Leicester City Council

Council **Date: 5th October 2017**

Treasury Strategy 2017/18 - Investments

Report of the Director of Finance

1. **Purpose of Report**

1.1 This report proposes changes to the types of investments that the Council may make and the limits on such investments.

2. **Summary**

2.1 The Council approved the Treasury Strategy on 22nd February 2017. The purpose of the report is to propose some minor amendments.

3. **Recommendations**

3.1 The Council is asked to approve the revised investment strategy laid out within this report.

4. **Report**

4.1 The Treasury Strategy governs the way the Council manages borrowing and investments. The proposed changes only affect investment strategy.

4.2 The level of investments fluctuate during the course of a year, and range from £180m to £270m dependent on circumstances (e.g. closeness to employees' pay day).

4.3 It needs to be stressed that these are not monies which are available to spend. Our ability to spend depends on our income, expenditure and spendable reserves. We have these investments because:-

(a) Whilst the Government no longer supports capital spending with borrowing allocations, we are still required to raise money in the budget each year to repay debt. Because of the punitive rules which apply to debt repayment, we do not actually repay any debt, and therefore have no option but to invest the cash;

(b) We have working balances arising from our day to day business (e.g. council tax received before we have to pay wages, and capital grants received in advance of capital spending).

(c) To the extent that we do have reserves, the monies are invested until they are spent. This includes the managed reserves which will support future budgets.

4.4 Increasing levels of cash balances over the years have led us to look for more ways to invest, and to diversify our investments to reduce risk.

4.5 The shape of the investment strategy remains unchanged and in summary:-

(a) We will lend on an unsecured basis to the largest UK banks for periods not exceeding one year. We will also lend to some smaller building societies for periods not exceeding six months. “Bail-in” rules mean lending for longer on an unsecured basis is too great a risk;

(b) We will lend for longer periods, and to smaller banks, if our money is secured (i.e. if we can take possession of the bank’s assets in the event of failure to repay);

(c) Lending to other local authorities has long been a cornerstone of our investment strategy, and this will continue. We will lend to local authorities, either directly or through their bonds;

(d) We will place some money with pooled investments, such as money market funds. These are professionally managed funds, which place money in a range of financial assets, some based overseas. This helps achieve diversification. In cases where money is not secured, we will make sure funds can be returned very quickly;

(e) We will place up to £15m in pooled funds that invest in property. Such funds would only be appropriate to invest if we expect to retain our holding for at least five years. Such funds typically pay dividends at a rate of 4% to 4.5%, which exceeds current cash returns of around 0.5%. However, with such a fund there is always a risk that values will decrease;

(e) We will lend to the Government and other public sector bodies.

4.6 The overarching investment priorities remains the security of capital and the liquidity of investments.

4.7 The proposed changes to the investment strategy are made to reflect practical issues encountered in implementing the 2017/18 treasury strategy, namely:-

(a) The peak levels of cash balances are higher than expected when the 2017/18 strategy was set. Accordingly increases are proposed to the limits on the amount of money that may be invested in some of the categories of investments;

(b) Increasingly investment counterparties seek a commitment to investments being made in advance. Such commitments create a credit exposure (we are contractually bound to lend the money). This has caused practical problems in complying with investment limits, and the revisions therefore permit greater exposure for limited periods of time in these circumstances;

(c) The maximum period for direct investment in local authorities is increased from 2 years to 5 years;

(d) The minimum long-term credit rating for some investments is reduced from AA to AA-, which remains a high credit rating (for example some local authorities have this rating). This change expands the pool of available investments and also gives some flexibility if the credit rating of the UK government, currently AA, were to be reduced. This change prevents us from unexpectedly finding a lot of UK borrowers no longer meet our requirements;

(e) The policy now permits investing in a range of property funds instead of just one;

(f) The strategy now permits investments in non-UK banks operating and regulated within the UK (such investments will only be made on the advice of our treasury advisors). We still are not recommending direct investment in overseas banks; only those regulated in the UK.

4.8 The following part of this report updates the schedules within the Investment Strategy that detail the instruments in which the Council may invest, the counterparties with whom it can invest with and the credit worthiness requirements to be applied.

3.1 UK Banking Sector: Credit Rated Institutions			
Type	**Description**	**Investment Period**	**Controls**
General	Covers the largest UK banks and building societies. Covers non-UK banks operating in the UK and regulated in the UK.		No more that £100M will be invested in total with these institutions. No more that £20M will be invested with any one institution. Of this £20M no more than £10M will be unsecured except when invested with Barclays (our bankers). An additional £5M may be invested overnight with Barclays New bodies will not be added to the list without the written approval of the Director of Finance. In addition investments may be committed in advance by up 10 working days.
Unsecured deposits	Banks regulated within the UK.	Maximum 366 days.	A list of approved counterparties will be maintained, based on credit ratings. Principally, we use Fitch. Minimum ratings as below. Other market intelligence will also be considered.
		Up to 366 days.	Long-term rating of A & short term rating of F1
		Up to 6 months.	Long-term rating of A- & short term rating of F2
		100 days or less.	Long-term rating of BBB+ & short term rating of F2
Covered Bonds	This is a deposit with a bank or building society, which is secured on assets such as mortgages. These assets are not immediately saleable but the value of the assets exceeds loans secured upon them. If the deposit is not repaid the assets are sold and the proceeds used to repay the loan.	Maximum 5 years.	Bond is regulated under UK law and majority of assets given as security are UK based. Minimum long-term rating of AA- .

Reverse REPOs	This is a deposit with a bank, which is secured on bonds and other readily saleable investments and which will be sold if the deposit it not repaid.	Maximum 1 year.	Judgement that the security is equivalent, or better than the credit worthiness of unsecured deposits. REPO/Reverse REPO is accepted as a form of collateralised lending and should be based on the GMRA 2000 (Global Master REPO Agreement) or a successor agreement. Should the counterparty not meet our senior unsecured rating then a 102% collateralisation would be required. The acceptable collateral is as follows:- • Index linked Gilts • Conventional Gilts • UK Treasury bills • DBV (Delivery By Value) • Corporate bonds
3.2 Unrated Building Societies			
Type	**Description**	**Investment Period**	**Controls**
General	Smaller building societies who do not have credit ratings. Many are mutually owned.	Up to 6 months.	No more than £10M will be invested in total with these institutions. No more than £1M will be invested with any one institution. A list of approved counterparties will be maintained. This will be based upon an analysis of the financial strength of the institution by our Treasury Advisers. New bodies will not be added to the list without the written approval of the Director of Finance. Investments committed in advance will not count against these limits provided that committed no more than 3 working days in advance of the actual investment.

3.3 UK Public Sector & Quasi Public Sector

Type	Description	Investment Period	Controls
General	The UK Government and UK local authorities, including Transport for London (TFL) . Also bonds issued by the Local Government Bond Agency. It also includes bodies that are very closely linked to the UK Government or to local government such as Cross Rail or National Grid.		No more than £200M to be lent to local authorities. No more than £20M to be lent to any one local authority. No more than £40M to be lent to bodies very closely linked to the UK Government and no more than £20M to be lent to any one body. No limit on amounts lent to the UK Government. In addition investments may be committed in advance by up 10 working days.
Deposits	Deposits with Local Authorities and the UK Government.	Up to 5 years.	Our judgement is that local authorities are of high credit worthiness and that the law provides a robust framework to ensure that all treasury loans are repaid. However, should the occasion arise, we would have regard to adverse news or other intelligence regarding the financial standing of a local authority.
Bonds – Local Authority	Bonds issued by local authorities.	Up to 5 years.	
Bonds – Municipal Bond Agency	Bonds issued by local authorities collectively through the Local Government Bond Agency.	Up to 5 years.	Minimum AA- credit rating. The agency is new and until established the number of underlying borrowing local authorities will be low. When investing with the agency we will look at the underlying exposure to individual authorities when these are material and take into account existing exposures to those authorities.
Bonds – Bodies Closely Linked to UK Government		Up to 5 years.	Minimum AA- credit rating. Approval by Director of Finance to the body being added to the lending list on the basis of a written case, including advice from the Council's treasury advisors.

3.4 International Development Banks

Type	Description	Investment Period	Controls
Bonds	International Development Banks which are	Up to 5	No more than £40M to be lent in total and no more than £10M to be lent

	backed by the governments of the world's largest and strongest economies. The funding obligations are established by treaties or other binding legal agreements.	years.	to any one bank. Approval by Director of Finance, in consultation with the City Mayor, to the body being added to the lending list on the basis of a written case, including advice from the Council's treasury advisors. A minimum credit rating of AA- plus backing of one or more G7 country.
3.5. Pooled Investments – Shorter Dated Investments			
Type	**Description**	**Investment Period**	**Controls**
General	A structure where a wide base of investors share a common pool of investments. The most common legal form involves an intermediate company. The company has legal title to a pool of investments. The underlying investors own the company with a claim to their share of the assets proportional to their investment in the company.		We will only invest in funds where there is evidence of a high level of competence in the management of the investments, and which are regulated. Approval by Director of Finance to the body being added to the lending list on the basis of a written case, including advice from the Council's treasury advisors. The investment period will reflect advice from our Treasury Advisors on a fund by fund basis. We will be alert to "red flags" and especially investments that appear to promise excessive returns. We look for diversification away from the banks permitted elsewhere in this lending list (though some overlap is unavoidable). No more than £120M to be invested in all fund types listed in this table.
Money market funds	The underlying pool of investments consists of interest paying investments, for example deposits. The underlying borrowers include banks, other financial institutions and non-financial institutions of good credit worthiness. Banks may be UK or overseas.	Must have immediate access to funds.	Fitch rating of AAAmmf (or equivalent). No more than £20M in any one fund.

Short Dated Government Bond Funds	Similar to money market funds but mainly concentrated in highly credit rated government bonds.	Must have immediate access to funds.	Whilst these are very safe the interest returned is very low. We may use these in times of market turmoil. Fitch rating of AAAf (or equivalent). No more than £20M in any one fund.
Money market plus funds / cash plus funds / Short dated bond funds	Similar to money market funds but the underlying investments have a longer repayment maturity. We would use these to secure higher returns.	Must have access with one month's notice but normally would wish to hold for 12-18 months.	Fitch rating of AAf (or equivalent). No more than £20M in any one fund. We will "drip feed" money that we invest rather than investing it all at once.
3.6. Pooled Investments – Longer Dated Investments			
Type	**Description**	**Investment Period**	**Controls**
General	A structure where a wide base of investors share a common pool of investments. The most common legal form involves an intermediate company. The company has legal title to a pool of investments. The underlying investors own the company with a claim to their share of the assets proportional to their investment in the company. Other legal structures will be considered. Longer dated investments expose us to the risk of a decline in value, but also provide an opportunity to achieve higher returns. Consequently, controls involve both the		We will only invest in funds where there is evidence of a high level of competence in the management of the investments, including, where relevant, how the fund is regulated. The investment period will reflect advice from our Treasury Advisors on a fund by fund basis. We will be alert to "red flags" and especially investments that appear to promise excessive returns. We will "drip feed" money that we invest rather than investing it all at once. We look for diversification away from the banks permitted elsewhere in this lending list (though some overlap is unavoidable). No more than £50m to be invested in all fund types listed in this table.

	personal authorisation of the Director of Finance and consultation with the City Mayor.		
Property Funds	The underlying investments are mainly direct holdings in property, but our investment is in a pool of properties. Whilst the fund normally has a small cash balance from which to fund redemptions the bulk of the fund is held in direct property investments. On occasions redemptions will not be possible until a property has been sold. Funds may have the power to borrow .	Generally have access with three months' notice but normally would wish to hold for five years.	No more than £15M to be invested in property funds. Investment amounts and timing to be approved by the Director of Finance, in consultation with the City Mayor.
Longer-dated Bond Funds.	Similar to money market funds but the underlying investments are now mainly bonds with a maturity with an average maturity of up to 8 years.	Must have access with one month's notice but normally would wish to hold for two to three years.	Fitch rating of AAf (or equivalent). Approval by Director of Finance, in consultation with the City Mayor, to the body being added to the lending list on the basis of a written case, including advice from the Council's treasury advisors. No more than £10M to be invested in any one fund.
Asset Based Securities	The base investments are "securitised investments" which pool consumer debt (mortgages, car loans and credit cards) and loans to small businesses. The base investments are loans to borrowers of good credit worthiness. They are a world away from the "sub-prime" investments that led to the 2008 crash.	Must have access with one month's notice but normally would wish to hold for two to three years.	Fitch rating of AAf (or equivalent). We look for particular strong evidence of expertise both from the organisations that issue the securitised investments and also from the managers of the pooled fund. We look for clear evidence of financial and operational independence between the fund managers and the banks that made the consumer loans in the first place. Approval by Director of Finance, in consultation with the City Mayor, to the body being added to the lending list on the basis of a written case,

	The investment we would make would be in a pooled investment containing a number of such securitised investments. They are normally issued by banks (UK or overseas).		including advice from the Council’s treasury advisors. No more than £10M to be invested in any one fund.

5. **Financial and Legal Implications**

5.1 The proposals are in accordance with the Council’s statutory duties under the Local Government Act 2003 and statutory guidance, and comply with the CIPFA Code of Practice on Treasury Management. In accordance with the Council’s constitution (Article 4.03), the strategy requires full Council approval.

6. **Background Papers**

6.1 None.

7. **Author**

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