EXETER CITY COUNCIL

SCRUTINY COMMITTEE - RESOURCES
28 JANUARY 2009

EXECUTIVE
10 FEBRUARY 2009

ANNUAL INVESTMENT STRATEGY - 2009-10

1. PURPOSE OF THE REPORT

1.1 To seek adoption by the Council of the Annual Investment Strategy 2009-10, as required under section 15(1)(a) of the Local Government Act 2003.

2. BACKGROUND

2.1 The Strategy was amended in December 2008 in response to the current financial environment and the Icelandic banking crisis.

3. ANNUAL INVESTMENT STRATEGY – CHANGES

3.1 There are no new amendments to the strategy.

4. RISKS INVOLVED

4.1 Although our strategy has always been to minimise the risk of lending money by only lending to those institutions with high credit ratings, the past year has proven that in exceptional trading conditions these credit ratings cannot be relied on. Landsbanki's F1 credit rating was withdrawn a week prior to the bank going under, which was a major cause of the substantial losses incurred by Local Authorities across the Country. We will continue to monitor credit ratings on a monthly basis.

5. ETHICAL INVESTMENTS

5.1 The Council invests in a range of different financial institutions which, in line with our investment strategy, are mostly banks or building societies. Our fund manager has produced a discussion document in respect of ethical investments, which is attached at Appendix B. Although this was written a few years before the current economic and banking crisis it is still very relevant. The fund manager will, if required, come to a future meeting to discuss the issue of ethical investments or any other aspect regarding the Council's investments.

6. CONCLUSIONS

6.1 There are no further amendments and therefore the Strategy remains as approved in December 2008.

7. RECOMMENDATIONS

7.1 It is recommended that the Executive recommend to Council the adoption of the amended Annual Investment Strategy and delegations contained therein.

HEAD OF TREASURY SERVICES

CORPORATE SERVICES DIRECTORATE

Local Government (Access to Information) Act 1985 (as amended
Background Papers used in compiling this report:

1. Treasury Management Strategy
2. Fund Manager Contracts

APPENDIX A

EXETER CITY COUNCIL

ANNUAL INVESTMENT STRATEGY – 2009-10

1. Introduction

1.1 The Council has regard to the ODPM's Guidance on Local Government Investments ("Guidance") and CIPFA's Treasury Management in Public Services: Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

2. Investment Principles

2.1 The overriding principles of the Council:

- All investments will be conducted in sterling;
- The Council's main objective is the security of its investments;
- The liquidity of investments is also a key objective.

2.2 The council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.

2.3 The Guidance maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The Council will however seek to borrow at the most appropriate time in order to finance its future capital programme.

3. Specified and Non-Specified Investments

3.1 In-house investments are either placed in call accounts or on term deposits with banks and building societies in line with the limits set out in section 5.1. No investments shall be made over one year. Our external Fund manager only invests in institutions or money market funds with the highest possible credit rating.

3.2 **Specified Investments**

- All investments up to one year, in sterling with institutions set out in 5.1 below shall be deemed specified.
- The types of investment include term deposits and certificates of deposits.
- The external managers may also invest in gilts and Government fixed interest securities for up to one year, which will also be classed as specified.
- Both in-house and external Fund Managers may place funds with the Government's Debt Management Office.
- Use of money markets may be made (AAA rated only) for periods of no more than a year by both the in-house and external investment managers.

3.3 **Non specified Investments**

- The external Fund Manager may invest in Government fixed interest Securities for more than one year as they are liquid, low risk and allow for good financial planning.
- The external Fund Manager may invest in Certificates of Deposit for more than one year using their professional judgement.
- The above is subject to the requirement that no more than 50% of the external managers Fund may be held in non-specified investments during the year.

4. Liquidity

4.1 Based on its cash flow forecasts, the Council anticipates its external fund balances in 2009-10 to range between £19m and £21m. Daily cashflow balances will normally range between £0 and £12m.

4.2 Giving due consideration to the Council's level of balances over the next 5 years, the need for liquidity, its spending commitments and provisioning for contingencies, the Council has determined that the external Fund Manager may hold up to 50% in 'non specified' investments during the year.

5. Security of Capital: The use of Credit Ratings

5.1 Credit quality of counterparties (issuers and issues) and investment schemes will, in the first instance, be determined by reference to credit ratings published by Moody's and Fitch. No institution with less than a Fitch F1 (Moody P-1) rating will be used for any investment.

In-house investment

Type of Institution	Limit per Institution £m
Banks – UK only Minimum Fitch Rating F1+ short term Minimum Fitch Rating F1 short term and Moody's rating P-1 short term	 3m 2m 2m
Building Society – UK only Minimum Fitch Rating F1+ short term Minimum Fitch rating F1 short term and Moody's rating P-1 short term, within top 25 asset rankings	 3m 2m
Local Authorities	2m

External Fund Managers

Type of Institution	Limit per Institution £m
Banks Minimum Fitch Rating F1+ short term	 4m
Building Society Minimum Fitch Rating F1+ short term	 4m

5.2 As the Fund Managers and in-house team can both invest in F1+ institutions, there may be occasions when the Council has up to £7 million invested with an F1+ rated institution. As this is the highest rating possible it is considered that the risk involved is acceptable. This would in any case now be very difficult to avoid particularly as the in-house team is restricted to making investments to UK only institutions.

5.3 **Monitoring of credit ratings**
The Council subscribes to Sterling Consultancy Services, which provide a monthly credit rating list for the Council, as well as updates throughout the month. The following monitoring is therefore in place:

• All credit ratings will be monitored monthly.
• If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria as outlined in 5.1 its further use, as a new investment will be withdrawn immediately and the external fund managers informed of the same.
• If a counterparty/investment scheme is upgraded so that it fulfils the Council's criteria, the Section 151 Officer will have the delegated authority to include it on the lending list.

6. Investments defined as capital expenditure

6.1 The Council will not use or allow its external fund managers to make any investment, which will be deemed capital expenditure.

7. Investment Strategy to be followed in-house

7.1 The Council's in-house managed funds are based on the likely cash-flow position and are usually for periods of up to one month. Investments will be made to ensure that cash flow is protected and borrowing is not required. There may be occasions however where money may be invested for a longer period up to 364 days. These will be surplus funds that are not required for day-to-day cash management purposes.

7.2 The Council will continue to seek to utilise its Bank of Scotland reserve account (which is linked to base rate) and use short-dated deposits up to 3 months to ensure liquidity of assets for day-to-day cashflow. Additionally, the Council's bankers, the Co-operative Bank operate a Public Sector Reserve Account, which automatically sweeps excess funds from our general bank account into one paying a higher interest rate. The limit on the account is £3 million, with interest varying depending on the amount in the account. The interest paid is still much lower than other investments and therefore only limited funds are kept in this account.

8. External Cash Fund Management

8.1 Investec manages the Council's funds on a discretionary basis. The Strategy is in line with the contractually agreed procedures. These have been amended to allow the placement of deposits with the Debt Management Office.

9. Prudential Indicators

9.1 The Council sets each year, in February, prudential indicators for Treasury Management, to ensure that proper control of borrowing and investing is maintained. These indicators can be found in the Council's budget book.

10. End of year Investment Report

10.1 At the end of the financial year, the Council will prepare a report on its investment activity as part of its Annual Treasury Report.

HEAD OF TREASURY SERVICES
JANUARY 2009

APPENDIX B

ETHICAL INVESTMENT

HAS ETHICAL INVESTMENT OR SOCIALLY RESPONSIBLE INVESTMENTS (SRI) A ROLE FOR CASH DEPOSITS?

By Paul Cammies, Director - Client Services

August 2003

Many Local Authorities with responsibilities for pension funds have considered the adoption of investment policies for their pension funds that give priority to environmental awareness, including the extent to which Ethical Investment or Socially Responsible Investment (SRI) criteria should influence the placement or withdrawal of investments.

There are two options available:
(a) Place or withdraw investments only if they fit SRI policies; or
(b) Adopt a policy of engagement.
This means that more is achieved by actively engaging with offending companies to influence their behaviour rather than simply refusing to invest. Clearly this approach is most effective where the investment is in shares (e.g. for Pension Fund) – since only a shareholder (or a representative body thereof) achieves the right to attend Annual General meetings and thus gain a forum to air criticisms of unethical activity.

This article explains, some of the issues and comments on the extent, or otherwise, to which such criteria can be successfully applied to the investment of cash reserves.

Ethical Investment means choosing investments in a way that reflects a Council's ethical values. As Local Authorities with pension fund responsibilities will well know that work done by the Ethical Investment Research Service (EIRIS), in respect of equities, is widely regarded as a benchmark for deciding on the making of investments in companies. Usually such 'values' are defined in terms of negative criteria or positive criteria whereby investments are to be encouraged or avoided.

Non pension fund authorities may not be so familiar with the subject, so examples of the criteria usually adopted are listed below.

	Negative Criteria	
Advertising complaints	Intensive farming and meat sale	Roads
Alcohol production or sale	Military	Sensitive sites
Animal testing	Mining	Size
Financial institutions	Nuclear power	Third world debt
Fur	Ozone depleting chemicals supply and use	Tobacco
Gambling	Pesticides marketing and manufacture	

Greenhouse gases	Political donations	Transnational interests
Health and safety convictions	Pollution convictions	Tropical hardwood
Human rights	Pornography and cut 18 films	Water pollution

Positive Criteria		
Animal testing policy/phase out	Equal Opportunities policy	Trade unions
Basic necessities	Ozone depleting chemical policy/phase out	Training and education
Community involvement	Public transport and bicycles	Tropical hardwood policy/phase out
Disclosure	Safety and protection	Waste disposal
Environmental policy	South Africa	Women on the board

These criteria may be applied relatively easily to equities however their application in the context of the instruments and credits that fall within the scope of the Approved Investment Regulations is more problematic. For example:

UK GOVERNMENT

In practice, the Government commissions weapons, raises taxes from Companies involved in all the areas listed earlier, builds roads etc.

LOCAL AUTHORITY

Local Authority may welcome the nuclear industry or the military to their areas because of the jobs that are created.

BANKS & BUILDING SOCIETIES

Financial institutions present a particular difficulty in that it will be impossible for the Council to ensure that funds deposited with an institution will not be on-lent to another which may not fulfil the authorities ethical criteria maintain a specific fund which is only used by that bank to lend in ethical business. It is more usual for banks to determine that the “non ethical” activities of any counterparty to whom they lend (however defined), should not account for more than, say, 5% of that company’s profits. Beyond this undertaking major banks (or similar financial institutions) will not be able to satisfy depositors as to whether the ultimate destination of an investment will meet a Council’s ethical policies.

Building societies as mortgage lenders to individuals are traditionally viewed as not giving rise to ethical issues. However, building societies will deposit surplus funds in banks which in turn may lend-on funds to a wide range of companies that may or may not meet the required ethical criteria. With more building societies becoming banks, an investment in a building society instrument today could become an investment in a bank instrument in the future.

CASH DEPOSITS DIFFER FROM EQUITIES

There are, therefore, issues with all areas in which a Council is allowed to invest in cash, and it is not possible when lending to the Government, another Local Authority or a building society or a bank, to ask for the investment only to be used for "ethical" purposes. It would not be possible to exclude these areas of investment. Looking at areas where any Council can invest its cash in approved investments, it seems likely that monetary instruments of the Government, banks, building societies and public bodies, such as Local Authorities should all be regarded as ethical.

THE LEGAL ISSUES IN MAKING ETHICAL INVESTMENTS

Whether or not the reader shares my views, he/she will also need to take account of the legal issues which impact on ethical investments.

All Treasurers will know that every decision taken by a Council must comply with the "Wednesbury Principles". Put simply, the Council, in adopting any discretionary function, should:

1. Have regard to all relevant matters which the Authority is bound to consider.

2. Exclude from its considerations matters which are irrelevant to what has to be considered.

3. Not come to a decision which is so unreasonable that no reasonable Authority could ever have come to it.

Thus, in the context of any investment, the Council must not lose sight of the fact that, as stated by Lord Diplock in the Case of Bromley London Borough Council v Greater London Council (1982), an Council owes the Taxpayer from who it obtains monies needed to carry out its statutory functions, the duty to deploy the full financial resources available to it to the best advantage. This clearly indicates an obligation to obtain the best financial return from investments which maybe available; but it is clear that the Authority has a discretion as to how those investments may be made – and the obligation resting upon the Authority is clearly that it must not, in the final analysis, come to such an unreasonable decision in relation to such investments that no reasonable Authority could ever have come to such a decision. In the light of this fiduciary duty, it might be argued that engagement, if possible, is more acceptable than negative exclusion.

SUMMARY

Recent case law has shown that a Council can successfully adopt a policy for making decisions which have regard to ethical considerations (see R v Somerset Council ex parts Fewings Leyland and Downs (1993) – commonly known as the Somerset Stag Hunting case) provided it gives proper consideration to all the relevant issues. For Councils with pension fund investment responsibilities, this may give scope for action. For the remaining Authorities it seems unlikely that ethical considerations when applied to approved investments will be a worthwhile or practical issue.