7. Treasury Management Performance to September 2010

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Purpose of the Report

1. To review the treasury management activity and the performance against the Prudential Indicators for the six months ended 30th September 2010.

Recommendations

2. The Audit Committee are asked to:

   - note the Treasury Management Activity for the six-month period ended 30th September 2010;
   - note the position of the individual prudential indicators for the six-month period ended 30th September 2010;
   - increase the group limit for Bank of Scotland/Lloyds banking group (see paragraph (8).

Summary of Investment Strategy for 2010/11

3. The Council's strategy for investments is based upon minimising risk and safeguarding the capital sum. There is a reliance on the investment income receivable in maintaining a balanced revenue budget and therefore the long-term strategy is to maintain stability by having a significant amount invested in fixed rate of return investment instruments.

4. Our minimum rating is A+ long term (or equivalent). Following the guidance from our advisors, Arlingclose, we are keeping investments to a rolling programme of 12 months where cash flow permits.

5. The sum invested in longer dated securities at fixed rates of interest at the end of September represented 29% of the total portfolio. The sum invested in longer dated securities at variable rates of interest at the end of September represented 14% of the total portfolio. Investments made in longer dated securities comprise EuroSterling bonds and a Corporate bond; these investments have all been made following advice from our treasury advisers.

6. The Treasury Management Strategy Statement and Annual Investment Policy were both approved by Council on 18th March 2010. The strategy identified that the overall investment portfolio should, subject to current economic conditions, include investments in the following ranges:-

	%
Fund Managers and pooled managed funds.	0% - 25%
Term deposits (up to 2 years).	0% - 75%
3 – 5 year cash deposits.	0% - 25%
1 – 5 year callable deposits.	0% - 15%
1 – 5 year EuroSterling/Corporate Bonds.	10% - 75%

7. The table below compares the investment portfolio at 30th September 2010 to the investment strategy:-

	£'m	%	Strategic aim
Pooled Managed Funds and business reserve accounts	2.48	5.60	0% - 25%
Term deposits (up to 2 year)	23.00	51.94	0% - 75%
3 – 5 year cash deposits.	0	0	0% - 25%
1 – 5 year callable deposits.	0	0	0% - 15%
1 – 5 year EuroSterling/Corporate Bonds.	18.80	42.46	10% - 75%
	44.28	**100.00**	

The above table shows that the current portfolio broadly reflects the strategy.

Amendment to Investment Strategy

8. The maximum limit for investments with the Lloyds Banking Group/Bank of Scotland is currently set at £6,002,000. This is in line with all the other banking groups. Our Treasury Advisors, Arlingclose, are comfortable with us increasing the group limit to £9,002,000 but maintaining a £6,000,000 individual limit for each of the 2 banks (plus any outstanding interest for Bank of Scotland). This will enable us to take advantage of higher interest rates for investing for longer periods rather than using our short term money market funds. Lloyds and Bank of Scotland are currently offering 1.08% for 3 months. The money market funds are returning on average 0.63% (28/10/2010).

9. Arlingclose support this group increase by saying: 'The Lloyds Banking Group is 40% owned by the UK government. There has been some stabilisation in credit conditions in general. The long-term ratings of the Lloyds TSB Bank and Bank of Scotland have at least an A+ long-term rating across all three agencies. Other creditworthiness factors such as the share price of Lloyds Banking Group (there is no share price for the individual banks) and credit default swaps of the two banks do not give cause for concern'.

Interest Rates 2010/11

10. Base rate began the financial year and remains at 0.5%.

11. Our advisors are forecasting that rates will continue at 0.5% during the remainder of this financial year with a likelihood of increasing by 0.25% in September 2011.

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Official Bank Rate										
Upside risk	-	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**2.00**	**2.50**	**2.75**
Downside risk	-	-	-	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50

Investment Portfolio

12. The total amount of investments has increased since 1st April due to the fact we are now six months into the ten month council tax collection cycle.

13. The table below shows the Council's overall investments as at 30th September 2010:

	Value of Investments at 01.04.10 £	Value of Investments at 30.09.10 £	Fixed/ Variable Rate
Investments advised by Arlingclose			
Euro Sterling Bonds	9,850,072	7,561,574	Fixed
Corporate Bonds	5,336,559	5,243,425	Fixed
Euro Sterling Bonds	2,000,630	6,000,000	Variable
Total	**17,187,261**	**18,804,999**	
Internal Investments			
Short Term Deposits	19,000,000	23,000,000	Variable
Money Market Funds & Business Reserve Accounts	2,960,000	2,480,000	Variable
Total	**21,960,000**	**25,480,000**	
TOTAL INVESTMENTS	**39,147,261**	**44,284,999**	

Returns for 2010/11

14. The returns to 30th September 2010 are shown in the table below:

	Actual Income £'000	% Rate of Return
Investments advised by Arlingclose		
Euro Sterling Bonds (Fixed)	242	
Corporate Bonds	117	
Euro Sterling Bonds (Variable)	22	
Total	**381**	**3.95%**
Internal Investments		
Short Term Deposits	161	
Money Market Funds & Business Reserve Accounts	25	
Total	**186**	**1.30%**
Other Interest		
Miscellaneous Loans	73	
Total	**73**	
TOTAL	**640**	
PROFILED BUDGETED INCOME	**674**	
SHORTFALL	**34**	
BENCHMARK RATE OF RETURN		**0.42%**

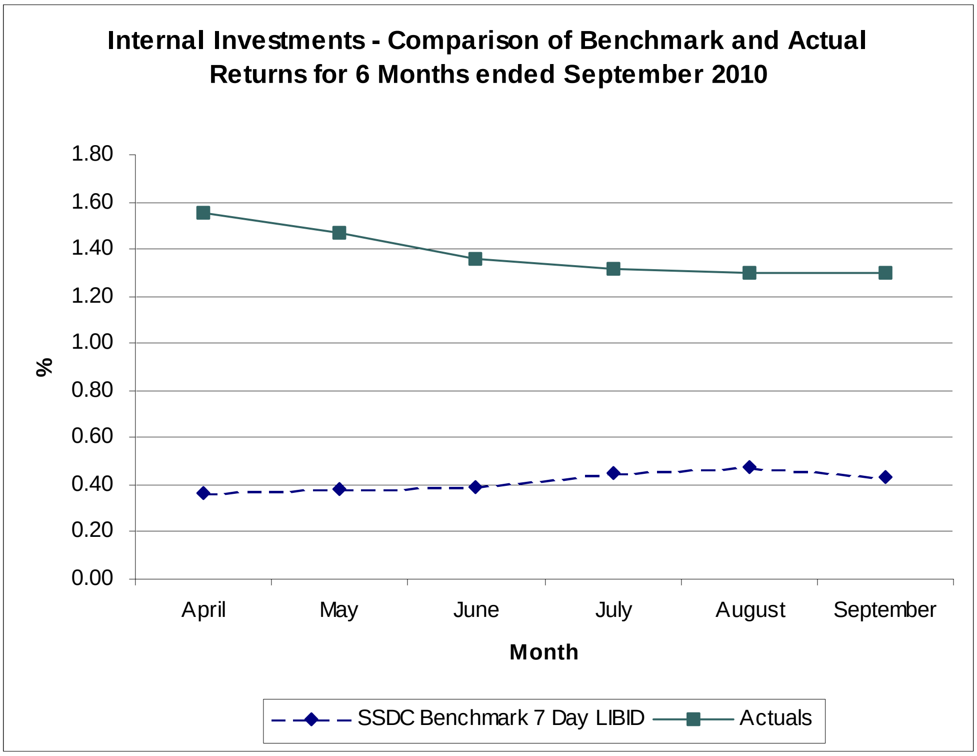
15. The table above shows investment income for the first six months of the year compared to the profiled budget. The figures show a shortfall under budget of £34,000. We currently estimate that the position at the end of the financial year will be an adverse variance in the order of £46,000.

16. The outturn position is affected by both the amount of cash we have available to invest and the interest base rate set by the Bank of England. Balances are affected by the timing of capital expenditure and council tax and business rate collection.

17. The original Treasury Management budget of £1,347,620 was derived by forecasting an average rate of return of 2.74%. The actual interest rate received for the first half of the year was 2.30%.

Internal Investments (Short Term)

18. The graph below shows the In-house performance in respect of short-term investments as at 30th September 2010.



19. The current benchmark set for the in house team is the 7-day LIBID (London Interbank Bid) rate which is the rate used for quick benchmarking by the CIPFA benchmarking club.

20. The above graph shows that the internal investments returns are consistently outperforming the benchmark by around 80 basis points. This is due to a large amount of our investment portfolio being in longer dated securities such as Eurobonds and Corporate Bonds as well as maintaining a rolling programme of 12 month term deposits where cash flow permits.

Borrowing

21. An actual overall borrowing requirement (CFR) of £9.2 million was identified at the beginning of 2010/11. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 30th September 2010, the Council had no external borrowing.

Prudential Indicators – Quarter 1 monitoring

Background:

22. In March 2010, Full Council approved the indicators for 2010/11, as required by the Prudential Code for Capital Finance in Local Authorities. The Local Government Act 2003 allows local authorities to determine their own borrowing limits provided they are affordable and that every local authority complies with the code.

Prudential Indicator 1 - Capital Expenditure:

23. The revised estimates of capital expenditure to be incurred for the current year compared to the original estimates are:

	2010/11 Original Estimate £'000	Expected outturn £'000	2010/11 Variance £'000	Reason for Variance
Approved capital schemes	9,301	10,324	1,023	Increase arises from net slippage to later years and new schemes agreed by Full Council in February 2010 as part of the annual process merged into programme
Reserves	1,111	2,697	1,586	Slippage from 2009/10 accounts for the majority of the variance as well as an increase in the amount of money allocated to the affordable housing scheme
Total Expenditure	**10,412**	**13,021**	**2,609**	

24. The above table shows that the overall estimate for capital expenditure has increased.

Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream:

25. A comparison needs to be made between financing capital costs and the revenue income stream to support these costs. This shows how much of the revenue budget is committed to the servicing of finance.

Portfolio	2010/11 Revised Estimate £'000	Expected outturn £'000	2010/11 Variance £'000	Reason for Variance
Financing Costs	(1,348)	(1,302)	46	Interest rates forecast to stay lower for longer than originally anticipated

Portfolio	2010/11 Revised Estimate £'000	Expected outturn £'000	2010/11 Variance £'000	Reason for Variance
Net Revenue Stream	20,310	20,673	363	The budget has increased due to the approval of the carry forwards from 2009/10
%*	**6.6**	**6.3**		

26. The financing costs include interest payable, notional amounts set aside to repay debt and revenue contributions to capital less interest on investment income. The figure in brackets is due to investment income outweighing financing costs significantly for SSDC but is nevertheless relevant since it shows the extent to which the Council is dependent on investment income.

Prudential Indicator 3 - Capital Financing Requirement:

27. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Estimates of the year-end capital financing requirement for the authority are:

	2010/11 Original Estimate £'000	Expected outturn £'000	2010/11 Variance £'000	Reason for Variance
Opening CFR	9,157	9,157	0	
Capital Expenditure	10,412	13,021	2,808	See explanations for indicator 1 above
Capital Receipts*	(8,227)	(8,714)	671	Slippage of schemes approved in previous years
Grants/Contributions*	(2,185)	(4,307)	2,137	Reprofiling of income expected in future years.
Minimum Revenue Position (MRP)	(36)	(36)	0	
Closing CFR	**9,121**	**9,121**	**0**	

*Figures in brackets denote income through receipts or reserves.

Prudential Indicator 4 – Net external Borrowing compared to the medium term Capital Financing Requirement:

28. The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the net external borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period.

	2010/11 Original Estimate £'000	2010/11 Qtr 2 Actual £'000	2010/11 Variance £'000	Reason for Variance
Net Borrowing	(34,802)	(42,738)	7,936	Capital receipts totalling £422.5k have been received but not yet spent and we are six months into the ten month Council Tax collection cycle
CFR	9,121	9,121	0	See explanations for indicator 3 above

29. The figures above in brackets described as net borrowing actually represent net investments. Our net borrowing is forecast to remain as net investment for the foreseeable future and therefore will not at any time be in excess of the capital financing requirement.

Prudential Indicator 5 - Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

30. The Council must set three years of upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that its limit would allow it to have up to 100% invested in variable rate investments to cover against market fluctuations. For this purpose, term deposits of less than 365 days are deemed to be variable rate deposits. Fixed rate deposits are investments in Eurobonds, Corporate Bonds and term deposits exceeding 365 days.

	2010/11 % Limit	2010/11 Qtr 2 Actual %	2010/11 Variance %	Reason for Variance
Fixed	80	29	51	Within limit
Variable	100	71	29	Within limit

31. The Council must also set limits to reflect any borrowing we may undertake.

	2010/11 % Limit	2010/11 Qtr 2 Actual %	2010/11 Variance %	Reason for Variance
Fixed	100	0	100	SSDC currently has no borrowing
Variable	100	0	100	SSDC currently has no borrowing

32. The indicator has been set at 100% to maximise opportunities for future debt as they arise.

Prudential Indicator 6 - Upper Limit for total principal sums invested over 364 days:

33. SSDC must also set upper limits for any investments of longer than 364 days. The purpose of this indicator is to ensure that SSDC, at any time, has sufficient liquidity to meet all of its financial commitments.

Upper Limit for total principal sums invested over 364 days	2010/11 Maximum Limit £'000	2010/11 Qtr 2 Actual £'000	2010/11 Expected Outturn £'000	Reason for Variance
Between 1-2 years	25,000	10,597	3,209	Within limit
Between 2-3 years	20,000	1,071	6,000	Within limit
Between 3-4 years	10,000	7,136	1,136	Within limit
Between 4-5 years	10,000			Within limit
Over 5 years	5,000			Within limit

34. The table above shows that the Council adopts a policy of safeguarding its investments by minimising investments that are redeemable more than five years ahead.

Prudential Indicator 7 - Actual External Debt:

35. This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities **(this represents our finance leases as per the Statement of Recommended Practice)**. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2010	£'000
Borrowing	0
Other Long-term Liabilities	44
Total	**44**

Prudential Indicator 8 - Authorised Limit for External Debt:

36. This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this limit is exceeded the Council will have acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. A ceiling of £12 million was set for each year.

	2010/11 Estimate £'000	2010/11 Qtr 2 Actual £'000	2010/11 Variance £'000	Reason for Variance
Borrowing	11,900	0	(11,900)	SSDC currently has no borrowing
Other Long-term Liabilities	100	44	(56)	Within limit
Total	**12,000**	**44**	**(11,956)**	

Prudential Indicator 9 – Operational Boundary for External Debt:

37. The operational boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million for each of the next three years was set.

	2010/11 Estimate £’000	2010/11 Qtr 2 Actual £’000	2010/11 Variance £’000	Reason for Variance
Borrowing	9,900	0	(9,900)	SSDC currently has no borrowing
Other Long-term Liabilities	100	44	(56)	Within limit
Total	**10,000**	**44**	**(9,956)**	

Prudential Indicator 10 - Maturity Structure of Fixed Rate borrowing:

38. This indicator is relevant when we borrow, then we can take a portfolio approach to borrowing in order to reduce interest rate risk. This indicator is shown as the Council has set limits in anticipation of future borrowing.

Maturity structure of fixed rate borrowing	2010/11 Upper Limit %	2010/11 Lower Limit %	2010/11 Qtr 2 Actual %	2010/11 Variance %	Reason for Variance
Under 12 months	100	0	0	Not applicable	
12 months and within 24 months	100	0	0	Not applicable	
24 months and within 5 years	100	0	0	Not applicable	
5 years and within 10 years	100	0	0	Not applicable	
10 years and within 20 years	100	0	0	Not applicable	
20 years and within 30 years	100	0	0	Not applicable	
30 years and within 40 years	100	0	0	Not applicable	
40 years and within 50 years	100	0	0	Not applicable	
50 years and above	100	0	0	Not applicable	

Prudential Indicator 11 - Incremental Impact of Capital Investment Decisions:

39. SSDC must show the effect of its annual capital decisions for new capital schemes on the council taxpayer. Capital spend at SSDC is financed from additional receipts so the figure below actually shows the possible decreases in council tax if all capital receipts were invested rather than used for capital expenditure.

Incremental Impact of Capital Investment Decisions	2010/11 Original Estimate £
Decrease in Band D Council Tax	0.20

Prudential Indicator 12 - Adoption of the CIPFA Treasury Management Code:

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

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 18th April 2002.

Conclusion

41. The council is currently within all of the Prudential Indicators and is not forecast to exceed them.

Background Papers: *Prudential Indicators Working Paper, Treasury Management Strategy Statement*