FINANCE, AUDIT AND PERFORMANCE SELECT COMMITTEE – 11 JUNE 2012

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

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1. PURPOSE OF REPORT

To inform the Select Committee of the Council's Treasury Management activity during 2011/12.

2. RECOMMENDATION

That the Select Committee note the report.

3. BACKGROUND TO THE REPORT

At its meeting in August 2011 the Council approved the Council's Treasury Management Policy for the year 2011/12 and delegated the oversight of the execution of the Policy to the Select Committee.

This report sets out the Treasury Management activities for 2011/12 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

In 2011/12 there has been a continuation of the longest period of consistently low interest rates. The UK Base Rate has now been at 0.5% for over 3 years. This together with continuing uncertainty in the money markets, including the financial stability of banks and other institutions and the Sovereign debt crisis in parts of the EU has had an impact on Treasury operations.

Whilst it is generally accepted that the next move in interest rates will be upwards there is no real consensus in the market as to when that movement will take place.

Given the current economic situation, growth levels in the UK, low worldwide economic growth, and the Chancellor's austerity measures, it appears unlikely that the Base Rate will show any appreciable increase until at least the second half of 2013.

This particularly impacts on the availability and choice of investment counterparties. These 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. Interest rates may increase and therefore it would be unwise to lock the investment in for too long, so that it is not possible to take advantage of increasing rates when they occur.

2. In a volatile market the financial strength of a counterparty can change at fairly short notice and therefore to invest for shorter periods reduces the Council's risk exposure.

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 criteria 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 March 2012 the Council held the following investments totalling £2,500,000

Counterparty	Investment Date	Maturity Date	Amount	Interest Rate
Newcastle Building Society	01/12/2012	23/05/2012	500,000	1.0000
Hinckley & Rugby Building Society	25/08/2011	23/05/2012	2,000,000	1.5000

Details of all investments held from April 2011 to 31st March 2012 are included in Appendix A attached.

Details of the weighted average investment for the year are shown in the table below together with the average overnight, 7 day and 3 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 LIBOR	7 Day LIBOR	3 Month LIBOR
April to March	7,713,671	15.92	1.0384	0.5734	0.6051	0.9426

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.

Borrowing Activities

Long term borrowing to finance Capital Expenditure

Excluding the HRA self financing element the Council has a Capital Financing Requirement of around £14m 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 1.5% so if the Council was fully funded with short term money and was receiving investment income of 1% there would be a cost of £50,000 pa. With longer term rates at about 4.5% the cost would be £350,000pa. 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 8 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 2011	£5,500,000
Plus Total Amount borrowed in year	£15,500,000
Less Total Amount repaid in year	£18,400,000
Amount outstanding at 31 March 2012	**£2,600,000**

The average amount borrowed was	£ 575,068
Average period of loans	7.7 Days
Number of occasions	15
Average rate of interest paid	0.5835%

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

4. **FINANCIAL IMPLICATIONS (IB)**

None arising directly from this report.

5. **LEGAL IMPLICATIONS (EP)**

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. **<u>KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS</u>**

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

10. **<u>CORPORATE IMPLICATIONS</u>**

By submitting this report, the report author has taken the following into account: [if you require assistance in assessing these implications, please contact the person noted in parenthesis beside the item]

- 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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