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| Committee | Finance and Administration Committee | **Agenda Item** **11** |
| Date | 25 November 2010 | |
| Title | Half Year Treasury Outturn Report 2010/11 | |
| Author | Toby Cowper, Principal Accountant<br>Stephen Joyce, Assistant Chief Executive - Finance | Item for decision |

**Summary**

The Treasury Management Strategy has been underpinned by the adoption of the CIPFA Code of Practice on Treasury Management, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. 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.

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."

**Recommendations**

Members are requested to note this report.

**Background documents**

CIPFA Treasury Management Code
UDC Treasury Management Strategy 2010/11
DCLG Investment Guidance
Arlingclose advice

**Impact**

| | |
|---|---|
| Communication/Consultation | No specific implications |
| Community Safety | No specific implications |
| Equalities | No specific implications |
| Finance | Details are contained within the report. |
| Health and safety | No specific implications |
| Human Rights | No specific implications |
| Legal implications | Confirms compliance with CIPFA's Treasury Management Code of Practice |
| Ward-specific impacts | No specific implications |
| Workforce /Workplace | No specific implications |

**Debt Management**

| | Balance on 01/04/2010 £000s | Debt Maturing £000s | Debt Repaid £000s | New Borrowing £000s | Balance on 30/09/2010 £000s |
|---|---|---|---|---|---|
| Short Term Borrowing | - | - | - | - | - |
| Long Term Borrowing | - | - | - | - | - |
| Other Long Term Liabilities | 6,921 | - | 192 | - | 6,729 |
| **TOTAL BORROWING** | **6,921** | **-** | **192** | **-** | **6,729** |

The use of internal resources, in lieu of borrowing, has been the most cost effective means of financing £1.030m of capital expenditure, so far in 2010/11. This has lowered overall treasury risk by reducing both external debt and temporary investments. However, this position will not be sustainable over the medium term.

**Investment Activity**

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

| | Balance on 01/04/2010 £000s | Investments Made £000s | Investments Repaid £000s | Balance on 30/09/2010 £000s | Increase/ Decrease in Investments |
|---|---|---|---|---|---|
| Short Term Investments and Cash | 7,451 | 79,955 | (73,243) | 14,163 | 6,712 |
| Long Term Investments | 1,653 | - | - | 1,653 | - |
| **TOTAL INVESTMENTS** | **9,104** | **79,955** | **(73,243)** | **15,816** | **6,712** |

**Investment Strategy**

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2010/11. This restricted new investments to the following:

- the Debt Management Office
- Other Local Authorities (not used in practice)
- AAA-rated Stable Net Asset Value Money Market Funds (use suspended due to not being UK-domiciled)
- Deposits with UK Banks and Building Societies systemically important to the UK banking system.

Counterparty credit quality is assessed and monitored with reference to: Credit Ratings (Council's minimum long-term counterparty rating of A+ across all three rating agencies, Fitch, S&P and Moody's); Credit Default Swaps; Sovereign Support Mechanisms /potential support from a well-resourced parent institution; Share Price.

**Credit Risk**

Counterparty credit quality has been maintained through the first half of the year, as can be demonstrated by the Credit Score Analysis summarised below:

| Date | Value Weighted Average – Credit Risk Score | Value Weighted Average – Credit Rating | Time Weighted Average – Credit Risk Score | Time Weighted Average – Credit Rating |
|---|---|---|---|---|
| **31/03/2010** | 3.22 | AA | 3.72 | AA- |
| **30/06/2010** | 3.25 | AA | 4.13 | AA- |
| **30/09/2010** | 3.44 | AA | 4.12 | AA- |

*Please note that these credit scores exclude the deposit with Landsbanki*

Scoring:

- Value weighted average reflects the credit quality of investments according to the size of the deposit
- Time weighted average reflects the credit quality of investments according to the maturity of the deposit
- AAA = highest credit quality = 1
- D = lowest credit quality = 15
- Aim = A+ or higher credit rating, with a score of 5 or lower, to reflect current investment approach with main focus on security

**Counterparty Update**

Deposits with Santander UK Plc (a wholly owned subsidiary of Banco Santander) were initially suspended during Q1. Within Q2 investor nervousness following the ‘PIIGS’ sovereign crisis in Q1 abated. There was an improvement in Banco Santander’s creditworthiness indicators (share price and CDS) and therefore a prudent increase in the maturity limit for Santander UK plc to six months was warranted.

**Investment Income**

The Council’s budgeted investment income for the year has been estimated at £0.072m. The average cash balances were £14,245,749 during the period.

The UK Bank Base Rate has been maintained at 0.5% since March 2009. Short-term money market rates have remained at very low levels.

**Landsbanki Icelandic Investment Update**

Following guidance from CIPFA, issued in September 2010, the following is now known:

The Landsbanki Winding-Up Board has classed Local Authority deposits as preferential creditor status. This is subject to legal challenge by other creditors. It is expected that the courts will come to the same conclusion for Landsbanki. It is considered unlikely that there will be a settled position on priority status before Q2 2011. If preferential creditor status is awarded, 95% recovery is expected. If non-preferential creditor status is awarded, recovery is expected to be 38%.

**Compliance with Prudential Indicators**

The Appendix confirms that the Council has complied with its Prudential Indicators for 2010/11, which were set in February 2010 as part of the Council’s Treasury Management Strategy Statement

## Outlook for Q3-Q4

At the time of writing this activity report, the outlook for interest rates was as follows:

| | Dec-10 | Mar-11 | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 | Mar-13 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Official Bank Rate** | | | | | | | | | | |
| **Upside risk** | - | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| **Central case** | **0.50** | **0.50** | **0.50** | **0.75** | **1.00** | **1.25** | **1.50** | **2.00** | **2.50** | **2.75** |
| **Downside risk** | - | - | - | -0.25 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 |

The path of base rates reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates.

## Other Information

**CLG Investment Guidance –** The revised guidance came into effect on 1st April 2010. The guidance reiterated the need to focus on security and liquidity, rather than yield. It also recommended that strategies include details of assessing credit risk, reasons for borrowing in advance of need and the use of treasury advisers. The Council has incorporated the changes into its Treasury Strategy, Practices and Procedures.

## Summary

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the 1st half of 2010/11. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

# Appendix

**Capital Financing Requirement**

The Capital Financing Requirement is a notional measure of the level of indebtedness that might be expected. It is broadly equivalent to the difference between the value of the Council's assets, and the value of the capital receipts, grants and other funding applied to acquire those assets.

Estimates of the Council's cumulative maximum external borrowing requirement for 2010/11 to 2012/13 are shown in the table below:

| | 31/3/2010 Actual £000s | 31/3/2011 Estimate £000s | 31/3/2012 Estimate £000s | 31/3/2013 Estimate £000s |
|---|---|---|---|---|
| Capital Financing Requirement | 6.577 | 6.092 | 7.259 | 7.519 |
| **Less:** Existing Profile of Borrowing | - | - | - | - |
| **Less:** Other Long Term Liabilities | 6.921 | 6.436 | 5.935 | 5.424 |
| **Cumulative Maximum External Borrowing Requirement** | 0.344 | 0.344 | 1.324 | 2.095 |

The reason for the growth in the 'Cumulative Maximum External Borrowing Requirement' during years 2012 &2013 will be due to the Council's policy of using internal borrowing to fund capital expenditure.

**<u>Prudential Indicator Compliance</u>**

**(a) Authorised Limit and Operational Boundary for External Debt**

- The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Council's Affordable Borrowing Limit was set at £13.5m for 2010/11.

- The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent, but not worst case, scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2010/11 was set at £11.5m.

- The Assistant Chief Executive - Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30/09/10; borrowing and other liabilities at its peak was £6.921m.

**(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure**

- These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

| | **Limits for 2010/11 £** |
|---|---|
| **Upper Limit for Fixed Rate Exposure** | 25m |
| Compliance with Limits: | Yes |
| | |
| **Upper Limit for Variable Rate Exposure** | 25m |
| Compliance with Limits: | Yes |

**(c) Maturity Structure of Fixed Rate Borrowing**

- This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

  The Council currently has no fixed rate borrowing.

**(d) Total principal sums invested for periods longer than 364 days**

- This indicator allows the Council to manage the risk inherent in investments longer than 364 days.

- The Council's policy response since the onset of the credit crunch in 2007 was to keep investment maturities to a maximum of 12 months. No investments were made for a period greater than 364 days during this period.