REPORT TO	DATE OF MEETING
Governance Committee	14 June 2010

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SOUTH RIBBLE BOROUGH COUNCIL
forward with South Ribble

SUBJECT	PORTFOLIO	AUTHOR	ITEM
Treasury Outturn 2009/2010	Finance & Resources	Susan Guinness	9

SUMMARY AND LINK TO CORPORATE PRIORITIES

This report summarises the treasury activities of the Council for 2009/10, which have been prepared in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities.

This report should be considered together with the draft Statement of Accounts for 2009/10.

It links to the Council's corporate priorities in the delivery of excellent services

RECOMMENDATIONS

That the Governance Committee:

1. Note and comment as appropriate on the content of the report and appendices.
2. Note the treasury position and prudential indicators for 2009/10 as set out in the report.
3. Note the charging of the £989,200 impairment charge for Icelandic Investments to the 2009/10 General Fund Accounts.
4. Note the Revised Investment Strategy 2010/11, attached at **Appendix B**, which Council will be asked to approve at the meeting on 4 August 2010.

DETAILS AND REASONING

Background

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 has been adopted by the Council and this Council fully complies with its requirements.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report*)* for the year ahead, a midyear review report (as a minimum) and an annual review report of the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Governance Committee.

Treasury management in this context 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. "

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2009/10.

In March 2009 Council approved the Treasury Strategy 2009/10 to 2011/12, the Investment Strategy 2009/10 and the related Treasury Prudential Indicators. In summary, these satisfy best practice and regulatory requirements relating to treasury operations providing:

- Details of expected treasury activities of the Council for the year acting as a base position against which performance can be monitored and reported upon;
- The rules and boundaries within which the Council will operate with regard to treasury activities.

A key theme in 2009/10 has been the continued turbulence in financial markets and the approved Treasury Strategy reflects this. In particular, even greater restrictions have been placed on the financial institutions (counterparties) in which the Council has been able to make investments. Combined with this interest rates have remained at historically low levels significantly reducing overall interest earned by the Council compared to previous years.

In January 2010 Governance Committee received an update report on Treasury Management activity and performance for 2009/10 and compliance with the Treasury and Investment Strategies. It also summarised the latest position with regard to the recovery of deposits currently frozen in two Icelandic banks, Heritable and Landsbanki.

TREASURY POSITION at 31 MARCH 2010

The treasury position at the 31st March 2010 compared with the previous year was:

Note		Principal		
		31st March 2009 £m	**31st March 2010 £m**	**Movement in 2009/10 £m**
1	Fixed interest rate debt (borrowing)	3.308	0.472	2.836
	Total Debt	**3.308**	**0.472**	**2.836**
2	Short term fixed interest investments	5.2	5.3	(0.1)
3	Long term investments	3.0	0.0	3.0
	Total Investments	**8.2**	**5.3**	**2.9**

Table 1: Year end Treasury Summary 2009/10

The above table excludes investments in Heritable of £2m and Landsbanki of £3m.

The authority's approved Treasury and Investment Strategy takes full account of the continued turbulence in financial markets and has been informed by support and advice from the Council's specialist treasury advisors. The strategy:

- Places strong restrictions on the financial institutions (counterparties) in which the Council has been able to make investments.
- Recognises that the low Bank of England Base Rate has impacted on investment returns and is likely to continue to do so for some time. In these circumstances the advice from the treasury advisors is to keep the duration of investments made relatively short term in nature.

There were no changes in the Bank of England Base Rate during 2009/10. The last change took place on 5th March 2009 when the rate fell to 0.5%.

LANDSBANKI & HERITABLE

As reported to Governance Committee on 12th January 2010, efforts to secure recovery of the Council's frozen deposits in Heritable (£2m) and Landsbanki (£3m) are ongoing. We also continue to work proactively with the Local Government Association (LGA) whose specialist legal advisors are working collectively on behalf of all local authorities with deposits in Icelandic banks.

Specifically, the latest position with regard to each of the two banks can be summarised as follows:

Heritable

- To date payments totalling 35% have been made to creditors of Heritable. In our case this amounted to a repayment of £704,692;
- On 28th January 2010, the administrators issued their latest formal update to creditors. The report stressed that the base case return of 79-85% could be expected. It also stated that if conditions change over the next few years, the final recovery could be higher than the base case projections. Conversely, in more adverse circumstances, they could be lower, with a 'stressed-case' return in the region of 63%-73%;
- A further dividend payment is expected at the end of June 2010;
- We have submitted our claim to Landsbanki in relation to the guarantee of Heritable liabilities that Landsbanki, as the parent company, made in 2004. However, as an unsecured creditor in Landsbanki, it is not expected that the guarantee will realise any assets for Heritable.

Landsbanki

- Our claim has been accepted as having preferential creditor status. This position will be challenged by the unsecured creditors of Landsbanki, however the LGA's specialist legal advisors remain very confident of being able to fend off such a challenge.
- Agreement has now been reached on the terms of the deal that will compensate creditors of "old" Landsbanki (including local authorities) in relation to assets transferred to "new" Landsbanki (which was set up to ensure the maintenance of a banking system in Iceland following the collapse of the old banks).
- As anticipated, the "forecast" recovery rate continues to fluctuate as time moves on and better information becomes available. The latest valuation forecast would suggest that recoveries will now be equal to (or exceed) the previous estimate of 83p in the pound, i.e. c95%.
- The impairment charges for Landsbanki are based on an assumed recovery of 85%.

Updated CIPFA Local Authority Accounting Panel (LAAP) bulletin 82 (update 2)

Please note that after completion of this report and the Statement of Accounts the Council received updated guidance from CIPFA regarding the recovery of the Icelandic deposits. The audited Statement of accounts to be submitted to this committee in September will be compiled in accordance with the latest guidance, please refer to the Statement of Accounts 2009/10 on the agenda [Item 8].

Accounting related issues

In the 12th January report to Governance Committee members were informed of an application that had been made to the government to capitalise the net cost of anticipated impairment charges in the sum of £0.91m. The Council has since been informed that it was unsuccessful in this application closing the door on this method of finance that would have allowed the spreading of the cost over a number of years.

The current assumption in the Council's Financial Strategy is that the impairment will be deferred to 2010/11 in accordance with government legislation permitting this. However, based on the out-turn figures for 2009/10 that are separately reported on this agenda, an opportunity exists to charge this to the 2009/10 accounts. This allows the Council to account for the cost at the earliest possible point, making clear what the implications are and reflecting this in its financial statements. The net cost of impairment charges has now been updated and stands at £989,200 and the Committee is requested to approve the charging of this to the 2009/10 General Fund Accounts.

BORROWING REQUIREMENT 2009/10 (Note 1 of Table 1)

At its meeting on 29th July 2009 the Council approved the repayment of PWLB borrowings totalling £2.836m. This had two benefits, the achievement of revenue savings in reduced interest costs for debt repayment, and also a reduction in investment counterparty risk as a result of a reduction in cash investments.

At the 31st March 2010 the Council has only one outstanding loan for £472,000 from the Public Works Loans Board (PWLB) that matures in the next financial year.

Date of Advance	Value £	Interest Rate %	Repayment Date
07.07.05	472,000	4.25	29.01.11

Table 2: Loan Outstanding at 31st March 2010

INVESTMENTS (Notes 2 and 3 of Table 1)

The following table summarises investment activity during 2009/10.

Details	Average daily investment £'000	Interest earned £	Average Rate %
Long term deposits	3,000	200,700	6.69
Short term deposits	4,325	29,063	0.67
Call accounts	3,739	25,423	0.68
Debt Management Office (DMO)	938	2,649	0.28
Total – Short term	**9,002**	**57,135**	**0.63**
Retained in Council's own bank	1,494	0	0.00
TOTAL INVESTMENTS	**13,496**	**257,835**	**1.91**

Table 3: Investment Summary 2009/10

Short term Investments

Cash flow is managed on a daily basis throughout the year and surplus funds have been invested with external counterparties in accordance with the Council's treasury management policy.

The average daily investment during the year was £ 9.002m at an average interest rate of 0.63% which generated interest of £57,135 against a budget of £52,975. Of this type of investment the DMO account provides maximum security but in return it earns the lowest rate of interest at 0.28%. Cash is retained in the Council's own bank to provide liquidity, and also on those occasions when it is not economical to place it elsewhere.

Long term Investments

In 2009/10 the Council had only one long term investment details of which are shown in Table 4 below.

Investment Profile	Amount Invested £million	Rates %	Interest Earned 2009/10 £'000	Counterparty
3 year fixed term/fixed interest deposit	£3m	6.69	201	Clydesdale

Table 4: Long Term Investments Summary 2009/10

The benchmark against which the long term investment performance is judged is the 7 day London Interbank Rate (LIBID).This represents a minimum level of return on cash invested for a minimum period. The average 7 day LIBID rate for 2009/10 was 0.421%. The actual return, as shown in table 4 above, was 6.69%.

TREASURY ADVISORS

Treasury services to the Council are now provided within the Financial Shared Services Arrangement with Chorley Borough Council. During the latter part of 2009/10 the two Councils undertook a procurement exercise and appointed Sector Treasury Services as a single external advisor to both Councils for the period 1st April 2010 to 31st March 2013. This brings the benefit of improved service and economies of scale.

On 10th February 2010 Cabinet approved the Council's Investment Strategy 2010/11 providing the framework for investment decisions during the current year. This needs amending to reflect the advice of Sector Treasury Services relating in particular to the financial institutions and criteria that will govern all investment decisions. A copy of the updated Investment Strategy 2010/11 is attached at **Appendix B** and members are asked to approve this.

PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES

The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. These are set at the start of the year and provide targets for expected activity and establish boundaries and limits upon that activity. **Appendix A** summarises performance during the year against each of these indicators for 2009/10.

Certain of the indicators at Appendix A provide either an overview or a limit on treasury activity, and these are shown below.

	31st March 2010 Actual £'000	**31st March 2010 Estimate £'000**
Net borrowing position	(7,754)	(8,690)
Capital Financing Requirement (CFR)	5,065	5,037

The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow or lease for a capital purpose, and this is a gauge for the Council's debt position shown above. In order to ensure that over the medium term borrowing net of investments will only be for a capital purpose net borrowing should not, except in the short term, exceed the CFR for 2009/10 plus the expected changes to the CFR over 2010/11 and 2011/12. The table above shows that the Council has complied with this requirement for the financial year ended March 2010.

	2009/10
Original Indicator – Authorised Limit	£6m
Original Indicator – Operational Boundary	£4.8m
Maximum gross borrowing position during the year	£5.2m
Minimum gross borrowing position during the year	£1.9m *

* *this reflects the PWLB borrowings which were repaid to the Council in July 2009*.

The authorised limit is the “affordable borrowing limit” required by section 3 of the Local Government Act 2003. The table demonstrates that during 2009/10 the Council has maintained gross borrowing within this authorised limit.

The operational boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or above the boundary are acceptable subject to the authorise limit not being breached.

WIDER IMPLICATIONS

In the preparation of this report, consideration has been given to the impact of its proposals in all the areas listed below, and the table shows any implications in respect of each of these. The risk assessment which has been carried out forms part of the background papers to the report.

FINANCIAL	As set out in the report and its appendices.
LEGAL	Compliance with various Regulations and statutory Codes of Practice
RISK	The Council’s treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities.
OTHER (see below)	

Asset Management	*Corporate Plans and Policies*	*Crime and Disorder*	*Efficiency Savings/Value for Money*
Equality, Diversity and Community Cohesion	*Freedom of Information/ Data Protection*	*Health and Safety*	*Health Inequalities*
Human Rights Act 1998	*Implementing Electronic Government*	*Staffing, Training and Development*	*Sustainability*

BACKGROUND DOCUMENTS Financial Strategy/Budget and Council Tax 2010/11

Treasury Management in the Public Services: Code of Practice
CIPFA Prudential Code for Capital Finance in Local Authorities
Treasury Management Strategy for 2009/10 Report to Council 04/03/2009
Treasury Management Progress Report to Governance Committee 12/01/2010

Appendix A

Treasury Management Prudential Indicators

Estimated and Actual Treasury Position and Prudential Indicators

		2009/10 Actual £'000	2009/10 Estimate £'000
1	**Capital Expenditure**	2,270	4,191
2	**Capital financing Requirement**	5,065	5,037
3	**Authorised Limit for external debt (against maximum position)**	5,025	6,000
4	**Operational Boundary for external debt**	2,472	4,800
5	**Ratio of financing costs to net revenue stream**	8.98%	2.87%
6	**Incremental impact of capital investment decisions on the Band D Council Tax**	n/a	-£0.32
7	**Upper limits on fixed interest rates based on net debt**	100%	100%
8	**Upper limits on variable interest rates based on net debt**	Nil	25%
9	**Maturity structure of fixed interest rate borrowing (against maximum position)**		
	Under 12 months	100%	20%
	12 months to 2 years	-	20%
	2 years to 5 years	-	50%
	5 years to 10 years	-	75%
	10 years and above	-	100%
10	**Maximum principal funds invested for periods longer than 364 days (against maximum position)**	£m 3	£m 6

In addition to the above the Council is required as a prudential indicator to:

- Adopt the CIPFA Code of Practice
- Ensure that over the medium term borrowing will only be for a capital purpose (i.e. net external borrowing is less than the CFR)

The compliance with these indicators is highlighted in the body of the report.

Appendix B

INVESTMENT STRATEGY 2010/11

1. Introduction

1.1 Under the Power in Section (15) (1) of the Local Government Act 2003 the CLG has issued Guidance on Local Government Investments in March 2004, and is currently consulting on a new version updated in light of the investigations into the Icelandic banking crisis. Each Authority is recommended to produce an annual strategy that sets out its policies to manage investments, giving priority to security and liquidity. This strategy follows the updated guidance.

1.2 The major element in the guidance is that authorities should distinguish between lower risk (specified investments), and other investments (non-specified). These terms are explained in more detail below.

1.3 The specific issues to be addressed in the Investment Strategy are as follows. This includes new matters proposed in the draft; these are marked (UPD) below:

- How “high” credit quality is to be determined
- How credit ratings are to be monitored
- To what extent risk assessment is based upon credit ratings and what other sources of information on credit risk are used (UPD)
- The procedures for determining which non specified investments might prudently be used
- Which categories of non-specified investments the Council may use
- The upper limits for the amounts which may be held in each category of non-specified investment and the overall total.
- The procedures to determine the maximum periods for which funds may be committed.
- What process is adopted for reviewing and addressing the needs of members and treasury management staff for training in investment management (UPD).
- The Authority’s policies on investing money borrowed in advance of spending needs. The statement should identify measures to minimise such investments including limits on (a) amounts borrowed and (b) periods between borrowing and expenditure (UPD)

2. South Ribble Strategy 2010/11

Objectives

2.1The Council’s investment priorities are:

- The security of capital and
- The liquidity of its investments.

2.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

2.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The Council will restrict borrowing to a maximum of that envisaged to be required in the following eighteen months.

Use of Specified and Non-Specified Investments

2.4 Specified investments are those made

- with high “quality” institutions, the UK Government or a local authority,
- for periods of less than one year and
- denominated in sterling.

Other investments are “non-specified”. These could include investments in gilts, bond issues by other sovereign bodies and those issued by multilateral development banks, commercial paper, and any deposits for a period exceeding one year.

In 2010 the Council will restrict its investments to those which are specified.

Counterparty selection criteria

2.5 A specified investment is defined as one with a high quality institution. In determining which institutions are “high quality” the Council will rely on the credit rating service of Sector, its current treasury advisor. This utilises the following information:

- Credit ratings of the three main agencies.
- Credit watches and outlooks, also provided by the agencies.
- Credit default swap spreads – the “spread” is the charge levied by one institution against another for providing what is in essence insurance against the risk that the loan might be subject to certain events (including default). It is an indicator of the market’s perception of the credit standing of an institution.
- The sovereign rating of the country in which an institution is based.
- Whether an institution is nationalised or partly nationalized.

It results in institutions being colour coded. The colour coding is used to determine the maximum amount and duration of any investment in those institutions.

2.6 The Council may use AAA rated Money Market Funds.

2.7 The Council may lend to the UK Government (which includes the Debt Management Office).

2.8 The Council may lend to other Local Authorities.

The current list of counterparties falling within this criteria is attached.

Monitoring of Credit Ratings

2.9 Credit Ratings are monitored daily and email alerts are received if a rating changes or an institution is put on ratings watch.

Time and money Limits

2.10 Currently the maximum amounts that can be placed with a financial institution are £3m (HSBC), and £2m (all other institutions). These limits apply to the total of all deposits (in call accounts, in deposit accounts or on short term deposit). In addition, to allow some flexibility, in discussion with the cabinet Member for Finance & Resources, in exceptional circumstances, the £2m limit may be increased to £3m for short term deposits, provided that this is no more than 15% of total investments.

2.11 Currently the maximum period for investment is 3 months. In light of the high credit rating criteria adopted by the Council **it is recommended that this be increased to a maximum of 12 months**

Member Training

2.16 The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date, requires a suitable training process for members and officers. The Council will address this by arranging training through its treasury management consultants.

Current list of Financial Institutions and Investment Criteria

Invest-ment Group	Category	Institutions	Sector Colour Code	Sovereign rating	Max period	Limit per Institution
Tier 1	Sovereign or Sovereign "type"	DMADF Local Authority UK Govt backed Money market funds			6 months 1 year n/a instant access	No limit (£3m) (£3m)
Tier 2	UK Nationalised Institutions	None (N Rock deposits no longer guaranteed)				
Tier 3	Institutions guaranteed by other governments	None (Irish Banks removed from list)				
Tier 4A (nb2)	UK Partly nationalised institutions; with access to funds under the Credit Guarantee Scheme	RBS group (inc Nat West) Lloyds Group (inc HBoS & Lloyds)	Blue Blue	AAA stable from all 3 agencies	1 Year (3 months) 1 Year	(£2m) Per group Nb1
Tier 4B (nb2)	Independent UK Institutions with access to the Credit Guarantee Scheme	HSBC Santander Barclays Nationwide	Orange Red Green	AAA stable from all 3 agencies	1 Year 6 months 3 months 3 months	£2m £2m £2m £2m Nb1
Tier 5	Money Market Funds		Aaa/MR1+		instant access	£3m
Tier 6	Deposit/Call Accounts with Council's Bank	HSBC Deposit a/c Santander, Bank of Scotland			instant access Call accounts with instant access	£3m

Note - Under the Credit Guarantee Scheme certain "eligible institutions" have access to liquidity from HM Treasury if required.

Note - The Sector colour coding suggests the following time limits on investments Green (3 months), Orange (6 months), Red (1 year), Purple (2 years), Blue (1 year)

The proposals in the Investment Strategy will not increase the list of institutions. If approved it will increase the amounts which can be placed in the call accounts (Tier 6).

Nb1 To allow some flexibility, in discussion with the Cabinet Member for Finance & Resources, in exceptional circumstances, this cash limit may be increased to £3m for short term deposits, provided that this is no more than 15% of total investments.

Nb2 HM Treasury Credit Guarantee Scheme gives access to liquidity, if required, by Eligible Institutions.