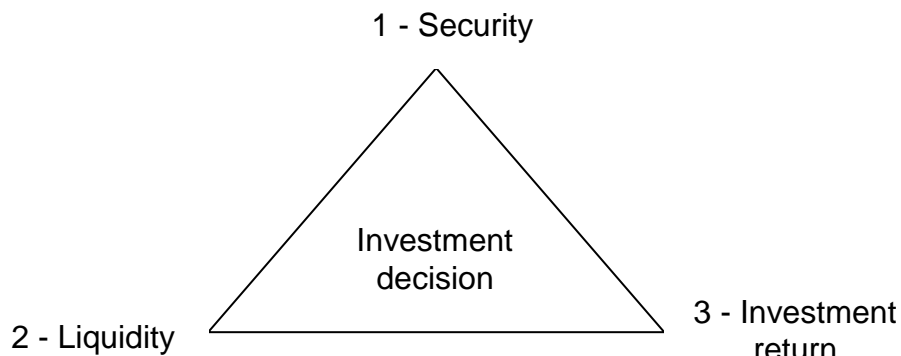


SOUTHEND-ON-SEA BOROUGH COUNCIL
REVISED ANNUAL INVESTMENT STRATEGY 2015/16

1 Investment Objectives

- 1.1 To secure the principal sums invested
- 1.2 To maintain liquidity (i.e. adequate cash resources)
- 1.3 To optimise the income generated by surplus cash in a way that is consistent with a prudent level of risk
- 1.4 Security and liquidity are placed ahead of the investment return. This is shown in the diagram below:



2 Policy on use of external fund managers

- 2.1 The Council currently uses one fund manager, Aberdeen Asset Management (formerly Scottish Widows Investment Partnership Limited). The fund is estimated to have an average of £25m in 2015/16. This money is placed with the fund manager to invest on our behalf, to use their knowledge and experience with a balance of monies that is, under normal circumstances, not required for day to day cash flow purposes.
- 2.2 Withdrawals may be made during 2015/16 so that a proportion of the council's debt can be repaid or the monies invested as part of the in-house managed funds. Conversely, monies may be placed with the existing and/or a new fund manager during 2015/16 to take full advantage of the knowledge and experience of fund managers in making investment decisions. As to whether monies are deposited or withdrawn, the reason and timing of the decision will have regard to the council's cash flow, relevant interest rates and advice from our treasury management advisers.
- 2.3 A new fund manager may be appointed during 2015/16. Any further appointments will need to be approved by Cabinet.

3 Policy on investment of in-house managed funds

- 3.1 The remaining funds will be managed in-house with the investment period and amounts being determined by the daily cash flow requirements of the Council. Cash flow forecasts will be produced in order to inform in-house investment decisions.
- 3.2 This authority has accepted the risk of placing funds with financial institutions, rather than solely with the UK government Debt Management Office. However, the risk is minimised by this Annual Investment Strategy, which restricts the types of investment, the counterparties used and the limits for these counterparties.
- 3.3 Guidance from the Communities and Local Government (CLG) department recommends that specified and non-specified investments are identified in the Investment Strategies of local authorities. Specified investments have relatively high security and liquidity, with high credit quality and a maturity of no more than a year. Non-specified investments are investments that do not fall into this category. The types of in-house investment and whether they are specified or non-specified are set out in Annex A.
- 3.4 During 2015/16 the Section 151 officer will, if appropriate, approve the placing of monies in deposit accounts, fixed term deposits or certificates of sterling cash deposits up to five years, subject to the proposed banks and building societies satisfying the investment criteria in a combined matrix of credit ratings, and having regard to other market information available at the time.
- 3.5 During 2015/16 the Section 151 officer will, if appropriate, approve the placing of monies in Money Market Funds, term repurchase arrangements, Treasury bills, with other Local Authorities or the Debt Management Office.
- 3.6 During 2015/16, if appropriate, the Section 151 officer will approve the placing of monies in Property Funds and will approve the direct investment in property. Any resulting updates to the capital programme would be submitted to Cabinet for approval.
- 3.7 Where credit ratings are used to assess credit risk, they will be checked when an investment is taken out to ensure that investment satisfies the criteria in this Investment Strategy. Our treasury management advisers provide alerts when credit ratings are changed by the three main rating agencies. If the credit ratings of an institution or investment no longer satisfy the criteria the monies will be withdrawn as soon as possible. This would depend on the maturity date or notice period.
- 3.8 During 2015/16 the Section 151 officer will, if appropriate, approve the short term borrowing of monies from other Local Authorities or the PWLB in order to manage the cash flow and maintain liquidity.
- 3.9 Fixed term deposits may be made directly with the banks and building societies or through the use of a broker. Monies will be placed with other Local Authorities through the use of a broker. Investments in Certificates of Deposit and Treasury bills will be made through the use of a custodian

account. The Council acknowledges that it retains responsibility for all investment decisions made whether they are made on its behalf or not.

- 3.10 When investing in-house managed funds, the following are considered; the type of investment, the individual counterparty, the amount that can be invested, the method of placement of monies. These are summarised in Annex A.
- 3.11 The services of our treasury management adviser, Capita Asset Services, will be used throughout 2015/16 to provide advice as well as credit rating and other market information regarding counterparties and types of investment. However, the Council recognises that responsibility for investment decisions remains with the authority at all times.

4 Investment Criteria for Funds Managed In-house

- 4.1 All financial institutions considered for investment will be assessed for credit worthiness against a combined matrix of pre determined criteria using available credit ratings. Credit ratings are assessments by professional organisations of an entity's ability to punctually service and repay debt obligations. Credit ratings are used by investors as indications of the likelihood of getting their money back in accordance with the terms on which they invested.
- 4.2 The credit rating components used in the matrices comprise:
- Short term ratings;
 - Long term ratings.

Ratings provided by all three credit rating agencies will be consulted and the lowest rating will be taken.

- 4.3 The short term rating covers obligations which have an original maturity not exceeding one year. The short-term rating places greater emphasis on the liquidity necessary to meet financial commitments. All three credit rating agencies provide short term ratings. The ratings are expressed from F1+ (highest credit rating) through to D (highest default risk) for Fitch, from A-1+ (highest credit rating) through to D (highest default risk) for Standard and Poors, and from P-1 (highest credit rating) through to NP (highest default risk) for Moody's.
- 4.4 The long term ratings generally cover periods in excess of one year. Due to the larger time horizon over which the rating is determined, the emphasis shifts to the assessment of the ongoing stability of the institution's prospective financial condition. All three credit rating agencies provide long term ratings. The ratings are expressed from AAA (highest credit rating) through to D (highest default risk) for Fitch and Standard and Poors and from AAA (highest credit rating) through to C (highest default risk) for Moody's.
- 4.5 In order to balance the objective of securing the maximum level of return on investments with a prudent level of risk a matrix of criteria will be

adopted as a starting point to determine the acceptability of a potential investment.

4.6 These matrices are set out below:

For Lending of up to 100 days to Banks and Building societies:

If the short and long term ratings are at least:

| | Fitch | S&P | Moody's |
|---------------------------|-------|-----|---------|
| Short term rating minimum | F1 | A-1 | P-1 |
| Long term rating minimum | A- | A- | A3 |

For Lending of up to 6 months to Banks and Building societies:

If the short and long term ratings are at least:

| | Fitch | S&P | Moody's |
|---------------------------|-------|-----|---------|
| Short term rating minimum | F1 | A-1 | P-1 |
| Long term rating minimum | A+ | A+ | A1 |

For Lending of up to 1 year to Banks and Building societies:

If the short and long term ratings are at least:

| | Fitch | S&P | Moody's |
|---------------------------|-------|-----|---------|
| Short term rating minimum | F1 | A-1 | P-1 |
| Long term rating minimum | AA- | AA- | Aa3 |

For Lending of up to 3 years to Banks and Building societies:

If the short and long term ratings are at least:

| | Fitch | S&P | Moody's |
|---------------------------|-------|------|---------|
| Short term rating minimum | F1+ | A-1+ | P-1 |
| Long term rating minimum | AA | AA | Aa2 |

For Lending of up to 5 years to Banks and Building societies:

If the short and long term ratings are at least:

| | Fitch | S&P | Moody's |
|---------------------------|-------|------|---------|
| Short term rating minimum | F1+ | A-1+ | P-1 |
| Long term rating minimum | AA+ | AA+ | Aa1 |

4.7 An example of the use of this credit ratings matrix as at 05 December 2014 is shown below (the long and short term ratings are Fitch, then Standard and Poors, then Moodys).

| Financial Institution | Long Term Rating | Short Term Rating | Maximum length of investment |
|-------------------------------|-------------------------|--------------------------|-------------------------------------|
| KfW (<i>a German bank</i>) | AAA AAA Aaa | F1+ A-1+ P-1 | 5 years |
| Toronto-Dominion Bank | AA- AA- Aa1 | F1+ A-1+ P-1 | 1 year |
| Lloyds Bank plc | A A A1 | F1 A-1 P-1 | 100 days |
| National Westminster Bank Plc | A A- Baa1 | F1 A-2 P2 | Initially fails investment criteria |

4.8 The Council's treasury management advisers, Capita Asset Services, will continually review the appropriateness of our investment criteria and continue to develop a best practise counterparty list. The latest advice has now been incorporated in this Strategy, which is set out below.

4.9 The individual ratings for some banks and building societies are low which means that they do not meet the criteria in our credit ratings matrix. However, this does not take account of part nationalised banks. These banks can be included in the counterparty list if they continue to be part nationalised or they meet the criteria of our credit ratings matrix or the criteria in paragraph 4.10. An example of the institutions meeting the criteria for the UK will therefore include:

- Bank of Scotland
- Lloyds TSB Bank
- Royal Bank of Scotland
- National Westminster Bank
- Barclays
- HSBC Bank plc
- Nationwide Building Society
- Santander UK plc

For example, National Westminster Bank plc fails the investment criteria of the credit ratings matrix but is one of the part nationalised banks and would therefore be added back to the counterparty list. Counterparties that are manually added back to the list will have a maximum length of investment of 100 days. Amendments to the counterparty list can happen at any point in time.

- 4.10 In addition, for practical purposes the Council's bank will form part of the counterparty list, whether or not it meets the criteria in our credit ratings matrix.
- 4.11 Regard will be given to forward looking rating warnings (i.e. rating watches and outlooks) provided by our treasury management advisers.
- 4.12 The current advice from the Audit Commission is not to rely solely on the credit rating agencies and the Council recognises that ratings should not be the sole determinant of the quality of an institution. So regard will also be given to market information such as the financial press, and officers will engage with their advisers to maintain a monitor on market pricing (such as share and 'credit default swap' prices) and other such information pertaining to the banking sector. Where available credit information, other than credit ratings has been used, this will be documented when the investment decision is made.
- 4.13 Consideration will also be given to Capita Asset Services' rating methodology approach, where counterparties are put into bands of risk. These reflect the differences in credit quality of suggested duration and counterparties are assigned a risk number/colour.
- 4.14 The achievement of an appropriate balance between short-term and longer-term deposits will be driven by the credit quality of counterparties, the council's cash flow requirements, and the need to achieve optimum performance from our investments consistent with effective management of risk.

5 Investment Limits for Funds Managed In-house

- 5.1 The ratings agencies produce a credit rating for each country, called a sovereign rating. The ratings are expressed from AAA (highest) to D (lowest). The following limits have been set for an investment with a bank or building society whose parent company is registered in a country with a sovereign rating from Fitch and S&P of AAA or AA+ or a sovereign rating from Moody's of Aaa or Aa1. IDR sovereign ratings provided by all three credit rating agencies will be consulted and the lowest rating will be taken.

| Country Sovereign Rating | Limit* All except UK (£ million) |
|---------------------------------|---|
| AAA/Aaa | 20 |
| AA+/Aa1 | 5 |
| Lower than AA+/Aa1 | 0 |

* These limits relate to the principal sums invested and do not include any accrued interest on that principal.

- 5.2 These limits will also apply to supranationals (international organisations whereby member states transcend national boundaries or interests to share in the decision-making and vote on issues pertaining to the wider grouping). An example of a supranational is the European Investment Bank.

- 5.3 Fitch have downgraded the UK's sovereign rating to AA+. Therefore, to ensure the continued use of UK institutions that fall within our investment criteria, the country sovereign rating limits exclude the UK. The limit will therefore remain at £20 million for all counterparties where the parent company is registered in the UK.
- 5.4 Where the parent company of a bank is not registered in a country with a sovereign rating from Fitch and S&P of AAA or AA+ or a sovereign rating from Moody's of Aaa or Aa1 but that bank's UK operations are ring-fenced to the UK (as is the case for Santander UK), if these banks are included in the counterparty list they will have a counterparty limit of £20 million.
- 5.5 £20 million is 4.8% of the authority's estimated 2014/2015 gross revenue expenditure of £419m. £5m is slightly more than 1% of the estimated gross revenue expenditure.
- 5.6 To minimise counterparty risk, the limit on any investment with a bank or building society (with the exception of the Council's bank which is currently Barclays Bank) will be determined in the following way:
- consider the country in which the parent company of the bank or building society is registered
 - use the sovereign rating of that country to apply the limits above
 - consider the cumulative balance of funds already held in various investment products with that bank or building society
 - consider the cumulative balance of funds already held in various investment products for any related group of financial institutions
 - determine the remaining amount that can be placed with that bank or building society

For example, the limit on an investment with Lloyds Bank would be determined in the following way:

| Steps to determine limit: <i>(for illustrative purposes only and not an indication of actual investments)</i> | Remaining limit available at each stage: |
|---|---|
| Lloyds Bank is part of the Lloyds Banking Group which is registered in the UK | £20 million |
| £4 million already placed in an instant access account with Lloyds Bank | £16 million |
| £5 million already placed in a fixed term deposit with Lloyds Bank | £11 million |
| £6 million already placed in a notice account with Bank of Scotland Plc (part of the Lloyds Banking Group) | £5 million |
| Therefore the maximum investment would be £5 million | |

The Council's bank is the exception to these investment limits however, and under normal circumstances our intention would be to comply with a counterparty limit of £30 million, to enable the efficient and effective management of the Council's cashflow.

- 5.7 The limit on deposits in Money Market Funds will be £20 million with any one AAAM rated liquidity fund. These work in the same way as a deposit account but the money in the overall fund is invested in a number of counterparties, therefore spreading the counterparty risk.
- 5.8 There are products being developed that are similar to, but not the same as Money Market Funds, such as 'term repurchase arrangements'. The risk associated with these funds is somewhere between a fixed term deposit and a Money Market Fund. The Section 151 officer will approve the placing of monies in these types of fund up to a maximum of £20 million per fund, if deemed appropriate and in consultation with our treasury management advisers.
- 5.9 The limit on deposits in Property Funds will be £20 million with any one fund that passes the selection process.
- 5.10 Given the prevailing financial market conditions, financial institutions will inevitably devise various investment products to offer enhanced returns. The Council's Section 151 Officer will consider these in consultation with our treasury management advisers and will approve the placing of monies in such investment products with appropriate limits, only after the options and their associated risks have been fully analysed by the treasury management team and our treasury management advisers.
- 5.11 To maximise flexibility, there is no limit on deposits with the UK Government (e.g. Debt Management Office, HM Treasury bills). These deposits will have a maximum duration of 6 months.
- 5.12 The limit on deposits with other Local Authorities will be £40 million which is 9.5% of the authority's estimated 2014/2015 gross revenue expenditure of £419m. These deposits will have a maximum duration of 5 years.

6 Fund Managers investment criteria

- 6.1 Investments undertaken by external fund managers on behalf of the Council can only be placed in certain types of investment as permitted under the Local Government Act. The types of investment, counterparties and limits used by each fund manager are set out in their Investment Management Agreement.
- 6.2 The Council's Section 151 Officer is authorised to amend these Investment Management Agreements as appropriate to reflect the needs of the Council, after fully considering the options and their associated risk and in consultation with the Council's treasury management advisers.

| Type of Investment | Individual Counterparty | Limit | Method of placement | Specified/non-specified |
|--|--|---|---|--|
| Deposit accounts | Bank or building society that meets the criteria of our combined matrix of credit ratings, or one of the part nationalised banks or building society | Per bank or building society, based on country sovereign rating | Directly or through a broker | Specified (if 1 year or less), Non-specified (if more than 1 year) |
| Fixed term deposits | | | Directly or through a broker | |
| Certificates of sterling cash deposits | | | Custodian account | |
| Money Market Funds | AAAm rated* liquidity fund | Per fund | Directly or via an on-line site for managing money market funds | Specified |
| Property Funds | Via selection process | Per fund | Directly or through a broker | Non-specified (more than 1 year) |
| Term repurchase arrangements | AAAf/S1 rated# | Per fund | Directly | Specified (if 1 year or less), Non-specified (if more than 1 year) |
| Other Local Authorities | Depends on which Local Authorities want to borrow money at that time | For total invested with other Local Authorities | Through a broker | Specified (if 1 year or less), Non-specified (if more than 1 year) |
| Debt Management Office | UK Government | For total invested with UK Government | Directly | Specified |
| Treasury Bills | | | Custodian account | |

* A fund with a principal stability rating of 'AAAm' has an extremely strong capacity to maintain stability and to limit exposure to losses of the principal sums invested due to credit, market and/or liquidity risks.

A fund with a credit quality rating of 'AAAf' has a portfolio holding that provides extremely strong protection against losses from credit defaults. A fund with a volatility rating of S1 possesses low sensitivity to changing market conditions.

This table is subject to change as new products are added as deemed appropriate – see paragraph 5.8.