ABERDEEN CITY COUNCIL

COMMITTEE	Finance and Resources
DATE	02 December 2010
DIRECTOR	Stewart Carruth
TITLE OF REPORT	Treasury Management – Mid Year Review
REPORT NUMBER:	CG/10/198

1. PURPOSE OF REPORT

To provide an update on Treasury Management activities undertaken so far this year and advise of current developments.

2. RECOMMENDATION(S)

The Committee is asked to note the report and make recommendations to Council for approval as follows:-

a) Note the Treasury Management activities undertaken in 2010/11 as detailed, and

b) Approve the revised Counterparty list as detailed at Appendix 1

3. FINANCIAL IMPLICATIONS

Treasury Management activities influence the loans pool interest rates and aim to minimise the cost of borrowing. This directly impacts upon costs chargeable to the Council's revenue budgets through the interest rates that are applied to capital financing costs. Whilst the level of borrowing a Council can undertake is now devolved from the Scottish Government to individual Councils, they are still constrained by the requirement for capital investment to be affordable, sustainable and prudent. The main test of affordability will be whether the capital financing costs can be contained within the revenue budgets.

4. OTHER IMPLICATIONS

If a policy of active Treasury Management is not undertaken there may be future budgetary implications for the Council through greater than budgeted capital financing costs.

5. BACKGROUND/MAIN ISSUES

5.1 Introduction

The Treasury Management Policy and Strategy was approved on 17 June 2010. This included the requirement to provide a mid-year review.

With effect from 1 April 2004, Councils are now required by regulation to have regard to the Prudential Code (the Code) when carrying out their duties under part 7 of the Local Government in Scotland Act 2003 and from 1 April 2010 to the Local Government Investment (Scotland) Regulations 2010.

Historically, the Council's annual programme of capital investment has been funded by Treasury Management activities, such as additional long-term borrowing.

It is a requirement of this Code that Treasury Management is carried out in accordance with good professional practice. The Code requires the Council to comply with CIPFA "Code of Practice for Treasury Management in the Public Services", which this Council does.

This mid-year review on activities undertaken is in line with reporting requirements from the latest update of the CIPFA Code of Practice which requires that the annual strategy is approved by the Council.

5.2 Treasury Management 2010/11

The following is a summary of Treasury Management activities which have been undertaken thus far in 2010/11: -

<u>Long Term Borrowing</u>

<u>New Borrowing</u> - Three new <u>PWLB (Public Works Loans Board)</u> loans totalling £20 million have been entered into at relatively low rates (average rate 2.93%) with this years capital requirement in mind.

<u>PWLB Interest Rates</u> - As a direct result of the Government Spending Review in October, there was a major change to PWLB public sector lending rates. There was an immediate increase of approximately 0.90% on all rates. The rationale behind this major change is that HM Treasury will now set the rates at an average of 1% over the relevant gilt price.

This presents the Council with 2 challenges going forward.

The first of these is the immediate rise in borrowing costs. In the current financial year, this can be overcome by a combination of factors - due to the previously mentioned borrowing at relatively low rates, and by reducing the repayment term of future loans. (e.g. borrowing over 10 years rather than 20).

The second challenge is that, as reported last year, the PWLB introduced "penalty rates" to discourage debt rescheduling by Councils. This reduced the Council's ability to make savings. However, the above additional rise in rates was not reflected in the penalty rates, and will further reduce opportunities for the Council and discourage the use of PWLB loans, forcing the Council to look increasingly to other forms of long term borrowing, such as LOBO loans (Lenders Option Borrowers Option) from financial institutions.

Short Term Borrowing

Short-term borrowing rates for periods of up to 1 year continue at relatively low levels. The Council's borrowing strategy this year has been to borrow short-term where possible, to take advantage of these lower rates. Since the rise in PWLB rates, short-term borrowing rates have risen but are still comparatively low. The Council currently has some £50m of Temporary Loans from other Local Authorities, at an average rate of 0.60%.

Investments

Due to the downturn in the global economy, many previously undoubted financial institutions have been removed from the Council's Counterparty list during the last few years.

The Counterparty list is the approved banks and building societies that the Council may lend to either directly or through the Money Markets, on a temporary basis.

Reviews of the Council's Counterparty list were undertaken and approved by Committee as the situation deteriorated. The proposed amendments were needed to further tighten the Council's lending criteria and further protect the Council's investments in the fragile financial climate. As well as removing certain institutions from the list, lending periods were also reduced from 'up to 12 months', to 'up to 3 months'.

It is proposed that the Council increases the Counterpart Limit of the Nationalised UK Banks from £10m to £20m. This will enable the Council with additional flexibility required to maximise returns on short-term surplus funds

The Council's Counterparty list is compiled using credit rating information supplied by the major credit rating agencies to Sector Treasury Services, the Council's appointed Treasury management advisors.

6. IMPACT

Corporate – Failure to approve the changes to the Counterparty list could lead to reduced earnings to the Council.

Public – None.

7. BACKGROUND PAPERS

None.

8. REPORT AUTHOR DETAILS

Neil Stewart, Treasury Officer, nstewart@aberdeencity.gov.uk,
01224 522696