West
Dunbartonshire
Council

WEST DUNBARTONSHIRE COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

The Council defines its treasury management activities as:

"*the management of the organisation's cash flows, its banking, money markets 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 Council 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 the risk implications for the Council.

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

Appendix 2

WEST DUNBARTONSHIRE COUNCIL

TREASURY MANAGEMENT
CLAUSES TO BE FORMALLY ADOPTED

1. This 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 (TMP's), 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 Council will receive reports on its treasury management policies, practices and activities, including 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 TMP's.

3. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Corporate and Efficient Governance Committee, and for the execution and administration of treasury management decisions to the Section 95 Officer, who will act in accordance with the Council's Treasury Policy Statement and TMP's and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. The organisation nominates the Audit and Performance Review Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Appendix 3

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WEST DUNBARTONSHIRE COUNCIL

THE TREASURY MANAGEMENT ROLE OF THE SECTION 95 OFFICER

The S95 officer is responsible for:

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- Submitting regular treasury management policy reports;
- Submitting budgets and budget variations;
- Receiving and reviewing management information reports;
- Reviewing the performance of the treasury management function;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy of internal audit, and liaising with external audit;
- Recommending the appointment of external service providers.

Appendix 4

Prudential Indicators 2011/12 to 2014/15

1. The Capital Expenditure Plans

1.1 The Council's gross capital expenditure plans are summarised below in Table A and this forms the first of the prudential indicators. Total expenditure is partially funded by resources such as capital receipts, capital grants, etc. Any remaining expenditure which cannot be immediately funded from other resources will form a borrowing need.

1.2 A certain level of capital expenditure will be grant supported by the Government; anything above this level will be unsupported and funded from the Council's own resources.

1.3 There are two main limiting factors which may impact on the Council's ability to fund capital expenditure which is not funded by receipts, grants or Government grant support:

- Whether the revenue resource is available to support in full the revenue implications of capital expenditure, both borrowing costs and running costs; and

- The Government may impose a control to limit either the total of all councils' plans nationally; or in the event of an assessment by central government that local plans are unaffordable at a specific council, it may implement a local control. No such control was implemented during 2011/12, however, this the situation may change in the future.

1.4 The summary capital expenditure projections for both General Services and HRA are detailed in the table below:

Table A:

£000	2011/12 Probable	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
General Services	17,943	26,239	9,853	11,001
HRA	17,820	30,504	25,911	23,927
Capital Expenditure	**35,763**	**56,743**	**35,764**	**34,928**
Financed by:				
Capital receipts	1,063	8,266	3,095	2,850
Capital grants	12,060	17,670	7,316	8,359
Revenue	826	2,291	242	242
Net financing need for the year	**21,814**	**28,516**	**25,111**	**23,477**

1.5 Both General Services and the HRA capital expenditure estimates peak in 2012/13 due to the inclusion of anticipated costs relating to large one off projects in year (replacement of Dumbarton Academy and 75 new Council Houses).

2. The Council's Borrowing Need (the Capital Financing Requirement)

2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources and includes the capital value of assets built under the PPP project. It is a measure of the Council's underlying borrowing need. The net capital financing need (as indicated in Table A) will impact directly on the CFR as any capital expenditure above, which has not immediately been paid for, will increase the CFR.

2.2 Following accounting changes the CFR includes any other long term liabilities (e.g. PPP schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £94.588m of such schemes within the CFR.

2.3 The CFR projections for both General Services and HRA are detailed in the table below:

Table B:

£000	**2011/12 Probable**	**2012/13 Estimated**	**2013/14 Estimated**	**2014/15 Estimated**
Capital Financing Requirement				
CFR – General Services	213,194	205,562	194,167	187,883
CFR – HRA	111,945	130,718	149,492	167,092
Total CFR	**325,139**	**336,280**	**343,659**	**354,974**
Movement in CFR (from Previous year)	4,136	11,141	7,379	11,315
Movement in CFR represented by				
Net financing need for the year (from Table A, above)	21,814	28,516	25,111	23,477
Less scheduled debt amortisation and other financing movements, in year	(17,678)	(17,375)	(17,732)	(12,162)
Movement in CFR	**4,136**	**11,141**	**7,379**	**11,315**

2.4 The CFR for General Services is projected to fall from 2012/13 onwards due to the fact that future capital spend is projected to be fully funded from either grants or capital receipts based on current information. In contrast the CFR for HRA is projected to increase as the majority of HRA capital spend is funded through prudential borrowing.

2.5 The expected impact of the capital expenditure decisions above on the Council's debt and investment position are shown in the treasury strategy (Appendix 5).

3. Affordability Prudential Indicators

3.1 The previous sections cover the overall capital and control of borrowing, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These indicate the impact of the capital investment plans on the overall Council's finances. The Council is asked to approve the following indicators:

3.1.1 Probable outturn and future Estimates of the ratio of financing costs to net revenue stream – This indicator identifies the trend in the cost of capital (loan charges) against the net revenue stream (funding sources e.g. AEF and council tax for General Services, rent charges for HRA). The estimates of financing costs include current commitments and the impact of capital expenditure estimates included within this report.

Table C:

£000	**2011/12 Probable**	**2012/13 Estimated**	**2013/14 Estimated**	**2014/15 Estimated**
General Services				
Net Revenue Stream	237,150	239,713	233,647	235,208
Loan Charges	15,866	15,984	15,731	9,984
	6.69%	**6.67%**	**6.73%**	**4.24%**
HRA				
Net Revenue Stream	31,792	32,362	33,009	33,669
Loan Charges	12,659	13,311	13,451	13,417
	39.82%	**41.13%**	**40.75%**	**39.85%**

3.1.2 Estimates of the incremental impact of capital investment decisions on the Council Tax – This indicator identifies the trend in the anticipated cost of the three year General Services capital estimates included within this report. The assumptions are based on the estimates within this report, but will invariably include some elements which are estimated over the three year period. The incremental impact in 2013/14 and 2014/15 is minimal due to the fact that all capital expenditure is projected to be fully funded from grants and capital receipts rather than prudential borrowing as noted in 2.2 above.

Table D:

	Proposed Budget 2012/13	Forward Projection 2013/14	Forward Projection 2014/15
Council Tax - Band D	£2.13	£0.03	£0.03

3.1.3 Estimates of the incremental impact of capital investment decisions on Housing Rent levels – Similar to the council tax calculation this indicator identifies the trend in the anticipated cost of the three year HRA capital estimates included within this report, expressed as a discrete impact on weekly rent levels.

Table E:

	Proposed Budget 2012/13	Forward Projection 2013/14	Forward Projection 2014/15
Weekly Housing Rent levels	£2.33	£2.12	£1.98

Appendix 5

Treasury Management Strategy 2012/13 – 2014/15

1. Background

1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Whilst the prudential indicators in Appendix 4 consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions. There are specific treasury prudential indicators included in this strategy which need approval.

1.2 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2011). This Council adopted the Code of Practice on Treasury Management on 31 March 2010, and will adopt the revised Code.

1.3 As a requirement of the Code the Council adopted a Treasury Management Policy Statement and four Treasury Management clauses on 31 March 2010. These form part of the Council's financial regulations and are also a requirement of one of the prudential indicators. The revised Code of Practice has amended the Treasury Management Policy Statement and this was attached at Appendix 1 for approval. The Treasury Management clauses also require to be updated as the Executive Director of Corporate Services is no longer the S95 officer and the revised clauses were attached at Appendix 2 for approval. The treasury management role of the Section 95 officer was attached at Appendix 3.

1.4 The policy requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. Further reports will be provided as follows:

- Mid year monitoring report on actual activity during the year including revised indicators where appropriate; and
- Year-end report on actual activity for the previous year.

1.5 This strategy covers:

- The Council's debt and investment projections;
- Limits to the Council's borrowing activity;
- The economic climate and expected movement in interest rates;
- The Council's borrowing, debt and investment strategies;
- Treasury performance indicators; and
- Specific limits on treasury activities.

2. The Council's debt and investment projections

2.1 The Council's treasury portfolio position at 31 March 2011, with forward projections are summarised below. Table F shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any under or over borrowing.

Table F:

£000	2011/12 Probable	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
External Debt				
Debt at 1 April	219,801	225,416	237,713	246,279
Maturing Debt	(35)	(26,036)	(7,980)	(13,015)
New Borrowing : Maturing Debt	0	26,000	7,950	12,999
New Borrowing : CFR	5,650	12,333	8,596	12,640
Debt at 31 March (1)	**225,416**	**237,713**	**246,279**	**258,903**
Long Term Liabilities (LTL) at 1 April	94,588	93,074	91,882	90,665
Expected Change in LTL	(1,514)	(1,192)	(1,217)	(1,325)
LTL at 31 March (2)	**93,074**	**91,882**	**90,665**	**89,340**
Actual Debt at 31 March (1) + (2)	**318,490**	**329,595**	**336,944**	**348,243**
CFR (from Table B in appendix 4)	**325,139**	**336,280**	**343,659**	**354,974**
Under/(Over) Borrowing	**6,649**	**6,685**	**6,715**	**6,731**
Investments				
Total Investments at 1 April	12,930	15,000	15,000	15,000
Annual Change in Investments	2,070	0	0	0
Total Investments at 31 March	15,000	15,000	15,000	15,000
Net Debt	**303,490**	**314,595**	**321,944**	**333,243**

2.2 Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt (net of any investments) does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2012/13 and next two financial years (shown as net debt above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. This calculation is detailed in Table G below:

Table G:

£000	2011/12 Revised
Probable Outturn re CFR (from Table H)	
2011/12	325,139
Estimated movement in CFR (From Table B in appendix 4)	
2012/13	11,141
2013/14	7,379
2014/15	11,315
Anticipated CFR at 31 March 2015	**354,974**
Anticipated Net Debt at 31 March 2012	**303,490**

2.3 **The Section 95 Officer reports that the Council has complied with this prudential indicator, and no difficulties are envisaged for the current or future years.** This view takes into account current commitments, existing plans, and the proposals in the draft 2012/13 capital plan which was estimated during the setting of the 2011/12 capital plan.

3. Limits to Borrowing Activity

3.1 The Operational Boundary is detailed in Table H below and is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Table H:

£000	2011/12 Revised	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
External Debt	350,339	362,555	370,638	369,163

3.2 The Authorised Limit for External Borrowing – a further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is not allowed to exceed. This needs to be set or revised by Members. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit (Affordable Capital Expenditure Limit) determined under section 35(1) of the Local Government in Scotland Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised. The Council is asked to approve the authorised limit detailed in Table I below:

Table I:

£000	2011/12 Revised	2012/13 Estimated	2013/14 Estimated	2014/15 Estimated
External Debt	382,188	395,514	404,333	417,892

3.3 **Advance Borrowing** - This Council will not borrow more than or earlier than required purely in order to profit from the investment return of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

3.3.1 Advance borrowing will only be taken for risk management purposes subject to sound justification. The Section 95 Officer may do this under delegated power where, for instance, a sharp rise in interest rates is expected and so borrowing early at fixed interest rates will be economically beneficial. A cautious approach to any such borrowing will be adopted, however where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

3.3.2 Full consideration will be given to balancing investment risks, such as the credit and interest risk resulting from the temporary investment of the sums, against the risk of adverse interest rate movements in addition to the existing debt maturity profile over the medium term.

3.3.3 As required by The Investment Regulations (Code on the Investments of Money by Scottish Local Authorities) which came into force on 1 April 2010 the Council will appraise all risks associated with advance borrowing activity. The Council will fully document the justification for the decision prior to the activity being undertaken, with subsequent reporting either within the mid year or annual reporting mechanism.

4. Prospect for Interest Rates

4.1 The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Table J gives the Sector central view.

Table J:

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
March 2012	0.50	0.70	1.50	2.30	4.20	4.30
June 2012	0.50	0.70	1.50	2.30	4.20	4.30
Sept 2012	0.50	0.70	1.50	2.30	4.30	4.40
Dec 2012	0.50	0.70	1.60	2.40	4.30	4.40
March 2013	0.50	0.75	1.70	2.50	4.40	4.50
June 2013	0.50	0.80	1.80	2.60	4.50	4.60
Sept 2013	0.75	0.90	1.90	2.70	4.60	4.70
Dec 2013	1.00	1.20	2.20	2.80	4.70	4.80
March 2014	1.25	1.40	2.40	2.90	4.80	4.90
June 2014	1.50	1.60	2.60	3.10	4.90	5.00

4.2 Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

4.3 Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

4.4 This challenging and uncertain economic outlook has a several key treasury mangement implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2012/13;

- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;

- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

5. Borrowing and Debt Strategy 2011/12 – 2013/14

5.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high.

5.2 Against this background and the risk within the economic forecast, caution will be adopted with the 2012/13 treasury operations. The Section 95 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

5.3 If it was felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

5.4 If it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively low cost.

5.5 The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

5.6 Any decisions will be reported to the Corporate and Efficient Governance Committee.

6. Investment Strategy

6.1 The Council's investment policy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular). The Council has also adopted both the 2011 revised Treasury Management Code of Practice and the 2011 revised Prudential Code. The day to day investment policies and practices are contained in the Council's Treasury Management Practices, which reflect the requirements of these codes. These practices are regularly reviewed.

6.2 **Key Objectives** – As a result of the economic background described above, the current investment climate has one over-riding risk consideration - counterparty security risk. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy. The Council's investment strategy has 3 primary objectives:

1. Safeguarding the re-payment of the principal and interest of its investments on time;

2. Ensuring adequate liquidity; and

3. Maximising the investment return.

After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

6.2.1 In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, outlooks and watches published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agengy. Using the Sector ratings service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

6.2.2 Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to contiunally assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "Credit Default Swaps" and overlay that information on top of the credit ratings. This is fully intergrated into the credit methodology provided by the advisors, Sector in producing its colour codings which show the varying degrees of creditworthiness.

6.2.3 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

6.2.4 The aim of the strategy is to generate a list of highly creditworthy counterparties which will enable diversification, and thus avoidance of concentration, with the prime intention of providing security of investment and minimisation of risk.

6.3 **Investment Strategy** – The process for investment strategy under the regulations covers a wide range of Council investments and will be broadly managed in the following way:

- Short Term Cash – Cash relating to day to day cash flow will be maintained on a shorter term basis in cash type products with consideration to the liquidity requirements outlined above.

- Longer Term Cash – Cash relating to reserves, provisions and balances on the balance sheet may be held for longer periods of time in cash type products or in longer term bonds or funds depending on:

  - Cash flow requirements:
  - The underlying expectation for interest rates; and
  - The economic background of these investments may be held longer term.

- Service Type Investments – These types of investments will predominately be policy driven and approved by Members. Loans to third parties (and equity instruments, and investment properties held for rental returns) will be regularly reviewed to judge the investment performance.

6.4 **Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service** – A development for Member reporting is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are additional new requirements to the Member reporting.

6.4.1 These benchmarks are targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

6.4.2 In the context of benchmarking, assessing security is a very subjective area to assess. Security is currently evidenced by the application of minimum quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. Table J shows average defaults for differing periods of investment grade products for each Fitch/Moody's Standard and Poors long term rating category over the period 1990 to 2010.

Table K:

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.02%	0.05%	0.10%	0.16%
AA	0.03%	0.06%	0.12%	0.17%	0.25%
A	0.08%	0.22%	0.40%	0.56%	0.74%
BBB	0.23%	0.69%	1.20%	1.77%	2.37%

6.4.3 The Council's minimum long term rating criteria is currently "A-", meaning the average expectation of default for a one year investment in a counterparty within the range of an "A" long term rating (either + or -) would be 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

6.4.4 As required by the CIPFA Treasury Management Code of Practice The Council will "ensure that it has adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives". In respect to liquidity as defined above the Council seeks to maintain:

- Bank overdraft - £1.000m; and
- Liquid short term deposits of at least £5m available on an overnight basis.

6.4.5 Local measures of yield investment benchmarks that will be used to assess returns are:

- Internal returns above the 7 day LIBID rate;
- Internal returns above the 1 month LIBID rate for fixed investments; and
- Internal returns above the Council's instant access account.

6.5 Council Permitted Investments – The Investments Regulations (Code on the Investment of Money by Scottish Local Authorities) requires the Council approval of all the types of investment to be used and set appropriate limits for the amount that can be held for each investment type. These types of investment are termed permitted investments and any investments used which have not been approved as a permitted investment will be considered ultra vires.

6.5.1 The permitted investments which may be used in the forthcoming year are noted below. Details of the risks, mitigating controls and limits associated with each of these permitted categories are shown in Appendix 6.

- **Cash Type Instruments**
    - Deposits with the Debt Management Account Facility (UK Government);
    - Deposits with other local authorities or public bodies;
    - Money Market Funds;
    - Call accounts, deposit accounts with financial institutions (banks and building societies;
    - Term deposits with financial institutions (banks and building societies);
    - UK Government Gilts and Treasury Bills;
    - Certificates of deposits will financial institutions (banks and building societies); and
    - Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates, etc).

- **Other Investments**

    - Investment properties;
    - Loans to third parties, including soft loans;
    - Loans to a local authority company;
    - Shareholding in a local authority company;
    - Non-local authority shareholdings

6.5.2 Permitted investments related to the Common Good are also shown in Appendix 6, and where applicable the same counterparty selection criteria as noted in 6.6 below will be applied.

6.6 Investment Counterparty Selection Criteria - The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

6.6.1 The Section 95 Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria selects which counterparties the Council will choose from, rather than defining what its investments are.

6.6.2 The minimum rating criteria to be used uses the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. Credit rating type and definitions are attached as Appendix 7.

6.6.3 Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to any counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

6.6.4 The criteria for providing a pool of high quality investment counterparties is:

- **Category 1 - Good Credit Quality** – the Council will only use financial institutions (including Certificates of Deposit's and Corporate Bonds) which:

    - Are UK banks; and/or
    - Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AA
    - And have, as a minimum, the following Fitch, Moody's and Standard and Poors (S&P) credit ratings (where rated):
        - Short Term – F1 (or equivalent from Fitch, Moody's and S&P)
        - Long Term – A- (or equivalent from Fitch, Moody's and S&P)
        - Viability / Financial Strength – bb+ (Fitch) / C (Moody's)

- Support – 3 (Fitch only)

The difference between the ratings will be reflected in the money limits as noted in Table L

- **Category 2 – Part nationalised UK banks** – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Category 1 above.

- **Category 3 – The Council's own banker** for transactional purposes if the bank falls below the above criteria specified in category 1, although in this case balances will be minimised in both monetary size and time.

- **Category 4 – Bank Subsidiary and Treasury Operations** – the Council will use these where the parent bank has the necessary ratings outlined in category 1.

- **Category 5 – Building Societies** – the Council will use all Societies which meet the ratings for banks outlined in category 1.

- **Category 6 – Money Market Funds** – the Council will use money market funds that are AAA rated.

- **Category 7 – UK Government** (including gilts, treasury bills and the DMADF)

- **Category 8 – Local Authorities and other Public Bodies**

6.6.5 Due to the uncertainty in the financial markets it is recommended that the Investment Strategy is approved which will provide officers with the flexibility to deal with any unexpected occurrences. Officers can restrict the pool of available counterparties from these criteria to safer instruments and institutions.

6.6.6 The maximum periods of time that the Council will invest each individual deposit in each category of counterparty detailed in section 6.6.4 above on a fixed term basis are as noted in Table L:

Table L:

Investment Category	Fitch (or equivalent)	Money Limit	Time Limit
1	F1+ / AA-	£10million	364 days
	F1 / A-	£5 million	
2	F1/A-	£5 million	364 days
3		£5 million	Overnight
4		£5 million	364 days
5	As in 1 above	£10 m and £5m	364 days
6	Sector Limit	£20 million	Very liquid no time limit applies
	Fund Limit	£5 million	
7		No limit	6 months
8	Sector Limit Fund Limit	£20 million £5 million	364 days

6.6.7 The Council's bankers are currently the Clydesdale Bank Plc which falls within Category 3. It is recognised that the money limit of £5million may be breached for purely operational purposes on a temporary overnight basis only. The treasury section will endeavour to avoid this scenario but this allows for circumstances that are outwith the Council's control where funds may be deposited unexpectedly or at short notice into the Council's accounts after the dealing deadline for the day has passed. In such a circumstance the funds will require to be kept on an overnight basis in the Council's bank account until appropriate arrangements can be made for investment.

6.6.8 Table L does not include a monetary limit for category 7 which are funds deposited with the UK Government namely the DMADF. This facility allows local authorities to deposit surplus cash on flexible terms and receive a market related rate of interest. Funds are held by the Bank of England and the scheme carried the Government's own sovereign AAA credit rating offering the highest available security and therefore no maximum monetary limit has been set.

6.6.9 Country and sector considerations - Due care will be taken to consider for each potential investment source the country, group and sectoral exposure (sectoral exposure refers to the type of counterparty such as the banking sector, money market sector, public sector, etc) of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Category 1 above and the list of approved countries for investments are detailed in Appendix 8. In addition:

- No more than 25% will be placed with any non-UK country at any time;
- Limits in place above will apply to Group companies; and
- Sectoral limits will be monitored regularly for appropriateness.

6.6.10Use of additional information other than credit ratings – Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

6.6.11Economic Investment Considerations - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise around September 2013. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

6.6.12 There is an operational difficulty arising from the current banking crisis. There is currently little value investing longer term unless credit quality is reduced. Whilst some selective options do provide additional yield uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

6.6.13 The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Section 95 Officer may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

6.6.14 Examples of these restrictions would be the greater use of the DMADF – a Government body which accepts local authority deposits, Money Market Funds and strongly rated financial institutions. The credit criteria have been amended to reflect these facilities.

6.7 Sensitivity to Interest Rate Movements - Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. Table L highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

Table M:

Loan Type	2012/13 Estimate	2012/13 Estimated + 1%	2012/13 Estimated - 1%
Revenue Budgets			
Variable Rate Debt Payments	£0.075m	+£0.049m	-£0.048m
Variable Rate Investment income	£0.120m	+£0.150m	-£0.120m

7. Treasury Management Limits on Activity

7.1 There are four further treasury activity limits, which were previously prudential indicators. The purpose of these prudential indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs:

- *Upper limits on variable interest rate exposure* – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments;

- *Upper limits on fixed interest rate exposure* – Similar to the previous indicator this covers a maximum limit on fixed interest rates;

- *Maturity structures of borrowing* – These limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits; and

- *Total principal funds invested for greater than 364 days* - These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The proposed indicators are shown within Table N:

Table N:

	2011/12 Upper		2012/13 Upper		2013/14 Upper	
Limits on fixed interest rates	100%		100%		100%	
Limits on variable interest rates	50%		50%		50%	
Maturity Structure of fixed interest rate borrowing						
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	50%	0%	50%	0%	50%
12 months to 2 years	0%	50%	0%	50%	0%	50%
2 years to 5 years	0%	50%	0%	50%	0%	50%
5 years to 10 years	0%	50%	0%	50%	0%	50%
10 years to 20 years	0%	50%	0%	50%	0%	50%
20 years to 30 years	0%	50%	0%	50%	0%	50%
30 years to 40 years	0%	50%	0%	50%	0%	50%
40 years to 50 years	0%	100%	0%	100%	0%	100%
50 years to 60 years	0%	100%	0%	100%	0%	100%
60 years to 70 years	0%	100%	0%	100%	0%	100%
Currently principal sums invested > 364 days	£nil		£nil		£nil	

7.2 The upper limit applied to the maturity structure of fixed interest rate borrowing for periods up to 5 years in the table above have been set at a higher level than in the 2011/12 strategy report. This is due to a change in 2011 Code regarding the way that local authorities have to record certain market loans where the maturity date is now deemed to be the next call date rather than the eventual repayment date.

8. Performance Indicators

8.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available;
- Debt – Average rate movement year on year; and
- Investments – Internal returns above the 7 day LIBID rate.

8.2 The results of these indicators will be reported in the Treasury Annual Report for 2011/12.

9. Treasury Management Advisers

9.1 The Council uses Sector as its treasury management advisors. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments; and
- Credit ratings/market information service comprising the three main credit rating agencies.

9.2 The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not place upon external service providers.

9.3 The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value is assessed are properly agreed and documented, and subjected to regular review.

9.4 Whilst the advisers provide support to the internal treasury function the final decision on treasury matters remains with the Council.

10. The Monitoring of Investment Counterparties

10.1 The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Section 95 Officer and, if required, new counterparties which meet the criteria will be added to the list.

11. Member and Officer Training

11.1 The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. Member training will take place later in the year, post election.

12. Local Issues

12.1 There are two major initiatives which may impact on both the level of debt and investments held by the Council during 2012/13 and in future years as noted below:

- Securitisation of the Council Non Operational Property Porfolio; and
- Partial Housing Stock Transfer

12.2 While both initiatives are currently ongoing at the present time (albeit at various stages) the final outcome is uncertain (due to consultation requirements) therefore the debt and investment indicators that are detailed in Table F do not include the anticipated impact of these initiatives at this time.

Appendix 6

West Dunbartonshire Council, Common Good Funds and Leisure Trust Permitted Investments - Associated Controls and Limits

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
Cash Type Instruments			
Deposits with the Debt Management Account Facility (UK Government) (**Very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.	As shown in the counterparty section criteria 6.6.6 above.
Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non- local authority deposits will follow the approved credit rating criteria.	As shown in the counterparty section criteria 6.6.6 above.
Money Market Funds (MMFs) **(Very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs are Constant Net Asset Value (CNAV), and the fund has a "AAA" rated status from either Fitch, Moody's or Standard & Poors.	As shown in the counterparty section criteria 6.6.6 above
Call account deposit accounts with financial institutions (banks and building societies) **(Low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than the first three categories above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
Term deposits with financial institutions (banks and building societies) **(Low to medium risk depending on period & credit rating)**	These tend to be low risk investments, but will exhibit higher risks than the first three categories above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity.	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	As shown in the counterparty section criteria 6.6.6 above.
Certificates of deposits with financial institutions **(Low risk)**	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than the first three categories above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) **(Low to medium risk depending on period & credit rating)**	These tend to be medium to low risk investments, but will exhibit higher risks than the first three categories above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement of the counterparty (penalties may apply).	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.

Type of Investment	Treasury Risks	Mitigating Controls	Council and Common Good Limits
Corporate Bonds **(Medium to high risk depending on period & credit rating)**	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. Corporate bonds will be restricted to those meeting the base criteria. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria 6.6.6 above.
Other Types of Investments			
Investment properties	These are properties that are not used to facilitate service delivery but are held solely to earn rentals or for capital appreciation or both. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).	In larger investment portfolios some small allocation of property based investment may counterbalance/compliment the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams.	Services will determine monetary and time limits managing risk accordingly.
Loans to third parties, including soft loans	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	Services will determine monetary and time limits managing risk accordingly.
Loans to a local authority company	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each loan to a local authority company requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	Services will determine monetary and time limits managing risk accordingly.
Shareholdings in a local authority company	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	Services will determine monetary and time limits managing risk accordingly.

Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by rational behind the service the investment and the likelihood of loss.	Services will determine monetary and time limits managing risk accordingly.

The Monitoring of Investment Counterparties - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Sector, including rating changes, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the S95 Officer, and if required new counterparties which meet the criteria will be added to the list.

Appendix 7

West Dunbartonshire Council, Common Good Funds and Leisure Trust Permitted Investments - Rating Definitions

Type of Rating	Rating	Explanation
Fitch -Short Term	F1+	Indicates exceptionally strong capacity for timely payment of financial commitments
	F1	Indicates strong capacity for timely payment of financial commitments
Fitch - Long Term	AA-	Indicates very strong capacity for timely payment of financial commitments and this capacity is not significantly vulnerable to foreseeable events
	A-	Indicates strong capacity for timely payment of financial commitments. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings
Moody's - Short Term	P-1	Banks based Prime-1 for deposits offer superior credit quality and a very strong capacity for timely payment of short term deposit obligations
Moody's - Long Term	Aa	Offer excellent credit quality, with susceptibility to long term risks with a vulnerability to greater fluctuations within protective elements
	A	Offer excellent credit quality, but elements suggest a Susceptibility to impairment over the long term
Standard & Poors - Short Term	A-1	Indicates a strong capacity to meet institutions financial commitments. Within this category, certain obligors are design with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitments is EXTREMELY STRONG
Standard & Poors - Long Term	AA-	Indicates strong capacity for timely payment of financial commitments
	A-	Indicates strong capacity for timely payment of financial commitments. This capacity may, nevertheless, be more susceptible to the adverse effects of changes in circumstances or in economic conditions than is the case for higher rated category

Appendix 8

West Dunbartonshire Council, Common Good Funds and Leisure Trust Permitted Investments - Approved Countries for Investments

Based on lowest available rating

AAA

- Austrialia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- United Kingdom

AA+

- France
- Hong Kong
- United States of America

AA

- Belgium
- Qatar
- United Arab Emirates

AA-

- Japan
- Saudi Arabia