COMMITTEE:	Finance and Resources
DATE:	21 April 2011
REPORT BY:	Head of Finance
TITLE OF REPORT:	Treasury Management Policy and Strategy
REPORT NUMBER:	CG/11/038

1. PURPOSE OF REPORT

To outline Treasury Management Policy and Strategy for 2011/12 to 2013/14, for approval.

2. RECOMMENDATION(S)

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

a) Consider and approve the Council's Treasury Management Policy Statement for 2011/12 to 2013/14, and

b) Consider and approve the Council's Borrowing and Investment Strategy for 2011/12 to 2013/14, and

c) Approve the revised Counterparty list as detailed at Appendix 3.

3. FINANCIAL IMPLICATIONS

Treasury Management activities influence the loans pool interest rates and aims 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, it will still be 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. SERVICE & COMMUNITY IMPACT

None

5. OTHER IMPLICATIONS

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

6. REPORT

6.1 Introduction

The Council previously approved a Treasury Management policy on 17 June 2010. Part of this policy is to report annually on strategy for future financial years. A final report reviewing Treasury Management activities for the year, as well as a mid-year review, will also be presented to Committee in due course.

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.

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. The 2009 update to the CIPFA Code of Practice states that Treasury Management Strategy must be approved annually by full Council.

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

6.2 Treasury Management Policy Statement 2011/12 to 2013/14

The proposed Treasury Management Policy Statement for 2011/12 to 2013/14 is set out in detail at Appendix 1, and is subject to annual review.

This Policy Statement uses a form of words as recommended by CIPFA in its Code of Practice for Treasury Management in the Public Services

6.3 Borrowing and Investment Strategy 2011/12 to 2013/14

The key changes within the Council’s Borrowing and Investment Strategy for 2011/12 to 2013/14 are :-

- to consider the use of longer-term LOBO (Lenders Option, Borrowers Option) loans;

- to increase the Council’s limit for investing in Collective Investment Schemes (specifically Money Market funds) from £20 million to £30 million;

- changes to the maximum investment periods within the Council’s Counterparty List, in line with professional advice.

Last year’s report introduced new investment regulations which were approved by the Scottish Government. Under these regulations, Appendix 2 includes for Committee's consideration and approval, the Council's Borrowing and Investment Strategy for 2011/12 to 2013/14. This will be subject to annual review.

The process of setting this strategy takes account of the pre-existing structure of the Council’s debt and investment portfolios.

The limits on fixed rate debt and variable rate debt within this Treasury Management Strategy may be subject to further change, in line with market conditions. However, any such change to these limits would be reported to Committee.

One of the key areas of the investment regulations is permitted investments. Under the regulations, local authorities are required to set out in their Strategy the types of investment that they will permit in the financial year. These will be known as permitted investments. The Council is required to set a limit to the amounts that may be held in such investments at any time in the year, although some types of investment may be classed as unlimited.

Permitted Investment instruments identified for use in the financial years 2011/12 to 2013/14 are listed in Appendix 2, together with the Council's Counterparty list which is listed in Appendix 3.

The Annual Investment Strategy is also required to identify:-

- the different types of risk that each permitted type of investments are exposed to;

- the objectives for each type of permitted investment;

- details of the maximum value and maximum period for which funds may prudently be invested; and

- procedures for reviewing the holding of longer-term investments

6.4 **Other Developments**

Prudential Code

The Council is required to comply with the requirements of the Prudential Code. This includes the setting of a number of Prudential Indicators. Included within these indicators are a number of Treasury Management Indicators for External Debt.

However, the Code does state "It will probably not be significant if the operational boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the operational boundary would be significant and should lead to further investigation and action as appropriate".

The Council has in place an early warning system to highlight when these indicators are likely to be breached. No indicators were breached during the previous year.

	2011/12	2012/13	2013/14
Operational Limit	£697.3m	£706.8m	£720.7m
Authorised Limit	£715.7m	£724.8m	£738.3m

National Limit on Local Authority Borrowing

HM Treasury has a reserve power to limit local authority borrowing for 'national economic reasons'. Legislation specifies that any such 'National Limit' would be used to protect the country's economic interest if local borrowing under the Prudential Code, albeit prudent locally, were unaffordable nationally.

In principal, a national limit could be set at any point during any financial year. Any such national limit would be implemented, based on local authorities outstanding borrowing with all future borrowing being reduced proportionately. There are no known plans for the introduction of a National Limit at this time.

7. AUTHORISED SIGNATURE

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8. REPORT AUTHOR DETAILS

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9. BACKGROUND PAPERS

CIPFA "Code of Practice for Treasury Management in the Public Services", Sector Treasury Services "Treasury Management Annual Investment Strategy", Scottish Government "The Investment of Money by Scottish Local Authorities".

Appendix 1

ABERDEEN CITY COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT FOR 2011/12 TO 2013/14

The proposed Treasury Management Policy for 2011/12 to 2013/14 is as follows:

1. Aberdeen City Council will adopt CIPFA Treasury Management in Public Services Code of Practice. The Council will also have regard to the Local Government Investment (Scotland) Regulations 2010.

2. This organisation defines its treasury management activities as:
   The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

3. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

4. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

5. The Council's appointed Treasury Advisors are Sector Treasury Services. Their expertise will continue to be used by the Council in making Treasury decisions in areas such as debt rescheduling, interest rate forecasts, market conditions, advice on new types of financial instruments and compiling the Council's Counterparty list.

Appendix 2

ABERDEEN CITY COUNCIL

BORROWING STRATEGY FOR 2011/12 TO 2013/14

The proposed Treasury Management Borrowing Strategy for 2011/12 to 2013/14 is as follows:

1. Under the Prudential Code previous borrowing restrictions linked to consents no longer apply. Short-term PWLB (Public Works Loans Board) rates for periods of up to 10 years continue at relatively low levels and the strategy would be to borrow, if required, in these periods to take advantage of those rates. In addition to PWLB, there may be an opportunity to use longer-term LOBO (Lenders Option, Borrowers Option) loans later in the year, once interest rates start to rise again. Rates are monitored on an on-going basis to determine the optimum time to undertake any necessary borrowing. When decisions on new borrowing are being made, due consideration must also be given to the Council's Debt Maturity Profile.

2. Approximately 95% of the Council's borrowing is in fixed rate money which reflects the low interest rates in recent years. Whilst there is no immediate intention to reschedule debts in 2011/12, if opportunities arise to do so that will result in a decrease in the Council's cost of borrowing then these will be fully examined to determine whether this represents Best Value. Due care and attention to FRS 25 and 26 will be examined prior to entering any such commitment.

3. It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2011/12, 2012/13 and 2013/14 of 95% of its net outstanding principal sums.

4. It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 2011/12, 2012/13 and 2013/14 of 30% of its net outstanding principal sums. This means that the Head of Finance will manage fixed interest rate exposures within the range 70% to 95% and variable interest rate exposures within the range 5% to 30%.

5. It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowing as follows:

   Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate:

	Upper limit	Lower limit
Under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	90%	25%

6. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

The Scottish Government defines 'Borrowing in Advance of Need' as "*borrowing undertaken by the local authority which will result in the total external debt of the local authority exceeding the estimated capital financing requirement of the local authority at the end of the next twelve month period*".

INVESTMENT STRATEGY FOR 2011/12 TO 2013/14

The proposed Treasury Management Investment Strategy for 2011/12 to 2013/14 is as follows:

1. The Council's investment priorities are: -
   (a) the security of capital and
   (b) the liquidity of its investments.

2. The risk appetite of this Council is low in order to give priority to security of its investments. The Council will also aim to achieve the optimum return on its investments in line with proper levels of security and liquidity.

3. The Council's approved counter party list will be adhered to when making short-term investments and reviewed as necessary. This ensures that only those counter parties with the highest credit ratings are used within the maximum limits set. If it is considered necessary to make any changes to the list Committee approval will be sought.

4. Prior to the introduction of the new investment regulations, investments made by Scottish local authorities were limited to one year. This restriction was removed from 1st April 2010 and the Council accordingly wishes to make use of these new powers at times when such investing is both appropriate and attractive.

5. Short-term investment rates for periods of up to 1 year continue at relatively low levels and in line with the Council's borrowing strategy of borrowing short-term to take advantage of lower rates, the Council does not envisage having substantial surplus funds to invest. Therefore any surplus cash which the Council does have at it's disposal will be required to be kept fairly liquid for cashflow purposes, and accordingly will be invested on a short-term basis, using either Bank deposits or Money Market Funds.

6. Rates are monitored on an on-going basis to determine the optimum time to undertake any investments. When decisions on new investments are being made, due consideration must also be given to the Council's projected cashflow position.

7. With the introduction of the new investment regulations, the Local Authority investment market will start to develop new products. In order to protect against any possible loss of income, the power to add a new investment instrument to the list of Permitted Investments, should be delegated to the Head of Finance. Any such approval would be reported at the next committee meeting.

LIST OF PERMITTED INVESTMENTS

This Council approves the following forms of investment instrument for use as permitted investments: -

DEPOSITS - Unlimited (subject to individual Counterparty list limits)
Debt Management Agency Deposit Facility
Term deposits – local authorities (as per Counterparty list)
Call accounts – banks and building societies (as per Counterparty list)
Term deposits – banks and building societies (as per Counterparty list)
Fixed term deposits with variable rate/maturities (Structured deposits, as per Counterparty list)

COLLECTIVE INVESTMENT SCHEMES - £30m
Government Liquidity Funds
Money Market Funds
Enhanced cash funds
Gilt Funds
Bond Funds

GOVERNMENT SECURITIES - £10m
Treasury Bills
UK Government Gilts
Bond issuance (from financial institution guaranteed by UK Government)
Bonds issued by multilateral development banks

CORPORATE SECURITIES - £10m
Certificates of deposit (as per Counterparty list)

PERMITTED INVESTMENTS - **NON TREASURY INVESTMENTS**

The Council can also invest in the following areas, which are outwith the Treasury Management scope and would be subject to separate committee approval: -

a) All share holding, unit holding and bond holding, including those in a local authority owned company;
b) Loans to a local authority company or other entity formed by a local authority to deliver services;
c) Loans made to third parties are investments;
d) Investment properties.

TREASURY RISKS AND CONTROLS

All investment instruments listed are subject to the following risks: -

1. **Credit and counter-party risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have a very high level of creditworthiness.

   Control: This authority has set minimum credit criteria to determine which counterparties are of high creditworthiness to enable investments to be made safely.

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. All counterparties are subject to at least a very small level of liquidity risk, as credit risk can never be zero. Liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. However, it has to be pointed out that while some forms of investment e.g. gilts, CDs, corporate bonds can usually be sold immediately if the need arises, there are two caveats: - a. cash may not be available until a settlement date up to three days after the sale b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer.

   Control: This authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately. However, some cash rich local authorities may positively want exposure to market risk e.g. those investing in investment instruments with a view to obtaining a long-term increase in value.

   Control: This authority does not purchase investment instruments that are subject to market risk in terms of fluctuation of their value.

4. **Interest rate risk:** this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report. All types of investment instrument have interest rate risk except for instruments with a variable rate of interest.

Control: This authority manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise borrowing costs.

5. **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

   Control: This authority will not undertake any form of investing until it has ensured that it has all the necessary powers and also complied with all regulations.

ABERDEEN CITY COUNCIL
REVISED COUNTERPARTY LIST

Appendix 3

As revised 21 April 2011

Deposits up to 12 months

UK Nationalised and Part Nationalised Banks - £20m limit

Lloyds Banking Group (includes Lloyds TSB Bank plc, Halifax Bank of Scotland)

The Royal Bank of Scotland plc
(includes National Westminster Bank plc, Ulster Bank Ltd)

UK Banks - £10m limit

HSBC Bank plc

UK Local Authorities, including Police Authorities - £10m Limit

Deposits up to 6 months

UK Banks - £10m limit

Barclays Bank plc

UK Building Societies - £10m limit

Nationwide Building Society

Deposits up to 3 months

Council's Bankers - £20m limit

Clydesdale Bank plc

UK Banks - £10m limit

Santander UK plc (includes Abbey, Alliance & Leicester plc, Cater Allen)