FINANCE, AUDIT AND PERFORMANCE COMMITTEE – 21 JANUARY 2013

REPORT OF DEPUTY CHIEF EXECUTIVE (CORPORATE DIRECTION)
RE: TREASURY MANAGEMENT TO 31 DECEMBER 2012

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1. PURPOSE OF REPORT

To inform the Select Committee of the Council's Treasury Management activity during 2012/13.

2. RECOMMENDATION

That the Select Committee note the report.

3. BACKGROUND TO THE REPORT

At its meeting in February 2012 the Council approved the Council's Treasury Management Policy for the year 2012/13 and delegated the oversight of the execution of the Policy to the Select Committee.

This report sets out the Treasury Management activities for the first half of 2012/13 and shows that they are in line with the limits set out in the Policy.

Treasury Management covers two main areas:-

1. The management of day to day cash flows by way of short term investing and borrowing. Longer term investment opportunities may arise depending on cash flow requirements.

2. Management of the Council's Long term debt portfolio which is used to finance capital expenditure that cannot be immediately funded by internal resources (e.g. by Capital Receipts).

Economic Background

UK
In 2012/13 has seen a continuing period of low interest rates. The UK Bank Rate has now been at 0.5% for over 3 years. The Bank of England's Inflation report in November has pushed back the timing of the return to growth. It now looks like quarter four in 2012 will see a return to negative growth. Estimates are currently showing a 0.4 percent drop in GDP in the last quarter, which would leave growth as a whole at about -0.1% in 2012. According to the Bank of England, banks were keeping financially weak firms on life support by allowing them to breach borrowing. This may mean more viable firms with expansion plans are being starved of credit.

The Chancellor's autumn statement recognised that the Government is not going to achieve its budget deficit timetable. The timetable has been extended accordingly. The Housing market remains weak and the construction industry is still contracting. Export markets are set to remain weak. A fair proportion of UK GDP is dependant on trade with the US and the Eurozone. Therefore the UK economy is likely to register weak growth in 2013 and 2014. Consumers are likely to remain focused on paying down debt. This together with job security fears will act to keep consumer expenditure suppressed.

<u>Eurozone</u>
Although market anxiety about Greece has subsided after the further support package of nearly 50bn Euros markets are still concerned that the eventual end game will be that Greece is forced to exit the Eurozone. The bailout and assistance given to Spanish banks has meant market have been subdued in the short term.

<u>USA</u>
Growth is likely to remain weak at around 2% but still higher then the Eurozone. The Federal Bank has indicated it is unlikely to increase rates until 2015 wants to focus on unemployment falling to 6.5% before rates are raised. The fiscal cliff has only partially been dealt with. Increasing the debt ceiling and agreeing expenditure

This economic background impacts directly on the availability and choice of investment counterparties. Appropriate credit quality institutions have become more restricted in recent years in terms of numbers of parties available, the amount that can be invested with a single counterparty and the length of time an investment can be made.

In the present climate it is considered to be imprudent to invest for an extended period of time for the following reasons:

1. In a volatile market the financial strength of counterparty can change quickly and therefore to invest for shorter periods reduces the Council's risk exposure.

2. Longer term interest rates, whilst higher than those for shorter periods, do not compensate the Council for the additional risk.

To invest with better quality counterparties for shorter periods does reduce the Council's exposure to risk and uncertainty but does mean that investment yields are reduced.

<u>Investment Activity</u>

The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time, then ensuring adequate liquidity, with the investment return being the final objective. Following the economic background above, officers are implementing an operational strategy which tightens the controls already in place in the approved investment strategy.

The Council's investment criteria, approved by Council in February 2012 are:-

- **Banks 1 - Good Credit Quality** – the Council will only use banks which:
    i. Are UK banks; and/or
    ii. Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AAA

  And have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
    i. **Short Term** – F1
    ii. **Long Term** – A
    iii. **Individual / Financial Strength** – C (Fitch / Moody's only)
    iv. **Support** – 3 (Fitch only)
- **Banks 2 – Guaranteed Banks with suitable Sovereign Support** – In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:
  - (a) wholesale deposits in the bank are covered by a government guarantee;
  - (b) the government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and
  - (c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.
- **Banks 3 – Eligible Institutions** - the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.
- **Banks 4** – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- **Bank Subsidiary and Treasury Operations** – the Council will use these where the parent bank has the necessary ratings outlined above.
- **Building Societies** – the Council will use all Societies which:
    i. meet the ratings for banks outlined above

    Or are both:

    ii. Eligible Institutions; and
    iii. Have assets in excess of £500m.

- **Money Market Funds** – *AAA*
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils etc**
- **Supranational institutions**

Funds for investment come from the following Sources

a) Revenue Account Balances held by the Council
b) Earmarked Reserves and Provisions
c) Unapplied Capital Receipts
d) Cash flow balances - income received before expenditure needs to be incurred

At 31 Dec 2012 the Council held the following investments totalling £12,930,000

Counterparty	Investment Date	Maturity Date	Amount	Interest Rate
Coventry BS	03/12/2012	03/01/2013	1,000,000	0.4100
Hinckley & Rugby BS	20/12/2012	21/01/2013	2,000,000	0.5000
Hsbc Call Account	31/12/2012	02/01/2013	2,280,000	0.3500
Nationwide BS	03/12/2012	03/01/2013	2,000,000	0.4000
Newcastle BS	05/12/2012	07/01/2013	500,000	0.4500
Newcastle BS	13/12/2012	03/01/2013	1,500,000	0.4500
Principality BS	07/12/2012	17/01/2013	1,650,000	0.3200
Skipton BS	17/12/2012	17/01/2013	500,000	0.4000
Skitpton BS	28/12/2012	28/01/2013	1,500,00	0.4000

Details of all investments held from April 2012 to 31st December 2012 are included in Appendix A attached.

Details of the weighted average investment to December 2012 are shown in the table below together with the average overnight, 7 day and 1 month London Inter Bank Offer Rates (LIBOR) as a bench mark to the rates received by the Council.

Period	**Weighted Average invested**	**Average period (days)**	**Average Return**	**Overnight LIBID**	**7 Day LIBID**	**1 Month LIBID**
April to Dec 2012	6,064,502	11.25 days	0.5059	0.3913	0.4055	0.4481

The figures above show that the Council received a rate of return that is compatible with the returns available in the market.

It also shows that the weighted average life is within the maximum set of 0.5 years.

Due to current economic conditions officers have decided to limit investment to less than one month and not to invest with banks other than with the Council's Bank. This together with mergers of Building Societies has meant the Counter

Party invest list of organisations has shrank. Average investments returns are however still higher then the comparable inter bank rate (return of 0.05059% compared against 0.04481%). The benchmarking rates in the table above are higher then the industry averages used by some local authorises. If industry benchmarks are used our average return is even more favourable. Industry average benchmark for 1 month rates are currently 0.037% compared against our average rate of 0.05059%.

<u>Borrowing Activities</u>

Long term borrowing to finance Capital Expenditure

Excluding the HRA self financing element the Council has a Capital Financing Requirement of around £18m which arises from previous decisions to incur Capital Expenditure that was not financed immediately by internal resources e.g. Capital Receipts or Grants giving rise to the need to borrow to finance the expenditure. This borrowing requirement can either be met by long or short term external borrowing or by internal borrowing i.e. using the cash behind the authority's balances and reserves and foregoing investment income. At the present time the interest payable on long term borrowing is significantly greater than the returns the Council could expect on its investments and therefore the Council has adopted a policy of being "underborrowed" with only £4.3m of long term loans on its books. Short term loans from the PWLB currently cost 1% so if the Council was fully funded with short term money and was receiving investment income of 0.4% there would be a cost of £82,200 pa. With longer term rates at about 4.0% the additional cost would be £548,000pa. In these circumstances the Council has not undertaken any long term borrowing in the current year and has relied on short term borrowing to meet cash flow needs.

Additionally, as part of the Self Financing HRA Settlement £67.652m has been borrowed from PWLB. Repayment options have been discussed with members and were presented to the Executive on 13th March 2012. Repayments for principal amounts for these loans will commence in 7 years time. The loan will be repaid in equal instalments of £2.9414m over 23 yrs.

Short term borrowing to cover cash flow shortfalls.

Some short term borrowing took place to cover temporary cash flow shortfalls. The movements are as follows:-

Amount outstanding at 1 April 2012	£2,600,000
Plus Total Amount borrowed to Dec 2012	£5,240,000
Less Total Amount repaid in year	£7,840,000
Amount outstanding at 31 Dec 2012	Nil

The average amount borrowed was	£115,671
Average period of loans	5.6 Days
Number of occasions	5
Average rate of interest paid	0.4458%

All borrowing was conducted with the Operational Limit set by the Council.

5. **FINANCIAL IMPLICATIONS (IB)**

Any losses resulting from a further tightening of our investment strategy will be reported within the Outturn position.

5. **LEGAL IMPLICATIONS (AB)**

There are no legal implications arising directly from this report.

6. **CORPORATE PLAN IMPLICATIONS**

This report supports the following Corporate Aims

- Thriving Economy

7. **CONSULTATION**

None

8. **RISK IMPLICATIONS**

It is the Council's policy to proactively identify and manage significant risks which may prevent delivery of business objectives.

It is not possible to eliminate or manage all risks all of the time and risks will remain which have not been identified. However, it is the officer's opinion based on the information available, that the significant risks associated with this decision / project have been identified, assessed and that controls are in place to manage them effectively.

The following significant risks associated with this report / decisions were identified from this assessment:

Management of significant (Net Red) Risks		
Risk Description	Mitigating actions	Owner
Loss of investments due to failure of Counterparty	Ensure Counterparty is financially secure prior to lending by confining activity to institutions on a list of approved institutions based on credit ratings. Ensure that lending is for appropriate periods and amounts as per Counterparty list	I Bham I Bham

9. **KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS**

Treasury management activities support all activities of the Borough Council and therefore impact on all areas of and communities within the Borough

10. **CORPORATE IMPLICATIONS**

By submitting this report, the report author has taken the following into account:

- Community Safety implications
- Environmental implications
- ICT implications
- Asset Management implications
- Human Resources implications
- Planning Implications
- Voluntary Sector implications

Background papers: Investment and borrowing records

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