Cherwell District Council
Investment Strategy 2010/11

1.0 Introduction

The proposed strategy for 2010/11 in respect of the following aspects of the treasury management function, is based upon the views of the Council's Treasury Management Team. This is informed by market forecasts provided by the Council's treasury advisor, Butlers.

The highest standard of stewardship of public funds remains of the upmost importance to the Council.

This document sets out the Council's priorities and policies for making, and managing investments made by the Council in the course of undertaking treasury management activities during the 2010/11 financial year. It fulfils 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.

The strategy covers:

- Treasury limits in force which limit the treasury risk and activities of the Council
- prospects for interest rates
- the borrowing strategy (not applicable in 2010/11)
- Prudential Indicators - The Prudential Indicators are part of the integrated treasury management strategy and are included in the budget book that will be recommended to Council.

2.0 Background

The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public services (the "CIPFA TM Code") requires local authorities to determine the Treasury Management Strategy Statement (TMSS). This statement also incorporates the Investment Strategy. Together, these cover the financing and investment strategy for the forthcoming financial year.

In response to the financial crisis in 2008, CIPFA has revised the TM Code and Guidance Notes as well as the Prudential Indicators which CIPFA publicised in late November 2009. Communities and Local Government (CLG) is consulting on a revised and updated Investment Guidance. If any changes are required as a result of this consultation we will bring an amended strategy back to Council for approval.

CIPFA has defined Treasury Management as:

"The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of its treasury management activities. The main risks to the Council's treasury activities are:

- Credit and Counterparty Risk (Security of Investments)
- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels)
- Inflation Risk (Exposure to inflation)
- Legal & Regulatory Risk

3.0 Regulatory Framework

There are two main elements to the regulatory framework for treasury management, the CIPFA TM Code and the CLG Investment Guidance. As both of these have been revised in November a summary of the main changes is set out below.

3.1 CIPFA Treasury Management Code

The main issues to highlight are:

- **3.1.1 Treasury Management Policy Statement**
  CIPFA recommends that organisations adopt the following words in their Treasury Management Policy Statement to be agreed by full Council:

  This organisation defines its treasury management activities as:

  "The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

  This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

  This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

- **3.1.2 In the new code CIPFA identify the following Key Principles:**
  <u>Key Principle 1</u>
  Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

  <u>Key Principle 2</u>
  Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk

should form part of their annual strategy and should ensure that priority is given to security and liquidity when investing funds.

Key Principle 3
They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

- **3.1.3 CIPFA recommends that the following four clauses are adopted as part of Financial Regulations:**

1. This organisation will create and maintain, as the cornerstones for effective treasury management, a treasury management policy statement stating the policies, objectives and approach to risk management of its treasury management activities. It will also have suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. This organisation (i.e. full body/council) will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to full Council, and for the execution and administration of treasury management decisions to Head of Finance, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's standard of professional practice on treasury management.

4. This organisation nominates the Accounts, Audit & Risk Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

The Head of Finance is currently revising Financial Regulations and these clauses will be incorporated.

3.2 CLG Investment Guidance

CLG are currently out to consultation on their Guidance. The main issues to highlight are:

- Reiterates security, liquidity and yield in that order. (See reference to security, yield, liquidity)
- Emphasis on ongoing risk assessment.
- Credit ratings alone should not be the only criteria for selecting counterparties.
- Borrowing purely to invest at a profit is unlawful. There still appears to be no legal obstacle to the temporary investment of funds borrowed for the purpose of expenditure in the reasonably
- near future.
- Clarity on the role of investment consultants.
- Training for Members and officers.

3.3 Relevant guidance

In preparing this document, in addition to the requirements noted above, the Council has also had regard to:

- The guidance issued by CIPFA entitled 'Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes'; revised 2009
- 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';
- The findings contained in the June 2009 report on local authority investments by the Parliamentary Select Committee for Communities and Local Government; and
- The Council's own Medium Term Financial Strategy (MTFS).
- CIPFA Prudential Code.

4.0 Scope of this document

The scope of this document does not extend to other investment activities undertaken by the Council, including investments made in local properties/community projects. Such investments are governed by the Council's Asset Management Strategy.

5.0 Ownership, roles and responsibilities

Ownership of the Council's investment strategy, and accountability for all investments made by the Council, resides fully with the members of the Council.

Responsibility for ensuring compliance with the regulatory framework rests with the Council's Chief Financial Officer (Section 151 Officer). The investment strategy, and any changes to it, must receive approval of the Section 151 Officer. In relation to the element of the Council's investments managed by the in-house Finance team, the Head of Finance is responsible for compliance with the parameters set out in this strategy.

To assist in executing the approved investment strategy, the Council relies on the professional input from the in-house Finance team and from external Treasury Advisors and Investment Managers. The Council's policies governing the basis of selection of these external organisations, their contractual arrangements, and the monitoring of the quality of service they provide are set out in the Council's procurement rules.

5.1 In-house Finance team

The Finance team will be responsible for:

- Managing the Council's overall cashflow requirements,
- Coordinating and monitoring the structure and performance of the aggregate portfolio of investments, including adherence to the strategy, and liaising with the external Treasury Advisors and investment managers, and
- Directly managing a small proportion of the Council's investments

5.2 Treasury Advisor

This role is currently fulfilled by Butlers who are contracted to provide accurate information and informed, up-to-date, guidance to the Council, specifically including:

- Interest rate forecasting and economic information;
- Counterparty credit ratings information;
- Guidance on Local Government Finance (Capital) legislation, the CIPFA Code of Practice and the Prudential Code; and
- Information on investment performance

Notwithstanding the above, it is fully recognised that the Council is required to apply judgement in determining the use of information and guidance received from the Treasury Advisor. The Council remains accountable for all investment decisions made.

We are in the process of a procurement exercise and a new contract will commence on 1st April 2010 which may result in a change of supplier.

5.3 External investment managers

It is envisaged that the responsibility for managing the Council's portfolio of investments will be split between the Council's in-house Finance team and the external investment managers. Direct management of the majority of the investment portfolio will be performed by the external professional investment managers. Currently, the external managers engaged by the Council are Investec and TUK.

The use of a combination of internal and external resources recognises that, whilst the Council's own Finance personnel are competent in and best placed to understand the cash-flow and working capital requirements of the Council, they do not have the expertise to manage the full range of investment instruments in which the Council is permitted to invest. Additionally, this blend of internal and external resources provides an element of diversification and "resilience" because the Council is not completely dependent on one organisation, or one or two key individuals, for the performance of investment management activities.

The external investment managers will be contractually obliged to adhere to the overall parameters of the Council's investment strategy, which are set out below. As such, the approved investment strategy document will be communicated annually to the external managers by the Council's Chief Financial Officer. Any changes to the strategy in-between the formal annual review dates will also be communicated to the investment managers by the Chief Financial Officer.

6.0 Monitoring of Investment Strategy

Monitoring and evaluation of the application and performance of the investment strategy will take place as follows:

- The Accounts, Audit and Risk Committee (AARC) will receive a quarterly report from the Chief Financial Officer on compliance of the Council's investments with the objectives and parameters set out in this document. This report will be at an aggregate portfolio level and so will summarise the position relating to both in-house and externally-managed investments.
- In recognition of the dynamic nature of the financial markets and the impact of change in the economic environment, the Chief Financial Officer, in consultation with the Portfolio Holder for Resources and Organisational Development, may take emergency actions outside of the framework of the investment strategy where necessary to enhance the security of amounts invested. Any action taken under this provision will be reported by the Chief Financial Officer to the next quarterly AARC meeting.
- Performance against financial targets, including actual investment income versus budget, will be reported to the Executive on a quarterly basis and to full Council on an annual basis as an integral element of the Council's financial statements.
- The performance of the Treasury Advisors against the specification agreed in the contractual documentation with those parties will be reported annually to the Resource and Performance Scrutiny Board, as part of the Council's contract management framework. In addition, the Board will receive reports that allow comparison of the respective investment performance of the in-house team and each of the external investment managers, as well as the performance of each group against relevant benchmarks.

All finance personnel who are involved in delivering against the treasury management strategy receive in-house and externally provided training as deemed appropriate. Members are also invited to attend appropriate training and in the past this has been delivered by PricewaterhouseCoopers.

Key officers are also encouraged to study towards the new CIPFA and ACT (Association of Corporate Treasurers) joint Certificate on International Treasury Management – Public Finance.

7.0 Investment objectives and priorities

The Council's priorities in executing its investment strategy are security, yield (interest receivable) and liquidity. These priorities are further articulated below.

- **Security** - in considering the suitability of investments, the Council's overriding objective is to ensure the security of amounts invested and to minimise the risk of loss of investment principal, though it is accepted that the total elimination of risk is not achievable or desirable. This reflects the expressed views of the Members on their appetite for investment risk.

- **Yield** – Whilst security of principal is the primary priority, the Members have expressed the view that the Council's investments should, to some extent, be "put to work" to generate a return to support the Council's ability to undertake capital expenditure on projects that benefit the community.

Subject to adhering to the restrictions and parameters set out in this document governing the security of investments, and the requirement described below for a small element of the portfolio to be retained as “on-call cash”, investments can be made by the Council with the objective of generating an income stream in support of the Council’s MTFS. A target investment yield will be specified as part of the Council’s annual budget.

In previous years, a key objective of the Council’s investment strategy has been to provide an income stream from investment returns to support annual revenue expenditure. The current MTFS provides that this reliance on investment returns to fund expenditure will reduce over the next three years, such that by 2013/14 there will be no reliance on investment returns to support the revenue account. From 2010/11, an increasing proportion of the investment income will be available to fund growth and one-off projects, such that from 2013/14 100% of investment income will be available for such projects.

- **Liquidity** – investment decisions will made in the context of known future cash flows to ensure sufficient funds are available as and when they are required. Cash flows are monitored on a daily basis by Finance with detailed forecasts prepared by time periods. In order to provide the necessary flexibility, and as a contingency for unexpected events, an element of the Council’s funds (£1m) will be maintained on-call, with no notice requirement.

8.0 Permitted Investments

The Council’s investment portfolio will be comprised of ‘Specified’ investments and ‘Non-specified’ investments.

8.1 Specified Investments

A Specified Investment is defined as an investment that:

- that is denominated in Sterling, and any payments or repayments in respect of the investment are payable only in Sterling;
- is not a *long term investment*;
- is not *capital expenditure*; and
- is made with a body, *which is described as having a strong or superior ability to meet its short term financial commitments by a range of credit rating agencies ensuring high credit quality*, or is made with the UK Government.

For the purpose of applying the above criteria, the following definitions will be applied:

- *Long Term Investment* - any investment other than one that is due to be repaid within 12 months from the date of transaction, or one that may be required by the Council to be paid within 12 months from the date of transaction. The date of transaction refers to the date the investment principal is actually invested. For clarity, any commitments given to a counterparty to make investments on a forward basis are "Non-Specified" investments.
- *Capital Expenditure* - capital expenditure will have the definition as set out in regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended].
- *A body that has been described as having a strong or superior ability to meet its short term financial commitments* – these are investment counterparties that meet the selection requirements set out below.

- *Credit Rating Agency* - a body that assesses the financial strength of companies and governments, both domestic and foreign, particularly their ability to meet the interest and principal payments on their bonds and other debt. Rating information will be obtained from 3 agencies: Fitch, Moody's and Standard & Poor's.

In addition to the above definitions, Specified Investments will be restricted to the following list of permitted instruments:

- Cash deposits
- Certificates of deposit
- UK Government investments – Debt Management Office (DMO) deposits and bonds (gilts) for which maturity date at time of purchase is less than 365 days away

8.2 Non-specified Investments

Non-specified Investments are defined as any investments that do not meet the criteria set out above for Specified Investments. The Council's investment objectives and priorities, as set out above, have been used to determine the selection of the types of investments that are permitted.

Non-specified Investments will be restricted to the following list of permitted instruments:

- Cash deposits
- Callable deposits
- Certificates of deposits
- Money market funds
- UK Government investments, sovereign and supranational bonds
- Investments with UK building societies that do not meet the criteria for Specified Investments
- Loans to other public sector bodies – local authorities, parish/community councils, Registered social landlords ("RSLs") and Primary Care Trusts ("PCTs")

For clarity, the Council's in–house Finance team will not be permitted to make any investments other than those designated as "Specified Investments", with the exception of:

- Building society investments – for which further specific credit risk criteria are set out below.
- Loans to other public sector bodies. The initiation of such loans will require Council approval on a case-by-case basis, in accordance with separately-documented procedures.

8.3 Investment Parameters and Restrictions

In managing the Council's investment portfolio (both Specified and Non-specified investments), certain overarching restrictions and parameters will apply. These are set out in the remainder of this section. Adherence to the restrictions and parameters will be monitored on an ongoing basis by Finance, and before new investments are undertaken, with assistance and information from the Treasury Advisors.

9.0 Portfolio Diversification

It is expected that, at any point in time:

- A minimum of 50% of the total value of the Council's investment portfolio will be comprised of Specified Investments, as defined above.
- A maximum of 50% of the total value of the Council's investment portfolio will be comprised of Non-specified Investments, as defined above
- In aggregate, across all categories of investments and taking in-house and externally-managed investments together, a maximum of £8m will be invested with any individual UK-domiciled investment counterparty (or group of related counterparties). A maximum of £5m will apply in respect of investment with counterparties (or groups of related counterparties) domiciled outside the UK.

9.1 Duration – maturity profile

Available on-call, no notice	Minimum £1m
Maturing in more than 6 months but less than 1 year	Minimum 30%
Maturing in more than 1 year but less than 3 years	Maximum 30%
Maturing in more than 3 years but less than 5 years	Maximum 15%

9.2 Geography

It is expected that, at any point in time:

- in aggregate, a maximum of 30% of the portfolio will be exposed to non-UK countries
- a maximum of 15% of the portfolio will be exposed to any single country, other than the UK

9.3 Investment Type

It is expected that, at any point in time, the amount invested in the following types of investment instrument will not exceed the following limits:

	Maximum
Callable Deposit	£5m
Certificates of deposit	£30m
Money market funds	£10m
Government/supranational bonds	£20m
Loans to public sector bodies	£5m
"Forward" commitments	£5m

Short Term Rating F1+, Long Term Rating AAA, AA+, AA, AA-		
	Support	
Individual	**1**	**2**
A	3 years	3 years
A/B	3 years	3 years
B	3 years	3 years
B/C	364 days	0
C	0	0

10.0 Credit risk – criteria for selection of investment counterparties

A list of approved investment counterparties will be maintained by Finance. Approval of investment counterparties will be subject to the potential counterparties satisfying the minimum credit rating criteria set out below.

The credit ratings of individual counterparties will be monitored daily by Finance using information received from Butlers. Any counterparty that no longer meets the minimum criteria for approval will be removed from the list immediately and no further investments will be made with that counterparty until such time that the criteria are again met.

Where investments are currently held with a counterparty that has been “downgraded”, consideration will be given to whether it is prudent to immediately liquidate that investment – this may include breaking a term deposit before maturity. Such considerations and decisions will be documented.

It is fully recognised by the Council that credit ratings and comments from Butlers are only one source of information that can be used to build an understanding of risks in the financial markets and with counterparties. Credit rating information should be viewed within the context of wider financial and economic information and advice. This information will be supplemented by information gathered through active research by Finance staff of counterparties and the markets, for example through reading of newspapers, internet research, and networking with staff from other Public Sector bodies. It is expected that the approved counterparty list will be managed proactively - and not merely in response to rating changes.

In order for an investment opportunity to be eligible to be a Specified Investment, the investment counterparty must have been awarded a minimum of the following credit ratings.

	Fitch	Moody’s	Standard & Poor’s
Short term rating (Note - only short term ratings are used since the duration of all investments in this category will be less than 12 months).	F1	P-1	A-1

Non-specified Investments may only be placed with counterparties that have been awarded a minimum credit rating, as set out below. A lowest common denominator approach will be applied to consideration of the three credit ratings referred to below i.e. the lowest agency rating will be applied to determine whether the counterparty meets the criteria to be on the Council's lending list.

Investment Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	N/A	In-house and Fund Managers
Term Deposits – UK Government	N/A	In-house
Term Deposits – other Local Authorities	N/A	In-house
Term Deposits – Banks and Building Societies	Fitch short-term F1, Long-term A, Individual rating C with support rating 2 or individual rating B with support rating 3, Minimum Sovereign Rating AA	In-house and Fund Managers
Term Deposits with Nationalised Banks with Government Guarantee for wholesale deposits	N/A	In-house
Term Deposits with Part Nationalised banks by the UK Government	N/A	In-house
Term Deposits with Banks and Building Societies signed up to the UK Government support to the banking sector	Fitch short-term F1, Long-term A, Individual rating C with support rating 2 or individual rating B with support rating 3, Minimum Sovereign Rating AA	In-house
Certificates of Deposit issued by Banks and Building Societies	A1 or P1	In-house on a buy and hold basis. Fund Managers
Short-term Funds (including Money Market Funds)	AAA	In-house and Fund Managers
Bond Funds	AAA	In-house and Fund Managers
UK Government Gilts	AAA	In-house on a buy and hold basis. Fund Managers
Treasury Bills	N/A	Fund Managers

In addition, investments may only be placed with non-UK domiciled counterparties where the sovereign rating of the counterparty's country of incorporation is at least "AA".

Investments with building societies not meeting the criteria for "Specified Investments" are only permitted if the society has a minimum asset size of £1,000m; the duration of the investment is no more than 12 months and the maximum amount invested is £1m. These investments will fall into the category of non specified instruments for the purposes of monitoring the Council's exposure.

11.0 Supporting Information

Schedule 1 - details the Counterparties that currently meet the above requirements.

Schedule 2 - TMPs.

Schedule 3 - contains a glossary of terms that may help the reader to understand financial terms used in this report.