

REPORT TO: THE MORAY COUNCIL ON 12 MAY 2010

SUBJECT: REVISIONS TO TREASURY MANAGEMENT STRATEGY 2010/11

BY: CHIEF FINANCIAL OFFICER

1. REASON FOR REPORT

- 1.1 To request that the Council agrees revisions to the Treasury Management Strategy agreed on 11 February 2010 in accordance with the new Investment Regulations.
- 1.2 This Report is submitted to Committee in terms of Section A (3), to implement and monitor the treasury policy statement dealing with the management of all money and capital market transactions in connection with cash and funding resources of the Council

2. RECOMMENDATION

- 2.1 **It is recommended that the Council agree that the change in circumstances set out in Sections 3.1- 3.5.2 below represent a relevant and material change in circumstances, in terms of Section 84 of the Council's Standing Orders, and agree to Suspend Standing Order 83 and agree:**
- (a) to note the implementation of the new Investment Regulations;**
 - (b) to approve the revisions to the Council's Treasury Management and Annual Investment Strategy as detailed in this report and apply to these strategies to both the Council and Common Good Funds;**
 - (c) the Permitted Investments and limits detailed in the tables in APPENDIX 1;**
 - (d) the Borrowing in Advance Strategy as detailed in APPENDIX 2;**
 - (e) that the day to day operation of the above limits be delegated to the Chief Financial Officer in accordance with current treasury management arrangements; and**
 - (f) that in future reports on Treasury Management Strategy will go to the Policy and Resources Committee for scrutiny before being considered at Full Council.**

3. BACKGROUND

- 3.1 **New Investment Regulations from 1 April 2010**

- 3.1.1 The Council considered and approved its Treasury Management Strategy for 2010 at its meeting on 11 February 2010 (para 8 refers). Since that meeting, the Scottish Government has issued investment regulations (The Local Government Investments (Scotland) Regulations 2010). A finance circular has also been issued which provides the Consent of Scottish Ministers for local authorities to make investments and sets out requirements of that Consent.
- 3.1.2 The Regulations came into force on 1 April 2010. As a result, elements of the Treasury Management Strategy for 2010 which were previously approved by the Council need to be revised to take account of the requirements of the new investment regulations.
- 3.1.3 The revisions cover:
- Annual Investment Strategy
 - Permitted Investments
 - Borrowing in Advance

3.2 **Annual Investment Strategy**

- 3.2.1 The Council's investment priorities are:
- the security of capital (minimise the risks)
 - the liquidity of its investments

The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

- 3.2.2 Prior to the introduction of the new investment regulations, investments by Scottish local authorities were limited to 364 days. This restriction has been removed from 1 April 2010 and the Council should therefore be able to make use of this new power at times when such investing is both appropriate and attractive.
- 3.2.3 The longer that cash is invested with a bank or other organisation, the longer the period during which that organisation, holding the Council's money, could potentially default. The Chief Financial Officer will manage such risk exposure by requiring a higher level of creditworthiness for all institutions with which deposits are placed in excess of 364 days. The higher level of creditworthiness will be dependent on credit ratings and take into account Credit Default Swap (CDS) spreads and other information.
- 3.2.4 Longer term investments are subject to greater interest rate risk in as much as there is more potential during a longer period for interest rates to move unexpectedly compared to the expectations at the time the investment was made. The Chief Financial Officer manages this risk by taking a view of the future course of interest rates and devising a treasury management strategy which aims to maximise investment returns whilst controlling risk.
- 3.2.5 Longer term investing will be considered at times where the expectation is for interest rates to fall and the level of funding held by the Council is likely to remain above expenditure requirements for some time. This would allow the Council to

lock into a higher level of earnings than would be available for the equivalent shorter investments over the same period.

3.3 Permitted Investments

- 3.3.1 One of the key areas of the new 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. Some types of investments may be classed as unlimited but the reasons for doing so must be set out in the Strategy.
- 3.3.2 As well as Treasury Investments (various investment instruments), Permitted Investments include the acquisition of properties and share or loan capital. These types of investments may have 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.
- 3.3.3 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.
- 3.3.4 The Annual Investment Strategy also requires to identify
- the different types of risk that each permitted type of investments are exposed to
 - the controls in place for mitigating those risks
 - the objectives for each type of permitted investment
 - forecasts for the level of investments over the same period as the Council’s capital investment plans
 - details of the maximum value and maximum period for which the funds may prudently be invested
 - procedures for reviewing the holding of longer-term investments

Proposed Permitted Investment instruments identified for use in 2010/11 are listed in **APPENDIX 1**, together with the requirements outlined above. Counterparty limits were approved by Members at the Council meeting on 11 February 2010.

3.4 Borrowing in Advance

- 3.4.1 Borrowing in advance is any borrowing undertaken by a 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.
- 3.4.2 Although in the medium term, it is unlikely that the Council will require to borrow in advance, the new guidance requires the Council to have a Borrowing In Advance Strategy.
- 3.4.3 Local Authorities must not borrow more or in advance of their needs primarily to profit from the investment return of extra sums borrowed. The Council must demonstrate that borrowing is for legitimate purposes such as the exercise of day to day cash management or the management of borrowing for capital purposes as set out in the CIPFA codes.
- 3.4.4 Borrowing in advance may be taken for risk management reasons, subject to sound justification, before any borrowing in advance is permitted; the Regulations require The Council to detail its policy for borrowing in advance within its Treasury Management Strategy. The proposed policy for the Council is set out in **APPENDIX 2**.

3.5 Investment Balances Forecasts

- 3.5.1 The Regulations require the Council to provide a forecast for the level of investments for the next three years, in line with the time frame of our capital investment programme.
- 3.5.2 As the Scottish Government only issued these regulations in April. It has not been possible to calculate three years figures in time for this report to be submitted to this meeting. The figures will be collated after the unaudited accounts have been finalised in June 2010 and will be reported along with the year-end Prudential Indicators Report to the Council on 15th September 2010.

4. SUSPENSION OF STANDING ORDERS

- 4.1 In terms of Standing Order 83, no resolution of the Council shall be amended or revoked within six months of its adoption except by the suspension of Standing Orders.

- 4.2 Given that it is less than 6 months since the Council approved the Treasury Management Strategy 2010/11 then should the Council determine, following further consideration of the matter, that there has been a relevant and material change in circumstances and agree to revise the Strategy it will be necessary to suspend Standing Order 83 and in doing so the relevant and material change in circumstances shall be specified in the motion proposing the suspension, in terms of Standing Order 84.
- 4.3 The relevant and material change in circumstances being the new Regulations referred to in Sections 3.1 – 3.5.2 above, which came into force on 1 April 2010.

4. **SUMMARY OF IMPLICATIONS**

(a) Single Outcome Agreement/Service Improvement Plan

None

(b) Policy and Legal

In setting the Councils' Annual Investment Strategy, the Council will have regard to the Local Government Investment (Scotland) Regulations 2010 and accompanying finance circular. The 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA "Treasury Management Code") and the Audit Commissions report on Icelandic Investments.

(c) Resources (Financial, Risks, Staffing and Property)

Local Authorities are required to develop their Treasury Management Strategies to include: the identification of the different types of treasury risk that their permitted Investments are exposed to credit or security risk (of default), liquidity risk (risks associated with committing funds to longer term investments) and market risks (effect of market prices on investment value). These are detailed in **APPENDIX 1**.

(d) Consultations

None

5. **CONCLUSION**

- 5.1 **The new regulatory framework introduced by the Investment of Money Regulations and the Consent issued by Scottish Ministers provides greater autonomy for local authorities in their investment activities. The Consent requires the Council to consider the totality of its investment activity which covers the investments of temporary cash balances with banks and similar institutions, shareholdings in companies or joint ventures, loans to third parties and also investments properties.**

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Background Papers: Attached

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