Report to:	Audit & Governance Committee	**Date of Meeting:**	28 March 2012

Subject: Members Treasury Management Training

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 summarise the main issues considered at the treasury management training undertaken on 10 February 2012; and to note the intention for a more detailed report to be presented at a future meeting on this Committee on the "direction of travel" for the Council's investment strategy.

Recommendation(s)
Audit & Governance Committee is recommended to: -

i) Note the treasury management training 10 February 2012 update; and
ii) That a report on the "direction of travel" of the Council's investment Strategy be presented to a future meeting of this Committee.

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

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

Reasons for the Recommendation:
To ensure that Audit & Governance are fully appraised on the Members training undertaken on 10 February 2012.

What will it cost and how will it be financed?

(A) Revenue Costs
No implications.

(B) Capital Costs
No implications.

Implications:

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

Legal		
Human Resources		
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 & ICT has been involved in the preparation of this report. (FD 1449/12)

The Head of Corporate Legal Services (LD 800/12) have been consulted and any comments have been incorporated into the report.

Are there any other options available for consideration?
None.

Implementation Date for the Decision
Immediately following the normal call-in period.

Contact Officer: Margaret Rawding Head of Corporate Finance & ICT
Tel: 0151 934 4082
Email: Margaret.rawding@sefton.gov.uk

Background Papers:
Treasury Management Training Day presentation.

1. Introduction

1.1 Members were invited to a training seminar on 10 February 2012, on the topic of Treasury Management, which was presented by the Council's Treasury Management advisor, Arlingclose. This was undertaken as part of the contract with the Council to provide advice and support to the Council on investment and borrowing.

1.2 The session was well attended and the feedback from Members has been positive. For the benefit of those Members who could not attend, the slides were circulated by e-mail. It was considered appropriate for the main issues raised at the meeting to be briefly summarised.

2. Summary of Key points

2.1 CIPFA definition of Treasury Management is as follows:

"It is the management of an organisation's investments and cash flow, 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."

The aim is to:

- Provide support towards achievements of business and service objectives
- Achieve best value
- Facilitate appropriate policies and practices.

2.2 Members Roles and Responsibilities

- Determining and approving treasury objectives for Sefton Council
- Determining Sefton's risk threshold
- Understanding risks and their effective control
- Considering a range of investment/borrowing options
- Approving treasury policy, framework and strategy and Prudential Indicators
- Adequacy of skills and resources
- Scrutiny / Governance and Audit
- Receiving reports, review of internal audit reports
- Monitoring treasury performance via reports above.

The key document is the Treasury Management Policy and Strategy document approved by Council in March each year.

3. Economic overview

3.1 An understanding of the economic environment is crucial to treasury management, in order that officers and Members are aware of the inherent risks of investment and borrowing appertaining at the time the transactions are made.

3.2 The key features of the UK economy at the present time, identified in the presentation were low demand, low growth, and falling inflation.

- Fall in banks share price appears to have bottomed, with RBS share price rising slightly from a low of 17.34p
- The Credit Default Swap spread (i.e a measure of the cost of insuring a deposit with a bank against bank failure) has reduced for banks such as Lloyds and RBS – less of a risk
- Interest rates will be low for longer due to low growth (potentially at 0.5% until 2015) and low consumption in the economy, as well as the falling away of inflation
- UK house prices still in negative territory
- UK unemployment on the rise which will reduce demand in the economy
- Consumer confidence still in negative territory reducing demand in the economy
- Mortgage equity withdrawal in negative territory as households are repaying mortgages early. In the past, equity withdrawal has stoked demand in the economy, but this is not being experienced currently.

4. Treasury risk management

4.1 The Key principles are identified below. They are always considered in the order shown below i.e. the security of the investment should be the paramount consideration, rather than the rate of return (yield) from that investment:

- Security – probability of getting your investment back at the end of the investment period
- Liquidity – ease of recalling the investment
- Yield – the rate of return on the investment

4.2 Factors influencing decisions as to which banking institutions any spare resources can be invested with, include the following:

- The balance sheet
- Interest rate outlook
- Credit risk
- Borrowing strategy

4.3 When assessing what institutions to invest in, the following are reviewed:

- Credit ratings from credit rating agencies
- CDS levels
- Share price
- Government support
- Press/articles

4.4 Current policy is to internally borrow i.e. run down cash balances rather than borrow. This reduces cost of borrowing and credit risk.

Many top UK banks were downgraded in February 2012. In response Arlingclose, our treasury advisors, have lowered credit criteria from A+ with investment duration of 2 years, to A- with duration of 1 year. Key UK banks on lending list are as follows:

Santander UK
Bank of Scotland
Barclays
HSBC
Lloyds TSB
Natwest
Nationwide
RBS
Standard Chartered Bank

5. Issues on borrowing raised at the seminar

5.1 The key here is the cost of borrowing when compared to the return on investments i.e. - the “cost of carry”. At the moment the cost of borrowing is in the region of 5%, whilst the investment rate earned is approximately 1%. Hence the decision has been taken to internally borrow, which describes running down cash balances rather than borrowing in order to minimise the cost of carry.

5.2 However, this requires close monitoring of future interest rate projections to ensure that interest rates do not suddenly rise. This is so that any borrowing to reduce internal borrowing is made at the lowest rate possible, so that the benefits of the reduced cost of carry are not outweighed by increased borrowing charges in the future.

6. Direction of Travel

6.1 Investments

A question was raised at the meeting regarding the direction of travel for Sefton’s future investments. This followed the identification of a number of alternative investment opportunities, mainly surrounding improved security.

Some of the options available to the Council are:

i) Bonds
A bond is an instrument that pays a coupon, or fixed rate of interest. For example a £100 bond may be purchased paying 2% interest for a fixed term. There is a risk that a bond can be sold prior to its redemption date but may incur a loss if not held to maturity. This is because if the bond is paying a rate of interest lower than the current rate of interest offered by the market, it is less attractive to potential buyers and its resale value is reduced.

ii) Gilts
Gilts also pay a coupon, but on a twice yearly basis. It is issued at face value, which is the value repaid at maturity.

iii) Treasury Bills
No interest is payable on treasury bills as they are bought at a discount and redeemed at face value.

iv) Local Authorities
Deposits can be made with other local authorities.

v) **Debt Management Office (DMO)**

A government backed agency that is extremely secure, but conversely pays very low rates of interest, currently 0.25%.

The Council has already set up relevant agreements with the relevant bodies for Treasury Bills and Bonds, should they be needed urgently in the event of a collapse in the viability of investing in the current list of high street banks. However, the strategy for the direction of travel of future investments is to be investigated in the coming months and will be the subject of a more detailed report to Audit & Governance Committee at a future meeting.

6.2 Borrowing

The Revenue Budget for 2012/13 assumes that any borrowing (i.e. to replace existing loans which are due to mature and for new capital spending) will be from the Public Works Loans Board. However, the opportunity to borrow short-term from other local authorities at lower rates of interest is being investigated. The wider strategy for borrowing will also be included in the Direction of Travel report.