

TREASURY MANAGEMENT

1 PURPOSE

- 1.1 This report is to bring Members up to date with treasury management issues and to agree a new basis for the lending list of the Authority. The lending list is the agreed counterparties with whom we can place investments.

2 BACKGROUND

- 2.1 Members will recall that the Council agreed the appointment of Sector Treasury Services Ltd to provide consultancy advice. To date they have provided detailed advice of borrowing options for 2000/01, three man days of training for staff, weekly bulletins on the economy which include borrowing and lending options and they have also made available an ability to deal directly with the Abbey National. At the moment this is an advantage against other investments.
- 2.2 The Council usually has around £7 to 10 million out in investments at any one time. Interest on the investments is credited to the general fund and for 2001/02 the net figure is estimated at £530,000.
- 2.3 The achievement of this figure is under some pressure owing to the decrease in base rate. Although interest rates are generally expected to increase in the second half of the year there will be some ground to be made up. Further implications of this budget issue will be given to Members later in the year.
- 2.4 An additional complication for the early months of this financial year has been the negative yield curve. Normally the longer one is prepared to invest funds the higher the rate of interest. This is a positive yield curve. The opposite has been true with better interest rates available for short-term investments. This made the Authority vulnerable to changes in the base rate.
- 2.5 One of the key tasks of Sector was to guide us to a new basis for the lending list of the Authority. The existing list is shown at Appendix 'A'. The current list causes problems in that it is fairly restricted, as we would not actually deal with a number of those shown on the list owing to the small scale of our investments. In addition the list is not totally determined by a structured policy.
- 2.6 The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a Code of Practice for Treasury Management in the public

sector. In relation to credit and counterparty risk management, the following are the key points:

- A prime objective is the security of capital.
- Counterparty risks and limits should reflect a risk adverse and prudent attitude towards organisations with which funds may be deposited.
- Investment activities will be limited to the instruments, methods and techniques shown in the Treasury Management Procedure Guide for Rochford.

2.7 For most authorities the setting of a counterparty list and limits will be based on the credit rating of the organisations who are named in the Banking Act 1987 as institutions authorised to accept deposits in the United Kingdom plus the investment in Building Societies. Investments made by the Authority are in sterling. It should be noted that not all institutions covered by the Banking Act receive a credit rating.

2.8 Sector provides information from 3 credit rating companies: Fitch IBCA Duff & Phelps, Standard & Poor's and Moody's. Within the credit ratings there is information on short and long term credit quality, individual ratings and information on support that would be available in the event of difficulties. Using the information, institutions and building societies have been placed into sections which reflect those with the strongest credit rating, whom it is proposed, are given a credit limit of £6M, second level who are shown at £4M, the third at £3M and the lowest level at £2M. Here it should be remembered that the lowest level is against our selected criteria and not rankings on the market as a whole. Where two or more counterparties are members of the same group, the above limits should be the maximum, which can be placed with the group as a whole. Therefore, following the formal merger of two institutions shown separately on the list, they will be assigned a single credit limit depending on the rating published.

2.9 CIPFA guidelines recommend a risk adverse approach to Treasury Management. Consequently, even with the highest credit rating the advice is to spread investments to lessen the exposure to potential loss.

2.10 These limits are of course varied between each authority. A large authority may have an investment limit of £50M on a particular institution whereas Rochford's may be £6M.

2.11 The revised list is as follows:

Title	£M Limit
Abbey National Plc	6
Abbey National Treasury Services Plc	}
Bank of Scotland	6
Barclays Bank	}
Woolwich	}
Halifax	6
HSBC	6
Lloyds TSB	}
Cheltenham & Gloucester	}
National Westminster	6
Royal Bank of Scotland	6
Alliance & Leicester	}
Alliance & Leicester Group Treasury Plc	}
Nationwide Building Society	4
Cheltenham & Gloucester	3
Woolwich PLC	3
Bradford & Bingley	3
Clydesdale Bank	3
Northern Rock PLC	3
Standard Life Bank PLC	3
Ulster Bank PLC	3
Bristol & West	2
CIBC world markets PLC (to Oct 2004 only)	2

2.12 The instruments for investment are as follows:-

- Deposits with banks, building societies or local authorities for up to 364 days
- Gilts and Treasury Bills following professional advice
- Certificates of Deposits with banks or building societies for up to 364 days
- Deposits accounts with banks or building societies
- Euro sterling issues by certain Supra-national bodies listed on the London Stock Market following professional advice

- 2.13 It can be seen that with investments which average between £7 to 10M a maximum limit of £6M to the higher level counterparties represents a large percentage of investments with a single organisation. The dilemma for the Council is that it may have the opportunity to invest in an institution with high credit rating and who offer attractive rates of interest but the need to spread risk constrains that investment. In practice there are times when it is difficult for Rochford to place money with the market and therefore maximum use has to be made of quality investment opportunities. Hence the upper limit is shown at £6M.
- 2.14 In addition to the above we have the ability to invest in any principal local authority. Here the credit limit will be £6M irrespective of the authority.
- 2.15 Local authorities are allowed to invest in gilt-edged stock of any maturity or type. Such investments however are best undertaken by a specialist fund manager and therefore they should be included as a form of investment but only on the basis of proper advice. They should be included in the list of approved investment instruments. The limit on investment is £ 4m.
- 2.16 The regulations also allow investment in bonds in certain supranational organisations. Examples are the European Investment Bank, the World Bank and various Banks established on a regional basis around the world. These institutions have Government backing and so these securities are AAA rated, i.e. they are of the highest credit quality. These are not investments that are available all the time and would only be used if the rates offered were attractive. The advantage of these bonds is that from time to time they have enabled local authorities to fix into a higher level of investment income than would have been available on the money market. They are particularly attractive when interest rates are expected to fall. These investments would only be undertaken following specific advice from Sector. They do carry a risk to capital similar to investments in gilts, however they would only be acquired if it were intended to hold them for the full term.
- 2.17 They should therefore be included in the list of approved investment instruments. The limit on investments is £4M.
- 2.18 Sitting behind the list of approved counter parties is Rochford's Treasury Management Procedure Guide. This Guide covers the operational policy on Treasury Management as well as the operational day to day process.
- 2.19 In line with CIPFA Treasury Management Policies the Rochford Treasury Management Procedure Guide should cover the following areas:

- Treasury Management Policy
- Treasury Management Practices
- Delegated responsibilities
- Reports to Members of the appropriate Committee

2.20 In order to update the Rochford Treasury Management Procedure Guide the following key points need to be considered:

Treasury Management Policy

- Treasury Management should be undertaken in compliance with CIPFA Code of Practice for Treasury Management in the public sector. The key objectives are to maximise the returns/minimise the cost to the general fund and to ensure that proper costs and income are included within the Housing Revenue Account supported where possible by housing subsidies.
- All transactions should be in accordance with the Rochford Treasury Management Procedure Guide.
- The Principal Committee shall be Finance and General Purposes Committee and the Principal Officers shall be the Corporate Director (Finance & External Services) and the Head of Financial Services.

Treasury Management Practices

Investments

- All lending to be in accordance with the approved lending list and list of approved instruments.
- Lending may only be carried out by named Officers approved by the Principal Officers.
- Named Officers can only invest up to a total aggregate of £12M.
- Named officers can only place Investments for a period up to 6 months.
- The Principal Officers must agree amounts and periods exceeding this.

Borrowing

- Named Officers may borrow up to £2M for periods up to 3 months. This borrowing may be by fixed or variable rate loans.
- Borrowing in excess of 3 months and up to 1 year and over the total of £2M has to be agreed with a Principal Officer.
- Borrowing in excess of 1 year requires the agreement of the Corporate Director (Finance & External Services).
- All borrowing, other than the £2M above shall be fixed interest.

Reports to Members

- At present Members receive a report immediately prior to the start of the financial year as part of the aggregate credit ceiling report and one following the closure of accounts showing the out-turn for the year.

3 RESOURCE IMPLICATIONS

- 3.1 The net investment income to the general fund depends on the volume of investments, the interest rate structure and the transfers between the Housing Revenue Account and the General Fund. The actual income to the General Fund is mainly vulnerable to interest rate changes. In broad terms a 1% reduction in interest rates will cost the general fund £90,000 in income for the year.

4 RECOMMENDATION

- 4.1 It is proposed that the Committee **RESOLVES**
- (1) That the revised approved counter party list be in accordance with the above report.
 - (2) That the Rochford Treasury Management Procedure Guide be amended in line with this report.

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Background Papers:

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ROCHFORD DISTRICT COUNCIL

APPROVED LENDING LIST

Top 11 Banks -

Barclays
National Westminster
Halifax
Lloyds (inc. TSB)
Abbey National
Royal Bank of Scotland
Bank of Scotland
Woolwich
Alliance & Leicester
Northern Rock
Bradford & Bingley

Building Societies (Assets Exceeding 3 Billion)

Nationwide
Britannia
Yorkshire
Coventry
Skipton

Other

Plus any local authority

Butlers Building Society Guide 1999/Rankings by Total Assets