

Audit Committee – 27th October 2011

7. Treasury Management Performance to September 2011 and Mid-year Review of the Treasury Management Strategy

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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 2011. To carry out the mid-year review of the Treasury Management Strategy.

Recommendations

2. The Audit Committee are asked to:
 - Note the Treasury Management Activity for the six-month period ended 30th September 2011.
 - Note the position of the individual prudential indicators for the six-month period ended 30th September 2011.
 - Carry out the mid-year review of the Treasury Management Strategy and recommend it to Council. (The Strategy is attached at pages 31 - 59 with amendments highlighted).

The Investment Strategy for 2011/12

3. The Treasury Management Strategy for 2011/12 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.
4. The Code of Practice recommends that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.
5. 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.
6. Our Minimum rating is A+ long term (or equivalent). Although Natwest does not meet the minimum credit criteria of A+ (or equivalent) long term, it is the Council's bank and will still be used for operational purposes. Balances of smaller amounts (less than £300,000) will be kept within our Natwest Account to ensure operational and contingency purposes are maintained.

7. Until early September, where cash-flow permitted the Council followed a cautious investment strategy of a rolling programme of 6 month deposits with named counterparties for a proportion of its investments.
8. Following the growing problems facing peripheral Europe, the Council responded to the growing stress by scaling back maturities for new investments on the advice of the Council's treasury advisors. Limits for European banks have been temporarily reduced to 1 month and French institutions have been suspended for new investments. Limits for UK banks, Nationwide Building Society and Australian, Canadian and US banks have now been temporarily reduced to 6 months except for Santander UK plc which is now restricted to 3 months.

On 28th September Clydesdale Bank was suspended from the lending list following the bank's downgrade to A2 by Moody's, which falls below the Council's minimum criteria of A+ or equivalent.

During the first quarter Moody's placed the ratings of a number of UK institutions on review for possible downgrade. This was not based on strength or viability of banks but a review of government support should they need it. This was to align their ratings with evolving systemic support post credit crisis. The review is now completed and has led to downgrades of some counterparties on the Council's lending list (Nationwide Building Society and Royal Bank of Scotland). No changes have been made from the other rating agencies; Fitch and Standard & Poors.

9. The sum invested in longer dated securities at fixed rates of interest at the end of September represented 28% of the total portfolio. The sum invested in longer dated securities at variable rates of interest at the end of September represented 13% of the total portfolio. Investments made in longer dated securities comprise EuroSterling bonds and Corporate bonds; these investments have all been made after advice from our treasury advisors, Arlingclose.
10. The Treasury Management Strategy Statement and Annual Investment Policy were both approved by Council on 17th March 2011. 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%

11. The table below compares the investment portfolio at 30th September 2011 to the investment strategy:-

	£'m	%	Strategic aim
Pooled Managed Funds and business reserve accounts	1.54	3.42	0% - 25%
Term deposits (up to 2 year)	25.00	55.58	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.	18.44	41.00	10% - 75%
	44.98	100	

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

Interest Rates 2010/11

12. Base rate began the financial year and remains at 0.5%.
13. Our advisors are forecasting that rates have a likelihood of increasing by 0.25% in December 2012.

	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Official Bank Rate													
Upside risk				0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.25	1.50	1.75	2.00	2.25
Downside risk						-0.25	-0.25	-0.50	-0.75	-1.00	-1.25	-1.50	-1.75

Investment Portfolio

14. The total amount of investments has increased since 1st April as the capital receipt from Right to Buy income (£323k) and £2.5m from the Birchfield Easement has been received, but not yet spent, and we are now six months into the ten month council tax collection cycle.
15. The table below shows the Council's overall investments as at 30th September 2011:

	Value of Investments at 01.04.11 £	Value of Investments at 30.09.11 £	Fixed/ Variable Rate
Investments advised by Arlingclose			
Euro Sterling Bonds	7,537,881	7,339,484	Fixed
Corporate Bonds	5,194,979	5,101,845	Fixed
Euro Sterling Bonds	6,000,000	6,000,000	Variable
Total	18,732,860	18,441,329	
Internal Investments			
Short Term Deposits	16,000,000	25,000,000	Variable
Money Market Funds & Business Reserve Accounts	4,000,000	1,540,000	Variable
Total	20,000,000	26,540,000	
TOTAL INVESTMENTS	38,732,860	44,981,329	

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Returns for 2011/12

16. The returns to 30th September 2011 are shown in the table below:

	Actual Income £'000	% Rate of Return
Investments advised by Arlingclose		
Euro Sterling Bonds (Fixed)	194	
Corporate Bonds	117	
Euro Sterling Bonds (Variable)	25	
Total	<u>336</u>	3.61%
Internal Investments		
Short Term Deposits	156	
Money Market Funds & Business Reserve Accounts	27	
Total	<u>183</u>	1.26%
Other Interest		
Miscellaneous Loans	49	
Total	<u>49</u>	
TOTAL INCOME TO 30TH SEPTEMBER 2011	<u><u>568</u></u>	2.17%
PROFILED BUDGETED INCOME	<u><u>400</u></u>	
FORECAST SURPLUS FOR YEAR END	76	
BENCHMARK RATE OF RETURN		0.45%

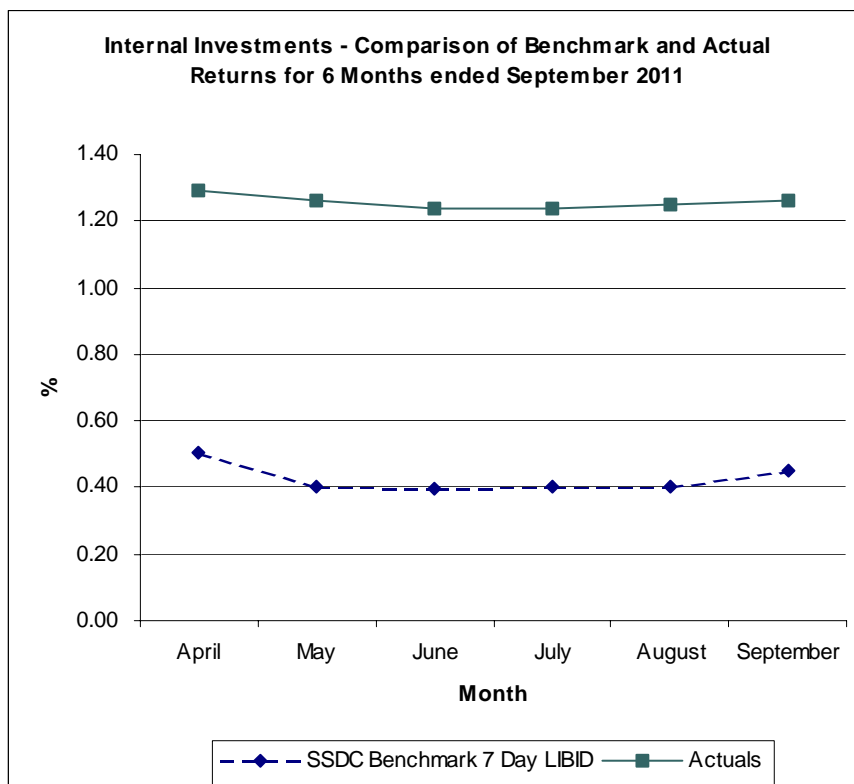
17. The table above shows investment income for the first six months of the year compared to the profiled budget. The figures show a surplus over budget of £168,000. We currently estimate that the position at the end of the financial year will be an overall favourable variance in the order of £76,000.

18. 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.

19. The original Treasury Management budget of £799,620 was derived by forecasting an average rate of return of 1.78%. The actual interest rate received for quarter 1 was 2.17%.

Internal Investments (Short Term)

20. The graph below shows the In-house performance in respect of short-term investments as at 30th September 2011.



21. 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.

22. 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, Corporate Bonds and also in maintaining a rolling programme of 6 month term deposits where cash flow permits.

Borrowing

23. An actual overall borrowing requirement (CFR) of £9.4 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 2011 the Council had no external borrowing.

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Breakdown of investments as at 30th September 2011

Date Lent	Counterparty	Amount	Rate	Maturity Date
10-Jan-11	Bank of Scotland	2,000,000	1.95%	10-Jan-12
14-Oct-10	Bank of Scotland	2,000,000	1.85%	14-Oct-11
1-Mar-11	Bank of Scotland	1,000,000	2.05%	1-Mar-12
14-Apr-11	Nationwide Building Society	1,000,000	1.44%	13-Apr-12
7-Jun-11	Nationwide Building Society	1,000,000	1.41%	6-Jun-12
5-Aug-11	Nationwide Building Society	1,000,000	1.03%	20-Feb-12
25-Aug-11	Barclays Bank Plc	1,000,000	1.09%	27-Feb-12
4-Nov-10	Barclays Bank Plc	1,000,000	1.45%	4-Nov-11
17-Nov-10	Barclays Bank Plc	1,000,000	1.47%	17-Nov-11
23-Mar-11	Bank of Scotland	1,000,000	2.05%	23-Mar-12
31-Mar-11	Barclays Bank Plc	2,000,000	1.58%	30-Mar-12
12-Jul-11	Nordea Bank	2,000,000	1.40%	12-Jul-12
15-Jul-11	Nordea Bank	2,000,000	1.38%	13-Jul-12
15-Jul-11	Nordea Bank	2,000,000	1.01%	15-Feb-12
2-Sep-11	Royal Bank of Scotland	1,000,000	1.10%	2-Mar-12
7-Sep-11	Barclays Bank Plc	1,000,000	1.13%	12-Mar-12
13-Sep-11	Santander UK Plc	1,000,000	0.97%	13-Oct-11
21-Sep-11	Nationwide Building Society	1,000,000	1.04%	17-Feb-12
26-Sep-11	Nationwide Building Society	1,000,000	1.11%	16-Mar-12
	Prime Rate Money Market Fund*	1,540,000	0.83%	
	Eurobond Fixed Rate	2,080,426	5.72%	6-Jun-12
	Eurobond Fixed Rate	3,094,290	3.93%	7-Dec-11
	Eurobond Fixed Rate	1,051,109	5.41%	14-Jan-13
	Eurobond Fixed Rate	1,113,659	3.11%	15-Apr-14
	Corporate Bond Fixed Rate	5,101,845	2.74%	4-Nov-11
	Eurobond Floating Rate Note	6,000,000	SONIA+ 0.35%	18-Mar-14
		44,981,329		

Note: Money Market Funds are instant access accounts so the rate displayed is a daily rate.

Prudential Indicators – Quarter 2 monitoring

Background:

24. In March 2011, Full Council approved the indicators for 2011/12, as required by the Prudential Code for Capital Finance in Local Authorities. The Local Government Act 2003 allowed 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:

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

	2011/12 Original Estimate £'000	Expected Outturn £'000	2011/12 Variance £'000	Reason for Variance
Approved capital schemes	5,341	8,096	2,755	Increase arises from net slippage from previous year to current year
Capital Investments	0	(5,000)	(5,000)	Corporate Bond maturing in November 2011
Reserves	1,168	3,752	2,584	Slippage from 2010/11 accounts for the majority of the variance
Total Expenditure	6,509	6,848	339	

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

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

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

Portfolio	2011/12 Original Estimate £'000	Expected Outturn £'000	2011/12 Variance £'000	Reason for Variance
Financing Costs*	(673)	(716)	(43)	
Net Revenue Stream	17,345	17,684	339	Carry forwards approved in June have now been incorporated within the overall budget
%*	(3.9)	(4.1)		

*figures in brackets denote income through receipts and reserves

28. The financing costs include interest payable, notional amounts set aside to repay debt, 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:

29. 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:

	2011/12 Revised Estimate £'000	Expected Outturn £'000	2011/12 Variance £'000	Reason for Variance
Opening CFR	9,352	9,415	63	
Capital Expenditure	5,341	8,096	2,755	See explanations for indicator 1 above
Capital Receipts*	(3,664)	(5,121)	(1,457)	Slippage of schemes approved in previous years
Grants/Contributions*	(1,677)	(2,975)	(1,298)	Reprofiling of income expected in future years
Minimum Revenue Position (MRP)	(126)	(159)	33	Additional finance leases
Additional Finance Leases		131	131	
Closing CFR	9,226	9,387	227	

*Figures in brackets denote income through receipts or reserves.

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

30. 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.

	2011/12 Original Estimate £'000	2011/12 Qtr 1 Actual £'000	2011/12 Variance £'000	Reason for Variance
Net Borrowing	(46,434)	(43,447)	2,987	
CFR	9,226	9,256	30	

31. 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:

32. 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.

	2011/12 % Limit	2011/12 Qtr 1 Actual %	2011/12 Variance %	Reason for Variance
Fixed	80	27.66	52.34	Within limit
Variable	100	72.34	27.66	Within limit

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

	2011/12 % Limit	2011/12 Qtr 1 Actual %	2011/12 Variance %	Reason for Variance
Fixed	100	0	100	SSDC currently has no borrowing
Variable	100	0	100	SSDC currently has no borrowing

34. 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:

35. 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	2011/12 Maximum Limit £'000	2011/12 Qtr 1 Actual £'000	2011/12 Expected Outturn £'000	Reason for Variance
Between 1-2 years	25,000	1,051	6,000	Within limit
Between 2-3 years	20,000	7,114	1,114	Within limit
Between 3-4 years	10,000	0	0	Within limit
Between 4-5 years	10,000	0	0	Within limit
Over 5 years	5,000	0	0	Within limit

36. 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.

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Prudential Indicator 7 - Actual External Debt:

37. 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). This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2011	£'000
Borrowing	0
Other Long-term Liabilities (Finance Leases)	301
Total	301

Prudential Indicator 8 - Authorised Limit for External Debt:

38. 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.

	2011/12 Estimate £'000	2011/12 Qtr 1 Actual £'000	2011/12 Variance £'000	Reason for Variance
Borrowing	11,600	0	(11,600)	SSDC currently has no external borrowing
Other Long-term Liabilities (Finance Leases)	400	273	(127)	Within limit
Total	12,000	273	(11,727)	

Prudential Indicator 9 – Operational Boundary for External Debt:

39. 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.

	2011/12 Estimate £'000	2011/12 Qtr 1 Actual £'000	2011/12 Variance £'000	Reason for Variance
Borrowing	9,700	0	(9,700)	SSDC currently has no external borrowing
Other Long-term Liabilities (Finance Leases)	300	273	(27)	Within limit
Total	10,000	273	(9,727)	

Prudential Indicator 10 - Maturity Structure of Fixed Rate borrowing:

40. 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	2011/12 Upper Limit %	2011/12 Lower Limit %	2011/12 Qtr 1 Actual %	2011/12 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:

41. 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	2011/12 Original Estimate £
Decrease in Band D Council Tax	0.20

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

42. 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 18 th April 2002.

Conclusion

43. 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*