

REPORT TO: Cabinet

DATE: 4 February 2010

SUBJECT: Treasury Management 2009/10 – Third Quarter Update

WARDS AFFECTED: All

REPORT OF: Lynton Green
Acting Finance and Information Services Director

CONTACT OFFICER: Jeff Kenah
0151 934 4104

EXEMPT/CONFIDENTIAL: No

PURPOSE/SUMMARY:

To inform members of Treasury Management Activities undertaken in the second quarter of 2009/10.

REASON WHY DECISION REQUIRED:

To comply with the requirements of the Council's Treasury Management Policy Statement.

RECOMMENDATION(S):

Cabinet is requested to note the Treasury Management update for the second quarter of 2009/10.

KEY DECISION: No

FORWARD PLAN: No

IMPLEMENTATION DATE: Following the expiry of the 'call-in' period for the minutes of this meeting.

ALTERNATIVE OPTIONS:

This report is put before Cabinet in order to comply with the Treasury Management Policy and Strategy document 2009/10 that was approved by Cabinet in February 2009.

IMPLICATIONS:

Budget/Policy Framework: Compliance with the Policy and Strategy Documents, incorporating appropriate reporting, will enable the Council to secure the most favourable terms for raising funds, maximise returns on investments whilst at all time minimising the level of risk to which it is exposed.

Financial: There are no additional Financial implications as a result of the report.

<u>CAPITAL EXPENDITURE</u>	2009/ 2010 £	2010/ 2011 £	2011/ 2012 £	2012/ 2013 £
Gross Increase in Capital Expenditure	---	---	---	---
Funded by:	---	---	---	---
Sefton Capital Resources	---	---	---	---
Specific Capital Resources	---	---	---	---
<u>REVENUE IMPLICATIONS</u>				
Gross Increase in Revenue Expenditure	---	---	---	---
Funded by:				
Sefton funded Resources	---	---	---	---
Funded from External Resources	---	---	---	---
Does the External Funding have an expiry date? Y/N	When?			
How will the service be funded post expiry?				

Legal: None.

Risk Assessment: Compliance with the Policy and Strategy Documents minimise the level of risk to which the Council is exposed.

Asset Management: None.

CONSULTATION UNDERTAKEN/VIEWS

Discussion with the Council's Treasury Management Advisor – Sector Treasury Services.

CORPORATE OBJECTIVE MONITORING:

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

LIST OF BACKGROUND PAPERS RELIED UPON IN THE PREPARATION OF THIS REPORT

None.

1. BACKGROUND

- 1.1 The Treasury Management Policy and Strategy document for 2009/10 (approved by Council on 26 February 2009) included a requirement for quarterly reports to be provided to Cabinet on the investment activity of the Authority. This report is the third of such documents and presents relevant Treasury Management information for the period ending 31 December 2009.
- 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 we aim to work).
- 1.3. The technical nature of this report is recognised by officers and in order to help Members a glossary of terms is attached at Annex B.

2. INVESTMENTS HELD

- 2.1 Investments held at the end of December 2009 comprise the following:

Overnight deposits

Institution	Deposit £m	Rate %	Maturity date	On current counterparty list?
Clydesdale	2.920	0.75	N/A	Yes
NatWest	13.810	0.80	N/A	Yes
Abbey National	25.000	0.80	N/A	Yes
Total	<u>41.730</u>			

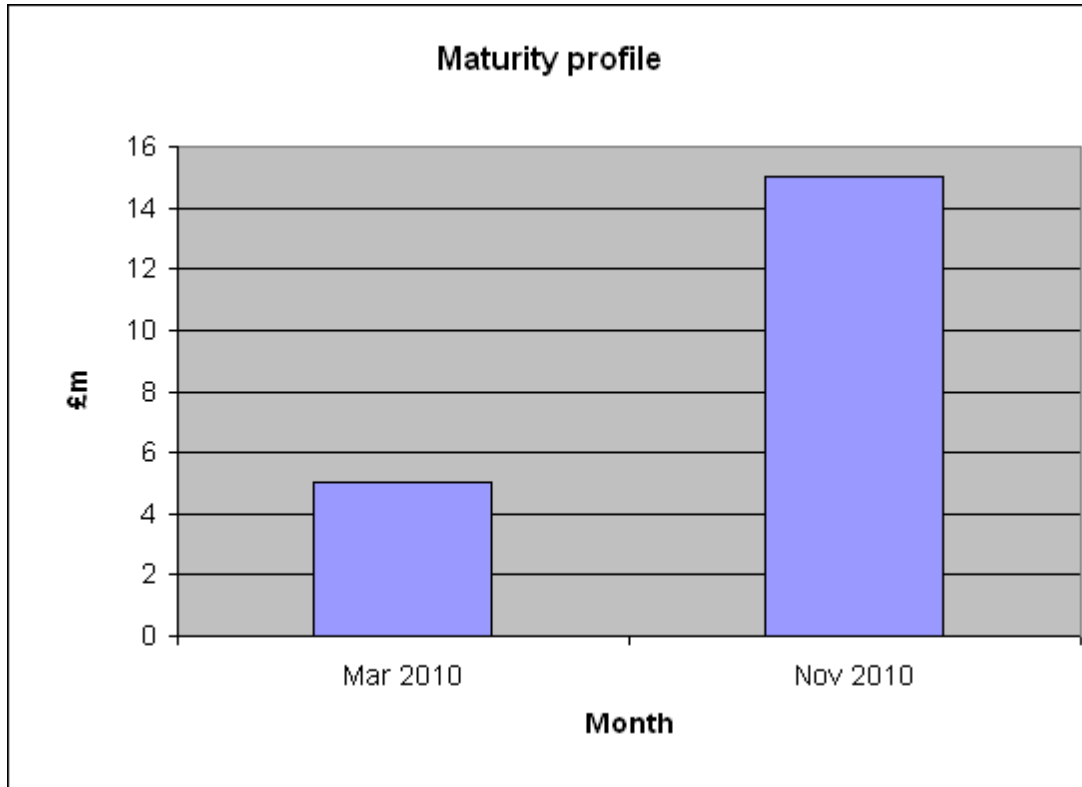
Fixed term deposits

Lloyds TSB	5.000	1.82	30/11/10	Yes
NatWest	10.000	1.32	30/11/10	Yes
Skipton	5.000	5.58	11/03/10	No
Total	<u>20.000</u>			
TOTAL	<u><u>61.730</u></u>			

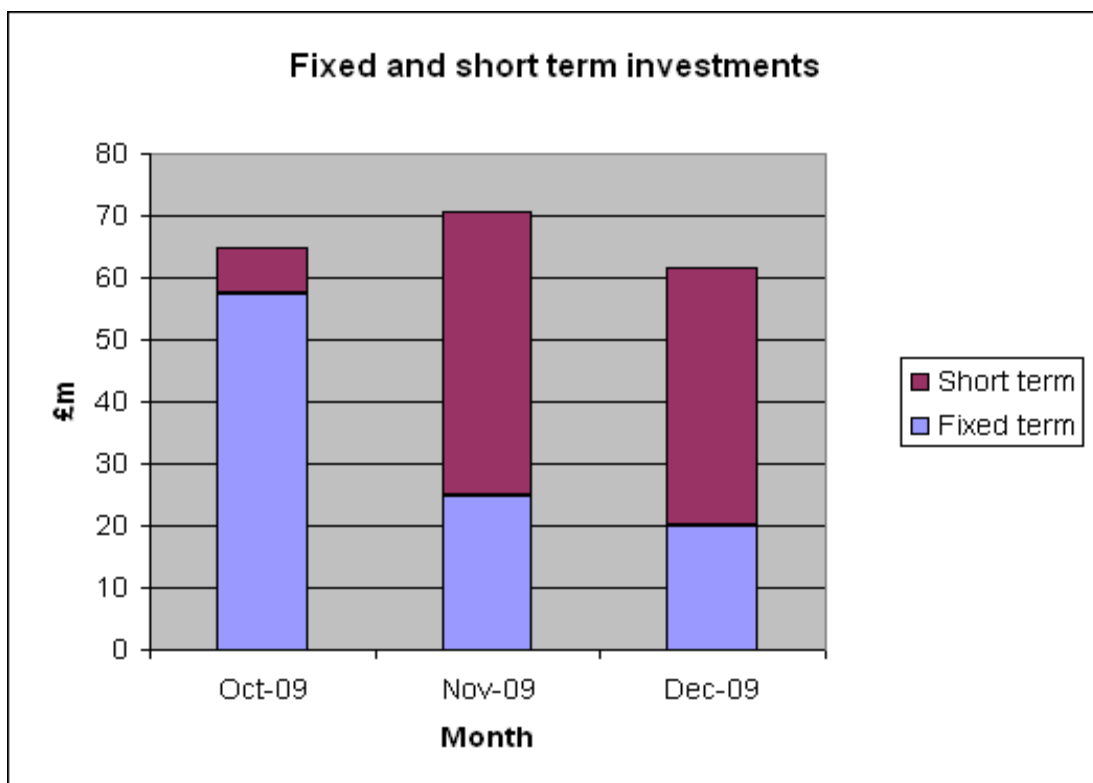
- 2.2. All of the organisations are on the current counterparty list, with the exception of Skipton (who were on the counterparty list when the investment was made). Current market conditions are improving and the range of institutions with which the Council can invest, and receive reasonable return has increased. The maximum level of investment in any one institution, or banking group, is currently £25m. Whilst the maximum should be retained, in case conditions worsen, 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.

2.3 The maturity profile of the above investments is illustrated in the bar chart below. This highlights the need for forward planning of investment opportunities prior to maturity date.



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



2.5 The current economic situation has provided problems 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. Since the approval of the new limit, the Council has remained within that boundary. At present, it is not expected that there will be any need to review this limit.

3 INTEREST EARNED

3.1 The performance of investments against budget for the first three quarters of the year is shown below:

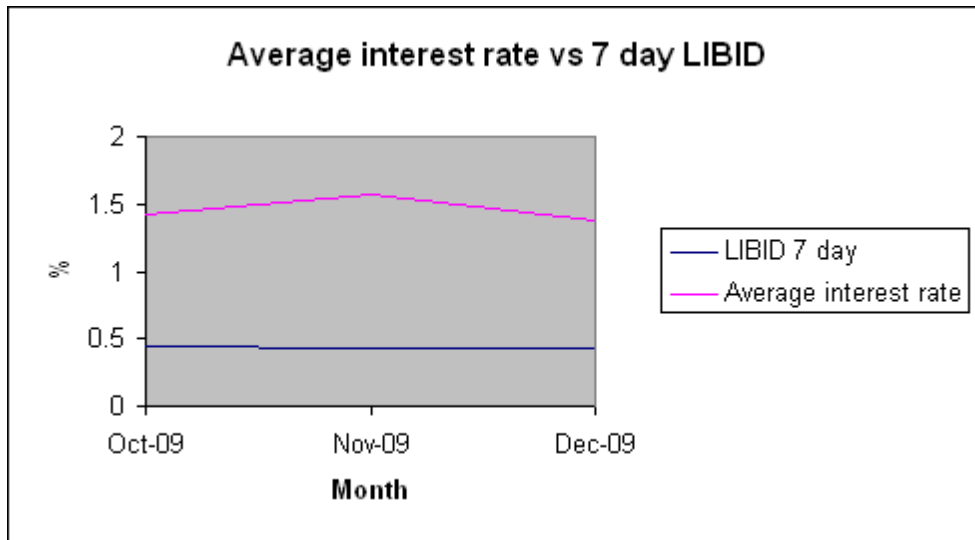
2009/10 Quarterly Investment Income

Full year budget £'000	Budget for Qtr 1 £'000	Actual for Qtr 1 £'000	Variance £'000
699	258	402	144
	Budget for Qtr 2 £'000	Actual for Qtr 2 £'000	Variance £'000
	143	324	181
	Budget for Qtr 3 £'000	Actual for Qtr 3 £'000	Variance £'000
	143	271	128

3.2 The budgeted investment average interest rate for 2009/10 is 1.15%, which equates to £0.699m income for the year. This figure assumes the income from investments already in place at 1st April 2009 and new returns based upon Bank of England's Base Rate projection as supplied by SECTOR.

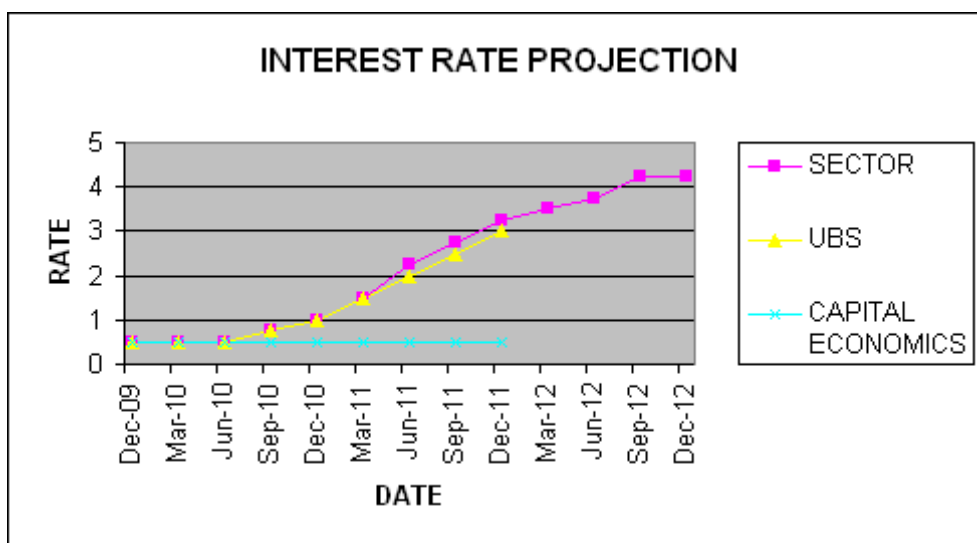
3.3 The investment income achieved during the third quarter is £0.271m, which in conjunction with qtr 1 and qtr 2 equates to an average interest rate to date of 1.8%. As noted in the qtr 2 report, the increase in investment income over budget is due to higher than anticipated cash balances, and higher than projected returns from fixed rate investments. As the existing longer term investments mature and are reinvested this will be at the lower prevailing rates, hence the year end average rate will reduce from its current position.

We have outperformed the 7 day LIBID average as follows:



4 LATEST BASE RATE FORECAST – HAS THIS BEEN REVISED?

- 4.1 SECTOR's base rate projection has been recently revised down slightly from December 2010 onwards. This is based upon the view that the economic recovery will be slower than expected.
- 4.2 SECTOR's revised base rate projection is detailed in the graph below. It compares Sector's base rate projection with those of UBS and Capital Economics.



5 COUNTERPARTY LIST

- 5.1 The current counterparty list is detailed in **Appendix A**. There is no change to the composition of the list when comparing the position at the end of Qtr 2 and Qtr 3, which does suggest that some stability is returning to the banking sector.

6 REVISED SECTOR CREDIT RATING METHODOLOGY

- 6.1 Given the recent turmoil in the banking sector, SECTOR has revised its' methodology which we use as the basis for producing our counterparty list. It now uses a simple mathematical calculation to produce a score which is then used to categorise an institution in terms of the duration of an investment, a spread of scores defining each duration period. Each duration period is classified by a colour as follows

•	Green	3 months
•	Red	6 months
•	Orange	12 months
•	Purple	24 months

- 6.2 The calculation involves taking a simple weighted average across the main three credit ratings agencies, for the key factors of long term ratings, short term ratings, individual support, and external support rating. This gives a final score attributed to the institution. Overlaid over this are rating watches, which can either improve or worsen the score, depending upon whether the rating watch is positive or negative.
- 6.3. Credit default swap data (CDS) is then taken account of as part of the process. If the CDS causes the institution to be classed as being monitored, it is dropped to the next shortest duration. If it is considered to be out of range, it will no longer be considered credit worthy.

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 the indicators set by the Council in February 2009 for Interest Rate Exposure have been exceeded:

- The limits for fixed rate interest rate exposure expressed as a percentage of net outstanding debt were set to remain between 160% and 85%.
- The limits for variable rate interest rate exposure expressed as a percentage of net outstanding debt were set to remain between 15% and -60%.

7.3 The above 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.

7.4 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 2.5, the problem of identifying institutions with which to invest has meant higher levels of investments in liquid funds. Although these deposits do not earn as much income as fixed term deposits, they are felt to be safer in current economic conditions due the immediate access to funds that they allow. Hence, this breaching of these indicators may continue over coming months, and no corrective action is considered necessary.

8 MEMBERS TRAINING

8.1. The Treasury Management Code of Practice and Cross-Sectoral Guidance Notes (Fully Revised Second Edition 2009), requires that council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

8.2. A treasury management training session for Audit and Governance Committee, and Corporate Services Committee was presented in November 2009, and delivered by SECTOR. This was timely, as the recent Cabinet report to Audit and Governance Committee highlighted the likely inclusion, in a revised Treasury Management Code of Practice by CIPFA due in the autumn, of the need for training in treasury management to be made available to relevant Council Members with responsibility in this area.

9 STAFF TRAINING

9.1. The Treasury Management Code of Practice and Cross-Sectoral Guidance Notes (Fully Revised Second Edition 2009), requires that treasury management staff will have training provided to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

- 9.2. CIPFA has recently joined forces with the Association of Corporate Treasurers in order to produce a course that delivers core knowledge, technical and practical skills. It is the only course that provides a fundamental understanding of all aspects of treasury management for public services. It has now been agreed that the Treasury Management Group Accountant should obtain this qualification.

10 RECOMMENDATION

Cabinet is asked to note the Treasury Management update for the third quarter 2009/10.

APPENDIX A

SEFTON COUNCIL

STANDARD LENDING LIST

**UK and
International
Banks
(including
Nationwide
Building Society**

**United
Kingdom
AAA**

	RATING	Negative rating watch?	Individual rating	Support rating	CDS
Abbey National (part of Santander)	F1+ / AA-	Yes	B	1	In range
Alliance & Leicester (part of Santander)	F1+ / AA-	Yes	B	1	In range
Barclays	F1+ / AA-	Yes	B	1	Monitoring
Clydesdale Bank	F1+ / AA-	Yes	C	1	N/A
HSBC	F1+ / AA	Yes	A/B	1	In range
Lloyds TSB/HBOS – nationalised	F1+ / AA-		C	1	N/A
RBS Group – nationalised	F1+ / AA-		E	1	N/A
Nationwide	F1+ / AA-	Yes	B	1	Monitoring

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

<u>UK and International Banks (including Nationwide Building Society)</u>	RATING	Negative rating watch?	Individual rating	Support rating	CDS
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
France AAA					
BNP Paribas	F1+ / AA	Yes	B	1	In range
CNCE Calyon Corporate & Investment	F1+ / AA-	Yes	C	1	Monitoring
Credit Industriel et Commercial	F1+ / AA-		B/C	1	N/A
Germany AAA					
Deutsche Bank	F1+ / AA-	Yes	B/C	1	Monitoring
Landwirtschaftliche retenbank	F1+/AAA		W/D	1	N/A
Netherlands AAA					
Bank Nederlandse Gemeenten	F1+ / AAA		A	1	N/A
Coop Centrale Raiffeisen – Boerenleenbank BA	F1+ / AA+	Yes	A	1	In range

**UK and
International
Banks
(including
Nationwide
Building Society**

**Singapore
AAA**

	RATING	Negative rating watch?	Individual rating	Support rating	CDS
DBS	F1+ / AA-	Yes	B	1	In range
Overseas Chinese Banking Corporation	F1+ / AA-	Yes	B	1	In range
United Overseas Bank	F1+ / AA-	Yes	B	1	In range

Spain AAA

Banco Bilbao Vizcaya Argentaria	F1+ / AA-	Yes	A/B	1	Monitoring
Banco Santander Central Hispano (parent of Abbey National)	F1+ / AA	Yes	A/B	1	Monitoring
Confederacion Espanola de Casas de Ahorros	F1+ / AA-	Yes	B/C	2	N/A

Sweden AAA

Nordea Bank	F1+ / AA-	Yes	B	1	N/A
Svenska Handelsbanken	F1+ / AA-	Yes	B	1	In range

**Switzerland
AAA**

**UK and
International
Banks
(including
Nationwide
Building Society**

	RATING	Negative rating watch?	Individual rating	Support rating	CDS
Credit Suisse	F1+ / AA-	Yes	B/C	1	In range

USA AAA

Bank of New York Mellon	F1+ / AA-		A/B	2	N/A
Deutsche Bank Trust Company Americas	F1+ / AA-	Yes	N/R	1	N/A
HSBC Bank USA	F1+ / AA	Yes	B/C	1	N/A
JP Morgan Chase Bank	F1+ / AA-	Yes	B	1	In range
Wachovia	F1+ / AA-	Yes	B	1	N/A
Wells Fargo	F1+ / AA-	Yes	B	1	Monitoring

GLOSSARY OF TERMS

FIXED TERM INVESTMENT	Cash on deposit that is locked away for a fixed term at a fixed rate of interest
SHORT TERM INVESTMENT	Cash on deposit that can be accessed on a daily basis, and which gives a variable rate of interest that is typically less than for fixed term investments
BANK OF ENGLAND BASE RATE	This is the rate at which the Bank of England lends to other financial institutions
LIBID	London Interbank Bid Rate is the rate at which banks borrow from each other for periods ranging from overnight to 5 years.
7 DAY LIBID	Average of LIBID over the last 7 days. This is the benchmark for investment performance
MMF	A fund that invests in a range of investments in order to spread the risk of any one institution failing, whilst giving daily access to funds invested
IMMFA	This is the International Money Market Fund Association, which is a voluntary code of practice issued in 1992 that regulates MMFs.
AAA RATING	The rating given to the most secure MMFs. It denotes superior capacity to maintain the principal invested and limits exposure to loss
MR1/V1+	This is the rating given to those MMFs that have the greatest stability in their value