REPORT TO	DATE OF MEETING
Cabinet Governance Committee	3 November 2010 1 December 2010

Report template revised June 2008

SOUTH RIBBLE BOROUGH COUNCIL
forward with South Ribble

SUBJECT	PORTFOLIO	AUTHOR	ITEM
Treasury Management Activity Half year to 30 September 2010	Finance & Resources	G Whitehead	

1 Summary and link to corporate objectives

The report advises that, on average, the Council had surplus cash balances of £12.3m on which it received a return of 1.45% during the first half of 2010/11. Investments continue to be made only for short periods and with highly rated institutions. The report also includes the commentary of the Council's treasury advisor on the economic background.

It confirms compliance with the prudential indicators specified in the Treasury Strategy

2 Recommendations

Governance Committee is asked

- To note the report AND
- to recommend to Council that the limit on term deposits with the partly nationalised banking groups Lloyds/HBoS and RBS be increased to £3m (paragraph 7 refers)

3 Details and reasoning

The Code of Practice for Treasury Management specifies that Councils should review their treasury strategy and activity half yearly. A report on the first quarter has already been made to Cabinet and Governance Committees. This report rolls the information forward to present cumulative information for the half year.

4 Economic background

A detailed review of economic events in the first half year is attached at appendix B. The headlines were as follows:

- Sovereign debt crises which resulted in EU and IMF rescue packages
- Strong growth in the first quarter in the UK, EU and USA which is expected to reduce over the remainder of the year.;
- In the UK austerity plans implemented to correct the public sector deficit over the next five years. Economic growth is likely to have peaked, and since July there have been small increases in unemployment
- Inflation has been stubbornly above target, but the Bank of England (BoE) is confident it will be below target over the next two years;
- The threat to the UK's AAA rating has eased since the budget on 22 June 2010..

5 Treasury Advisor's (Sector) view for the next second half of 2010/11

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, and there are a range of views in the market. Sector has adopted a moderate view.

There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the speed of economic recovery in the US and EU
- the degree to which government austerity programmes will dampen economic growth
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- changes in the consumer savings ratio
- the potential for more quantitative easing, and the timing of this in both the UK and US
- the speed of recovery of banks' profitability and balance sheet imbalances
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy

The overall balance of risks is weighted to the downside and there is some risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

6 Sector's interest rate forecast

	As at 30 Sept %	Dec 2010 %	Mar 2011 %	June 2011 %	Sep 2011 %	Mar 2012 %	June 2012 %	Dec 2012 %	Mar 2013 %
Base rate	0.50	0.50	0.50	0.50	0.75	1.25	1.50	2.50	3.00
5 yr PWLB	1.88	2.20	2.20	2.40	2.60	3.00	3.30	3.80	4.10
10 yr PWLB	3.14	3.30	3.30	3.40	3.70	4.00	4.30	4.60	4.60
25 yr PWLB	4.04	4.20	4.30	4.30	4.40	4.70	4.70	5.00	5.00
50 yr PWLB	4.10	4.20	4.30	4.30	4.40	4.70	4.70	5.00	5.00

7 **Review of the Treasury Strategy**:

The Treasury Management and Investment Strategies for 2010/11 were approved by Council on 10 February 2010. They defined the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council also aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity.

The strategies fixed limits on the amounts that could be invested with individual institutions, and the length of investment, based on each institutions credit ratings, credit alerts, and credit default spreads. These limits are detailed in appendix C.

In practice, when the Council's balances are high, it can be difficult to keep within these limits. In consultation with the Cabinet Member for Finance & Resources, officers are therefore in the process of selecting a money market fund. Their use is approved by the current investment criteria (see appendix C) but hitherto they have not been used because in terms of yield they will probably only pay around base rate (0.5%). These funds are actively managed, use a variety of instruments and, by being pooled, they allow a spread of risk. The AAA rating means that the fund must have a maximum weighted average duration of 60 days, and invest only in highly rated securities. The cash is available “on call” to the authority. They are therefore extremely liquid and secure. Progress will be reported to the next meeting.

The present strategy also imposes a basic limit on investments in any institution of £2m. This can be increased to £3m if the additional deposit is placed in a call account. Exceptionally deposits can be increased to £3m (for instance if the Council’s balances are sufficiently high to make this essential). Administratively this is complicated and the following amended limits are proposed:

- The limit on term deposits with the partly nationalised banks (Lloyds/HBoS and RBS groups) be increased from £2m to £3m.
- The limit on Call accounts and the Council’s own bank HSBC be kept at £3m,
- The limit on the Money Market fund, when opened, be retained at £3m
- The limit for a local authority be kept at £3m
- No limit shall apply to deposits with the Debt management Office (DMADF)
- The above limits are not cumulative. The maximum that can be placed with any bank, group or local authority (in the call account and on a term deposit) shall not exceed £3m

8 Treasury activity

Investment activity in the half year is summarised in the following table:

	Average Daily investment. £’000	Earnings £	Average Rate %
DMO	235	295	0.25
Clydesdale term deposit	1,443	48,388	6.69
Other fixed term deposits	2,415	16,758	1.38
Call accounts	6,569	23,894	0.73
Council’s own bank	1,644	0	0
	12,306	89,335	1.45

The above table excludes the Icelandic loans. These are commented on below.

A full list of investments held as at 30 September 2010 is shown at Appendix A.

The interest earning benchmark is the LIBID 7 day rate. This was 0.42% during the first half year. As illustrated, the authority has outperformed the benchmark.

The following table compares the budgets for interest payable and receivable against the latest projection.

	Budget for year £’000	Actual for half year £’000	Forecast for year £’000
Interest payable	17	5	17
Interest earned			
On current investments	(173)	(89)	(132)
On Icelandic loans	(220)	(105)	(207)
Net cost/(surplus)	(376)	(189)	(320)

The forecast net surplus of £320k, of interest earned over that payable, is greater by £14k than that predicted at the end of the first quarter. This is because cash balances have increased as the year has progressed, and this situation is expected to continue over the next quarter. The anticipated out-turn is still less than the original budgeted surplus of £376k, largely because interest rates have been below the budgeted level.

9 Icelandic Loans

There have been no developments in respect of Landsbanki. It is still several months off the court hearing which will decide whether Council investments retain priority status.

A further £83,353 in repayment of the Heritable loan was received on 18 October. This brings total repayments to £918k, 45.6% of the claim of £2.014m. The latest guidance continues to assume that 85% will ultimately be recovered.

10 Borrowing:

PWLB rates have been extremely attractive over the last few months and serious consideration was given as to whether this was the time to take borrowings in anticipation of future needs. The conclusion was that the Council's cash resources would be adequate for the next few years, and there would be a carrying cost (i.e. that the interest cost of the loan would exceed the return on its investment). No borrowings were therefore made.

The situation has changed significantly following the announcement in the Comprehensive Spending Review that PWLB rates would rise with immediate effect by approximately 1%. This has effectively ruled out additional borrowing in the immediate future.

11 Treasury management training

The joint members training seminar was held on October 5th 2010 and representatives of both the Cabinet and Governance Committee were in attendance.

12 Prudential Indicators:

It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits" which were reported in the approved Treasury Management Statement.

The following table shows the approved limits and the current position:

Prudential Indicator	2010/11 Indicator £'000	Actual 30/9/10 £'000
Capital Financing Requirement (CFR)	7,889	6,074
Gross borrowing	472	472
Investments (note 2)	(£5.8m) at year end	(18,809)
Net borrowing/(investments)	(5,800)	(15,071)
Authorised limit for external debt (note 3)	7,889	1,895
Operational boundary for external debt (note 3)	7,500	1,895
Limit of fixed interest rates (based on net debt)	9,900	9,900
Limit of variable interest rates (based on net debt)	100% on inv cash	100%
Principal sums invested for periods exceeding 364 days	0	0
Maturity structure of borrowing limits		
Under 12 months	0 to 50%	See note 1
12 months to 2 years	0 to 50%	
2 years to 5 years	0 to 100%	
5 years to 10 years	0 to 100%	
10 years and above	0 to 100%	

Note 1 - The limits on the maturity structure will only be applicable if the Council were to take further borrowings to finance capital expenditure associated with the changes to the waste collection/recycling service.

Note 2 - The prudential indicators assumed investments, inclusive of Icelandic loans, falling from £8.4m at 1/4/10 to £5.8m at 1/4/11. The actual value at 30 September 2010 exceeds this at £18.8m, but this is expected to fall significantly by year end.

Note 3 – The figure of £1.895m consists of external borrowings of £0.472m plus “on balance sheet” financing arrangements of £1.423m (i.e. finance leases and deferred purchase).

12 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	The financial implications are outlined within the report.
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
Quarter 1 monitoring report – Governance Committee 22 September 2010.
Treasury Management in the Public Services: Code of Practice
CIPFA Prudential Code for Capital Finance in Local Authorities

Appendix A

Investments held as at 30 September 2010:

Counterparty	Amount £'000	Rate %	Period	Maturity	Sector recommended time limit
Call Account – Bank of Scotland	500	0.75	Overnight		12 months
Call Account – Santander	500	0.75	Overnight		6 months
Call Account – Royal Bank of Scotland	1,900	0.70	Overnight		12 months
Call Account – Lancashire CC	2,700	0.70	Overnight		12 months
Call Account – HSBC	100	0.30	Overnight		12 months
Debt Management Office	0	0.25			Not applicable
Term Deposit – Nationwide	1,000	0.65	3 months	19/10/10	3 months
Term Deposit – Nationwide	1,000	0.65	3 months	15/12/10	3 months
Term Deposit – Barclays	1,000	0.90	6 months	19/01/11	6 months
Term Deposit – Santander	2,000	1.32	6 months	07/03/11	6 months
Term Deposit – Bank of Scotland	2,000	1.84	1 year	08/06/11	12 months
HSBC current account	2,843	0	Overnight		12 months
	15,543				

Sector's time limit recommendation is based on the credit rating of an institution adjusted for any outlook warnings, and also takes account of the "spread" on credit default swap transactions (effectively the rate charged by the market to underwrite borrowings and thus a good and early indicator of market perception of risk).

Icelandic loans outstanding at 30/9/10 have a book value of £3.266m

Appendix B

Economic Background

Global economy

The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May.

Growth in the US, UK and the Euro zone in quarter 2 of 2010 was particularly driven by strong growth in the construction sector catching up from inclement weather earlier in the year and is unlikely to be repeated; general expectations are for much more subdued figures for the remainder of 2010. Market expectations for all three sectors of the economy is that these have all peaked and are pointing downwards, though not necessarily in to negative territory.

UK economy

Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The inevitable result of fiscal contraction will be major job losses during this period, in particular in public sector services. This will have a knock on effect on consumer and business confidence. House prices have started a negative trend during the summer and mortgage approvals are at very weak levels and also declining.

Economic Growth – GDP growth is likely to have peaked at 1.2% in quarter 2 of 2010.

Unemployment – the trend of falling unemployment (on the benefit claimant count) has now been replaced since July with small increases which are likely to be the start of a new trend of rising unemployment.

Inflation and Bank Rate – CPI has remained high so far during 2010. It peaked at 3.7% in April and has fallen back to 3.1% in August. RPI remains high, at 4.7% in August. Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years. The last quarterly Inflation Report in August showed a significant undershoot after the end of 2011.

The Bank of England finished its programme of quantitative easing with a total of £200bn in November 2009 (although there is currently some increase in expectations that there might be a second round of quantitative easing).

Sector's view is that there is unlikely to be any increase in Bank Rate until the middle of 2011.

AAA rating – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, then the AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22 June, Sterling has strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors now view UK government gilts as being a safe haven from EU government debt. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and PWLB rates.

Appendix C

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 (nb 1 and 2)	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	12 months 12 months	£2m per group £2m per group
Tier 4B (nb 1 and 2)	Independent UK Institutions with access to the Credit Guarantee Scheme	HSBC Santander UK, Barclays, Nationwide	Orange Move between red and green green	AAA stable from all 3 agencies	12 months 6-3 months 3 months	£2m £2m £2m
Tier 5	Money Market Funds	None currently used	AAA only		instant access	£3m
Tier 6	Deposit/Call Account Call accounts	HSBC Santander group HBOS group RBS group			Instant access Call accounts with instant access	£3m £3m less value of term deposits

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.
Nb 2 HM Treasury Credit Guarantee Scheme gives access to liquidity, if required, by Eligible Institutions.

The Sector colour coding suggests time limits of Green (3 months), Orange (6 months), red (1 year), purple (2 yrs) and blue (1 year)
The Credit Guarantee Scheme gives access to eligible institutions to liquidity from HM Treasury