**AGENDA ITEM 8 (ii)**

# FALKIRK COUNCIL

**Subject:** **REFERRAL FROM POLICY & RESOURCES COMMITTEE 9 MARCH 2010 - TREASURY MANAGEMENT STRATEGY 2010/11**
**Meeting:** **FALKIRK COUNCIL**
**Date:** **28 April 2010**
**Author:** **DIRECTOR OF FINANCE**

## 1. INTRODUCTION

1.1 The Policy & Resources Committee held on 9 March considered the Council's Treasury Management Strategy for 2010/11 and the Committee agreed to refer the Report to Council for approval. The Committee also requested a Report on "the concept of an "ethical investment" element to the investment strategy by such as not investing in banks that breach the Chancellor of the Exchequer's guidance on the payment of bonuses."

1.2 The purpose of this report is to refer the Report (attached at Appendix A), dated 17 February 2010, considered on 9 March 2010 to Council for approval and to provide detail on the issues around introducing an "ethical investment" framework as part of its investment strategy when placing surplus Council monies with banks and other financial institutions.

## 2. BACKGROUND

2.1 The Policy and Resources Committee considered a Report (a) advising that in terms of the Council's Financial Regulations relating to Treasury Management an Annual Strategy Report requires to be prepared and submitted to the Policy and Resources Committee, for approval; (b) confirming that this strategy outlines the framework for the expected treasury activities in the financial year 2010/11; (c) intimating that revised Code of Practice for Treasury Management, as referred to in the Report, explains that future reports should be considered and approved by full Council, and (d) informing that a final draft of the Local Government Investments (Scotland) Regulations 2010 were laid before the Scottish Parliament on 11 February 2010.

The Committee agreed to recommend that Council:-

i) adopt the clauses set out in Appendix 1 to the report as part of its Financial Regulations;

ii) approve the Treasury Management Policy Statement as presented in Appendix 2 to the report;

iii) adopt the Borrowing Strategy for 2010/11 as set out in the report;

iv) adopt the Investment Strategy for 2010/11;

v) approve the list of "Permitted Investments" as set out in the report;

vi) approve the Treasury Indicators as set out in the report, and

vii) instruct the Director of Finance to arrange training for Members as outlined in the Report

2.2 Following discussion Committee also agreed to:-

viii) " request a Report on the concept of an "ethical investment" element to the investment strategy by such as not investing in banks that breach the Chancellor of the Exchequer's guidance on the payment of bonuses."

## 3. ETHICAL INVESTING

3.1 There are practical difficulties in defining and applying what might be termed as "ethical investing" insofar as it relates to the banking sector and as a basis for compiling an approved counterparty list. It is relevant to note that a clear social responsibility framework does apply to the Falkirk Pension Fund investments.

3.2 A policy might be constructed around bank lending policies and the extent to which individual banks make available loans to small and medium sized companies and also to mortgage applicants. Here, bank lending has been severely curtailed since the credit crunch but government pressures are now being brought to bear, particularly so through the nationalised and part-nationalised banks, to raise funding levels. Problems will persist, however, as banks have imposed much tighter risk criteria before approving loans. As such, it would be extremely difficult to assess and monitor meaningful criteria which would determine a "good" bank in terms of the level of its lending and in turn it becoming an approved counterparty. This is moreso as the stance of individual banks evidently shifts over relatively short timeframes.

3.3 A second option is to form an "ethical investing" policy around the payment of excess bonuses as referred to at para 1.1. Here, it is understood that the guidance referred to is the new Financial Services Authority Banking and Other Financial Institutions disclosures on remunerations as well as the Walker Review. Both are designed to combat inappropriate risk taking, promote financial stability, be used as a benchmark for good practices and provide greater transparency and disclosure of remuneration packages. The main focus is on perceived excess bonuses payable to company directors and "high end" employees (normally employees within the investment banking arms of certain banks). The payment of bonuses is however a feature across the whole banking sector. Recognising this and given that the reporting requirements are only a new development, it might prove difficult to set an appropriate benchmark and provide adequate monitoring of the same by which this Council can determine a "good" bank for inclusion on its counterparty list.

## 4. COUNTERPARTY LIST

4.1 The Council has approved a list of counterparties to whom they will lend surplus funds. The counterparties are determined by credit rating criteria with the level of deposits managed by both time and monetary limits. This is designed to ensure the optimum protection of public monies which is the primary investment criteria.

4.2 The Council applies very strict investment criteria (see Appendix 4 of Treasury Management Strategy 2010/11) when determining its list of approved counterparties which limits the number of financial institutions to a narrow range of UK based banks and one building society. Should an ethical policy be adopted, this would in all likelihood narrow the choice even further and cause operational difficulties when implementing the Council's investment strategy.

4.3 The average surplus funds available for investment will amount to no more than £10m during financial year 2010/11. Indeed, it is anticipated that the Council will become a net borrower by the end of the financial year.

4.4 Given the relatively low level of surplus funds, these are by and large invested with two institutions, Santander UK and Clydesdale Bank (the Council's own bank) with access to the funds available on demand. It is worth noting that both these banks were among the least exposed to the vagaries of the credit crunch.

4.5 When looking at "ethical" issues among banks, it is normal to highlight the Co-operative Bank as one of the main players in this area. Currently this bank fails to meet the Council's minimum short term credit rating criteria and is not on the counterparty list. Also, this bank normally seeks its funding for periods of one month and above whereas the Council has placed a maximum time limit of one month but in reality concentrates on instant access accounts which reduces the risk profile of the Council's investments significantly and better suits management of cashflows.

## 5. CONCLUSION

Whilst a socially responsible framework is applied to the wide investment range of the Falkirk Pension Fund, it is in practice difficult to apply an ethical framework to the narrow sector of banking. Two dimensions have been highlighted, lending and bonuses, as having practical difficulties in seeking to apply criteria.

## 6. RECOMMENDATIONS

**Council is invited to:-**

1. **adopt the clauses set out in Appendix 1 to the Report of 17 February 2010 as part of its Financial Regulations;**

2. **approve the Treasury Management Policy Statement as presented in Appendix 2 to the Report of 17 February 2010;**

3. **adopt the Borrowing Strategy for 2010/11 as set out in the Report of 17 February 2010;**

4. **adopt the Investment Strategy for 2010/11 as set out in the Report of 17 February 2010;**

5. **approve the list of "Permitted Investments" as set out in the Report of 17 February 2010;**

6. **approve the Treasury Indicators as set out in the Report of 17 February 2010;**

7. **instruct the Director of Finance to arrange training for Members as outlined in the Report of 17 February 2010, and**

8. **to note the supplementary information regarding the concept of an "ethical investment framework".**

Director of Finance

Date: 13 April 2010

Contact Officer: Alastair Redpath

**LIST OF BACKGROUND PAPERS**

NIL

**APPENDIX A**

**AGENDA ITEM**

# FALKIRK COUNCIL

**Subject:** **TREASURY MANAGEMENT STRATEGY 2010/11**
**Meeting:** **POLICY & RESOURCES COMMITTEE**
**Date:** **9 March 2010**
**Author:** **DIRECTOR OF FINANCE**

## 1. INTRODUCTION

1.1 Current Financial Regulations relating to Treasury Management require that an Annual Strategy Report be prepared and submitted to Policy & Resources Committee for approval. This strategy outlines the framework for the expected treasury activities in the following financial year (2010/11).

1.2 A revised Code of Practice for Treasury Management outlined in Section 2 below advises that future reports should be considered and approved by full Council. This is also a requirement of the new Regulations per para 1.3.

1.3 This report also provides an opportunity to bring to the Committee's attention that a final draft of The Local Government Investments (Scotland) Regulations 2010 were laid before the Scottish Parliament on 11 February 2010. As these have been laid before the Parliament in draft form it is unlikely, although not impossible, that there will be further changes before the implementation date of 1 April 2010. Compliance with the Regulations, which provide for a more structured approach to accounting for, and reporting on, local authority investments, are dealt with in more detail under Section 7 Investment Strategy.

## 2. TREASURY MANAGEMENT IN THE PUBLIC SERVICES – CIPFA CODE OF PRACTICE 2009

2.1 The Council's treasury activities are strictly regulated by statutory requirements and adherence to a professional code of practice. The latest revision to the CIPFA Code of Practice on Treasury Management was published in November 2009.

2.2 The Code requires the Council to formally adopt, as part of its Financial Regulations, some revisions to a number of key Treasury Management clauses. The main change relates to a requirement for <u>the Council</u> to receive, as a minimum, reports on annual strategy, a mid-year review and annual review of the year whereas previously this was the remit of Policy & Resources Committee. In future, Policy & Resources will be responsible for effective review of the treasury management process. The revised Treasury Management clauses are attached at Appendix 1.

2.3 The Code also requires adoption of a Treasury Management Policy Statement which defines the Council's strategic policies and objectives pertaining to its Treasury operations. The revised policy statement is attached at Appendix 2 for consideration.

2.4 Consistent with publication of the revised Code, the Treasury Management Practices (TMPs), which sets out how the Council will manage and control all operational aspects of its Treasury Management activities, will be reviewed and updated.

## 3. ECONOMIC AND INTEREST RATE OUTLOOK

3.1 Accommodating monetary policies by central banks has finally allowed a number of the major economies to tentatively emerge from recession in the latter part of 2009. There is a danger, however, that any early reversal of low interest rates and the various liquidity measures in place could trigger a dip back to negative growth. The health of the corporate and personal sectors is key to any recovery and here banks lending to these areas remains patchy and as such is likely to hamper economic growth.

3.2 The main drag on the UK economy is expected to be weak consumer demand given their desire to reduce the level of personal debt and fear of unemployment. Also, the consumer is faced with the prospect of tax rises over the next few years. The Bank of England Monetary Policy Committee (MPC), held in early February, placed official interest rates on hold at 0.5% and announced a suspension of its £200bn quantitative easing programme for the time being. Loose monetary policy is expected to remain a feature in the forthcoming year but as inflation rises there will be pressure on the MPC to raise rates to some extent.

3.3 Critical to when, and by how much, short term interest rates will rise will focus on how the UK government manages its exit strategies from its quantitative easing and other liquidity measures. Butlers, the Council's treasury adviser, envisages in a weak recovery/low inflation scenario, a modest rise in short term rates to 1.25% by the end of financial year 2010/11 and as the economy further recovers, rates rising to 4.5% over the next few years.

3.4 The prospects for longer term fixed interest rates is a lot less favourable. The significant government budget deficits to be financed over the next few years will require an exceptionally heavy programme of gilt issuance. Given the absence of the Bank of England as the largest buyer of gilts under its now suspended quantitative easing programme, there is an expectation that other investors will require some incentive to continue buying gilts and that is likely to take the form of higher interest rates. As such, Butlers forecast for the forthcoming year envisages rates of around 4% for periods of up to 5 years and for longer dated periods, rates of around 5% and over the next few years rising to circa 5.5% across all periods.

## 4. DEBT OUTSTANDING AT 01/04/10

The Council's estimated debt position at 01/04/10 is:

| | £'m | |
|---|---|---|
| LONGER TERM FUNDING | | |
| - Maturing loans in 2010/11 | 0.5 | (0.3%) |
| - Loans with Maturity > 1 year | 139.0 | (89.9%) |
| | 139.5 | |
| SHORT TERM FUNDING | 15.1 | (9.8%) |
| TOTAL ESTIMATED DEBT | 154.6 | |

## 5. LONGER TERM BORROWING REQUIREMENT 2010/11

5.1 The expected longer term borrowing requirement for 2010/11 is £6.2m, as set out below:

| | £'m |
|---|---|
| Capital Programme (net of capital receipts) | 22.5 |
| Service Payments | (16.8) |
| Longer term loans maturing in 2010/11 | 0.5 |
| TOTAL LONGER TERM BORROWING REQUIREMENT | 6.2 |

5.2 In addition to the borrowing requirement identified at para 5.1, there is potential for Market Loans up to the value of £26m to be repaid during the year should any of the lenders invoke a rate change clause as per their individual contracts. Given the current level of interest rates, the risk of early repayment of any of the loans is assessed as low.

5.3 The Council's main source for longer term funding remains the Public Works Loan Board (PWLB) from which it can access all of its borrowing requirement or alternatively funding can be accessed through the London Money Market.

5.4 There is a possibility that HM Treasury, as part of its overall strategy to reduce government debt, may bring in a cap on local authority borrowing.

## 6. BORROWING STRATEGY

6.1 It is recognised that there is great uncertainty over the timing of future interest rate increases but it is anticipated that the trends in both short term and longer term interest rates, as outlined in paras 3.3 and 3.4, are considered to be the most probable outcome.

6.2 At the present time, there is a significant interest rate differential in favour of short term rates and this scenario is anticipated to persist over the next few years. Given the relatively low level of longer term borrowing requirement (£6.2m), and that the Council's short term borrowing accounts for only circa 10% of our overall debt portfolio, it is planned to concentrate funding linked to short term rates or perhaps longer term fixed rates for periods of up to 5 years.

6.3 In the event that any of the £26m of Market Loans, as outlined at para 5.2, are repaid during the year, a judgement will have to be made at that time on the benefit of replacing the loan(s) on either a variable rate or fixed rate basis.

6.4 With the likelihood of long term rates increasing, potential debt restructuring opportunities are likely to focus on switching from longer term fixed rate PWLB loans to cheaper shorter term debt. The option of postponing new borrowing and running down investment balances will also be considered. The Treasury Section, in conjunction with Butlers, will closely monitor prevailing rates to identify such opportunities during the year.

6.5 It is also worth noting that there will be significant cashflow implications on 31 March and 1 April 2011 whereby aggregate payments of £24m are due under the terms of the Council's NPDO project to provide four new high schools. An assessment will be made to decide the most appropriate form of borrowing depending on the prevailing interest rates and cashflows at that time.

## 7. INVESTMENT STRATEGY

7.1 The new regulatory framework provides greater autonomy for local authorities but makes clear that the onus is on local authorities to act prudently with regard to their investment and treasury management activities. Local authorities are required to manage their investments in a way that minimises the risk to the capital sum and optimises the return on the funds consistent with those risks.

7.2 The primary objectives of the Council's investment strategy is first and foremost to ensure timeous and full repayment of principal and interest, then securing adequate liquidity of funds invested and finally optimising investment returns consistent with those counterparty risks.

7.3 It is estimated that the Council will have circa £5m - £10m of surplus funds available for investment from time to time during the period 2010/11 – 2012/13. The source of surplus funds is expected to arise largely from availability of internal balances held by Council accounts.

7.4 The draft Local Government Investments (Scotland) Regulations 2010 requires <u>Council</u> approval of <u>all</u> the types of investments, known as "Permitted Investments", to be used and set limits, where appropriate, for the amount and time that can be held in each type of investment.

7.5 The Permitted Investments which may be used in the forthcoming year are:

- CASH TYPE INSTRUMENTS
  - Deposits with other local authorities
  - Instant Access or On-Notice deposit accounts with financial institutions (banks and building societies)

- Term deposits with financial institutions (banks and building societies)
  - Money Market Funds

- OTHER INVESTMENTS
  - Investment Properties (none currently held by the Council)
  - Loans to third parties, including soft loans (refer Appendix 5)
  - Loans to a local authority company (none currently held by the Council )
  - Shareholdings in a local authority company (refer Appendix 5)
  - Non-local authority shareholdings (none currently held by the Council)

7.6 The Investment Regulations also require the investment position of the Common Good fund(s) to be made explicit. Surplus funds are invested in the Council's loans fund on which interest is earned. There is also a property asset (Kilns House) which attracts a rental yield.

7.7 Details, as appropriate, of the risks, mitigating controls and limits associated with each of the Permitted Investments are attached at Appendix 3.

7.8 For permitted cash type investments, the Council maintains a counterparty list in compliance with the relevant counterparty selection criteria. Appropriate extracts from the Council's TMPs are attached for Members' information at Appendix 4.

7.9 The draft Regulations make clear that the Council must not borrow more, or in advance of its capital financing requirement as determined under the Prudential Code purely to profit from the investment of the extra sums borrowed. It is confirmed that the Council has no plans to borrow in advance of need in the forthcoming financial year.

## 8. TREASURY INDICATORS

8.1 Previously, a number of treasury activity limits were reported to Committee as part of the suite of Prudential Indicators, but as part of the revised Code these have now been incorporated under this Strategy Report. The purpose of the 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.

8.2 The Council is asked to approve the undernoted Treasury indicators:

| | | 2010/11 Upper | 2011/12 Upper | 2012/13 Upper |
|---|---|---|---|---|
| **1)** | **INTEREST RATE EXPOSURE** | | | |
| | Limits on fixed interest rates based on net debt | 100% | 100% | 100% |
| | Limits on variable interest rates based on net debt | 40% | 40% | 40% |
| **2)** | **MATURITY STRUCTURE ON FIXED INTEREST RATE BORROWING 2010/11** | | | |
| | | **LOWER** | **UPPER** | |
| | | % | % | |
| | Under 12 months | 0 | 25 | |
| | 12 months – 2 years | 0 | 25 | |
| | 2 years – 5 years | 0 | 50 | |
| | 5 years – 10 years | 0 | 75 | |
| | 10 years – 20 years | 0 | 75 | |
| | 20 years – 30 years | 0 | 75 | |
| | 30 years – 40 years | 0 | 75 | |
| | 40 years – 50 years | 0 | 75 | |
| **3)** | **MAXIMUM PRINCIPAL SUMS INVESTED > 364 DAYS** | | | |
| | The Council does not envisage having sums available for investment for periods longer than 364 days. | | | |

## 9. TREASURY MANAGEMENT ADVISERS

9.1 The Council has appointed Butlers as its treasury management advisers. The contract is subject to regular review and comprises:

- Technical support on treasury and capital finance issues
- Economic and interest rate analysis
- Advice on debt rescheduling
- Borrowing and investment advice on interest rates, timing and financial instruments
- Credit ratings/market information service accessing the three main credit rating agencies

9.2 It is important to recognise under the terms of the revised Code, that regardless of the input from Butlers, the final decision on treasury matters always rests with the Council.

## 10. MEMBER AND OFFICER TRAINING

10.1 There is a requirement that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. To this end "in-house" support will form the basis of basic training but staff have the opportunity to attend training courses/seminars organised by the Council's Treasury Advisers or other institutions in the field of Treasury Management or CIPFA (Scotland) Treasury Management Forum.

10.2 Under the new Investment Regulations, the increased Member consideration of treasury management issues requires the Director of Finance to ensure that those tasked with such responsibilities have access to training relevant to their needs and responsibilities. In consequence, Training for Members will be arranged during the forthcoming year.

## 11. CONCLUSION

11.1 The Code and associated guidance notes and the new Investment Regulations represents a major strengthening of the framework required for local authority treasury management operations. This follows the considerable turmoil experienced by financial markets during the "credit crunch" and the Icelandic banks crisis to which a number of local authorities had significant investment exposure.

11.2 While it is largely accepted that interest rates will rise, there is still great uncertainty over the timing and extent of such rises. The prospects for both short term and longer term interest rates will clearly be influenced by the impact of the very high gilt issuance expected over the next few years, how the government manages an exit strategy from its quantitative easing programme, and the general recovery of the economy. A mid-year review of the treasury management function will be submitted to this Committee and then Council in November.

## 12. RECOMMENDATIONS

**That the Committee recommends that Council:**

**i) adopts the clauses set out in Appendix 1 of this report as part of its Financial Regulations**
**ii) approves the Treasury Management Policy Statement as presented at Appendix 2**
**iii) adopts the Borrowing Strategy for 2010/11 as set out in Section 6 of this report**
**iv) adopts the Investment Strategy for 2010/11 and approves the list of "Permitted Investments" as set out in Section 7 of this report**
**v) approves the Treasury Indicators as set out in Section 8 of this report**
**vi) instructs the Director of Finance to arrange training for Members as outlined in Section 10 of this Report**

A. Launette

**Director of Finance**
**Date: 17 February 2010**
**Contact Officer: Alastair Redpath/Bryan Smail**

## LIST OF BACKGROUND PAPERS

1. The Local Government Investments (Scotland) Regulations 2010 (draft)
2. CIPFA Treasury Management in the Public Services – Code of Practice and Guidance Notes - 2009

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506338 and ask for Alastair Redpath.

**APPENDIX 1**

# FALKIRK COUNCIL

## TREASURY MANAGEMENT

## FINANCIAL REGULATIONS UPDATE

1. This Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services : Code of Practice 2009 (as subsequently revised)

2. Accordingly, 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, setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities

3. 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 report and an annual report after its close, in the form prescribed in its Treasury Management Practices.

4. This Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Policy & Resources Committee and for the execution and administration of treasury management decisions to the Director of Finance, who will act in accordance with the Council's Policy statement and Treasury Management Practices and CIPFA's Standard of Professional Practice on Treasury Management.

5. This Council nominates Policy & Resources Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

**APPENDIX 2**

# FALKIRK COUNCIL

## THE TREASURY MANAGEMENT POLICY STATEMENT

1. This Council defines its treasury management activities as:

   "the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

2. This 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 their risk implications for the Council.

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

**APPENDIX 3**

## FALKIRK COUNCIL PERMITTED INVESTMENTS, ASSOCIATED CONTROLS AND LIMITS

| Type of Investment | Treasury Risks | Mitigating Controls | Council Limits |
|---|---|---|---|
| (a) Deposits with other local authorities **(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. | Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. | £5m and maximum 1 month |
| (b) 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 as a "AAA" rated status from all of Fitch, Moody's or Standard & Poors | £5m and maximum 1 month |
| (c) Instant Access or On-Notice 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 categories (a) and (b) above. There is little risk to value with these types of investments, liquidity is high and investments can be returned at short notice. | The counterparty selection criteria restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard & Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures.<br><br>On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence. | £8m and maximum 1 month subject to individual institution criteria |

| Type of Investment | Treasury Risks | Mitigating Controls | Council Limits |
|---|---|---|---|
| (d) Term deposits with financial institutions (banks and building societies) **(low to medium risk depending on period and credit rating)** | This tends to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is little 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 restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard & Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures.<br><br>On day to day investment dealing with the criteria will be further strengthened by the use of additional market intelligence. | £8m and maximum 1 month subject to individual institution criteria |
| (e) Investment Properties (The Council does not currently hold, nor does it plan to, any investment properties) | These are non-service properties which are being held pending disposal or for a longer term rental income stream. 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.<br><br>Property holding will be re-valued regularly and reported annually with gross and net rental streams. | N/A |
| (f) Loans to third parties, including soft loans | These are service transactions either at market rates of interest or below market rates (soft loans). These types of transactions may exhibit credit risk and are likely to be highly illiquid. | Each third party loan and each application is supported by the service rationale behind the loan and the likelihood of partial or full default | Consistent with the particular scheme |
| (g) Loans to a local authority company (the Council currently has no such 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 loan to a local authority company and each application is supported by the service rationale behind the loan and the likelihood of partial or full default. | N/A |

| Type of Investment | Treasury Risks | Mitigating Controls | Council Limits |
|---|---|---|---|
| (h) Shareholdings in a local authority company. (The Council has an investment of £9.224m as at 31/03/09 in Falkirk Community Stadium Ltd represented by a range of assets at Westfield, Falkirk) | 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 rationale behind the investment and the likelihood of loss | £10m |
| (i) Non-local authority shareholdings (The Council currently has no such shareholdings) | These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be illiquid. | Any non-service equity investment will require separate Member approval and each application will be supported by the service rationale behind the investment and the likelihood of loss. | N/A |

**The Monitoring of Investment Counterparties** – The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Butlers, from which 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 Director of Finance and, if required, new counterparties which meet the criteria will be added to the list.

**APPENDIX 4**

## CREDIT AND COUNTERPARTY POLICIES

Criteria to be used for creating/managing approved counterparty lists/limits.

- Director of Finance in conjunction with its treasury management advisers, will formulate a suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising period, type, sector and specific counterparty limits.

- The Council will use credit criteria from credit rating agency, Fitch (but see next para) to select creditworthy counterparties for placing investments with.

- The rating criteria will use the lowest common denominator method (across Fitch, Moody's and Standard & Poors) 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.

- The Council will also have regard to additional operational market information such as negative rating watches/outflows before selecting the relevant counterparties.

- The Council's approved counterparty list will extend to selected counterparties from the following sectors:

  UK Banks
  Overseas Banks (but with UK authorisation)
  Building Societies
  UK Local Authorities

- The minimum level of credit rating for an approved counterparty per Fitch ratings will be as undernoted, with particular reference to the short term rating but having regard to other ratings.

| | | |
|---|---|---|
| SHORT TERM | F1 | Indicates the strongest capacity for timely payment of financial commitments within a 12 month timeframe |
| LONG TERM | A | High Credit Quality. A low expectation of credit risk with a strong capacity for timely payment of financial commitments |
| INDIVIDUAL | A/B/C | A bank's exposure to, appetite for, and management of risk, and the likelihood that it would run into significant difficulties, such that it would require support |
| SUPPORT | 1/2/3 | An assessment of whether a bank would receive outside support if it ran into financial difficulties that it could not cope by itself |

| | | |
|---|---|---|
| | | |

- An approved counterparty can also be selected from those Eligible Institutions under the HM Treasury Credit Guarantee Scheme with the necessary short and long term ratings noted in the above table. These specific institutions have access to HM Treasury liquidity, if required.

- The maximum period for investments will be 1 month unless an alternative period is recorded against a specific counterparty.

- The maximum value for any one investment transaction will be £8 million unless a lesser amount is recorded against a specific counterparty.

Full individual listings of counterparties and their limits are shown at Schedule 1 below.

**SCHEDULE 1**

## APPROVED COUNTERPARTIES AND COUNTERPARTY LIMITS

## REVISED – 17 FEBRUARY 2010

Investments in the form of Temporary Deposits may be placed with the institutions noted below subject to the limit per institution indicated.

**UK BANKS**

| **INSTITUTIONS** | **LIMIT** | **MAX PERIOD** |
|---|---|---|
| Santander UK | £8m | 1 Month |
| Barclays Bank | £5m | 1 Month |
| Clydesdale Bank | £8m | 1 Month |
| HSBC | £5m | 1 Month |
| Lloyds Banking Group * | | |
| Lloyds TSB | £5m | 1 Month |
| Bank of Scotland | £5m | 1 Month |
| * A maximum combined monetary limit of £8m | | |
| Royal Bank of Scotland | £5m | 1 Month |
| **BUILDING SOCIETIES** | | |
| Nationwide | £5m | 1 Month |
| **UK LOCAL AUTHORITIES** | £5m | 1 Month |

**APPENDIX 5**

## THIRD PARTY LOANS

The draft Investment Regulations require all loans to third parties to be classified as investments.

The (questionable) rationale behind this is to identify monies utilised in this way, which would otherwise be available for general investment and give rise to investment income.

To comply with the draft Regulations, the following is presented:-

| Category and Context | Outstanding | |
|---|---|---|
| | **No of loans** | **Value £** |
| **(a)** **Car Loans to Employees**<br>Loans advanced to assist employees finance a vehicle needed for their work. Current interest rate is 4.45% per NJC Circular | 68 | 242,785 |
| **(b)** **Home Loans**<br>There are a small number of residual loans which were advanced to people purchasing under the right to buy scheme. The interest rate is set by the Scottish Government and is currently 3.13%. | 16 | 81,285 |
| **(c)** **Care Home Deferred Payments**<br>When a person enters a care home, legislation requires the Council to offer the facility to pay care home fees to avoid a forced house sale. A standard security allows the monies to be recovered in due course. The Council is not allowed to charge interest. | 10 | 120,539 |
| **(d)** **Bike to Work Scheme**<br>During the course of 2010/11, the Council will launch a "Bike to Work" Scheme to encourage employees to become greener. The scheme will provide tax and national insurance savings to employees who obtain bicycles and safety equipment used mainly for cycling to and from work. The scheme provides a loan which is paid over a one year period. | N/A | N/A |