at the highest level of the strategy of Security, Yield (subject to cash-flow) and Liquidity in that order. These priorities in turn set the parameters for the specific investment instruments, duration, exposure and counter party criteria reflected in the attached strategy.

1.5 The security of principal remains the top priority for members. The strategy also reflects Member's recognition that they feel further obligated to ensure Council funds work hard and some element of return is required to ensure the Council's ability to incur capital expenditure for the community is sustainable in the future. As a result, it is accepted that some element of risk is prevalent within the investment portfolio by the very nature of the activity of "investing".

1.6 Adopting this revised strategy will drive a change to the profile of our investment portfolio. The current investments remain sound and as such there is no need for any of the changes to be retrospective. A smooth transition over time will be achieved by applying the new criteria to investments entered into after the effective date of adoption.

## 2 Background Information

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- 2.1 PWC facilitated two separate workshops; participants included Members from the Councils' Accounts Audit & Risk Committee, Scrutiny and the Executive. The information gained and views expressed by Members involved in relation to the full range of related subject matters directly shaped the recommended strategy.
- 2.2 In considering risk, and the priority for security of principal, the consultation exercise considered the role of external advisors, fund managers and the in house finance team. The recognition for appropriate expertise ( given the complexity of the nature of some financial instruments) alongside the desire for diversification (not "putting all eggs in one basket") influences the provision within the strategy for retaining external advisors alongside a combination of external fund management and internally managed investments. The expertise of the internal team in relation to cash-flow management is recognised and investment activity of the team focused on specifically set out, less complex shorter term investments.
- 2.3 The portfolio of investments remains grouped into 2 categories, "specified" (short term lower risk instruments) and "non specified" – covering longer term more complex investments. As with the previous strategy 70% of the portfolio is restricted to the "specified instrument" group. Within each group express reference is made to the individual allowable instruments. Investment activity by fund managers is restricted to the instruments listed.
- 2.4 Outside the scope of this strategy, The Council will continue to engage in non cash investment activity as set out in the asset management strategy and remains committed to participating in community finance arrangements with appropriate public and voluntary sector partners. The financial areas of these activities will be supported by the In house finance team.
- 2.5 A key component of managing risk and performance is the assurance and evaluation framework. The strategy provides for monitoring in 3 distinct areas: Compliance, which will be overseen by the Councils Account Audit and Risk Committee. Quantitative financial performance in relation to budgeted outcomes, which is an integral element of the Councils performance management framework reported to the Executive. Qualitative and comparative performance monitoring of responsible parties which will be reported to the Resources and Performance Scrutiny function.
- 2.6 The agreed priorities drive the provisions within the strategy relating to counter-party criteria and appropriate bodies for investment. The strategy sets express criteria relating to credit ratings. Firstly the highest ratings from 3 agencies are pre-requisite to investment in specific bodies and additionally provision is made in relation to establishing credit worthiness of sovereignty as being pre-requisite to any investments in non UK domiciled bodies.
- 2.7 All elements of the recommended strategy relating to non UK domiciled bodies, investment in UK building societies and the permitted instruments within the specified and non specified list have been considered in the light of the investment activities of other Councils as an additional measure of assurance.

## **Key Issues for Consideration/Reasons for Decision and Options**

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- 3.1 Compliance with Best Practice in the light of recently published external guidance
- 3.2 Review of strategic investment “priorities” in the light of risk appetite and the newly approved medium term financial strategy.

The following options have been identified. The approach in the recommendations is believed to be the best way forward

**Option One** Do nothing. Whilst the current strategy continues to comply fully with the regulatory framework the recommended changes reflect the Council’s consideration of the most recent external developments and newly published guidelines in keeping with our commitment to best practice.

**Option Two** Impose immediate changes to the Council’s investment portfolio. The Council’s current investment portfolio is sound and the parameters governing those investments appropriate and robust. There is no need to exit current arrangements. To do so could incur unnecessary financial penalties.

**Option Three** Continue to incorporate best practice, accommodating newly published external guidance via a smooth transitional process re-profiling investments over time.

## **Consultations**

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<b>Members</b>	Members Workshop: Accounts, Audit & Risk, Scrutiny group (20 May 2009)
<b>Members, Corporate Management Team</b>	Executive/Corporate Management Team Workshop (15 June 2009)
<b>External Advisors</b>	The Council’s retained advisors, Butlers

## **Implications**

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**Financial:** Financial Effects – Closer management of the Council’s cash-flows and working capital will increase the level of short-term investment income. This will be monitored during the year and budgets amended accordingly.

It is possible that with falling interest rates and the tightening of the counterparty strategy this could impact significantly on the level of interest income. Each 0.25% fall in interest rates has a potential impact of £138,000 on revenue budget. In order to mitigate this risk an interest rate reserve has been generated.

The additional requirements for quarterly compliance

statements from the Retained Advisors and phased increase in external investment activity could have a small financial impact on the contract costs price in the short term, however this will be an integral element budgeted accordingly in the re-tendered specification and any extended contractual arrangements.

Efficiency Savings – None is arising direct from this report.

Comments checked by Karen Curtin, Head of Finance 01295 221595.

**Legal:**

There is a requirement for the Council to fulfil two key requirements of the Local Government Act 2003:-

- approval of the Treasury Management Policy in accordance with the CIPFA Code of Practice on Treasury Management; and
- approval of the Investment Strategy in accordance with the DCLG investment guidance.

The revised strategy attached has been formulated with regard to the following recently published guidance:

- The guidance issued by CIPFA entitled 'Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes';
- The findings contained in the report issued by the Audit Commission in March 2009 entitled 'Risk and return, English local authorities and the Icelandic banks'; and
- The Council's own Medium Term Financial Strategy (MTFS) approved in 6<sup>th</sup> April, 2009
- Select Committee Report, Communities and Local Government, Local Government Investments (June 2009).

**The recommendations arising from the guidance above are not regulated by statute and compliance is not mandatory but regard to such guidance is evidence of good practice.**

Comments checked by Liz Howlett, Head of Legal and Democratic Services, 01295 221686.

**Risk Management:**

a) Risk of capital loss – the prime objective of treasury management activities is to ensure the security of the amounts invested. In the past this has primarily been managed by using a counterparty list which only includes organisations having a suitable credit rating and which has a maximum amount that can be invested with each

organisation at any one time. The revised strategy provides additional measure relating to credit worthiness of sovereignty, further limitations in time and exposure limits and a clear framework for monitoring and compliance.

Comments checked by Karen Curtin, Head of Finance  
01295 221551.

**[Other Implications]**      None

**Wards Affected**

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All

**Corporate Plan Themes**

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An Accessible and Value for Money Council

**Executive Portfolio**

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**Councillor James Macnamara**  
**Portfolio Holder for Resources**

**Document Information**

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<b>Appendix No</b>	<b>Title</b>
Appendix 1	Investment Strategy
Appendix 2	Glossary of Terms
<b>Background Papers</b>	
CIPFA Treasury Management Code of Practice 2008/09 Treasury Management Strategy 2009/10 Budget Medium Term Financial Strategy	
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