

FINANCE, AUDIT AND PERFORMANCE SELECT COMMITTEE – 31 OCTOBER 2011

REPORT OF DEPUTY CHIEF EXECUTIVE (CORPORATE DIRECTION)
RE: TREASURY MANAGEMENT ACTIVITY HALF YEAR TO 30 SEPTEMBER 2011

1. PURPOSE OF REPORT

To inform the Select Committee of the Council's Treasury Management activity during the first half of 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 the first six months of 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

The first half of financial year 2011/12 has seen a continuation of the longest period of consistently low interest rates in history. 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 it would appear to be unlikely that rates will show any appreciable increase until at least the start of 2013.

This particularly impacts on the availability and choice of investment counterparties. These have become more restricted in recent years both in terms of numbers of available to invest with, 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.

Investment Activity

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 AAAAnd 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 30 Sep 2011 the Council held the following investments totalling £5,926,000

Counterparty	Date of Investment	Date of Maturity	Amount	Interest Rate
Hinckley & Rugby BS	25/08/2011	23/05/2012	2,000,000	1.5000
Principality BS	31/01/2011	28/10/2011	1,650,000	1.4000
West Bromwich Building Society	20/07/2011	08/02/2012	600,000	1.2000
West Bromwich Building Society	09/08/2011	25/10/2011	800,000	0.7500
Newcastle Building Society	03/02/2011	03/11/2011	500,000	1.5000
HSBC Money Market	30/09/2011	03/10/2011	376,000	0.2500

Details of all investments held during the half year are included in Appendix A attached.

Details of the weighted average investment returns for each month and the quarter as a whole are shown in the table below together with the average overnight, 7 day and 3 month London Inter Bank Offer Rates (LIBOR) as a benchmark 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 Sept	4,940,814	26.96	1.005	0.5725	0.5939	0.8453

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

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.

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
Total Amount borrowed	£9,400,000
Total Amount repaid	£14,900,000

Amount outstanding at 30 Sep 2010	£0.00
The average amount borrowed was	£1,490,000
Average period of loans	6.3 Days
Number of occasions	10
Average rate of interest paid	0.557%

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

4. **FINANCIAL IMPLICATIONS (DB)**

None arising directly from this report.

5. **LEGAL IMPLICATIONS (AB)**

There are none

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	D Bunker

	on credit ratings.	
	Ensure that lending is for appropriate periods and amounts as per Counterparty list	

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: [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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Executive Member: