SOUTH CAMBRIDGESHIRE DISTRICT COUNCIL

REPORT TO:	Leader and Cabinet	9 March 2006
AUTHOR:	Finance and Resources Director	

INVESTMENT STRATEGY (TREASURY MANAGEMENT) 2006/07

Purpose

1. To recommend to Council that the investment strategy 2006/07 is approved and to consider whether alternative options should be pursued further.

Effect on Corporate Objectives

2.

Quality, Accessible Services	Effective treasury management provides support towards the achievement of the Council's corporate objectives
Village Life	
Sustainability	
Partnership	

Background

3. With effect from 1st April 2004, the Local Government Act 2003:
   i. included a power for a local authority to invest for the purposes of prudent management of its financial affairs;
   ii. requires a local authority to have regard to any guidance the Secretary of State may issue; and
   iii. repealed all the previous legislation on approved investments.

Considerations

4. Guidance has been issued which:
   i. requires a local authority to draw up an annual investment strategy for the following financial year to be approved by full Council;
   ii. requires the strategy to give priority to security and liquidity rather than to yield, to identify which categories of investments may be prudently used and the maximum amount for each category and to set out procedures for determining maximum investment periods.

5. Treasury management in local authorities now has to comply with guidance issued by the Government and with the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and the Prudential Code for Capital Finance in Local Authorities, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

6. An investment strategy is attached as **Appendix A**. This is basically the previous year's Investment Strategy, with the prudential maximum limits for future periods reduced to take account of the falling level of capital receipts available for investment. It continues to restrict investment to the same groups of organisations as before, with more prudent maximum investment limits for building societies and with the same maximum investment limits with any one other type of organisation. For example, with the new criteria for building societies, the number with which up to £5 million can be

invested will be reduced from eight to four and the total number of building societies will be reduced from forty to thirty five.

Options

7. These include:

a) Continuing with the present policy which has produced good results. The Council is a member of the CIPFA Treasury Management benchmarking club. In 2003/04, our average rate was 4.12% compared to the club average of 3.65% and, in 2004/05, the respective rates were 4.84% and 4,66% with the Council being ranked fourth out of 120. These good results were achieved at minimal cost;

b) Increasing risk which should produce a higher rate of return. A proposal from the Council's bankers, HSBC, to invest in negotiable bonds, where the capital value is only certain if held to maturity, has already been rejected at a recent Resources and Staffing Portfolio Holder meeting;

c) With the rapidly declining level of capital receipts, outsourcing is probably no longer feasible as external fund managers often require at least £10 million for at least three years; and

d) The Council's external auditors, RSM Robson Rhodes, in their interim audit report dated July 2005 recommended that counterparties should be assessed for risk using credit ratings and that counterparties be classified in the investment strategy as specified (lower risk) and non-specified (higher risk) investments to comply fully with Government guidance.
Our current policy assumes that larger institutions are lower risk but this is not necessarily in accordance with their credit rating. For example, three of the largest building societies are given credit ratings by Standard & Poor's of A, A+ and A and do not achieve the highest rating where the top of the scale starts with AAA extremely strong, AA very strong and A strong. The smaller building societies with assets within the current range of between £250 million and £1,500 million do not seem to have applied to Standard & Poor's for a credit rating.
An option would be to stop using lists of named counterparties and have a policy of investing only with counterparties with an AAA rating. This would be a radical departure from present practice and would probably result in investing with foreign banks and other commercial organisations (but with all investments and repayments still denominated in £ sterling). Most of these organisations will only accept a minimum of £5 million so the Council would, therefore, have fewer higher value investments with the consequent higher risk. With reducing balances, the opportunity for these large investments will be very limited. At a recent Treasury Management conference, the trend with other local authorities seemed to be to move away from credit ratings in order to achieve a wider range of counterparties with the consequent greater flexibility and spread of risk.
A policy of investing only with counterparties with a AAA rating would be heavily dependent on the credit rating being an accurate assessment. Standard & Poor's credit ratings on their website include the caveat that "any user of credit ratings … should not rely on any such ratings … in making any investment decision".
An intermediate option would be to construct a list of named counterparties which have a minimum credit rating of, say, AA.

Financial Implications

8. The Council may currently earn less interest on its investments by having a very restricted range of investments but this is considered to be more than offset by the reduced risk of default by counterparties. Any change to the use of credit ratings may involve additional time and expenditure with no guarantee of an increased rate of return on investments.

Legal Implications

9. None.

Staffing Implications

10. Any change to the use of credit ratings would require detailed research by senior management and training for staff who deal with treasury management on a daily basis. There is no specific budget for this training.

Risk Management Implications

11. There is internal check with division of duties between dealing, administration and authorisation and any losses due to fraud should be covered by fidelity guarantee insurance. Credit and counterparty risk is currently managed by restricting the range of investment organisations to the main banks, building societies, etc.

12. A change to the use of credit ratings would transfer part or all of the risk assessment to the credit rating agency/ies which do not provide any indemnities against loss. There may be fewer higher value investments which would concentrate and may increase the risk of default by counterparties.

Consultations

13. None.

Recommendations

14. Cabinet is requested to recommend to Council that the investment strategy in the Appendix is approved.

Background Papers: the following background papers were used in the preparation of this report: Guidance from the Office of the Deputy Prime Minister dated 12th March 2004
Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (CIPFA) and
The Prudential Code for Capital Finance in Local Authorities (CIPFA).

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