

## PERMITTED INVESTMENTS

A local authority may invest money for any purpose relevant to its functions under any enactment, or for the purposes of prudent management of its financial affairs. Investment or kinds of investments have to be defined as permitted investments and are approved by the Council in its Treasury Management Strategy.

### 1. TREASURY INVESTMENTS

The Council's Treasury Investments as set out in Tables 1.1 and 3.1 of this Appendix.

#### 1.1 DEPOSITS

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.

- a) **Debt Management Agency Deposit Facility (DMADF).** 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. The longest term deposit that can be made with the DMADF is 6 months.
- b) **Term deposits with high credit worthiness banks and building societies.** This is the most widely used form of investing used by the Council. It offers a much higher rate of return than the DMADF. New measures have been put in place to reduce the reliance on credit ratings and thus improving confidence that the residual risks of using such banks and building societies are at a low and acceptable level. The Council will ensure diversification of its portfolio of deposits ensuring that no more than £5 million can be placed with any one institution or group with the exception of the Council's own bankers where the limit is £10 million. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates.
- c) **Call accounts with high credit worthiness banks and building societies.** The objectives are as for 1b above 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.

#### 1.2 DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF GOVERNMENT SUPPORT / OWNERSHIP

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 the Council is that such backing makes these banks attractive 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.

- a) **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for 1b. except partial or full Government ownership 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. The Council considers this indicates a low and acceptable level of residual risk.

The table below provides details of the proposed investment limits and maturity periods.

### 1.1 Deposit Limits

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max Value of investments	Max. maturity period
Debt Management Agency Deposit Facility	n/a	term	no	No Limit	6 months
Term deposits – local authorities	n/s	term	no	£25m	2 years
Call accounts – banks and building societies **	Short Term - F1 Individual – C Support 1	instant	no	£25m	n/a
Term deposits – banks and building societies **	Short Term - F1 Individual – C Support 1	term	no	£25m	2 years
UK nationalised banks – term deposits	E/F	term	no	£25m	2 years
UK nationalised banks – call accounts	E/F	instant	no	£25m	n/a

All investments in this table are subject to the following risks:-

1. **Credit and counter-party risk:** this is the risk of failure by 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.
2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, 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 or 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 and (b) there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer. The column in the table above headed as 'market risk' will show each investment instrument as being instant access, sale T+3 = transaction date plus 3 business days before you get the cash, or term i.e. money is locked in until an agreed maturity date.

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.
4. **Interest rate risk:** this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances, against which the Council has failed to protect itself adequately. The Council has set limits for its fixed and variable rate exposure in its previously agreed Treasury Indicators.
5. **Legal and regulatory risk:** this is the risk that the Council 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 Council suffers losses accordingly.

### Controls on treasury risks

1. **Credit and counter-party risk:** the Council has set minimum credit criteria to determine which counterparties are of high creditworthiness to enable investments to be made safely.
2. **Liquidity risk:** the Council has cash flow forecasting models to enable it to determine how long investments can be made for and how much can be invested.
3. **Market risk:** the Council does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value.
4. **Interest rate risk:** the Council 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 minimising risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.
5. **Legal and regulatory risk:** the Council will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

## 2. UNLIMITED INVESTMENTS

The Regulations state that the Council can deem an investment as being 'unlimited' in terms of the maximum amount of the total portfolio that can be put into that type of investment but an explanation must be given for using that category.

The Council has given only the Debt Management Agency Deposit Facility an unlimited category. 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. NON TREASURY INVESTMENTS

Investments defined in the regulations include the acquisition of properties, share or loan capital. These types of investments may have originally been made for service or policy reasons or for treasury management purposes. If the Council makes an investment which is not listed as a permitted investment, that investment will not be made in accordance with the Consent of Ministers and as such will be *ultra vires*. The exception to this is where the Council makes a financial transaction that relies on separate legislative powers such as loans to third parties.

Loans to third parties can be advanced by local authorities under the Housing (Scotland) Act 1987, the Housing (Scotland) Act 2006 and the general power to advance well-being contained in the Local Government in Scotland Act 2003 at section 20. The inclusion of loans to third parties as part of the investments of the Council is to identify the value of local authority monies utilised in this way, monies which would otherwise be available for general investment and give rise to investment income.

Table 3.1 provides a summary of an initial review of the Councils Non-Treasury Investments at 1 April 2010 and the maximum value of investments that the Council will hold.

**Table 3.1: Non Treasury Investments Amounts Held and Proposed Limits**

	Actual Value at 1 April 2010 £m	Max value of investments £m
Investment Property * - Council	£1.2 m	£10m
Share Holdings Council	Note **	£0.1m
Loans to 3 <sup>rd</sup> Parties Market Rate - Council	£1.105m	£2.0m
Loans to 3 <sup>rd</sup> parties – Below Market Rate - Council	£0.039m	£0.1m
Investment Property * - Common Good Funds	£1.0	£1.5m
Share Holdings - Common Good Funds	nil	nil
Loans to 3 <sup>rd</sup> Parties Market Rate – Common Good Funds	nil	£0.1m
Loans to 3 <sup>rd</sup> parties – Below Market Rate – Common Good Funds	Nil	nil

#### Notes

\* Investments Properties have been categorised using IFRS guidelines and include both properties acquired for capital appreciation and income generation.

\*\* Although the Council has the following share holdings no value has been attached to them in its current Balance Sheet

- 1) 20.43% of total share capital in Grampian Venture Capital Limited
- 2) 17% Share in Varis Engineering Limited (including preference shares)
- 3) 50% in Joint Venture Moray Microbiological Lab Ltd