
Report to Council

Date of Meeting: 16 December 2010

**Subject: Investment Strategy 2010/11 - 2012/13 and adoption of New
Treasury Management Code of Practice**

Report by: Accountancy Manager

1.0 Purpose

- 1.1. The purpose of this report is to present the Council's Investment Strategy for 2010/11 to 2012/13.

2.0 Recommendations

- 2.1. It is recommended that Council

2.1.1. Agree to formally adopt CIPFA's new Prudential Code which will be implemented as required in 2010/11 and for the 2011/12 budget setting process.

2.1.2. Agree to formally adopt CIPFA's 2009 Treasury Management in the Public Services - Code of Practice and Cross Sectoral Guidance Notes as the basis for Treasury Management by Clackmannanshire Council

2.1.3. Approve the Investment Strategy for 2010/11 to 2012/13 attached as Appendix A in compliance with the Local Government Investments (Scotland) Regulations 2010.

3.0 Considerations

3.1. Background

- 3.2. Local authority investments are governed by the Local Government (Scotland) Act 1973 and Local Government in Scotland Act 2003. Section 40 of the 2003 Act allows Local Authorities to invest funds in accordance with regulations approved by ministers. Under these powers, the Local Government Investment (Scotland) Regulations 2010 were introduced. These came into effect on 1 April 2010.

- 3.3. In addition to the introduction of the Local Government in Scotland Act 2003, CIPFA has issued the following Codes relating to treasury management and capital borrowing. Both Codes have been and continue to be fully adopted by the Council, as follows:-

- 3.3.1. Treasury Management in Public Service; Code of Practice and Cross Sectoral Guidance Notes 2009 ("the Code")
- 3.3.2. The Prudential Code of Capital Finance in Local Authorities 2009 ("The Prudential Code")
- 3.4. The 2010 regulations refers to the 2009 revised versions of the Code and the Prudential Code and makes the requirements of both Codes mandatory for Local Authorities, rather than good practice, as was the case prior to April 2010.
- 3.5. The new Prudential Code does not introduce any significant new requirements on the Council but does make some changes to the classification of some of the Prudential Indicators the Council needs to set and monitor. These will be adopted and reported within the annual Prudential Indicators report that is presented to Council along with the Budget report.
- 3.6. The CIPFA Code of Practice on Treasury Management has recently been revised and updated. The new Code has been introduced partly in response to some of the issues arising from the Icelandic banking crisis in 2008, and although much of it is not new it does set some very demanding principles which the Council needs to comply with.
- 3.7. The revised Code identifies the following 3 Key Principles in respect of Treasury Management in public services:
1. Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
 2. Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly with their organisations. Their appetite for risk should form part of their annual strategy and should ensure that priority is given to security and liquidity when investing funds
 3. They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.
- 3.8. CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances the following four clauses
1. The Council will create and maintain, as the cornerstones for effective treasury management:
 - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

- suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
2. The full Council will receive reports on its treasury management policies, practices and activities, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs
 3. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Scrutiny Committee, and for the execution and administration of treasury management decisions to the Director of Finance and Corporate Services who will act in accordance with the organisation's policy statement and TMPs.
 4. The Council nominates the Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

3.9. Investment Strategy and Reporting

3.10. The Investment Strategy is attached as Appendix A.

4.0 Sustainability Implications

4.1. There are no sustainability implications.

5.0 Resource Implications

5.1. *Financial Details*

5.2. The full financial implications of the recommendations are set out in the report. This includes a reference to full life cycle costs where appropriate. Yes

5.3. Finance have been consulted and have agreed the financial implications as set out in the report. Yes

5.4. *Staffing*

5.5. *None*

6.0 Exempt Reports

6.1. Is this report exempt? Yes (please detail the reasons for exemption below) No

7.0 Declarations

The recommendations contained within this report support or implement our Corporate Priorities and Council Policies.

(1) **Our Priorities 2008 - 2011** (Please double click on the check box)

- The area has a positive image and attracts people and businesses
- Our communities are more cohesive and inclusive
- People are better skilled, trained and ready for learning and employment
- Our communities are safer
- Vulnerable people and families are supported
- Substance misuse and its effects are reduced
- Health is improving and health inequalities are reducing
- The environment is protected and enhanced for all
- The Council is effective, efficient and recognised for excellence

(2) **Council Policies** (Please detail)

8.0 Equalities Impact

8.1 Have you undertaken the required equalities impact assessment to ensure that no groups are adversely affected by the recommendations?

Yes No

9.0 Legality

9.1 It has been confirmed that in adopting the recommendations contained in this report, the Council is acting within its legal powers. Yes

10.0 Appendices

10.1 Please list any appendices attached to this report. If there are no appendices, please state "none".

Appendix A - Investment Strategy

Appendix B - Permitted Investments

11.0 Background Papers

11.1 Have you used other documents to compile your report? (All documents must be kept available by the author for public inspection for four years from the date of meeting at which the report is considered)

Yes (please list the documents below) No

Treasury Management in Public Service; Code of Practice and Cross Sectoral Guidance Notes 2009

The Prudential Code of Capital Finance in Local Authorities 2009

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Approved by

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Investment Strategy

1.1 Treasury Management Policy Statement

- 1.2 The Council defines its treasury management activities as the management of its 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. The Investment Strategy forms part of the framework surrounding the treasury management activities.
- 1.3 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its investment and treasury management activities will be measured. Accordingly, the analysis and reporting of investment and treasury management activities will focus on their risk implications for the organisation.
- 1.4 The Council acknowledges that effective investment and 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.

2.1 Strategy

- 2.2 This strategy reflects the requirements of Local Government Investment (Scotland) Regulations 2010, CIPFA Treasury Management in Public Service; Code of Practice and CIPFA Prudential Code of Capital Finance in Local Authorities 2009
- 2.2 The objectives of the Investment Strategy are to
- 2.2.1 Safeguard the principal of its investments while maximising the return on those investments,
 - 2.2.2 Ensure adequate liquidity for meeting its capital and revenue commitments
 - 2.2.3 Support the Borrowing Strategy to balance the maximisation of certainty on borrowing repayments while minimising the cost of borrowing.
- 2.3 In fulfilling these objectives, the Council will
- 2.3.1 Adopt a risk aware approach where the investment risks are assessed and managed.
 - 2.3.2 Manage funds in house with the support of the Treasury Management Advisor, Sector

- 2.3.3 Only invest with Permitted Investments, as defined in Appendix B,
- 2.3.4 For periods of investments less than 12 months, investments will be made with reference to core balances and cashflow requirements
- 2.3.5 For period of investment in excess of 12 months , any investment will be managed after careful assessment of creditworthiness and review of interest rate projections. The maximum value would not exceed £10m or a period over two years.
- 2.3.6 Not borrow in advance of need purely to profit from the return on investment. Any decision to borrow in advance of need (ie in a earlier financial than the capital funding is required) will be thoroughly assessed.
- 2.3.7 Consider opportunities for restructuring of Council debt where the potential to save exceeds breakage costs or future interest charges.

3.1 Investment Portfolio Position

3.1 The Council's investment portfolio position at 31 March 2010 was

	Principal 31.3.2010
Fixed Rate Funding:	
- Public Works Loan Board	£ 99.703m
- European Investment Bank	£ 0.158m
- Market	£ <u>13.500m</u> £113.361m
Variable Rate Funding:	
- Market	£ 10.000m
Total External Debt	£123.361m
Investments:	
- Internally managed	£10.194m
Total Net External Borrowing	£113.167m

- 3.2 The Council's long term borrowing of £123m is relatively high in relation to its tax revenue stream of £115m (ie Government grant funding together with Council tax income) compared to other councils. This reflects the substantial investment in infrastructure in the County in recent years including supporting the new Secondary Schools.
- 3.3 The strategy adopted within the current 5 year capital programme is to minimise new borrowing to levels at or below the sums budgeted for repayment of debt, thereby reducing overall external borrowing and bringing the Council debt levels closer to the national average.

3.4 As a result of the current government spending review, and the reductions in support for capital by 17.9% and revenue support by 2.6% there will be a requirement for a further review of the capital programme in respect of coming years to focus on reducing new borrowing to even lower levels.

3.5 Opportunities for investment arise naturally through Treasury Management activity and in particular the management of cash flows which can result in peaks and troughs in the amount of cash required during the year. The Council can also choose to have its various funds and reserves backed by cash held. Accordingly at any given point in time the Council is likely to have sizeable sums of cash available and in a best value context it is incumbent upon the Council to generate a return on such surplus cash by investing it wisely. It will noted that as at March 2010, these cash balances amounted to £10.2m. Income generated on the use of surplus cash contributes to keeping the net expenditure of the Council lower than it otherwise would be.

3.6 The Council's investment priorities are:

1. The security of capital
2. The liquidity of its investments

3.4 The Council will therefore aim to achieve the optimum return on its investments taking account of levels of security and liquidity. Striking an appropriate balance between risk and return is a matter of judgement for the Director of Finance and Corporate Services. However, the borrowing of monies purely to invest or on-lend and make a return is unlawful and thus the Council will not engage in such activity. The permitted investments that the Council can undertake are detailed in the scope of investment strategy that follows.

4.1 Scope of Investment Strategy

4.2 The scope of the Investment Strategy covers all investment undertaken by the Council, including but not limited to :-

- 2.1.1 Short and medium term liquid cash deposits with banks and buildings societies;
- 2.1.2 Investment in shares with companies, institutions and joint venture or related companies
- 2.1.3 Investment in non liquid fixed assets, for investment or resale

4.3 Under the 2010 Regulations, the Council is required to set out the types of investment that they will permit in the financial year, together with the limits for those investment. These are known as permitted investments.

4.4 The main permitted investments that the Council anticipates investing in will be immediate or short term deposit accounts with approved Banks or Buildings Societies. The Council currently receives favourable rates with one approved lender on instant access.

4.5 The full list if products and institutions that that the Council is permitted to invest is included in Appendix B.

5.1 Treasury Management Advisory Service

5.2 The Council uses Sector Treasury Services as its external treasury management advisers. Sector were appointed as advisor in September 2009 under formal tender arrangements and the contract is in place until March 2012. Sector are required to comply with this Strategy and have been consulted.

3. PERMITTED INVESTMENTS

3.1 This Council approves the following forms of investment instrument for use as permitted investments as set out in table 1.

3.2 Unlimited Investments

3.2.1 **Debt Management Agency Deposit Facility.** This is considered to be the lowest risk form of investment available to local authorities as it is operated by the Debt Management Office which is part of H.M. Treasury i.e. the UK Government's AAA rating stands behind the DMADF. It is also a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts.

3.2.2 **High credit worthiness banks and building societies.** See paragraph 9.2 for an explanation of this authority's definition of high credit worthiness. While an unlimited amount of the investment portfolio may be put into banks and building societies with high credit worthiness, the authority will ensure diversification of its portfolio ensuring that no more than £30m of the total portfolio can be placed with any one institution or group.

3.3 DEPOSITS

3.3.1 The following forms of investments are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date or is held at call.

3.3.2 **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk at a time when many authorities are disappointed at the failure in 2008 of credit ratings to protect investors from the Icelandic bank failures and are both cautious about other forms of investing and are prepared to bear the loss of income to the treasury management budget compared to earnings levels in previous years. The longest term deposit that can be made with the DMADF is 6 months

3.3.3 **Term deposits with high credit worthiness banks and building societies.** See paragraph 9.2 for an explanation of this authority's definition of high credit worthiness. This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term) and now that measures have been put in place to avoid over reliance on credit ratings, the authority feels much more confident that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. The authority will ensure diversification of its portfolio of investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

3.3.4 **Call accounts with high credit worthiness banks and building societies.** The objectives are as for 1b. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. However, there are a number of call accounts which at the time of writing, offer rates 2 – 3 times more than term deposits with the DMADF. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

3.4 **DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF GOVERNMENT SUPPORT / OWNERSHIP**

3.4.1 These banks offer another dimension of creditworthiness in terms of Government backing through either direct (partial or full) ownership or the banking support package. The view of this authority is that such backing makes these banks attractive to place institutions with whom to place deposits, and that will remain our view if the UK sovereign rating were to be downgraded in the coming year.

3.4.2 **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for 1b. but Government ownership partial or full implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers this indicates a low and acceptable level of residual risk.

3.4.3 **Term deposits with high credit worthiness banks and building societies which are specified as being eligible for support by the UK Government.** As for 2a. but Government stated support implies that the Government stands behind eligible banks and building societies and will be deeply committed to providing whatever support that may be required to ensure the continuity of such institutions. This authority feels this indicates a low and acceptable level of residual risk.

3.5 **COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)**

3.5.1 **Government liquidity funds.** These are very similar to money market funds (see below) but only invest in government debt issuance with highly rated governments. They offer a lower rate of return than MMFs but slightly higher than the returns from the DMADF.

3.5.2 **Money Market Funds (MMFs).** By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or risk appetite to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g. a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to bank, MMFs offer an effective way of

minimising risk exposure while still getting much better rates of return than available through the DMADF. They also offer a constant Net Asset Value (NAV) i.e. the principal sum invested has high security.

3.6 OTHER INVESTMENT PRODUCTS

3.6.1 The following is a list of other investment products which are available but which at this time have not been included in the list of permitted investments, however if these become attractive a report will be submitted to Council seeking approval to make use of the appropriate investment

1. Enhanced cash funds
2. Gilt Funds
3. Bond Funds
4. Treasury Bills
5. UK Government Gilts
6. Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)
7. Sovereign bond issues (other than the UK govt)
8. Bonds issued by multilateral development banks
9. Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee
10. Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)
11. Certificates of deposit issued by banks and building societies NOT covered by UK Government support package (implicit guarantee)
12. Commercial paper issuance covered by a specific UK Government (explicit) guarantee and issued by banks covered by the UK bank support package
13. Commercial paper issuance by UK banks covered by UK Government (implicit) guarantee
14. Commercial paper other
15. Corporate Bonds issuance covered by UK Government (implicit) guarantee and issued by banks covered by the UK bank support package
16. Corporate Bonds other
17. Other debt issuance by UK banks covered by UK Government (explicit) guarantee
18. Property Funds

4. OTHER INVESTMENT PRODUCTS COMMON GOOD

4.1 The Council does not hold any investments in relation to Common Good and as such, no types of investments are defined. If this changes, a revised list of Permitted Investments for Common Good will be presented to Council.

