Report to: Audit & Governance Committee **Date of Meeting:** 28 September 2011

Subject: Treasury Management 2011/12 – First Quarter Update

Report of: Head of Corporate Finance & ICT

Wards Affected: All

Is this a Key Decision? No

Is it included in the Forward Plan? No

Exempt/Confidential No

Purpose/Summary

To inform members of Treasury Management activity undertaken in the first quarter of 2011/12, and the amendment to the Prudential Indicators for 2011/12 approved by Cabinet on 11 August 2011.

Recommendation(s)

Audit and Governance Committee is requested to note: -

1. The Treasury Management update for the first quarter 2011/12; and

2. The approval of amended Prudential Indicators by Cabinet on 18 August 2011.

How does the decision contribute to the Council's Corporate Objectives?

Corporate Objective		Positive Impact	Neutral Impact	Negative Impact
1	Creating a Learning Community		√	
2	Jobs and Prosperity		√	
3	Environmental Sustainability		√	
4	Health and Well-Being		√	
5	Children and Young People		√	
6	Creating Safe Communities		√	
7	Creating Inclusive Communities		√	
8	Improving the Quality of Council Services and Strengthening Local Democracy		√	

Reasons for the Recommendation:
To ensure that the Audit and Governance Committee is fully appraised of treasury activity, undertaken in the first quarter of 2011/12.

What will it cost and how will it be financed?

(A) Revenue Costs
There are no financial implications as a result of this report.

(B) Capital Costs
None.

Implications:
The following implications of this proposal have been considered and where there are specific implications, these are set out below:

Legal	Statutory Duty	
Human Resources	None	
Equality		
1. No Equality Implication		√
2. Equality Implications identified and mitigated		
3. Equality Implication identified and risk remains		

Impact on Service Delivery:
None.

What consultations have taken place on the proposals and when?
The Head of Corporate Finance and ICT has no comments on this report because the contents of the report have no financial implications. **FD 06 /2011**

The Head of Corporate Legal Services has no comments on this report because there are no legal implications LD 359/11

Are there any other options available for consideration?
None.

Implementation Date for the Decision
Immediately following the Committee Meeting.

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Background Papers:
Treasury Management update Quarter 1 2011/12
Cabinet Report 11 August 2011.

1 BACKGROUND TO THE REPORT

1.1 The Treasury Management Policy and Strategy document for 2011/12 (approved by Council on 4 March 2011) included a requirement for quarterly reports to be provided to Cabinet on the investment activity of the Authority. This report is the first of such reports for the year and presents relevant Treasury Management information for the period ending 31 March 2012.

1.2 The report includes information on the investments held / entered into during the period and the interest rates obtained (with a comparison of performance against a standard benchmark figure). In addition, the report highlights whether there has been any variance from the Treasury Management Policy Strategy and the Prudential Indicators (the operational boundaries within which the Council aims to work).

2 INVESTMENTS HELD

2.1 Investments held at the end of June 2012 comprise the following:

Overnight deposits

Institution	Deposit £m	Rate %	Maturity date	On current counterparty list?
Natwest	15.000	0.80	N/A	Yes
Goldman-Sachs	13.680	0.60	N/A	Yes
Blackrock MMF	13.670	0.58	N/A	Yes
Insight MMF	11.660	0.62	N/A	Yes
Total	54.010			

Fixed term deposits

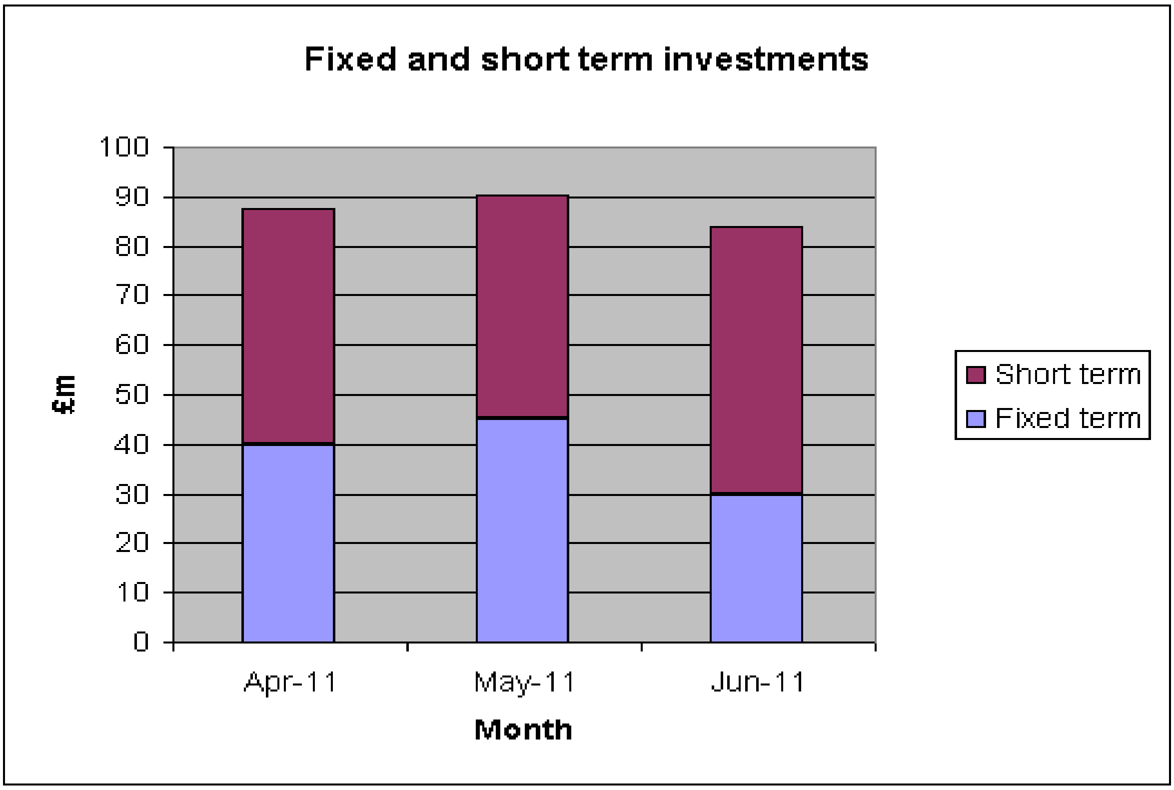
Santander	10.000	1.32	14/10/2011	Yes
Santander	5.000	1.35	22/12/2011	Yes
Lloyds	10.000	1.70	22/09/2011	Yes
Lloyds	5.000	2.65	22/09/2011	Yes
Total	30.000			
TOTAL	84.010			

2.2 All of the organisations are on the current counterparty list. The maximum level of investment permitted in the Treasury Management Strategy in any one institution, or banking group, is currently £25m. Whilst the maximum should be retained, in case economic conditions change, a day to day operational maximum of £15m is currently being imposed.

This will spread the risk of investments for the Council, but will have a small detrimental impact on the returns the Council will receive in the future. The

Council has remained within that boundary during year. At present, it is not expected that there will be any need to review this limit.

2.3 The ratio of overnight deposits (i.e. short term) to fixed term investments is illustrated below:



3 RISK APPETIITE

3.1 The Council will only invest in institutions that hold a minimum Fitch rating of F1+ AA- for banking institutions, or Aaa/Mr1+ for money market funds. The ratings applied to investment grade institutions, and the much riskier speculative grade institutions, as defined by Fitch, has been placed into a risk matrix – see Appendix B. The matrix defines institutions in terms of their Fitch rating, and grades them as follows:

- Low risk – score of 1 – 4
- Low to medium risk - score of 5 – 9
- Medium risk – score of 10 – 20
- High risk – score of 21 - 36

3.2 The matrix shows how the Council has set its risk appetite by being risk averse and putting security and liquidity before yield, by ensuring that it invests with institutions where the probability of default, and consequence of any default, is kept to a minimum. This is done by keeping within the confines of institutions rated with a risk profile of 1 - 4. The matrix also shows where the Council's deposits are held in terms of the matrix as at 31 March 2011.

3.3 Following a regular meeting with the Council's treasury management adviser's, Arlingclose, officers are currently investigating the possibility of a greater proportion of surplus cash being invested for longer periods. The advice given was that greater returns could be achieved, without a significant increase in risk. For example, some of the existing portfolios (currently invested overnight) could be invested for 12 months. However, the very recent turmoil in the markets has meant that Arlingclose's latest advice is for new investments to be no longer than 6 months. Therefore, whilst the option of longer investments is not being implemented in the short term, it is an issue that will be considered for the latter part of this year and for 2012/13.

4 INTEREST EARNED

4.1 The actual performance of investments against the profiled budget for the period to 30 June 2012 is shown below:

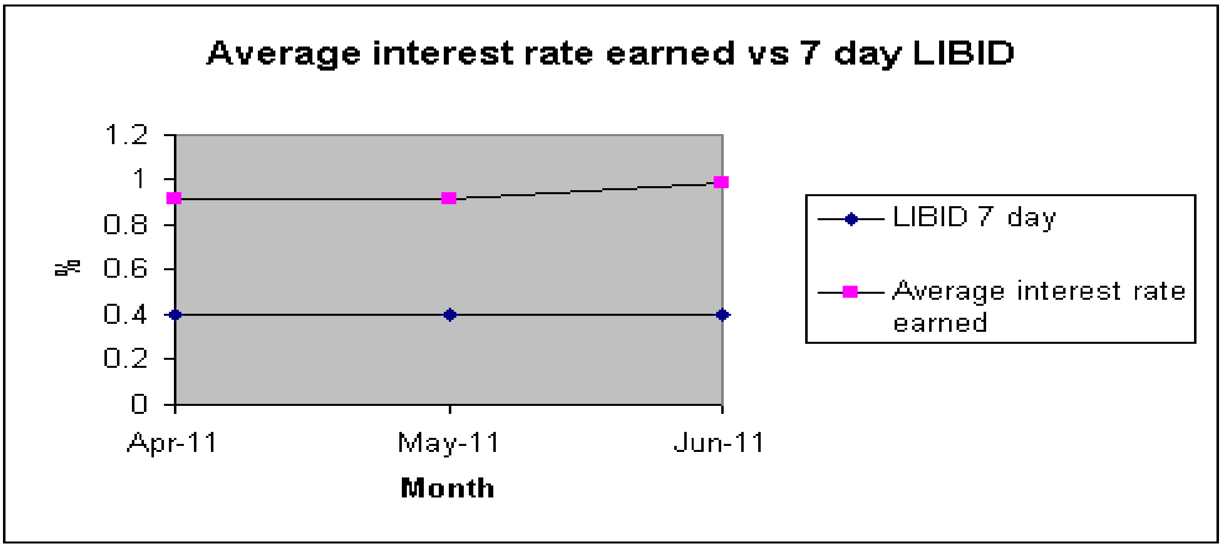
2011/12 Quarterly Investment Income

	Budget '000s	Actual '000s	Variance '000s
Qtr 1	108	176	68

4.2 The budgeted investment average interest rate for 2011/12 is 0.82%, which equates to £0.596m income for the year. This figure assumes the income from investments already in place at 1st April 2011 and new returns based upon Bank of England's Base Rate projection as supplied by our treasury consultants.

4.3 The investment income achieved during the first quarter is £0.176m, which equates to an average interest rate of 0.95%.

We have outperformed the 7 day LIBID average as follows:



5 LATEST BANK OF ENGLAND BASE RATE FORECAST

5.1 Our Treasury Management advisors, Arlingclose, projected base rate projection has been recently revised down slightly. This is based upon the view that the economic recovery will be slower than expected. This is detailed below:

6 COUNTERPARTY LIST

6.1 The current counterparty list is detailed in **Appendix A**. There is little change to the composition of the list when comparing the position at the end of Qtr 4 2010/11, which does suggest that an element of stability has returned to the banking sector.

7 PRUDENTIAL INDICATORS 2011/12

7.1 Members will recall that Prudential Indicators need to be established prior to the start of the financial year. These provide the financial framework / boundaries for the Authority with regard to ensuring that the Council complies with the relevant legislation, is acting prudently and that its capital expenditure proposals are affordable. These were approved by the Council on 3 March 2011 for the 2011/12 financial year.

7.2 International Financial Reporting Standards (IFRS) are the latest accounting standards introduced by the International Accounting Standards Board (IASB). They have been adopted by local authorities in 2010/11 for the preparation of year end Statement of Accounts. The introduction of IFRS has meant that some figures used within the determination of the Prudential Indicators have been amended. Consequently, an update of the Indicators is now required.

7.3 One of the key areas of change for Sefton, as part of the implementation of IFRS Accounting, has been the reclassification of certain “operating” leases as “finance” leases.

7.4 Under an operating lease, the value of future lease payments are disclosed in a note to the accounts, but are <u>not recorded within creditors</u> on the balance sheet. The value of the asset is also <u>not recorded within fixed assets;</u> whereas, under a finance lease, they have to be identified within the Balance Sheet. The value of the asset is recorded within fixed assets, whilst the liability for all future payments is now recorded within creditors.

7.5 The implication for Sefton has been that the value of assets and liabilities in the 2010/11 Accounts increasing significantly since the 2009/10 Statement. The effect of this change is:

- the value of fixed assets has risen by some £19.082m;

- the level of our borrowings recorded on the face of the balance sheet has also increased by £18.429m to reflect the anticipated future creditor payments under the finance lease.
  For information, in addition to the creditor payments recorded in the balance sheet, £0.653m of interest, payable under the leases, has been recorded within the Capital Adjustment Account i.e. the difference between the above two figures.

7.6 It should be noted that the above is a technical change to the Accounts. No new agreements or borrowing has been undertaken in respect of these leases, it is merely the way that these historic agreements are being presented within the Statement of Accounts.

7.7 As a consequence of this accounting change, the increase in fixed assets / borrowing figures needs to be reflected in the Prudential Indicators. The key indicators that require revision due the changes made on the balance sheet are the capital financing requirement (CFR), the operational boundary and the authorised limit. The amendments to these indicators are highlighted in **Appendix C**. The update of the indicators is merely a technical adjustment; it will not adversely affect the Council, or require any change to how we finance the newly categorised finance leases.

Appendix A

SEFTON COUNCIL

STANDARD LENDING LIST

UK and International Banks (including Nationwide Building Society	**RATING**	**Negative rating watch?**	**Individual rating**	**Support rating**	**CDS**
United Kingdom AAA					
Santander UK)	F1+ / AA-	Yes	B	1	Monitoring
Barclays	F1+ / AA-	Yes	B	1	In range
Clydesdale Bank	F1+ / AA-	Yes	C	1	N/A
HSBC	F1+ / AA	Yes	B	1	In range
Lloyds TSB/HBOS - nationalised	F1+ / AA-		C	1	N/A
RBS Group – nationalised	F1+ / AA-		C/D	1	N/A
Nationwide	F1+ / AA-	Yes	B	1	In range
Canada AAA					
Bank of Montreal	F1+ / AA-	Yes	B	1	N/A
Bank of Nova Scotia	F1+ / AA-		B	1	N/A
Canadian Imperial Bank of Commerce	F1+ / AA-	Yes	B	1	N/A
Royal Bank of Canada	F1+ / AA	Yes	A/B	1	N/A
Toronto Dominion Bank	F1+ / AA-	Yes	B	1	N/A
Finland AAA					
Nordea Bank	F1+ / AA-		B	1	N/A

UK and International Banks (including Nationwide Building Society	RATING	Negative rating watch?	Individual rating	Support rating	CDS
France AAA					
BNP Paribas	F1+ / AA	Yes	B	1	In range
Germany AAA					
Deutsche Bank	F1+ / AA-	Yes	B/C	1	In range
Sweden AAA					
Svenska Handelsbanken	F1+ / AA-		B	1	In range
Switzerland AAA					
Credit Suisse	F1+ / AA-	Yes	B	1	In range
USA AAA					
JP Morgan Chase Bank	F1+ / AA-	Yes	B	1	In range

Appendix B

RISK ASSESSMENT MATRIX - FITCH RATINGS

PROBABLITY of DEFAULT

High

INCREASING YIELD

F1 6	F2 12	F3 18	B 24	C 30	D 36
F1 5	F2 10	F3 15	F3 20	B 25	C 30
F1+/AA- 4	F1 8	F2 12	F3 16	F3 20	B 24
F1+/AA 3	F1 6	F1 9	F2 12	F3 15	F3 18
F1+/AA+ 2	F1+/AA- 4 *£45m*	F1 6	F1 8	F2 10	F2 12
F1+/AAA 1 *£39.010m*	F1+/AA+ 2	F1+/AA 3	F1+/AA- 4	F1 5	F1 6

High (probability of default) / Low

High

SEVERITY of CONSEQUENCE

SEFTON RISK TOLERANCE	4		INVESTED
LOW RISK	1 - 4	Investment Grade	£84.010m
LOW - MEDIUM RISK	5 - 9	Investment Grade	Nil
MEDIUM RISK	10 - 20	Investment Grade	Nil
HIGH RISK	21 - 36	Speculative Grade	Nil

Appendix C

PRUDENTIAL INDICATORS 2011/12 – AMENDED AUGUST 2011

1. Capital Financing requirement

The Capital Financing Requirement indicator reflects the Authority's underlying need to borrow for a capital purpose. This is based on historic capital financing decisions and a calculation of future years planned capital expenditure requirements. The indicator approved in March 2011 is compared to the revised indicator incorporating the effects of IFRS below:

Capital Financing Requirement					
	31/03/10 £m **Actual**	31/03/11 £m **Estimate**	31/03/12 £m Estimate	31/03/13 £m Estimate	31/03/14 £m Estimate
General Fund as approved	182.400	194.700	207.000	204.000	199.000
As revised under IFRS		211.500	224.000	222.000	217.000

This increase in the CFR reflects the reclassification of operating leases to finance leases, and also the revision of certain fixed asset valuations as noted in 1.4 above.

2 Prudential Indicator – Borrowing Limits

2.1. External borrowing undertaken by the Council arises as a consequence of all the financial transactions of the Authority, both capital and revenue, and not simply those arising from capital spending. The Council manages its Treasury Management position in terms of its external borrowings and investments in accordance with its approved Treasury Management Strategy and Policy Statements.

3 The Operational Boundary

3.1 The Operational Boundary sets a limit on the total amount of long-term borrowing that the Council can undertake. It reflects the Authority's current commitments, existing capital expenditure plans, and is consistent with its approved Treasury Management Policy Statement and practices. The figures are based on prudent estimates.

3.2 The indicator approved in March 2011 is compared to the revised indicator incorporating the effects of IFRS below:

Operational Boundary - approved March 2011				
	2010/2011 £m	2011/2012 £m	2012/2013 £m	2013/2014 £m
Borrowing (long-term)	140.000	159.000	163.000	164.000
Other long term liabilities	7.500	6.500	6.500	5.500
Total	147.500	165.500	169.500	169.500

Operational Boundary - revised under IFRS				
	2010/2011 £m	2011/2012 £m	2012/2013 £m	2013/2014 £m
Borrowing (long-term)	158.000	177.000	181.000	182.000
Other long term liabilities	7.500	6.500	6.500	5.500
Total	165.500	183.500	187.500	187.500

The above change reflects the inclusion of the finance lease liabilities on the balance sheet, which have been reclassified from operating leases as required under IFRS. The total value of the liability is £18.429m.

4 The Authorised Limit

4.1 The Authorised Limit sets a limit on the amount of borrowing (both short and long-term) that the Council undertakes. It uses the Operational Boundary as its base but also includes additional headroom to allow, for example, for exceptional cash movements. Under the terms of section 3 (1) of the Local Government Act 2003, the Council is legally obliged to determine and review how much it can afford to borrow i.e. the authorised limit. The authorised limit determined for 2011/12 will be the statutory limit determined under section 3 (1).

4.2 The Council is asked to delegate authority to the Head of Corporate Finance and Information Services to effect movement between the separately agreed figures for borrowing and other long-term liabilities within the total authorised limit for any year. Any such changes will be reported to the Council at the earliest opportunity.

4.3 The indicator approved in March 2011 is compared to the revised indicator incorporating the effects of IFRS below:

Authorised Limit - approved March 2011				
	2010/2011 £m	2011/2012 £m	2012/2013 £m	2013/2014 £m
Borrowing (short & long-term)	155.000	174.000	178.000	179.000
Other long term liabilities	7.500	6.500	6.500	5.500
Total	162.500	180.500	184.500	184.500

Authorised Limit – revised under IFRS				
	2010/2011 £m	2011/2012 £m	2012/2013 £m	2013/2014 £m
Borrowing (short & long-term)	173.000	192.000	196.000	197.000
Other long term liabilities	7.500	6.500	6.500	5.500
Total	180.500	198.500	202.500	202.500

The above change reflects the inclusion of the finance lease liabilities on the balance sheet, which have been reclassified from operating leases as required under IFRS. The total value of the liability is £18.429m.

5 Prudential Indicator – Financing Costs/Net Revenue Stream

5.1 This indicator measures the total capital financing costs of capital expenditure as a proportion of the total level of income from Government grants and local Council Taxpayers. From 2011/12 Net Revenue Stream no longer includes Area Based Grant.

5.2 The indicator approved in March 2011 is compared to the revised indicator incorporating the effects of IFRS below:

Financing costs/Net revenue stream - approved March 2011				
	2010/2011	2011/2012	2012/2013	2013/2014
General Fund	5.2%	6.4%	6.9%	6.7%

Financing costs/Net revenue stream - revised under IFRS				
	2010/2011	2011/2012	2012/2013	2013/2014
General Fund	5.3%	6.3%	6.7%	6.5%