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**Report to:** Audit & Governance Committee

**Date of Meeting:** 28 March 2012

**Subject:** Treasury Management 2011/12 – Third Quarter Update

**Report of:** Head of Corporate Services & ICT **Wards Affected:** All

**Is this a Key Decision?** No

**Is it included in the Forward Plan?**  
No

**Exempt/Confidential**

No

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**Purpose/Summary**

To inform Members of Treasury Management Activities undertaken in the third quarter of 2011/12.

**Recommendation(s)**

Audit & Governance Committee is requested to note the Treasury Management update for the third quarter of 2011/12.

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

	<b><u>Corporate Objective</u></b>	<b><u>Positive Impact</u></b>	<b><u>Neutral Impact</u></b>	<b><u>Negative Impact</u></b>
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 Committee are fully apprised of the treasury management activity for the third quarter of 2011/12.

**What will it cost and how will it be financed?**

**(A) Revenue Costs**

None.

**(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:

<b>Legal</b>	
<b>Human Resources</b>	
<b>Equality</b>	
1. No Equality Implication	<input checked="" type="checkbox"/>
2. Equality Implications identified and mitigated	<input type="checkbox"/>
3. Equality Implication identified and risk remains	<input type="checkbox"/>

**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 1448/12 )

Legal Services (LD 799/12) have been consulted and any comments have been incorporated into the report.

**Are there any other options available for consideration?**

No.

**Implementation Date for the Decision**

Immediately following the normal call-in period.

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**Background Papers:**

The following papers are available for inspection by contacting the above officer(s):  
Treasury Management quarter 1 2011/12 update report, and treasury management half year 2011/12 update report.

## 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 Audit & Governance Committee on the investment activity of the Authority. This report is the third of such reports for the year and presents relevant Treasury Management information for the period ending 31 December 2011.
- 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 December 2011 comprise the following:

### Overnight deposits

Institution	Deposit £m	Rate %	Maturity date	On current counterparty list?
Natwest	12.000	0.80	N/A	Yes
Goldman-Sachs MMF	4.080	0.64	N/A	Yes
Blackrock MMF	4.085	0.62	N/A	Yes
Insight MMF	4.080	0.75	N/A	Yes
<b>Total</b>	<u>24.245</u>			

### Fixed term deposits

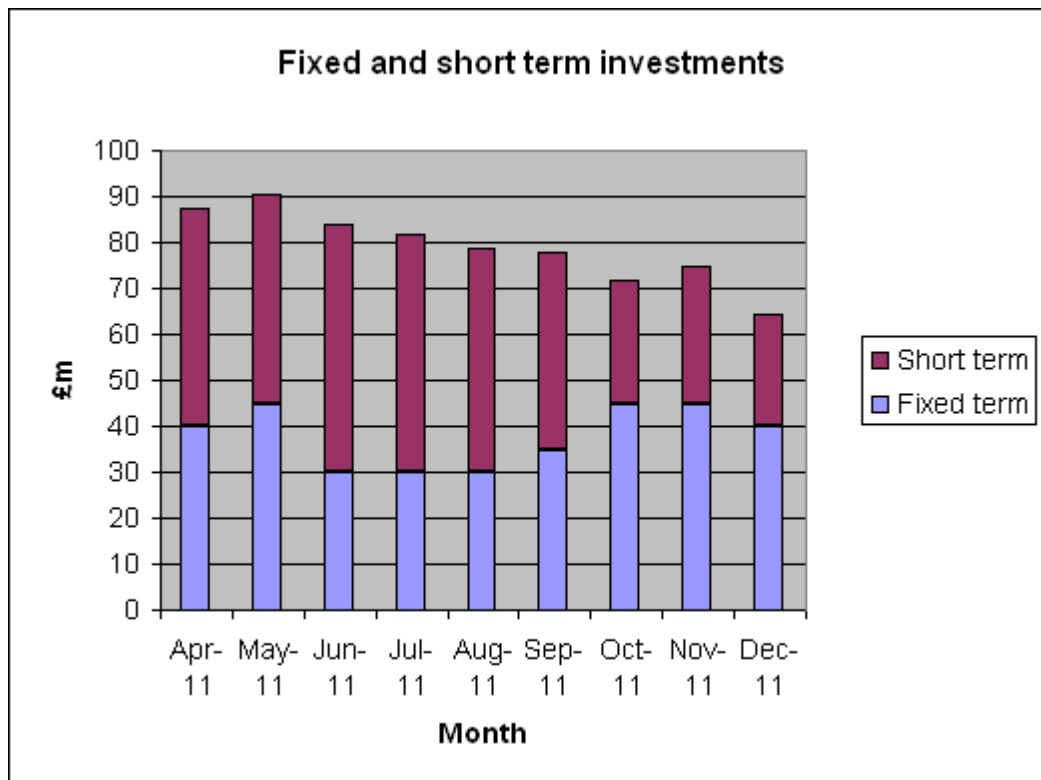
Santander	10.000	1.21	16/01/2012	Yes
Lloyds	10.000	1.14	23/03/2012	Yes
Lloyds	5.000	2.65	27/07/2012	Yes
Barclays	5.000	1.20	30/03/2012	Yes
Barclays	5.000	1.17	04/04/2012	Yes
Nationwide	5.000	1.19	04/04/2012	Yes
<b>Total</b>	<u>40.000</u>			
<b>TOTAL</b>	<u>64.245</u>			

- 2.2 All of the organisations are on the current counterparty list. However, it should be noted that the duration of investments with these institutions has since been shortened by our treasury advisors, Arlingclose. All of the above institutions now have recommended investment duration of one month maximum, except Santander which has an advised overnight duration, although Arlingclose do not advise breaking any of the above term deposits. 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 APPETITE

3.1 The Council will only invest in institutions that hold a minimum Fitch rating of F1 A- for banking institutions, or Aaa/Mr1+ for money market funds. The rating criteria was revised down to this level after advice from Arlingclose, and this reduction was agreed by Council on 24 November 2011. 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 - 9. The matrix also shows where the Council's deposits are held in terms of the matrix as at 31 December 2011.

## 4 INTEREST EARNED

4.1 The actual performance of investments against the profiled budget for the period to December 2011 is shown below:

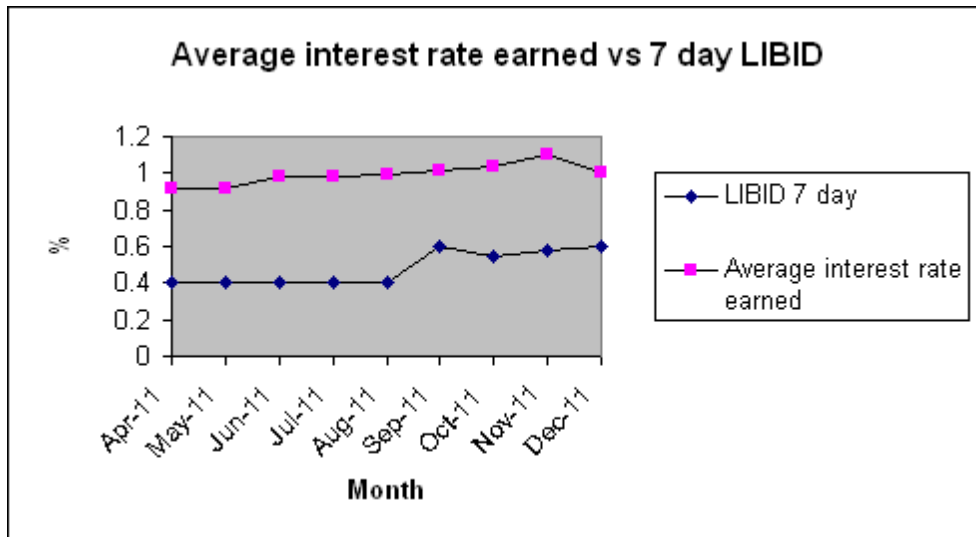
### 2011/12 Quarterly Investment Income

	Budget '000s	Actual '000s	Variance '000s
Qtr 3	570	609	39

4.2 The budgeted investment average interest rate for 2011/12 is 0.82%, which equates to £0.856m 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.

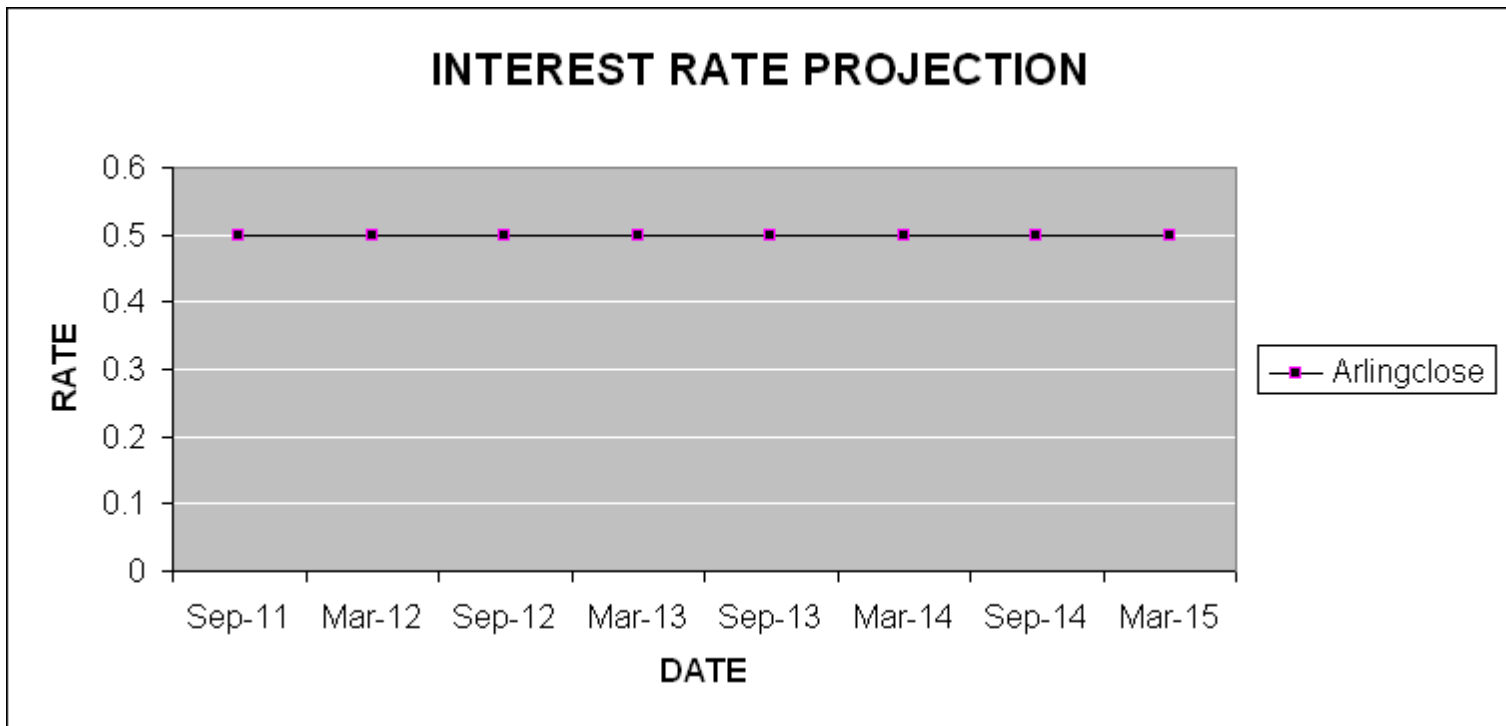
4.3 The investment income achieved during the first three quarters is £0.609 m, which equates to an average interest rate of 1.01%.

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, have revised down their base rate projection to a flat projection of 0.5% until March 2015. This is based upon the view that the economic recovery will be considerably 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 2 2011/12, which does suggest that stability has returned to the banking sector.

## 7 PRUDENTIAL INDICATOR MONITORING

7.1 Prudential indicators are an integral component of measuring how prudently a Council is acting with regard to its finances. They were introduced into all local authorities (by CIPFA) following the Local Government Act 2003. A number of measures/limits/parameters including capital financing, external debt, impact on Council Tax, and treasury management are set prior to the start of the year and are monitored on a monthly basis.

7.2 It should be noted that one of the prudential indicators has been breached. This position is consistent with that reported in the fourth quarter 2010/11.

The Interest Rate Exposure Indicators has been exceeded:

- The limits for fixed rate interest rate exposure expressed as a percentage of net outstanding debt were set to remain between 250% and 150%.
- The limits for variable rate interest rate exposure expressed as a percentage of net outstanding debt were set to remain between -50% and -150%.

The interest rate indicators are there to prevent either too much investment in fixed or variable interest rate arrangements. This is to ensure a reasonable balance between fixed rate investments where cash is locked away, and variable rate investments that earn a lower rate of interest but give more immediate access to funds.

The variance in both of these indicators is due to the higher level of overnight deposits being held than originally envisaged. As noted in paragraph 2.2, the problem of identifying institutions with which to invest has meant higher levels of investments in liquid funds, including Money Market Funds. Although these deposits do not earn as much income as fixed term deposits, they are felt to be safer in the economic conditions experienced during the year due the immediate access to funds that they allow.

- 7.3 The breaching of the above indicators has been caused by specific reasons which are not considered to be an indication of any inherent problems.



## STANDARD LENDING LIST

### UK and International Banks (including Nationwide Building Society)

RATING	Individual rating	Support rating
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#### ***United Kingdom AAA***

Santander UK	F1 / A+	B	1
Barclays	F1+ / AA-	B	1
Lloyds TSB/HBOS – nationalised	F1 / A	C	1
RBS Group – nationalised	F1 / A	C	1
Nationwide	F1 / A	B	1
HSBC	F1+ / AA	B	1

#### ***Australia AAA***

Australia & New Zealand Banking Group	F1+ / AA-	B	1
Commonwealth Bank of Australia	F1+ / AA-	A/B	1
National Australia Bank	F1+ / AA-	B	1
Westpac Banking Group	F1+ / AA-	A/B	1

#### ***Canada AAA***

Bank of Montreal	F1+ / AA-	B	1
Bank of Nova Scotia	F1+ / AA-	B	1
Canadian Imperial Bank of Commerce	F1+ / AA-	B	1
Royal Bank of Canada	F1+ / AA	A/B	1
Toronto Dominion Bank	F1+ / AA-	B	1

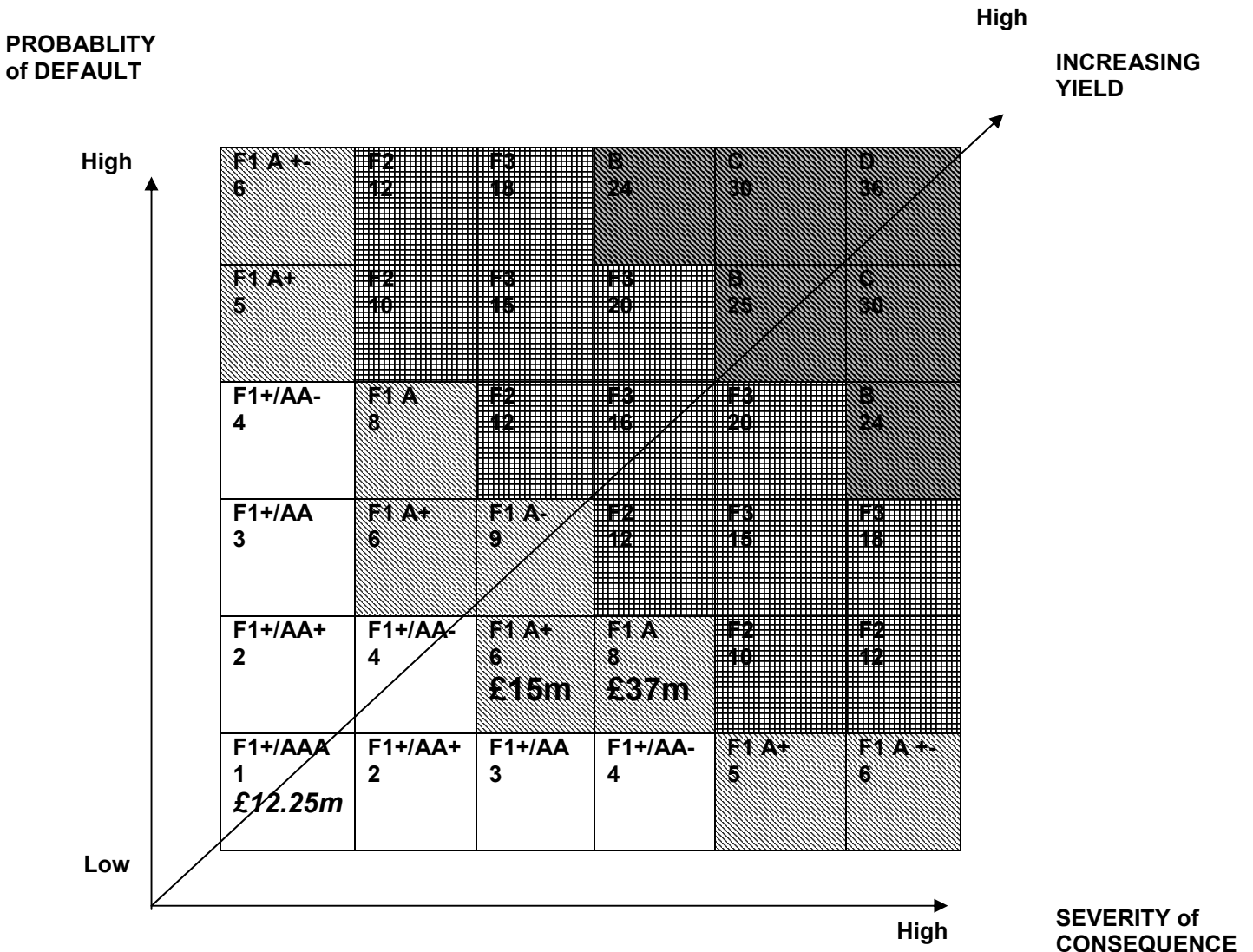
#### ***USA AAA***

JP Morgan Chase Bank	F1+ / AA-	B	
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The recent economic situation has provided challenges for the Council with regard to its investment strategy. The report presented to Cabinet on 11 June 2009 explained the difficulties in identifying banking institutions to invest in (which provided reasonable investment

returns), whilst remaining within the deposit limit of £15m. Consequently, Cabinet agreed to increase the deposit limit from £15m to £25m. As noted in 5.2 above, the Council has remained within an operational boundary of £15m. At present, it is not expected that the operational boundary will be increased to £25m.

# RISK ASSESSMENT MATRIX - FITCH RATINGS



SEFTON RISK TOLERANCE	4		INVESTED
LOW RISK	1 - 4	Investment Grade	£12.25m
LOW - MEDIUM RISK	5 - 9	Investment Grade	£52m
MEDIUM RISK	10 - 20	Investment Grade	Nil
HIGH RISK	21 - 36	Speculative Grade	Nil