

Audit Committee	Agenda Item:
Meeting Date	14 December 2011
Report Title	Treasury Management Half Year Report
Portfolio Holder	Cllr Duncan Dewar-Whalley, Cabinet Member for Finance and Performance
SMT Lead	Nick Vickers, Head of Finance
Head of Service	Nick Vickers, Head of Finance
Lead Officer	Deborah Walton, Senior Accountant
Key Decision	No
Classification	Reference number:
Recommendations	1. Members are asked to note the performance information in this report.

1 Purpose of Report and Executive Summary

- 1.1 The Audit Committee is nominated by the Council to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.
- 1.2 The purpose of this report is to review the mid year outturn position on treasury management transactions for 2011/12 including compliance with treasury limits and Prudential Performance Indicators.
- 1.3 Given the exceptional turmoil which has continued in financial markets the Council has taken a very cautious approach to the management of cash deposits with the emphasis being on minimising the risk of losing funds and meeting minimum liquidity requirements.

2 Background

- 2.1 The Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009.
- 2.2 In accordance with the Code of Practice members are informed of Treasury Management activities twice a year.

3. Treasury Report

Investment Activity

- 3.1 The Council's current Treasury Management Policy Statement and Annual Investment Strategy for 2011/12 can be found in Appendix I.

- 3.2 The investment activity during the first six months of the year conformed to the approved strategies at all times, with no breaches.
- 3.3 Investments held at 30 September 2011 can be found in Appendix II.
- 3.4 Appendix I set out the Council's credit rating requirements, as advised by Arlingclose, and the agreed counter parties. There are a number of issues relating to the counter parties which should be highlighted:
- Santander UK – Santander UK meets our credit rating requirements but has been suspended for over a year. This reflects concerns over parent company guarantees, the problems of the Spanish economy and continuing Euro zone uncertainties.
 - Royal Bank of Scotland (RBS) / NatWest, Nationwide – on 7 October these banks were downgraded by Moody's and no longer meet our minimum credit rating. They are therefore suspended subject to a caveat explained in paragraph 3.6.
 - Lloyds – downgraded by Fitch on 13 October again below our minimum requirement.
- 3.5 The Council has followed Arlingclose's advice with regard to RBS and Lloyds although the high degree of UK Government ownership of the banks, 84% and 40% respectively, could be seen as a reason to maintain their use. At the beginning of October the Council moved to Lloyds from RBS NatWest as its clearing bank following an EU tender process. To do business the Council has to have a clearing bank and this means that at points in the day the Council will have funds in RBS NatWest and Lloyds accounts.
- 3.6 On 13 October the Head of Finance determined as follows:
- A maximum balance of £250,000 could be maintained in RBS NatWest and Lloyds accounts.
 - A maximum balance of £500,000 could be maintained in each of the 3 AAA rated Money Market Funds (normally £2m each).
- All other monies as received will be placed in the Debt Management Office which is part of the Treasury. This position has since been amended to top up funds with Barclays to £2m and go back to the £2m limits on each Money market Fund.
- 3.7 The Council did not need to borrow to cover cash flow purposes in the period.
- 3.8 Interest income received for the first half of 2011 was £8,000 above the original budget of £24,000.
- 3.9 For the six months to 30 September 2011, the Council maintained an average sum invested of £8.0m compared with an original budget of £6.7m, and an average rate of return of 0.78% compared to a budget of 0.65%.

Investment Activity	Actual for 6 months to 30 September	Budget for 6 months to 30 September	Actual for Qtr 2	Budget for Qtr 2	Actual for Qtr 1	Budget for Qtr1
Average sum invested	£8.0m	£6.7m	£10.6m	£9.4m	£5.3m	£3.9m
Average Interest Rate of Return	0.78%	0.65%	0.87%	0.76%	0.69%	0.54%

3.10 The results for the six months to 30 September 2011 show that the Council achieved 0.34% average return above the average 7 day London Interbank Bid Rate (LIBID) and 0.28% average return rate above the Bank of England Base Rate as shown below:

Average Actual Return on Investments	Original Estimate	Average 7 day LIBID Rate	Average Bank Rate
0.78%	0.65%	0.44%	0.50%

Compliance with Prudential Indicators

3.11 The Council can confirm that it has complied with its Prudential Indicators for 2011/12 which were set on 23 February 2011 as part of the Council's Treasury Management Strategy Statement.

3.12 Prudential Indicators are set out in Appendix III.

4. Alternative Options

4.1 The Head of Finance will consider changes to the counterparty criteria with reference to the Council's agreed policy with regard to risk.

5. Consultation Undertaken

5.1 Consultation has been undertaken with the Council's treasury management advisor's Arlingclose.

6. Implications

Issue	Implications
Corporate Plan	Security and liquidity are the key priorities in selecting counterparties and making deposits.
Financial, Resource and Property	As detailed in the report.
Legal and Statutory	The Council has powers to both borrow funds to support its work and to invest and earn interest on funds available.
Crime and Disorder	Following CIPFA's Treasury Management Code of Practice is important to avoid involvement in potential fraud or money laundering.
Risk Management and Health and Safety	Risk is controlled through adherence to specific guidance included in CIPFA's Treasury Management Code of Practice. The principle of security of funds over-rides investment performance.
Equality and Diversity	None
Sustainability	None

7. Appendices

7.1 The following documents are to be published with this report and form part of the report.

- Appendix I: Treasury Management Policy Statement and Annual Investment Statement for 2011/12.
- Appendix II: Investments as at 30 September 2011
- Appendix III: Prudential Indicators

8. Background Papers

8.1 The background papers are held by Finance and include:

- Prudential Code for Capital Finance in Local Authorities (Fully Revised Second Edition 2009) – CIPFA
- Treasury Management in the Public Services Code of Practice and Cross Sectional Guidance Notes (Fully Revised Second Edition 2009) – CIPFA
- Treasury Management in the Public Services Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (Fully Revised Third Edition 2009) – CIPFA

- Treasury Management Strategy Statement and Investment Strategy 2011/12
- Arlingclose – Economic and Interest Rate Outlook

SWALE BOROUGH COUNCIL
TREASURY MANAGEMENT POLICY STATEMENT 2011/12

This Treasury Management Policy Statement supersedes all previous statements and takes immediate effect.

The Council has agreed to adopt the Council's Treasury Management Policy Statement in the following form of words to define the policies and objectives of its treasury management activities:

(i) The 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.

(ii) The 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 analyses and reporting of treasury management activities will focus on their risk implications for the Council.

(iii) The 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.

The Council's investment priorities are:

- the **security** of capital and
- **liquidity** of its investments.

The Council will also aim to achieve best value on its investments commensurate with the proper levels of security and liquidity.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-specified' Investment categories. Specified investments offer the highest level of liquidity and security while non specified investments can offer higher yields but are viewed as having a greater potential risk.

This Council will invest the surplus funds it holds on behalf of the community prudently, having regard to the credit ratings issued by the three main agencies and making decisions based on the lowest rating to meet the objectives above.

In addition to credit ratings, other factors such as share price (where quoted), credit default swaps (where quoted), sovereign ratings and gross domestic product (GDP) will be considered when assessing the credit worthiness of institutions.

The Council's Treasury Management policy identifies the type of financial instrument that can be used and identifies the limits for each counterparty.

Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance.

ANNUAL INVESTMENT STRATEGY 2011/12

Specified and Non Specified Investments

Specified Investments identified for use by the Council

Specified Investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high credit quality" as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Council's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK Local Authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)
- *Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

** Investments in these instruments will be on advice from the Council's treasury advisor.*

For credit rated counterparties, the minimum criteria will be the lowest equivalent short-term and long-term ratings assigned by Moody's Investors Services, Standard & Poor's and Fitch Ratings:

- Long-term minimum: A1 (Moody's) or A+ (S&P) or A+ (Fitch)
- Short-term minimum: P-1 (Moody's) or A-1 (S&P) or F1 (Fitch).

The Council will also take into account information on corporate developments of and market sentiment towards investment counterparties.

New specified investments will be made within the following limits:

Instrument	Country	Counterparty	Maximum Limit of Principal Investments £m	Maximum Duration of Investments
Term Deposits	UK	DMADF, DMO	No limit	364 days
Term Deposits/Call Accounts	UK	Other UK Local Authorities	No limit	364 days
Term Deposits/Call Accounts	UK	Counterparties rated at least A+ Long Term and F1 Short Term (or equivalent)		
Term Deposits/Call Accounts	UK	Santander UK (Banco Santander Group)	£2 million	364 days
Term Deposits/Call Accounts	UK	Bank of Scotland / Lloyds (Lloyds Banking Group)	£2 million	364 days
Term Deposits/Call Accounts	UK	Barclays	£2 million	364 days
Term Deposits/Call Accounts	UK	Clydesdale (National Australia Banking Group)	£2 million	364 days
Term Deposits/Call Accounts	UK	HSBC	£2 million	364 days
Term Deposits/Call Accounts	UK	Nationwide	£2 million	364 days
Term Deposits/Call Accounts	UK	Royal Bank of Scotland / National Westminster Bank (RBS Group)	£2 million	364 days
Term Deposits/Call Accounts	UK	Standard Chartered Bank	£2 million	364 days
Gilts	UK	DMO	No limit	364 days

Instrument	Country	Counterparty	Maximum Limit of Principal Investments £m	Maximum Duration of Investments
Bonds issued by multilateral development banks	EU	European Investment Bank / Council of Europe	£2 million	364 days
AAA rated Money Market Funds	UK / Ireland / Luxembourg domiciled	CNAV MMFs	£2 million	364 days
Other MMFs and CIS	UK / Ireland / Luxembourg domiciled	Pooled funds which meet the definition of a Collective Investment Scheme per SI 2004 No 534 and subsequent amendments	£2 million	364 days

Please note that this list could change if, for example, a counterparty / country is upgraded, and meets our other creditworthiness tools. Alternatively if a counterparty is downgraded, this list may be reduced.

MMFs - All investments should be diversified, including MMFs. As far as is practicable, investments in Money Market Funds will be spread between two funds or more.

Group Limits - For institutions within a banking group, the group limit will remain at £2 million.

Non-Specified Investments determined for use by the Council

An investment is a non-specified investment if it does not satisfy any one of the conditions as mentioned above under 'specified investments'.

Having considered the rationale and risk associated with Non-Specified Investments, the Council has determined to only use Specified Investments at this time. However, the Treasury Management Policy and Counterparty list will continue to be reviewed and any proposed changes reported accordingly.

Investments as at 30 September 2011

Counterparty/ Country	Short Term Rating (Fitch)	Long Term Rating (Fitch)	Balance Invested as at 30 September 2011 £000s			Total £000s
			Up to 1 month	Greater than 1 month and up to 3 months	Greater than 3 month and up to 6 months	
Banks-UK						
NatWest Bank	F1+	AA-	1,957	-	-	1,957
Barclays Bank Plc	F1+	AA-	2,000	-	-	2,000
Lloyds Bank TSB	F1+	AA-	-	-	2,000	2,000
Total Banks			3,957	-	2,000	5,957
Building Societies - UK						
Nationwide	F1+	AA-	-	2,000	-	2,000
Total Building Societies			-	-	-	2,000
Money Market Funds (MMFs) - UK						
Scottish Widows	AAAmmf		1,587	-	-	1,587
Total MMFs			1,587	-	-	1,587
Total			5,544	2,000	2,000	9,544

The Ratings above are from Fitch Ratings. The Long Term Rating is the benchmark measure of probability of default. The Short Term Rating has a time horizon of less than 12 months for most obligations, and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner. These ratings are shown for illustrative purposes only, as the Council uses the lowest rating across three agencies on which to base its decisions.

The deposits for the year are summarised below:

Investments	Balance on 01/04/2011 £000s	Investments Made £000s	Investments Repaid £000s	Balance on 30/09/2011 £000s	Average Rate %	Average Life (days)
Short Term Investments	1,910	64,376	(56,742)	9,544	0.78	45
Long Term Investments	8	0	0	8	3.34	Undated
Total Investments	1,918	0	0	9,552		
Increase/(Decrease) in Investments				7,634		

PRUDENTIAL INDICATORS

Adoption of the CIPFA Treasury Management Code:

This indicator demonstrates that the Council has adopted the principles of best practice.

The Council approved the adoption of the CIPFA Treasury Management Code on 26 June 2002 by the Executive and adopted by Council on 24 July 2002.

The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices as detailed in the Treasury Management Strategy Statement and Investment Strategy 2011/12 approved by Council 23 February 2011.

Authorised Limit and Operational Boundary for External Debt

- The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.

The Council's Affordable Borrowing Limit was set at £7m for 2011/12.

- The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

The Operational Boundary was set at £5.537m for 2011/12.

- The Council confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30 September 2011.

Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.
- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2011/12 %	Actual Average for 6 months to 30 September 2011 %
Upper limits on fixed interest rate exposure		
Upper Limit for Fixed Rate Borrowing	100	0
Upper Limit for Fixed Rate Investments	-100	-25
Upper limits on variable interest rate exposure		
Upper Limit for Variable Rate Borrowing	100	0
Upper Limit for Variable Rate Investments	-100	-75

The Council confirms that it complied with these limits during the period to 30 September 2011.

Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit	Lower Limit
under 12 months	100%	0%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%

The Council undertook no borrowing during the six months to 30 September 2011.

Upper Limit for Total Principal Sums Invested for periods longer than 364 days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days.

There are currently no proposals for the Council to invest sums for periods longer than 364 days.

Capital Financing Requirement

Estimates of the Council's cumulative maximum external borrowing requirement for 2011/12 to 2013/14 are shown in the table below:

	31/3/2011 Actual £000s	31/3/2012 Estimate £000s	31/3/2013 Estimate £000s	31/3/2014 Estimate £000s
Capital Financing Requirement	8,044	7,156	6,260	5,405
Less: Other Long Term Liabilities	2,526	1,857	1,222	799
Cumulative Maximum External Borrowing Requirement	5,518	5,299	5,038	4,606

The Capital Financing Requirement (CFR) is the Council's underlying need to borrow. This figure is a gauge for the Council's underlying need to finance its current and historic capital expenditure.