GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS FOR DISTRICT COUNCILS IN NORTHERN IRELAND

BACKGROUND

As part of the introduction of the new prudential capital finance system, the Department has issued this guidance on local government investments. Part 1 of this document gives informal advice only and is not part of the guidance itself, which is contained in Part 2.

Under the new prudential system, the onus is on councils to act prudently with regard to their investment and treasury management strategies. Elected members will need to be aware of this and be prepared to accept the consequences of their decisions.

Section 23 of the Local Government Finance Act (Northern Ireland) 2011 gives councils the power to invest for *"any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs"*. The reference to the *"prudent management of its financial affairs"* is included to cover investments which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This would also allow the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest remains unlawful. The Chartered Institute of Public Finance and Accountancy's (CIPFA) "Prudential Code for Capital Finance in Local Authorities" also states that councils should not borrow in advance of their need to profit from investment of the extra sums borrowed (paragraph 80).

APPLICATION

The guidance becomes operative on 1 April 2012.

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DOE

PART 1

INFORMAL COMMENTARY ON THE INVESTMENTS GUIDANCE

[References to paragraphs in the formal guidance are in square brackets]

GUIDANCE AND CODES OF PRACTICE

1. Two codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) contain investment guidance which complements the Departmental guidance. These publications are:

   - Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes. This CIPFA Code covers the whole range of treasury management issues, including the basic fundamental principles for making and managing investments; and
   - The Prudential Code for Capital Finance in Local Authorities.

2. Councils are required to have regard to the current editions of the CIPFA codes by regulations 7 and 19 of the Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011, No. 326.

3. The Local Government Finance Act (Northern Ireland) 2011, section 25(1), requires a council to "…have regard (a) to such guidance as the Department may issue, and (b) to such other guidance as regulations may specify …..".

4. The guidance in Part 2 of this document is issued under the power in section 25(1) of the 2011 Act and councils are therefore required to have regard to it. It does not duplicate the material covered in the CIPFA Code but builds upon it and supplements it as necessary.

APPLICATION [3.1]

5. This guidance applies with effect from 1 April 2012 – i.e. to the financial year 2012 – 2013 and subsequent years. The guidance applies to all district councils in Northern Ireland. It does not apply to trust funds which are covered by a completely separate regulatory regime.

ANNUAL INVESTMENT STRATEGY [4.1 – 4.7]

6. The preparation each year of an Investment Strategy is central to the guidance **[4.1]**. It encourages the formulation of policies for the prudent investment of the funds that councils hold on behalf of their ratepayers. In addition, the need for the Strategy to be **approved by the full council** ensures that these policies are subject to the scrutiny of elected Members.

7. The guidance defines a prudent investment policy as having two objectives: achieving first of all **security** (protecting the capital sum from loss) and then **liquidity** (keeping the money readily available for expenditure when needed) **[4.2]**. The generation of investment income is distinct from these prudential objectives and is accordingly not a matter for the guidance. However, that does not mean that councils are recommended to ignore such potential revenues. Once proper levels of security and liquidity are determined, it will then be reasonable to consider what **yield** can be obtained consistent with those priorities. This widely-recognised investment policy is sometimes more informally and memorably expressed as follows:

   Security – **L**iquidity – **Y**ield

8. The guidance recommends that an Investment Strategy should be prepared and approved by the prescribed date, 15 February, each financial year **[4.5]**. However, this need not be a once-a-year event, as the initial Strategy may be replaced by a revised Strategy, at issues which the full council might wish to have brought to their attention, submission of a revised Strategy should always be considered. The CIPFA Treasury Management Code contains guidance on reporting requirements.

9. It should however be possible to incorporate in the Strategy sufficient flexibilities and delegations to avoid the need for a formal submission to the full council being triggered by purely technical circumstances. It is also open to councils to arrange for in-depth scrutiny of Strategies to be undertaken outside full council meetings, with a view to informing and expediting the formal consideration by full council. Where external investment managers are used, they should be contractually required to comply with Strategies.

10. As noted above, district councils will also need to have regard to the CIPFA Treasury Management Code, which contains guidance on reporting requirements. There is no intention to require councils to duplicate any of the tasks specified in the CIPFA Treasury Management Code. It is open to councils to consider whether a single document might conveniently be used to cover both the requirements of the CIPFA code and the Department's guidance. However, in that case the document should state explicitly where it relates to the

guidance by the Department.

11. Publication of Strategies is now formally recommended **[4.7]**. Publication on the council's website is satisfactory. This does not mean that commercially confidential material such as detailed counterparty lists should be published.

INVESTMENT SECURITY [5.1 – 5.3]

12. The idea of **specified investments [5.1]** is to identify options with relatively high security and high liquidity, to which councils need make only minimal reference in their Strategies. All such investments must be in sterling and with a maturity of no more than a year. Such investments with the UK Government, a local authority in GB or a district council, will count as specified investments. In addition, such investments with bodies or investment schemes with "high" credit ratings will count as specified investments. However the Annual Investment Strategy will first need to define this term for broad categories of investment. For example, it might say that for money market funds, "high" means a rating of AAA, while for UK banks and building societies it means a rating of AA. The Strategy will need to state how frequently ratings are to be monitored. When making a major one-off investment, it would clearly be important to check the rating as closely as possible to the time when funds are to be committed. Where investments are being made very frequently with a particular institution, it may not be practicable to look at the rating before each individual transaction, but ratings should still be monitored regularly and the Strategy should give guidelines on the timing and procedure.

13. The Strategy should deal in more detail with **non-specified investments [5.3]**, given the different levels of potential risk. There is no intention of discouraging councils from pursuing these options, but the aim is to ensure that proper procedures are in place for assessing and mitigating risk. Therefore the Strategy should identify the types of such investments that may be used during the course of the year and should set a limit to the amounts that may be held in such investments at any time in the year. The limit may be a sum of money or a percentage of total investments or both. The Strategy should also lay down guidelines for making decisions on such investments, for example, on the circumstances in which professional advice is to be sought. Again, if the criteria mentioned refer to credit ratings, the recommendations in paragraph **[6.1]** of the guidance should be followed.

INVESTMENT RISK [6.1 – 6.4]

14. This section in the guidance addresses issues relating to credit risk and

the means of assessing it.

Risk assessment [6.1]

15. Underlying these recommendations is a concern that credit ratings should not be seen as the only means of assessing creditworthiness. The Strategy is therefore to indicate the extent to which the council's assessment of credit risk depends upon the use of credit ratings. Where they are used, the Strategy is to say how frequently ratings are monitored and what action is to be taken when they change. The Strategy is also to say what other sources of information on credit risk are used; that is particularly important if a favoured investment option has a low credit rating or is not rated at all. It is not appropriate for the Department to offer guidance on such alternative means of assessing credit risk.

Treasury management advisers [6.2]

16. Sources of information on credit risk may include private-sector treasury management advisers. The Strategy is to make clear how the council uses such advisers and what measures are in place to maintain an appropriate quality of service. The ultimate aim here is to encourage a constructive and transparent partnership between these contractors and their local government clients.

Investment training [6.3]

17. The Strategy is to report on the procedures for reviewing and addressing the needs of the council's finance officers for training in investment management. Even where significant reliance is placed upon external advisers, in-house expertise will still be needed to develop the proper kind of working relationship with them. Where elected members are involved in treasury management issues it is suggested they should also avail themselves of relevant training wherever possible. Further guidance on training issues is given in the CIPFA Treasury Management Code.

Investment of money borrowed in advance of need [6.4]

18. Section 23 of the Local Government Finance (Northern Ireland) Act gives councils power to invest for "any purpose relevant to its functions under any statutory provision, or for the purposes of the prudent management of its financial affairs". The Department cannot offer an authoritative interpretation of the law, but takes the informal view that, while the speculative procedure of borrowing purely to invest at a profit is unlawful, there appears to be no legal obstacle to the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future. CIPFA's *Prudential Code for Capital Finance in Local Authorities* makes recommendations about this

procedure in the context of prudent borrowing practice. To complement that, this guidance recommends that the Strategy reports the council's policies relating to the investment of any sums borrowed in advance. The Department considers that elected Members should have an opportunity to scrutinise this aspect of their council's investment practices, given that it may expose more money than is strictly necessary to investment risk.

INVESTMENT LIQUIDITY [7.1]

19. The Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed. This is to ensure that the council has properly assessed the risk of not having immediate access to some of its funds. An investment should be regarded as commencing on the date the commitment to invest is entered into, rather than the date on which the funds are paid over to the counterparty.

PART 2

Department of the Environment

GUIDANCE ON
LOCAL GOVERNMENT INVESTMENTS

Issued under section 25(1) of the Local Government (Finance) Act (Northern Ireland) 2011 and effective from 1 April 2012

(1) POWER UNDER WHICH THE GUIDANCE IS ISSUED

1.1 The following guidance is issued by the Department under section 25(1) of the Local Government Finance Act (Northern Ireland) 2011.

(2) DEFINITIONS OF TERMS

2.1 In this guidance, 2011 Act means the Local Government Finance Act (Northern Ireland) 2011.

2.2 An **investment** is a transaction which relies upon the power in section 23 of the 2011 Act and is recorded in the balance sheet under the heading of investments within current assets or long-term investments. The term does not include *trust fund investments*, which are subject to separate regulatory regimes and are therefore not covered by this guidance.

2.3 A **long-term investment** is any investment other than (a) one which is due to be repaid within 12 months of the date on which the investment was made or (b) one which the council may require to be repaid or redeemed within that 12 month period.

2.4 A **credit rating agency** is one of the following three companies: Standard and Poor's; Moody's Investors Service Ltd; or Fitch Ratings Ltd.

(3) APPLICATION

Effective date

3.1 This guidance applies to all district councils in Northern Ireland with effect from 1 April 2012.

(4) INVESTMENT STRATEGY

Preparation

4.1 The Department recommends that for each financial year a council should prepare an investment Strategy ("the Strategy") in accordance with the timetable in paragraphs 4.5 and 4.6.

4.2 The Strategy should set out the council's policies for the prudent management of its investments and for giving priority, firstly, to the security of those investments and, secondly, to their liquidity. It should therefore identify the procedures for monitoring, assessing and mitigating the risk of loss of invested sums and for ensuring that such sums are readily accessible for expenditure whenever needed.

4.3 The detailed contents of Strategy should be in accordance with paragraphs 5.1 to 7.1, but may include other matters considered relevant.

Approval

4.4 **<u>The Strategy, be it an initial or any revised strategy, should be approved by the full council.</u>**

Timing

4.5 The Department recommends that for any financial year an investment Strategy ("the initial Strategy") should be prepared and approved by the prescribed date, 15 February, each year.

4.6 The initial Strategy may be replaced by another Strategy ("the revised strategy") at any time during the year, on one or more occasions, subject to the same process of approval. The initial Strategy should specify circumstances in which a revised Strategy is to be prepared. A revised Strategy may be prepared in other circumstances, if at any time it is considered appropriate.

4.7 The Department recommends that the initial Strategy and any revised Strategy should, when approved, be made available to the public free of charge, in print or online.

(5) INVESTMENT SECURITY

Specified investments

5.1 An investment is a **specified investment** if it satisfies the condition below:

(a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;

(b) the investment is not a long-term investment (as defined in paragraph 2.3);

(c) the investment does not involve the acquisition of share capital or loan capital in any body corporate as set out in regulation 12 of the Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) Regulations 2011;

(d) the investment is made with a body or in an investment scheme of high credit rating (see paragraph 5.2); or with one of the following public-sector bodies;

(i) the United Kingdom Government;

(ii) a district council: or

(iii) or a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland;

(e) the principal sum to be repaid at maturity is the same as the initial sum invested other than investments in the UK Government.

5.2 For the purposes of paragraph 5.1(d) the Department recommends that the annual Investment Strategy should:

*	define high credit rating for the category of investments which the council intends to use in the financial year; and

*	monitor the credit arrangements and state what action is to be taken when ratings change.

Non-specified investments

5.3 With regard to **non-specified investments** (ie those not meeting the definition in paragraph 5.1), the Department recommends that the Strategy should:

(a) set out procedures for determining which categories of such investments may prudently be used (and where these procedures involves the use of credit ratings, paragraph 6.1 is relevant);

(b) identify which categories of such investments have so far been identified as prudent for use during the financial year; and

(c) state the upper limits for the amounts which, at any time during the financial year, may be held in each identified category and for the overall amount which may be held in non-specified investments (the limits being defined by reference to a sum of money or a percentage of the council's overall investments or both).

(6) INVESTMENT RISK

Risk assessment

6.1 The Department recommends that the Strategy should state the council's approach to assessing the risk of loss of investments, making clear in particular:

(a) to what extent, if any, risk assessment is based upon credit ratings issued by one or more credit rating agencies;

(b) where credit ratings are used, how frequently credit ratings are monitored and what action is to be taken when ratings change; and

(c) what other sources of information on credit risk are used, additional to or instead of credit ratings.

Treasury management advisers

6.2 The Department recommends that the Strategy should state:

(a) whether and, if so, how the council uses external advisers offering information, advice or assistance relating to investment; and

(b) how the council monitors and maintains the quality of any such service.

Investment training

6.3 The Department recommends that the Strategy should state what process is adopted for reviewing and addressing the needs of the council's finance officers for training in investment management.

Investment of money borrowed in advance of need

6.4 The Department recommends that the Strategy should state the council's policies on investing money borrowed in advance of spending needs. This statement should identify any measures to manage the amount of such investments, including any limits on (a) amounts borrowed and (b) periods between borrowing and expenditure. The statement should also comment on the management of the risks involved, including balancing the risk of investment loss against the risk of higher interest rates if borrowing is deferred.

(7) INVESTMENT LIQUIDITY

7.1 The Department recommends that the Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed.

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