Department for Communities and Local Government

GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

NOTE ON THE REVIEW OF THE GUIDANCE

[This note is not part of the guidance]

BACKGROUND

The CLG Investments Guidance was first published in 2004. Following consultation with local authorities and other interested parties, CLG has issued revised guidance, attached below. It consists of the formal **statutory guidance (Part 2)** and an **informal commentary (Part 1)**.

APPLICATION

The new guidance becomes operative on 1 April 2010.

CLG SELECT COMMITTEE INQUIRY ON LOCAL AUTHORITY INVESTMENTS

The review of the guidance was undertaken partly in response to the findings of the CLG Select Committee, which has issued these documents:

Evidence: http://www.publications.parliament.uk/pa/cm200809/cmselect/cmcomloc/164/164ii.pdf
Report: http://www.publications.parliament.uk/pa/cm200809/cmselect/cmcomloc/164/164i.pdf.
Responses: http://www.publications.parliament.uk/pa/cm200809/cmselect/cmcomloc/1013/1013.pdf

MAIN CHANGES

Apart from drafting changes, the key revisions relate to these recommendations:

a) The revised guidance makes even clearer that the investment priorities should be ***security and liquidity***, rather than yield *[Part 1 para 7; Part 2 para 4.2]*
b) Investment strategies should still go to the full council at the start of each year, but authorities are encouraged to consider submitting ***revised strategies*** at other times *[Part 1 para 9; Part 2 para 4.5, 4.6]*
c) Strategies should be ***published*** *[Part 1 para 12; Part 2 para 4.7]*
d) Strategies should comment on the use of ***credit ratings*** and of any additional sources of information on credit risk *[Part 1 para 16; Part 2 para 6.1]*
e) Strategies should comment on the use of ***treasury management advisers*** *[Part 1 para 17; Part 2 para 6.2]*
f) Strategies should comment on the investment of ***money borrowed in advance of spending needs*** *[Part 1 para 19; Part 2 para 6.4]*

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Department for Communities and Local Government

GUIDANCE ON
LOCAL GOVERNMENT INVESTMENTS

[Second edition – 11 March 2010]

PART 1 of this document provides an informal commentary on Part 2.
PART 2 contains the statutory guidance to which authorities must have regard.

[PART 1]

INFORMAL COMMENTARY ON THE INVESTMENTS GUIDANCE

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

POWER UNDER WHICH THE GUIDANCE IS ISSUED [1.1]

1. The **Local Government Act 2003**, section 15(1), requires a local authority "…to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify…".

2. The guidance on investments in Part 2 of this document is issued under section 15(1) of the 2003 Act and authorities are therefore required to have regard to it.

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

- *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*
- *The Prudential Code for Capital Finance in Local Authorities*

4. Local authorities are required to have regard to the current editions of the CIPFA codes by regulations 2 and 24 of the *Local Authorities* (*Capital Finance and Accounting) (England) Regulations 2003 [SI 3146].*

APPLICATION [3.1 - 3.3]

5. This guidance applies with effect from 1 April 2010 – ie to the financial year 2010-11 and subsequent years. It completely supersedes the former guidance issued on 12 March 2004. The guidance applies only in England. It applies to all local authorities. It may also apply to parish councils (and charter trustees), depending upon the level of their investments **[3.3];** for parish councils not expecting their investments to exceed £10,000, no action is necessary, but they are of course free to adopt the guidance if they wish. The guidance does not apply to pension and trust funds which are covered by a completely separate regulatory regime.

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 authorities hold on behalf of their communities. 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: this is particularly important, given that central Government in 2004 ceased its close regulation of local government investment.

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 authorities 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 - Liquidity - Yield …in that order!

8. The Strategy should be approved by the full council (or at equivalent level in authorities without a council) **[4.4]**. This is in accordance with the *Local Authorities (Functions and Responsibilities) (England) Regulations 2000* (regulation 4(1)(b) and Schedule 4) (S.I. 2000/2853, as amended by S.I. 2004/1158), which provides that the function of "*formulating a plan or strategy for the control of the authority's …investments…"* is the responsibility of the authority's full council, not the executive.

9. The guidance as before recommends that an investment Strategy should be prepared and approved before the start of each financial year **[4.5]**. However, the revised guidance makes even clearer that this need not be a once-a-year event, but that the initial Strategy may be replaced by a revised Strategy, at any time during the year, on one or more occasions, subject to full council approval **[4.6]**. The initial Strategy may specify a firm timetable for the production of in-year Strategies, or may identify contingencies in the event of which a revised Strategy is to be prepared (for example, significant changes in the risk assessment of a significant proportion of the authority's investments). However, a revised Strategy may be prepared even if it was not foreshadowed in that way. Generally, if there are investment 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.

10. 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 authorities to arrange for in-depth scrutinies 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.

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

12. Publication of Strategies is now formally recommended **[4.7]**. Publication on the authority'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]

13. The idea of **specified investments [5.1]** is to identify options with relatively high security and high liquidity, to which authorities 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 or parish council will count as specified investments, as will those with bodies or in investment schemes of "high credit quality". The meaning given by the authority to the latter term is to be stated in the Strategy **[5.2]** and it is expected that authorities will adopt rigorous standards of definition. If the criteria here refer to credit ratings, the recommendations in paragraph **[6.1]** of the guidance should be followed.

14. 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 authorities 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]

15. This is a largely new section in the guidance, addressing issues relating to credit risk and the means of assessing it.

Risk assessment [6.1]

16. 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 authority'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 Government to offer guidance on such alternative means of assessing credit risk.

Treasury management advisers [6.2]

17. Sources of information on credit risk may include private-sector treasury management advisers. The Strategy is to make clear how the authority 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 authority clients.

Investment training [6.3]

18. The Strategy is to report on the procedures for reviewing and addressing the needs of the authority's treasury management staff 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. The Government also hopes that elected Members involved in the scrutiny of treasury management issues will 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]

19. Section 12 of the 2003 Act gives a local authority 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". CLG 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* (2nd edition 2009) makes recommendations about this procedure in the context of prudent borrowing practice. To complement that, the CLG guidance recommends that the Strategy reports the authority's policies relating to the investment of any sums borrowed in advance. The Government considers that elected Members should have an opportunity to scrutinise this aspect of their authorities' investment practices, given that it may expose more money than is strictly necessary to investment risk.

INVESTMENT LIQUIDITY [7.1]

20. The Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed. This is to ensure that the authority 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 for Communities and Local Government

GUIDANCE ON
LOCAL GOVERNMENT INVESTMENTS

Issued under section 15(1)(a) of the *Local Government Act 2003*
and effective from 1 April 2010

(1) POWER UNDER WHICH THE GUIDANCE IS ISSUED

1.1 The following guidance is issued by the Secretary of State under section 15(1)(a) of the *Local Government Act 2003.*

(2) DEFINITIONS OF TERMS

2.1. In this guidance, ***2003 Act*** means the *Local Government Act 2003.*

2.2. ***Local authority*** (except in paragraph 5.1(d) below) has the meaning given in section 23 of the 2003 Act (and in regulations made under that section). To the extent that this guidance applies to parish councils and charter trustees (see paragraph 3.3), a reference to a "local authority" includes those councils and trustees.

2.3. An ***investment*** is a transaction which relies upon the power in section 12 of the 2003 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 *pension fund and trust fund investments*, which are subject to separate regulatory regimes and are therefore not covered by this guidance.

2.4. 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 local authority may require to be repaid within that period.

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

(3) APPLICATION

Effective date

3.1 This guidance applies with effect from 1 April 2010 and supersedes the guidance issued on 12 March 2004.

Local authorities

3.2 This guidance applies to all local authorities in England.

Parish councils and charter trustees

3.3 This guidance applies to parish councils and charter trustees, subject to the following:

> (a) Where the parish council or charter trustee expects its investments at any time during a financial year to exceed £500,000, the guidance should apply in relation to that year.
>
> (b) Where the parish council or charter trustee expects its investments at any time during a financial year to exceed £10,000 but not £500,000, it should decide on the extent, if any, to which it would be reasonable to have regard to the guidance in relation to that year.
>
> (c) Where the parish council or charter trustee expects its investments at any time during a financial year not to exceed £10,000, no part of this guidance need be treated as applying in relation to that year.

(4) INVESTMENT STRATEGY

Preparation

4.1 The Secretary of State recommends that for each financial year a local authority should prepare at least one investment Strategy (“the Strategy”) in accordance with the timetable in paragraphs 4.5 and 4.6.

4.2 The Strategy should set out the authority'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 The Strategy should be approved by the full council. For authorities without a full council, the Strategy should be approved at the closest equivalent level.

Timing

4.5 The Secretary of State recommends that for any financial year an investment Strategy (“the initial Strategy”) should be prepared and approved before the start of that 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, but a revised Strategy may be prepared in other circumstances, if at any time it is considered appropriate.

Publication

4.7 The Secretary of State 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 all of the following apply:

(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 2.4);

(c) the making of the investment is not defined as *capital expenditure* by virtue of regulation 25(1)(d) of the *Local Authorities* (*Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended]*;

(d) the investment is made with a body or in an investment scheme of *high credit quality* (see paragraph 5.2); or with one of the following public-sector bodies:
   - (i) the United Kingdom Government
   - (ii) a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
   - (iii) a parish council or community council.

5.2 For the purposes of paragraph 5.1(d), the Secretary of State recommends that the Strategy should define *high credit quality* (and where this definition refers to *credit ratings*, paragraph 6.1 is relevant).

Non-specified investments

5.3 With regard to ***non-specified investments*** (ie those not meeting the definition in paragraph 5.1), the Secretary of State 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 authority's overall investments or both).

(6) INVESTMENT RISK

Risk assessment

6.1 The Secretary of State recommends that the Strategy should state the authority’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 Secretary of State recommends that the Strategy should state:

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

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

Investment training

6.3 The Secretary of State recommends that the Strategy should state what process is adopted for reviewing and addressing the needs of the authority’s treasury management staff for training in investment management.

Investment of money borrowed in advance of need

6.4 The Secretary of State recommends that the Strategy should state the authority’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 Secretary of State recommends that the Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed.