Council	Agenda Item 76
26 March 2015	Brighton & Hove City Council

Subject:		**Annual Investment Strategy 2015-16**	
Date of Meeting:		**26 March 2015** 19 March 2015 – Policy & Resources Committee	
Report of:		**Interim Executive Director Finance & Resources**	
Contact Officer:	**Name:**	**James Hengeveld**	**Tel: 29-1242**
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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 2015/16 as set out in Appendix 1 to this report.

3. CONTEXT/ BACKGROUND INFORMATION

3.1 The Annual Investment Strategy (AIS) for 2015/16 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 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

- having limits on 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 specific exemptions (as set out in 1.3.3 of Appendix 1), the AIS 2015/16 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 is only one factor taken into account in determining investment counterparties. Other factors, such as articles in the financial press, will continue to be monitored and 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 in appropriate circumstances.

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 2015/16

3.6 The main ratings agencies (Fitch, Moody's, Standard & Poor's) had provided many financial institutions with a ratings "uplift" during the financial crisis due to the implied levels of sovereign support (i.e. the probability that the government would step-in in the event of a banking failure) . More recently, in response to the evolving regulatory regime, the agencies have indicated that they may remove these "uplifts", which may result in the downgrading of some of the major UK banks.

3.7 It is important to note that these ratings agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

3.8 The prevailing credit methodology within the AIS uses the lowest rating issued by the three ratings agencies to determine the maximum lending period and exposure limits for each counterparty. Following advice of our Treasury Advisors, and in response to the imminent downgrading of some major UK banks, the 2015/16 AIS removes this requirement for a specified list of UK Banks (see paragraph 1.3.3 of Appendix 1), and instead allows the highest rating to be applied. This ensures that the council is able to maintain sufficient capacity within it's investment portfolio in the event that one or two credit ratings agencies downgrade these institutions.

3.9 The provisions of the AIS also requires officers to undertake a review of a counterparty in the event of a significant deterioration of it's credit rating. Consequently, any further revision to the credit ratings of any of the institutions listed in 1.3.3 of Appendix 1 which is not as a result of the changes mentioned in 3.6, officers may restrict exposure limits and maximum periods if deemed appropriate.

3.10 In addition to the above change in methodology, the list of Non-UK banks that the council is able to invest in has been expanded. This is to take advantage of investment opportunity in highly rated institutions, and to provide additional capacity within the portfolio to mitigate the risk of a loss in capacity as a result of the credit rating changes.

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 2015. 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:

Financial Implications:

7.1 The financial implications arising from the AIS have been included in the Financing Costs budget for 2015/16

Finance Officer Consulted: James Hengeveld Date: 16/02/15

Legal Implications:

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: 02/03/15

Equalities Implications:

7.3 No equalities impact assessment is required for this report.

Sustainability Implications:

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 2015/16 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.

Corporate/Citywide Implications:

7.9 Investment income is a resource used by the council to fund revenue expenditure. The recommendations in this report will help to minimise capital risk whilst optimising investment returns over both the short and longer term.

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