

ANNUAL INVESTMENT STRATEGY FOR THE 2010/11 FINANCIAL YEAR

Introduction

1. This strategy is made in accordance with the Guidance on Local Government Investments issued by the government on 12 March 2004 and the proposed update to this Guidance issued for consultation in November 2009. It will be necessary to review this Strategy if there are significant changes to the proposed Guidance.
2. The Council approved the Annual Investment Strategy for 2010/11 on 9 March 2010. This strategy is consistent with the Council's overall treasury management strategy for 2010/11.
3. This strategy applies to both in-house and externally managed funds. External managers must confirm the acceptability of a counterparty before an investment is made.

General Provisions

4. All investments must be made in sterling

Credit risk assessment

5. Credit ratings are an important, but not the only, means of assessing creditworthiness. Full regard will be given to other available information on the credit quality of counterparties. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the criteria set out in this Strategy. The Director of Finance has access to treasury consultants, and has a copy of the Financial Times delivered daily, to help in providing this sort of information in an appropriate way. Therefore, in addition to credit ratings, the Director of Finance will consider the following factors when making investments and reviewing the credit quality of investments currently held:
 - a. **Quality financial press** – watch for any market rumours
 - b. **Credit default swaps** - CDS are a financial instrument for swapping the risk of debt default. The buyer of a credit default swap pays a premium for effectively insuring against a debt default. He receives a lump sum payment if the debt instrument is defaulted. The seller of a credit default swap receives monthly payments from the buyer. If the debt instrument defaults they have to pay the agreed amount to the buyer of the credit default swap. Although absolute prices can be unreliable, trends in CDS spreads do give an indicator of relative confidence about credit risk.
 - c. **Share price**– changes in share prices are an indicator of market confidence
 - d. **Annual reports**
 - e. **Statements to the market**
 - f. **Information on government support for banks**– if a government is likely to step in to support a bank then this reduces the risk of default
 - g. **Credit ratings of government support**– the weight you place on potential support from a government that does not itself have a high credit rating
 - h. **The rates being paid** - If they're out of line with the market, there's a reason and could indicate that the investment is likely to carry a high risk
 - i. **What other banks are saying** - Rumours spread quickly in markets
 - j. **Information provided by management advisors**– this may include some of information detailed above.

- k. **Market price (and movement in the market price) of existing debt securities issued by counterparties** – if other lenders are getting worried about a particular counterparty they will be selling the counterparty's debt securities and, by doing so, pushing down the price of those securities in the market.

Credit ratings used

6. Our treasury management consultants (currently Sterling Consultancy Services) provide us with routine lists of credit ratings at least every month, and any urgent changes on a daily basis. The lists of investment counterparties are changed immediately new credit rating are received. The tables below compare the long-term and short-term ratings used by the various credit rating agencies to enable fund managers to use ratings from different rating agencies:

Table A: Comparison of long-term credit ratings		
Moody's	S&P	Fitch
Investment grade		
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Speculative grade		
Ba1	BB+	BB+
Ba2	BB	BB
Ba3 and below	BB- and below	BB- and below

Comparison of Short-Term Ratings		
Moody's	S&P	Fitch
Investment grade		
Prime-1 "P1"	A-1+	F1+
Prime-1 "P1"	A-1	F1
Prime-2 "P2"	A-2	F2
Prime-3 "P3"	A-3	F3
Speculative grade		
Not Prime	B	B
	C	C
	D	D

7. All decisions on placing new investments are to be made on the basis of the lowest ratings issued by all three main agencies, Fitch, Moody's and Standard and Pools.

8. The individual and support ratings supplied by Fitch are to be used in addition to the long and short-term ratings. These ratings measure:
- Individual: A measure of the intrinsic safety and soundness, assesses the likelihood of a need for external support.
 - Support: A measure of the likelihood of owner or government support. Fitch uses a series of ratings from “1” (highest) to “4” to measure this likelihood.
9. Institutions who are under ‘negative watch’ or ‘review for possible downgrade’ notices (as distinct from negative outlook) are assessed on the basis of one category below their current credit rating and the term of any such new investment can be for no longer than 3 months. Definitions of these terms are set out at the end of this statement.

Sector limits

10. As far as reasonably possible, no more than 75% of total investments made are to be lent to building societies at any one time. Where possible, some investments outside of the banking sector will form part of the portfolio held. These sector limits are not to be regarded as absolute limits and it is recognised that, from time to time, short-term cash requirements may mean that the limit is temporarily exceeded.

Counter party maximum limit

11. Investments made must avoid an over concentration with one or two counter parties. A set of maximum counterparty limits is therefore appropriate. The limit of investment with any one authorised institution is to be £2.0m (lower limits apply to certain building societies).
12. The manager of externally managed funds is required to confirm that a counterparty name is acceptable before making an investment.
13. The limit for money market funds is £3.0m. This is higher than the limit (of £2.0m) for investment with any one authorised institution because of the protection offered by the diversity and high credit rating of such funds.

Investments in any parent and its wholly owned subsidiaries

14. Investments in any parent and its wholly owned subsidiaries are to be aggregated for the purpose of calculating the limit of investment to that parent or its subsidiaries.

Counterparty list

15. The Director of Finance will maintain a counterparty list in compliance with these criteria.

Policy for specified investments and credit criteria used

16. All specified investments must be in sterling and have a maturity of less than a year. Such investments with the UK Government and local authorities count as specified investments, as will those with bodies or in investment schemes with high credit quality. Non-specified investments are those that do not meet these criteria.
17. Table B sets out the counterparties that can be used and the limits that apply:

Table B: Specified investments - Limits					
	Minimum credit ratings (Fitch)			Maximum limits	
	Short-term	Individual	Support	Term up to	Sum to
UK Banks (see paragraph 12)	F1	B/C	3	364 days	£2m
Subsidiaries of UK Banks (if the parent bank satisfies the credit rating criteria)	F1	B/C	3	3 months	£2m
UK Banks (government-owned or likely to receive government support)	F1+	Any	1	2 months	£1m
Local, Police, Fire, Civil Defence and Transport Authorities	N/A	N/A	N/A	364 days	£2m
Government bonds (gilts) and treasury bills	N/A	N/A	N/A	364 days	No limit
Debt Management Agency Deposit Facility (DMADF)	N/A	N/A	N/A	364 days	No limit
Money Market Funds: In highly liquid funds (with immediate access or with periods of notice less than 8 days)	AAA rated			On call or at short notice	£3m
Multinational Development Banks	AAA rated			364 days	£1m
Foreign banks domiciled in one country that holds a AAA or AA+ sovereign credit rating	F1+	B	2	On call only	£1m
Building Societies (all must have been issued a certificate of eligibility under the UK Government's 2008 Credit Guarantee Scheme)					
UK Building Societies with assets exceeding £1,000m	F1	B/C	4	364 days	£2m
	F2	C	4	6 months	£1m
UK Building Societies with assets between £500m and £1,000m	F1	B/C	4	364 days	£1m
	F3	C	4	3 months and 7 days	£1m
UK Building Societies with assets exceeding £750m without a credit rating or with credit ratings that would not satisfy our credit criteria set out above.	N/A	N/A	N/A	3 months and 7 days	£1m
UK Building Societies, without a credit rating, with assets between £500m and £750m	N/A	N/A	N/A	3 months and 7 days	£0.5m

18. Investment in any bank and its wholly owned subsidiaries are to be aggregated for the purpose of calculating the limit of investment to that bank or its subsidiaries.
19. If credit ratings are downgraded below criteria, the counterparty will be suspended from counterparty list and no further investments will be made with it.

Money market funds

20. Accounts may be opened in money market funds that have a credit rating of AAA may be made subject to the advice of our treasury management consultants as to confirmation of the credit worthiness and liquidity of the fund, the performance of the fund, and other matters as appropriate. The maximum investment in any one fund is £3m. Our practice is to have more than one money market account available to ensure that there is sufficient flexibility to move funds if circumstances require, and to achieve a wide spread of investments.

Building Societies

21. UK building societies that hold lower or no credit ratings will be considered to be of "high credit quality" if they have been issued a certificate of eligibility under the UK Government's 2008 Credit Guarantee Scheme. The capital adequacy of these societies has been assessed by the Treasury, and they are eligible to raise funding with a government guarantee if they have trouble raising it elsewhere.
22. The Council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors. Investments in lower rated and unrated building societies will be reviewed if the insolvency regime is amended.

Forward deals up to one year

23. Forward deals may be entered into with banks and building societies that meet the appropriate credit rating criteria for specified investments where the total period of the investment (i.e. negotiated deal period plus period of deposit) is less than one year.

Policy for non-specified investments and credit criteria used

24. Non-specified investments are those that do not meet the criteria for specified investments.
25. The advice of our treasury management consultants will be sought prior to making any long-term investment as to appropriateness of the investment.
26. Non-specified investments may be made subject to the limits set out in Table C:

Table C: Non-specified Investments - Limits					
	Minimum credit ratings (Fitch)			Maximum limits	
	Long-term	Individual	Support	Term up to	Sum
UK Banks	See Table D				
Subsidiaries of UK Banks	See Table D				
Local authorities	N/A	N/A	N/A	5 years	£1m
UK Building Societies	See Table E				
UK Government bonds (gilts)	N/A	N/A	N/A	5 years (to maturity of gilt from date of purchase)	£7m
Multinational Development Banks	AAA rated			5 years	£1m

27. The maximum duration of a long-term investment with a UK bank will depend upon its lowest published long-term credit rating based on the criteria set out in Table D:

Table D: Credit rating criteria for determining the maximum duration of an investments with a UK Bank				
Long-term credit rating	Individual rating	Support rating	Time limit	Maximum sum
AAA	B	2	5 years	£1m
AA+	B	3	4 years	£1m
AA	B	3	3 years	£1m
AA-	B	3	2 years	£1m

28. The maximum duration of a long-term investment with a UK bank will depend upon its lowest published long-term credit rating based on the criteria set out in Table E:

Table E: Credit rating criteria for determining the maximum duration of an investments with a UK Building Society				
Long-term credit rating	Individual rating	Support rating	Time limit	Maximum sum
AAA	B	2	5 years	£1m
AA+	B	3	4 years	£1m
AA	B	3	3 years	£1m
A	B/C	3	2 years	£1m

29. The limit on the amount that may be held in non-specified investments at any time in the financial year is £7 million (excluding any accrued interest).

Policy for liquidity of investments

30. The proportion of the in-house portfolio that may be held in short-term and long-term investments will vary at any one time dependant on the cash flow position of the Council. The following table sets out the maximum, minimum and expected range of investments held at various times of the year:

Table F: Proportions of the in-house managed investments held in short-term and long-term investment instruments				
Time of year	Long-term investments		Short-term investments	
	Maximum	Minimum	Maximum	Minimum
	%	%	%	%
Start of year	100	0	100	75
June	50	0	100	50
September	50	0	100	50
December	50	0	100	50
End of year	100	0	100	0

31. The proportions in the table reflect that at the end of the year cash inflows are low because tax receipts are received in 10 instalments from April to January. Therefore, long-term investments may represent the entire investment portfolio for a short time. Normally it is expected that long-term investments will not exceed 50% of total investments.
32. The amount of investments (both managed in house and externally) that may be held in long-term investments will be, measured on a rolling basis, at any point in time:
- No more than £5 million of outstanding investments are to be over 3 years until maturity, and

- No more than £7 million of outstanding investments are to be over 1 year until maturity.
33. The maximum term of any one investment is 5 years.

Other issues

Investments defined as capital expenditure

34. The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'.
35. A loan or grant to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure. It is therefore important that it is clearly identified when the loan has made for policy reasons (e.g. to the registered social landlord for the construction/improvement of dwellings) or if it is an investment for treasury management purposes. The framework for 'specified' and 'non-specified' investments will govern investments that are for treasury management purposes.

Forward deals for more than one year

36. Forward deals with banks and building societies that meet the appropriate credit rating criteria for non-specified investments where the total period of the investment (i.e. negotiated deal period plus period of deposit) is greater than one year may be made subject to the limits set out in the "Policy for liquidity of investments" section.

Investment of money borrowed in advance on need

37. Borrowing in advance of need (if any) will only be undertaken if there is a risk that funds would otherwise not be accessible on the date they are required, or the terms of the borrowing are demonstrably favourable.

Provisions for credit-related losses

38. If any of the Council's investments appear at risk of loss due to default (i.e. this a credit-related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

Review of investment strategy

39. The 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 Treasury Management Practices.
40. This Strategy may be amended on these occasions, or other circumstances as may be appropriate. Any revised Strategy will be approved by the full Council.
41. This Strategy is deemed to include sufficient flexibilities and delegations to avoid the need for a formal submission to the full Council being triggered by purely technical circumstances.

Investment consultants

42. The Council contracts with Sterling Consultancy Services to provide advice and information relating to its investment and borrowing activities. However, responsibility for final decision making remains with the Council and its Officers. The services received include:
- advice and guidance on relevant policies, strategies and reports,
 - advice on investment decisions,
 - notification of credit ratings and changes,
 - other information on credit quality,
 - advice on debt management decisions,

- accounting advice,
 - reports on treasury performance,
 - forecasts of interest rates, and
 - training courses.
43. The quality of this service is controlled by the Director of Finance assessing the quality of advice offered and other services provided by Sterling Consultancy Services. In particular, the Director of Finance holds regular (normally 3 to 4 times a year) meetings with Sterling Consultancy Services where, in addition to discussing treasury strategy, the performance of the consultants is reviewed.
44. In addition, a market testing exercise is conducted every three years when other treasury consultants are invited to submit proposals to carry out the service. These proposals are analysed for quality and price in accordance with the procedures set out in the rules on the use of professional and consultancy services published in the Council's Constitution (as part of Standing Orders for Contracts).

Investment training

45. The needs of the Council's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Relevant training courses, seminars and conferences are provided by Sterling Consultancy Services.
46. A new Joint Qualification with the Association of Corporate treasurers was launched in 2009. The course is designed to give students a fundamental understanding of the core aspects of treasury management. Whilst the course does have a public sector focus, it also covers many aspects of treasury management which are currently relevant to corporates rather than public bodies. The appropriateness of this qualification for Officers will be kept under review.

Publication of this Strategy

47. This Strategy is published in the Minutes of the Council and is available on the Council's website under 'Finance' and then 'Treasury Policies'. A copy of this Strategy will be made available to the public free of charge in print if requested.

Definitions

(Negative) Rating Watch – Fitch Ratings

Rating Watches indicate that there is a heightened probability of a rating change and the likely direction of such a change. These are designated as "Positive", indicating a potential upgrade, "Negative", for a potential downgrade, or "Evolving", if ratings may be raised, lowered or affirmed. However, ratings that are not on Rating Watch can be raised or lowered without being placed on Rating Watch first, if circumstances warrant such an action.

Review for possible downgrade - Moody's (Standard & Poor's is very similar)

Moody's uses the 'Watchlist' to indicate that a rating is under review for possible change in the short-term. A rating can be placed on review for possible upgrade (UPG), on review for possible downgrade (DNG), or more rarely with direction uncertain (UNC). A credit is removed from the Watchlist when the rating is upgraded, downgraded or confirmed

(Negative) Rating Outlook – Fitch Ratings (Moody's and Standard & Poor's are similar)

Rating Outlooks indicate the direction a rating is likely to move over a one- to two-year period. They reflect financial or other trends that have not yet reached the level that would trigger a rating action, but which may do so if such trends continue. The majority of Outlooks are generally Stable, which is consistent with the historical migration experience of ratings over a one- to two-year period. Positive or Negative rating Outlooks do not imply that a rating change is inevitable and, similarly, ratings with Stable Outlooks can be raised or lowered without a prior revision to the Outlook, if circumstances warrant such an action. Occasionally, where the fundamental trend has strong, conflicting elements of both positive and negative, the Rating Outlook may be described as Evolving.