

Audit Committee – 22 November 2012.

## 6. Treasury Management Performance to September 2012

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### Purpose of Report

1. To review the treasury management activity and the performance against the Prudential Indicators for the six months ended 30th September 2012. 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 2012.
  - Note the position of the individual prudential indicators for the six-month period ended 30th September 2012.
  - Carry out the mid-year review of the Treasury Management Strategy and recommend it to Council. (Strategy attached with amendments highlighted)

### The Investment Strategy for 2012/13

3. The Treasury Management Strategy for 2012/13 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.
4. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.
5. Treasury management is defined as: "The management of the local authority'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."
6. With short term interest rates remaining lower for even longer than anticipated, our investment strategy will typically result in the lengthening of investment periods, where cash flow permits, in order to lock into higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.
7. In order to diversify the authority's investment portfolio which is largely invested in cash, investments will be placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return.

8. Money Market Funds (MMFs) will be utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Authority will also seek to diversify any exposure by utilising more than one MMF. The Authority will also restrict its exposure to MMFs with lower levels of funds under management and it will not exceed 0.5% of the net asset value of the MMF. In the case of Government MMFs, the Council will ensure exposure to each Fund does not exceed 2% of the net asset value of the Fund.
9. In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills (The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure).

### Interest Rates 2012/13

10. Base rate began the financial year and remains at 0.5%.
11. Our advisors are forecasting that rates will remain low for an extended period, as shown below;

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
<b>Official Bank Rate</b>													
<b>Upside risk</b>				0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50
<b>Central case</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>Downside risk</b>	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

### Investment Portfolio

12. The table below shows the Council's overall investments as at 30<sup>th</sup> September 2012:

	<b>Value of Investments at 01.04.12 £</b>	<b>Value of Investments at 30.09.12 £</b>	<b>Fixed/ Variable Rate</b>
<b>Investments advised by Arlingclose</b>			
Euro Sterling Bonds	4,182,407		Fixed
World Bonds	3,035,190	3,022,352	Fixed
Certificates of Deposit		4,501,118	Variable
Euro Sterling Bonds	<u>5,985,000</u>	<u>5,985,000</u>	Variable
<b>Total</b>	<b><u>13,202,597</u></b>	<b><u>13,508,470</u></b>	
<b>Internal Investments</b>			
Short Term Deposits (Banks)	8,000,000	25,000,000	Variable
Short Term Deposits (Other LA's)	14,000,000	7,000,000	Variable
Short Term Deposits (DMADF)			Variable
Money Market Funds & Business Reserve Accounts	<u>3,710,000</u>	<u>1,210,000</u>	Variable
<b>Total</b>	<b><u>25,710,000</u></b>	<b><u>33,210,000</u></b>	
<b>TOTAL INVESTMENTS</b>	<b><u>38,912,597</u></b>	<b><u>46,718,470</u></b>	

## Returns for 2012/13

13. The returns to 30<sup>th</sup> September 2012 are shown in the table below:

	<b>Actual Income £'000</b>	<b>% Rate of Return</b>
<b>Investments advised by Arlingclose</b>		
Euro Sterling Bonds (Fixed)	5	
World Bonds (Fixed)	12	
Certificate of Deposits (CDs)	11	
Euro Sterling Bonds (Variable)	25	
Total	<u>53</u>	<b>0.86%</b>
<b>Internal Investments</b>		
Short Term Deposits	119	
Money Market Funds & Business Reserve Accounts	27	
Total	<u>146</u>	<b>0.80%</b>
<b>Other Interest</b>		
Miscellaneous Loans	6	
Total	<u>6</u>	
<b>TOTAL INCOME TO 30<sup>TH</sup> SEPTEMBER 2012</b>	<u><b>205</b></u>	<b>0.81%</b>
<b>PROFILED BUDGETED INCOME</b>	<u><b>254</b></u>	
<b>FORECAST DEFICIT FOR YEAR END</b>	<b>151</b>	
<b>BENCHMARK RATE OF RETURN</b>		<b>0.48%</b>

14. The table above shows investment income for the year to date compared to the profiled budget. The annual budget is set at £507,030. Current estimates are predicting an underachievement of income to the value of £150,890. This shortfall will be covered by the Treasury Management Reserve, the balance of which is £500,000.

15. 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 the collection of council tax and business rates.

## Investments

16. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13. New investments can be made with the following institutions:

- Other Local Authorities;
- AAA-rated Money Market Funds;
- Certificates of Deposit (CDs) and Term Deposits with UK Banks and Building Societies systemically important to the UK banking system and deposits with select non-UK Banks (Australian, Canadian and American);

- T-Bills and DMADF (Debt Management Office);
  - Bonds issued by Multilateral Development Banks, such as the European Investment Bank;
  - Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments.
17. The graph shown in Appendix A shows the performance of the in-house Treasury team in respect of all investments for the quarter ending 30<sup>th</sup> September 2012 in comparison to all other clients of Arlingclose.
18. The graph shows that SSDC is in a satisfactory position in terms of the risk taken against the return on investments.

### Borrowing

19. An actual overall borrowing requirement (CFR) of £9.4 million was identified at the beginning of 2012/13. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 30<sup>th</sup> September 2012 the Council had no external borrowing.

### Breakdown of investments as at 30<sup>th</sup> September 2012

Date Lent	Counterparty	Amount	Rate	Maturity Date
06-Aug-12	Barclays Bank Plc	1,000,000	0.68%	12-Nov-12
31-Jan-12	Nottingham City Council	2,000,000	0.80%	29-Jan-13
13-Mar-12	Corby Borough Council	2,000,000	0.80%	12-Mar-13
01-Aug-12	Bank of Scotland	2,000,000	1.35%	9-Nov-12
22-Aug-12	Nationwide Building Society	1,000,000	0.55%	30-Nov-12
29-Aug-12	Barclays Bank Plc	1,000,000	0.63%	4-Dec-12
31-May-12	Newcastle City Council	3,000,000	0.72%	30-May-13
04-Sep-12	Barclays Bank Plc	1,000,000	0.63%	12-Dec-12
07-Jun-12	National Australia Bank	2,000,000	0.60%	7-Dec-12
04-Jul-12	Nationwide Building Society	1,000,000	0.60%	4-Oct-12
06-Jul-12	Commonwealth Bank of Australia	5,000,000	0.52%	7-Jan-13
09-Jul-12	Barclays Bank Plc	1,000,000	0.80%	9-Oct-12
09-Jul-12	Nationwide Building Society	1,000,000	0.60%	9-Oct-12
12-Jul-12	National Australia Bank	1,000,000	0.40%	12-Oct-12
12-Jul-12	National Australia Bank	2,000,000	0.55%	14-Jan-13
31-Aug-12	IPA SCB TD Incoming (Santander)	1,000,000	0.94%	2-Oct-12
02-Aug-12	National Australia Bank	1,000,000	0.55%	2-Aug-13
02-Aug-12	Nordea Bank (Finland)	2,000,000	0.60%	2-Nov-12
03-Aug-12	Bank of Scotland	2,000,000	1.35%	5-Nov-12
	Ignis Money Market Fund*	80,000	0.62%	
	Prime Rate Money Market Fund*	1,130,000	0.63%	
	International Bank for Reconstruction and Development (the World Bank)	2,014,080	0.84%	10-Dec-13

	International Bank for Reconstruction and Development (the World Bank)	1,008,272	0.71%	10-Dec-13
	Eurobond Floating Rate Note	5,985,000	SONIA+ 0.35%	18-Mar-14
	Certificate of Deposit	1,500,227	0.83%	14-Jan-13
	Certificate of Deposit	3,000,891	0.97%	31-Mar-13
		<b>46,718,470</b>		

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

### Prudential Indicators – Quarter 1 monitoring

#### Background:

20. In March 2012, Full Council approved the indicators for 2012/13, 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:

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

	2012/13 Original Estimate £'000	Expected Outturn £'000	2012/13 Variance £'000	Reason for Variance
Approved capital schemes	4,059	5,732	1,673	Slippage from previous years makes up the majority of the variance as well as new allocations in year and transfers into the main programme from the reserve schemes
Reserves	1,279	2,927	1,648	The variance is due to slippage from last financial year into this financial year and new allocation of monies
<b>Total Expenditure</b>	<b>5,338</b>	<b>8,659</b>	<b>3,321</b>	

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

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

23. 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	2012/13 Original Estimate £'000	Expected Outturn £'000	2012/13 Variance £'000	Reason for Variance
Financing Costs*	(397)	(242)	155	We are currently predicting an underachievement of investment income of £151k
Net Revenue Stream	16,577	17,162	585	Carry forwards of £497k and £74k for Evening/Sunday Car parking charges built into the budget
%*	<b>(2.4)</b>	<b>(1.4)</b>	<b>1.0</b>	

\*figures in brackets denote income through receipts and reserves

24. 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:**

25. 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:

	2012/13 Revised Estimate £'000	Expected Outturn £'000	2012/13 Variance £'000	Reason for Variance
Opening CFR	9,506	9,506	0	
Capital Expenditure	4,059	8,671	4,612	See explanations for indicator 1 above
Capital Receipts*	(3,650)	(5,732)	(2,082)	Slippage of schemes approved in previous years
Grants/Contributions*	(409)	(2,939)	(2,530)	Reprofiling of income expected in future years
Minimum Revenue Position (MRP)	(125)	(124)	1	Roundings
Additional Finance Leases	0	0	0	
<b>Closing CFR</b>	<b>9,381</b>	<b>9,382</b>	<b>1</b>	

\*Figures in brackets denote income through receipts or reserves. The original allocation of Capital Receipts and Grants/Contributions were transposed in the Treasury Management Strategy Statement.

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

26. 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.

	2012/13 Revised Estimate £'000	2012/13 Qtr 2 Actual £'000	2012/13 Variance £'000	Reason for Variance
Net Borrowing	(36,014)	(45,468)	(9,454)	The estimate is a prediction of the year end balance whilst quarter 2 is always higher as we are 6 months into the 10 month council tax collection cycle
CFR	9,381	9,382	1	

27. 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:

28. 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.

	2012/13 % Limit	2012/13 Qtr 2 Actual %	2012/13 Variance %	Reason for Variance
Fixed	80	6.5	(73.5)	Within limit
Variable	100	93.5	(6.5)	Within limit

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

	2012/13 % Limit	2012/13 Qtr 2 Actual %	2012/13 Variance %	Reason for Variance
Fixed	100	0	100	SSDC currently has no borrowing
Variable	100	0	100	SSDC currently has no borrowing

30. 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:**

31. 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.

<b>Upper Limit for total principal sums invested over 364 days</b>	<b>2012/13 Maximum Limit £'000</b>	<b>2012/13 Qtr 2 Actual £'000</b>	<b>2012/13 Expected Outturn £'000</b>	<b>Reason for Variance</b>
Between 1-2 years	25,000	9,007	0	Within limit
Between 2-3 years	20,000	0	0	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

32. 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:**

33. The purpose of this treasury indicator is to highlight a situation where the Council is planning to borrow in advance of need.

	<b>2012/13 Estimate £'000</b>	<b>2012/13 Qtr 2 Actual £'000</b>	<b>2012/13 Variance £'000</b>	<b>Reason for Variance</b>
Outstanding Borrowing (at nominal value)	0	0	0	
Other long-term liabilities (at nominal value)	196	258	62	Additional Leases taken out since setting the budget
<b>Gross Debt</b>	<b>196</b>	<b>258</b>	<b>62</b>	
<b>Less: Net Investments</b>	<b>(36,014)</b>	<b>(43,943)</b>	<b>(7,929)</b>	
<b>Net Debt</b>	<b>(35,818)</b>	<b>(43,685)</b>	<b>(7,867)</b>	

The figures above described as net debt actually represent net investments.

**Prudential Indicator 8 – Credit Risk:**

34. The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution and its sovereign
- Sovereign support mechanisms
- Credit default swaps (where quoted)
- Share prices (where available)
- Economic Fundamentals, such as a country's net debt as a percentage of its GDP
- Corporate developments, news articles, markets sentiment and momentum
- Subjective overlay

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

#### Prudential Indicator 9 - 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). This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

<b>Actual External Debt as at 31/03/2012</b>	<b>£'000</b>
Borrowing	0
Other Long-term Liabilities (Finance Leases)	383
<b>Total</b>	<b>383</b>

#### Prudential Indicator 10 - 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.

	<b>2012/13 Estimate £'000</b>	<b>2012/13 Qtr 2 Actual £'000</b>	<b>2012/13 Variance £'000</b>	<b>Reason for Variance</b>
Borrowing	11,000	0	(11,000)	SSDC currently has no external borrowing
Other Long-term Liabilities (Finance Leases)	1,000	258	(742)	Within limit
<b>Total</b>	<b>12,000</b>	<b>258</b>	<b>(11,742)</b>	

**Prudential Indicator 11 – 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.

	2012/13 Estimate £'000	2012/13 Qtr 2 Actual £'000	2012/13 Variance £'000	Reason for Variance
Borrowing	9,200	0	(9,200)	SSDC currently has no external borrowing
Other Long-term Liabilities (Finance Leases)	800	258	(542)	Within limit
<b>Total</b>	<b>10,000</b>	<b>258</b>	<b>(9,742)</b>	

**Prudential Indicator 12 - 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	2011/12 Upper Limit %	2011/12 Lower Limit %	2011/12 Qtr 2 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 13 - 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	2012/13 Original Estimate £
Decrease in Band D Council Tax	0.34

**Prudential Indicator 14 - 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
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The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 18 <sup>th</sup> April 2002.
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**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

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