

STEVENAGE BOROUGH COUNCIL – TREASURY MANAGEMENT STRATEGY SHORT TERM INVESTMENT CRITERIA REVIEW – 18 OCTOBER 2011

Agenda Item 7 Appx Bii

Background

Stevenage Borough Council maintains extremely high criteria for the selection of counterparties in which it is prepared to invest its surplus funds.

The Council has not adopted the approach proposed by CIPFA of using the lower of the three credit ratings agencies, as this would leave the Council with very few counterparties, and the need to maintain high limits with those counterparties, exposing the Council to greater risk.

Instead a review of ratings given by all agencies is considered, and used in conjunction with advice from our treasury advisors. Currently, we will invest short term in institutions with a short term rating of F1+, the highest possible short term Fitch rating, using durations as suggested by our Treasury Advisors.

On 7th October, **Moody's** (one of the three credit ratings agencies) announced the results of a review of its perceived level of government support for part nationalised financial institutions. This resulted in its short term rating remaining the same at Prime 1, and a small drop in the ratings for long term (greater than one year) risk. The fall was more marked for smaller institutions, with both Nat West (RBS Group) and Bank of Scotland (Lloyds Group) showing a small fall.

The position was reviewed by the Strategic Director, and it was agreed at that point that no further action was required, and the Leader and Resources Portfolio Holder was advised of this decision.

On 13th October, in response to Moody's downgrade, and the Chancellor's affirmation of their assessment, **Fitch** followed. However, this resulted in a reduction to their short term rating. They have assessed the short term rating as F1, from F1+.

In order to ensure compliance with our current Treasury Strategy, the Strategic Director (Resources) instructed the withdrawal of funds from the affected institutions, which have been deposited in the Governments DMO Account (effectively a safe-haven account).

Review of Current Strategy

Existing Criteria

The banking sector is still unstable, and it is therefore appropriate to review investment standards for short term investments.

However, in relation to part-nationalised institutions, the advice of our Treasury Advisors is that their position is stronger, and they have maintained their "blue" rating, which has a suggested counterparty duration of up to 12 months.

Given the high level of government investment through shareholdings in these institutions – RBS 84% of shareholding, and a large minority (more than 40%) in the Lloyds Group, it has a significant financial interest in continuing to support these institutions.

The nature of the Council's holdings in these institutions has been in the form of Call Accounts – these are highly liquid, instant access accounts, from which we can withdraw our funds without penalty.

Counterparty review and use of Money Market Funds

In recent years it has not been the practice of the Council to undertake investments in Money Market Funds (MMFs), although we do include the possibility of use within our specified investments, if rated AAA. These may be on an instant access basis.

The reason for not using them has been as a result of the Council's inability to control the level of investment undertaken by the Funds in any single counterparty, and therefore the likelihood that we may breach our £5Million counterparty limit.

However, the need to identify a greater number of high quality counterparties has increased the need to use such funds. The Council are able to set criteria in the selection of MMFs which includes the diversification of the fund portfolio, which minimises our exposure to one institution failing. It would however require that we disregard MMFs from our Counterparty limits.

Member Review of Credit Ratings and Investment Strategy

In response to the credit rating downgrading, the Leader agreed to convene a meeting at the earliest opportunity of:

Councillors

- The Leader (Cllr Sharon Taylor)
- The Deputy Leader (Cllr John Gardner)
- The Resources Portfolio Holder (Cllr Joan Lloyd)
- The Chair of the Resources Development and Scrutiny Committee (Cllr Janet Thomas)
- The Leader of the Opposition (Cllr Graham Clark)
- Opposition Member with Financial Experience (Cllr Phil Bibby)

Officers

- Strategic Director (Resources) (Scott Crudgington)
- Head of Finance (Clare Fletcher)

The purpose of this meeting was to review the minimum credit ratings for investment purposes as part of our Treasury Management Strategy.

The meeting was held on Tuesday 18 October 2011 at 2pm.

Minutes of the Meeting

SC outlined the events leading to the convening of the Member group, this being that last Friday when the credit agency Fitch followed Moody's (credit agency) to downgrade part state owned nationalised banks from F1+ to F1 (for short term investments), this meant that the Council would have a technical breach from its TM Strategy. The action taken by the SD (Resources) was to remove the investments from Nat West (RBS Group) and Bank of Scotland (Lloyds Group) and place the investments with the Governments Debt Management Office (DMO).

SC explained that the group was convened to consider the current issues and agree potential changes to the Strategy. Approval of the TM Strategy is a function of Council and the route to changing the TM would be to get the Mayor (or through delegated officer decision) to sign off any changes and then update Council at the next available date.

SC explained that each rating agency has a different system of rating and SBC use a combination of the 3 rating agencies overlaid with Sectors criteria (taking into account any CDC's etc) to come to a recommended length of time any investment can be made. Essentially 0-3 months, 6 months, 1 year, 2years and 5 years.

SC explained that the TM strategy is to lend to F1+ only counterparties, for clarity SC explained that the ratings went from F1+, F1, F2 and F3. In terms of putting the Council's current investment criteria into context, SC gave comparative data for other LA's in respect of short term investments:

Council	Lending Criteria
North Hertfordshire District Council	F3 or above
East Hertfordshire District Council	F1 or above
Welwyn Hatfield District Council	F1+ only

Members were advised that F3 was the lowest graded investment and that this would not be recommended.

Members were updated with the Key principles of the TM and these were Security, Liquidity Yield, with security being the most important. SC said the safest place would be to put the council's investments in the DMO at an investment return of 0.25% but this would be a low return. This should be compared with a higher risk strategy of lowering the grading of investments the Council would be prepared to invest in. Members agreed that they would agree to a middle way between the two.

SC and CF raised Money Market funds as an alternative placement for funds and the TMS allows for funds to be placed with AAA rated funds. Historically the interest rate has been lower on these funds compare to the call accounts with Santander and Bank of Scotland typically lower than the 0.75%-0.88% achieved on call accounts. Cllr PB asked about the interest rates achieved and the amount in the current budget. CF advised that the average rate of interest was 0.93% however this was partly due to the 1.35% investment with Newcastle City Council.

Cllr PB raised the issue of diversifying the portfolio particularly in times of risk. CF advised Members that when investment balances were higher than the limit at which each bank group or counterparty was £7.5Million, this has been reduced to £5M as investment balances have reduced. Cllr ST stated that it should be mentioned in the TM revision that there had been a review of diversification and the counter party limits.

SC advised the group that although the partly state owned banks had been downgraded from F1+ to F1, they still had a Sector rating of investments for up to 1 year and could be considered a lower risk due to the part ownership by the state. Members agreed that the TM strategy should be amended to allow lending to F1 part nationalised banks.

CF advised the group that the Council also had investments of £5M with Santander and there is a possibility that this bank could also be downgraded. Members also considered changing the TM to allow investments of F1 for all counterparties. The Council has one fixed term investment with a banking group (Nationwide), this investment was due for repayment on the 19 December 2011 and penalties would be incurred if the deal was revoked early.

Cllr ST proposed that the TM should say that the Council will use F1+ investments first and then in line with the need to diversify and spread the risk of default on investments, counterparties with F1 part state owned would be considered. After all these investment routes had been exhausted the TM would allow for investments with F1 counter parties.

CF asked about the link between the Audit Committee and the Steering Group and SC and Cllr ST stated that this group was setting the TM Strategy but the Chair of the Audit Committee would be advised of the changes and then the Chair could if required hold a special Audit Committee.

Summary Recommendations

That the Council's Treasury Management Strategy be amended as follows:

- That short term investments are made in the following order of preference:
 1. F1+ institutions
 2. Fully of part nationalised F1 institutions
 3. Other F1 institutions
- That officers review the applicability of money market funds during the current period of volatility in the investment market.
- That the Chair of the Audit Committee be advised of the changes proposed by the member steering group, and determine whether a review of the decisions taken is required.
- That the updated Treasury Management Strategy be submitted to Council at the earliest opportunity.
- That the above decisions be ratified via the appropriate constitutional route, whether that be an officer key decision or from the approval of the Mayor.