CITY COUNCIL – 10 OCTOBER 2011

REPORT OF THE DEPUTY LEADER

TREASURY MANAGEMENT STRATEGY 2011/12 – REVISED INVESTMENT STRATEGY

1 SUMMARY

1.1 This report details proposed changes to the City Council's 2011/12 investment strategy, which are required to be approved by a meeting of full Council.

2 RECOMMENDATIONS

2.1 It is recommended that the revisions to the 2011/12 investment strategy detailed in section 6.6 are approved.

3 REASONS FOR RECOMMENDATIONS (INCLUDING OUTCOMES OF CONSULTATION)

3.1 To ensure compliance with the Code of Practice on Treasury Management in Public Services (the Code), adopted by the City Council in February 2002.

4 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

4.1 A range of options for the expansion of the existing City Council investment strategy were considered and are summarised in section 6.5.

5 BACKGROUND

5.1 Treasury Management is the management of the Council's cash flows, including borrowings and investments. It is regulated by CIPFA's Treasury Management Code of Practice

5.2 Treasury Management is subject to robust governance arrangements including legislation, government guidance, codes of practice and financial regulations. The approval of a strategy relating to treasury management, including a strategy for debt repayment and investment, is good practice and ensures that the City Council complies with the governance framework.

6 INVESTMENT STRATEGY

6.1 The City Council's 2011/12 investment strategy was approved by the City Council on 7 March 2011, as part of the overall annual Treasury Management Strategy. Eligible counterparties for 2011/12 include UK banks and building societies, non-UK banks, Money Market Funds (pooled, short maturity, high quality investment vehicles offering instant access), supranational bonds (the debt of international organizations such as the World Bank, the Council of Europe and the European Investment Bank), UK local authorities and the Government's Debt Management Office (DMO).

6.2 The adopted strategy in 2011/12 to date has been to restrict investments to UK banks and building societies, other UK local authorities and AAA-rated Money Market Funds. This approach reflects an ongoing concern over the use of non-UK institutions and a desire to keep the maturity of investments relatively short, whilst financial markets remain volatile. At the beginning of August, City Council external investments totalled £140m, held with the following institutions:

- UK bank call accounts (instant notice) - £40m;
- UK bank fixed-term deposits (av. 151 days to maturity) – £60m;
- Money Market Funds (MMFs) – £40m.

Interest earned on these investments ranged from 0.59% to 2.10%, with an average rate of return equating to 1.12% per annum.

6.3 During the year, ongoing monitoring of the financial position of all approved counterparties is carried out by both treasury management colleagues and by our retained treasury management advisors. This review considers individual credit ratings, credit default swap prices, share prices, changes in sovereign state credit ratings and more general developments in financial markets and the global economy. This then informs decisions to temporarily revise the Investment Strategy to ensure that the Council is well placed to manage any emerging and/or potential risks. As a result, there have been a number of occasions in 2011/12 when the existing investment criteria (counterparty, size and period) have been suspended or reduced:

- Clydesdale Bank (UK) – counterparty suspended, following downgrading of credit rating of parent bank, National Australia Banking Group (18 May);

- UK institutions – maximum period for all new investments reduced from 2 years to 1 year, following market concerns regarding the increased potential of a default by Greece in respect of its sovereign debt (3 August);
- Santander UK (UK) – maximum period for new investments with counterparty reduced to 3 months because of possible credit rating downgrade relating to problems with Spanish parent bank (11 August);
- Societé General (France) – counterparty suspended because of negative market sentiment (11 August);
- all counterparties – maximum period for new investments reduced to 6 months for all UK, US, Canadian and Australian banks, and 1 month for all European banks, following further volatility in financial and equity markets (11 August).

6.4 Our advisors' view remains that there are no fundamental solvency issues with any of the existing counterparties, but it was considered prudent to make the above changes to the list of eligible institutions and to seek to reduce the average maturity profile of the investment portfolio. The financial position continues to be monitored, with further changes to be implemented if and when market conditions change. Such temporary changes are discussed with the Portfolio Holder as issues arise during the year.

6.5 As a consequence of the suspension of counterparties and the reduction in the maximum period of investments, significant levels of surplus cash have, on occasion, been placed overnight with the Council's own bank (the Co-Op), utilising their deposit account facility. Although such deposits are within the approved investment strategy, the interest rate earned is relatively low. Pressure therefore arose to consider alternative investment strategies. Consideration was given to a number of options:
- investing with other eligible UK counterparties – considered impractical currently given the large size of investment required and the poor returns available;
- investing with eligible non-UK institutions – considered imprudent in the face of ongoing financial problems in the European and US banking sectors;
- using other investment products such as supranational bonds etc. – a more secure option, but offering a poor rate of return at present;
- investing with other local authorities – impractical, with few authorities seeking to borrow monies at present;

- investing with the DMO – the most secure option, but one offering the lowest rate of return;
- increasing the limits for sums placed with existing counterparties – considered imprudent, as it would increase the proportion of the portfolio invested with a single counterparty;
- increasing the maximum amount invested in MMFs – a more secure option, providing liquidity and diversity although attracting a limited rate of return.

6.6 The above investment options were discussed at a meeting of the Treasury Management Panel (a group comprising the Chief Financial Officer, treasury management and other senior finance colleagues) on 8 August 2011, with an agreed proposal to increase the maximum sum to be invested in MMFs. This was endorsed by the Portfolio Holder. The strategic change was also referred to and endorsed by our external advisors. The perceived benefits of increasing the sums invested in MMFs are:

- **Security** – the additional MMFs would have a credit rating of AAA, which would increase the weighted average credit rating of the Council's investment portfolio;
- **Liquidity** - monies placed with MMFs can be recalled on a 'same day' notice basis, which would reduce the average 'days to maturity' rate of the portfolio;
- **Diversity** - MMFs 're-invest' pooled funds in a range of short-term debt instruments, many of which are not directly accessible by the Council. This enables the Council to participate in a more diverse and high-quality portfolio than they could invest in directly;
- **Yield** - the current rate of return offered by a number of eligible MMFs is greater than the rate paid in the Co-operative Bank's deposit account.

6.6 The proposal is to increase the maximum sum that can be invested in MMFs from £40m to £80m. An individual limit of £10m per Fund will be retained, with accounts with new Funds to be opened. The existing requirements for all Funds to have a credit rating of AAA and a Constant Net Asset Value (preserving the principal value of the sum invested) will remain.

6.7 To improve the existing administration process, it is also proposed to trial the use of a portal for the management of monies invested in MMFs. This entails all future transactions being channelled through an appointed independent third party. The Council pays no charge for the service, and retains all existing controls in respect of investment decisions and money transfers. The benefits will be seen through a more streamlined process for investing and withdrawing monies in MMFs, easier creation of new MMF accounts and access to detailed reports on individual Funds, including a breakdown of the portfolio, analysis of the return earned, etc.

7 RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS, CRIME AND DISORDER ACT IMPLICATIONS AND EQUALITY AND DIVERSITY IMPLICATIONS)

7.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is prepared for the treasury function. The adopted Risk Management Action Plan in respect of treasury management activity is included in the strategy documents.

The key Strategic Risk relating to treasury management is SR17 ‘Failure to protect the Council’s investments’. The current rating for this risk is ‘6’ (likelihood is rated unlikely, impact is rated moderate)

8 LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

8.1 Treasury management working papers.

9 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

9.1 Executive Board report and minutes, 20 September 2011.
Audit Committee report and minutes, 23 September 2011.

COUNCILLOR GRAHAM CHAPMAN - DEPUTY LEADER