Southend-on-Sea Borough Council

Agenda
Item No.

Report of Corporate Director of Support Services
to

Cabinet

on
15 March 2011

Report prepared by:
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Quarter Three Treasury Management Report – 2010/11
Economic and Environmental Scrutiny – Executive Councillor: Councillor AJ Moring
A Part 1 Public Agenda Item

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1. Purpose of Report

1.1 The Quarter Three Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for both quarter three and the period from April to December 2010.

2. Recommendations

That Cabinet notes that:

2.1 Treasury management activities were carried out in accordance with the CIPFA (The Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Sector during the period from April to December 2010.

2.2 The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.

2.3 An average of £43.5m of investments were managed in-house. These earned £0.34m of interest during this nine month period at an average rate of 1.03%. This is 0.6% over the average 7 day LIBID and 0.53% over bank base rate.

2.4 An average of £47.1m of investments were managed by fund managers. These earned £0.32m of interest during this nine month period at an average rate of 0.91%. This is 0.48% over the average 7 day LIBID and 0.41% over bank base rate.

2.5 The level of borrowing from the Public Works Loan Board (PWLB) (excluding debt relating to services transferred from Essex County Council on 1st April 1998) increased from £155.3m to £195.3m during the period from April to December 2010.

3. Background

3.1 This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this code. The code recommends that local authorities submit reports regularly as part of its Governance arrangements.

3.2 There have also been two publications that are significant for local authority treasury management: the Audit Commission Study on "Risk and Return – English local authorities and the Icelandic banks" and CIPFA's Treasury Management Panel Bulletin "Treasury Management in Local Authorities – Post Icelandic Banks Collapse". These two publications provide advice to local authorities on current good practice in treasury management practices in the light of the Icelandic Banks collapse and the prevailing financial market conditions.

3.3 Current guidance is that authorities should report formally at least twice a year and preferably quarterly. The Treasury Management Policy Statement for 2010/11 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation. This is the third quarter report for the financial year 2010/11.

3.4 Appendix 1 shows the cumulative treasury management position at the end of quarter three of 2010/11

3.5 Appendix 2 shows the treasury management performance specifically for quarter three of 2010/11.

4 National Context

4.1 The UK economy has been in recession and has a large fiscal deficit, but has recently shown signs of economic recovery. Following the hung parliament result from the General Election in May a coalition Government was formed and an emergency June Budget was announced. In the months that followed this, a series of measures to cut the fiscal deficit have been announced.

4.2 There are concerns that the measures taken to cut the fiscal deficit may de-stabilise the economic recovery and that we may be heading into a 'double-dip' recession. Inflation has been higher than the Bank of England's target of 2% for many months and is likely to increase further given the recent rise in VAT and higher oil and commodity prices. Despite these fears the Bank of England has not increased the base rate from its historically low rate of 0.5% as they are also concerned that this may stall any tentative economic recovery.

4.3 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. The ratings agencies had downgraded the credit ratings of many financial institutions and these have not yet been reversed, so we still have a much reduced list of counterparties (i.e. people we can invest with) that still meet our prudent investment criteria.

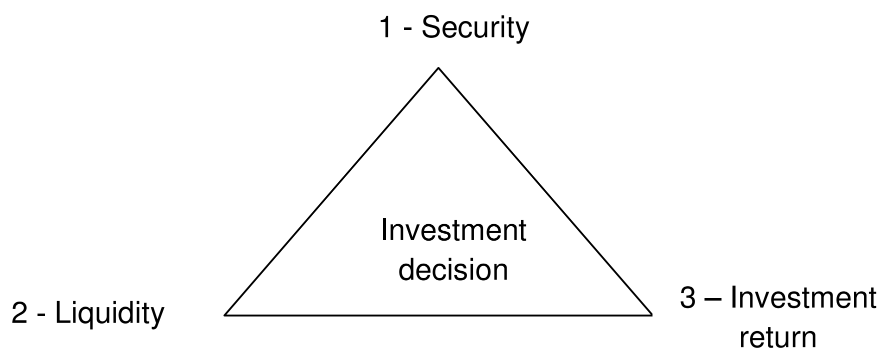
4.4 However, with a restricted list of counterparties and the increased focus on counterparty risk following the Icelandic Banks collapse, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.

4.5 Low interest rates have prevailed throughout the period from April to December 2010 and this led to low investment income earnings from all our investments.

5 Investments – quarter three (October to December)

5.1 A prime objective of our investment activities is the security of the principal sums invested. To ensure this security before a deposit is made an organisation is tested against a matrix of credit criteria. During the period from October to December 2010 investment deposits were limited to those who met the criteria in this matrix when the deposit was placed.

5.2 Other investment objectives are to maintain liquidity (i.e. adequate cash resources to allow the council to operate) and to optimise the investment income generated by surplus cash in a way that is consistent with a prudent level of risk. Investment decisions are made with reference to these objectives, with security and liquidity being placed ahead of the investment return. This is shown in the diagram below:



Security:

5.3 To maintain the security of sums invested, we seek to lower counterparty risk by investing in financial institutions with good credit ratings, across a range of sectors and countries. The risk of loss of monies invested is minimised through the annual investment strategy.

5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter three; 12% of our in-house investments were placed with financial institutions with a long term credit rating of AAA. The rest were placed with financial institutions with a long term rating of A+ and AA-, but these were all institutions participating in the UK Government-supported recapitalisation scheme.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 88% being placed directly with banks and building societies and 12% placed with a range of counterparties via money market funds.

5.6 Pie chart 3 of Appendix 1 shows the range of countries where the parent company of the financial institution with which we have monies invested is registered. For money market funds there are various counterparties spread across many countries. The cumulative balance of funds held with any one institution was kept within agreed limits.

Liquidity:

5.7 At the end of quarter three 54% of our in-house monies were available on an instant access basis. There was a small differential between short term deposit rates and instant access rates and it gives flexibility by keeping monies available to take advantage of better rates as they become available. The maturity profile of our investments at the end of quarter three is shown in pie chart 4 of Appendix 1.

Investment return:

5.8 During the quarter the Council continued to use two external fund managers to manage monies on our behalf. These are Aviva Fund Management and Scottish Widows Investment Partnership Limited. An average balance of £47m was invested in these funds throughout the quarter earning an average rate of 0.70%.

5.9 The Council had an average of £37.8m of investments managed in-house over the period from October to December 2010, and these earned an average interest rate of 0.79%.

5.10 Of the in-house managed funds, an average of £14m was held in fixed term deposits that earned an average interest rate of 0.96%. This included various investments in place during this quarter at a fixed rate of over 1%, an analysis is shown in Table 1 of Appendix 2.

5.11 In addition to the above, use was also made of call accounts during the year, because they provide instant access or 7-day notice to funds while paying base rate or better. An average of £15.2m was held in these accounts and earned an average return of 0.75% over the quarter.

5.12 An average of £8.6m was also held in money market funds earning an average of 0.59% over the quarter. These work in the same way as a deposit account but the money in the overall fund is invested in a number of counterparties, therefore spreading the counterparty risk.

5.13 In accordance with the Treasury Management Strategy the performance during the quarter is compared to the average 7 day LIBID (London Interbank Bid Rate). Overall, performance on our investments was higher than the average 7 day LIBID and higher than the average base rate for the quarter.
The bank base rate remained at 0.50% throughout the period from October to December 2010, and the 7 day LIBID rate fluctuated between 0.43% and 0.45%. Performance is shown in Graph 1 of Appendix 2.

6 Investments – quarter three cumulative position

6.1 During the period from April to December 2010 the Council complied with all of the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of the Code of Practice for Treasury Management means its treasury practices demonstrate a low risk approach.

6.2 The Council is aware of the risks of passive management of the treasury portfolio and has proactively managed levels of debt and investments over the nine month period with the support of its treasury management advisers.

6.3 The table below summarises the Council's investment position for the period from April to December 2010:

Table 1: Investment position

	April to December 2010	
	Average Balance (£000s)	Average Rate (%)
Fixed interest investments managed in-house	17,866	1.57*
Variable rate investments managed in-house	25,639	0.66*
Investments managed by fund managers	47,148	0.91
Total investments	90,653	0.97

* The average rate of interest earned on the investments managed in-house was 1.03%.

6.4 The majority of the cash balances held by the Council are required to meet short term cash flow requirements and therefore throughout the nine month period monies were placed 21 times for periods of one year or less. The table below shows the most used counterparties overall and the countries in which they are based. All deals are in sterling despite the country the counterparties are based in.

Table 2: Counterparties used

Counterparty	Country	No. of Deals	Value of Deals (£m)
Blackrock (formally Barclays Global Investors)	Money Market Fund (Various Counterparties)	6	36
Goldman Sachs	Money Market Fund (Various Counterparties)	9	58.5
Lloyds	UK (Government Backed)	4	14.5
Nationwide Building Society	UK (Government Backed)	2	10

6.5 In addition to the above, use was also made of call accounts during the year, because they provide instant access or 7-day notice to funds while paying bank base rate or better. This meant that funds were available for cash flow movements to avoid having to pay higher rates to borrow from the market. During the period from April to December 2010 an average of £13.6m was held in such accounts.

7. Borrowing – quarter three

7.1 The Capital Financing Requirement (CFR) is the Council's theoretical need to borrow but the Section 151 Officer can manage the Council's actual borrowing position by either:

1 - Borrowing to the CFR;
2 - Choosing to use temporary cash flow funds instead of borrowing (internal borrowing) or;
3 - Borrowing for future increases in the CFR (borrowing in advance of need)

The Council began the quarter in scenario 3.

7.2 This, together with the Council's cash flow, the prevailing Public Works Loans Board (PWLB) interest rates and the future requirements of the capital programme, were taken into account when deciding the amount and timing of any loans. No debt restructuring was carried out during the quarter.

7.3 During quarter three £10m of new PWLB loans were taken out for a period of between three and four years. Also a PWLB loan of £10m was taken out to re-finance a PWLB loan initially taken out in 2009/10 for a period of one year.

7.4 The level of PWLB borrowing (excluding debt relating to services transferred from Essex County Council on 1st April 1998) therefore increased during quarter three from £185.3m to £195.3m. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

7.5 The level of PWLB borrowing at £195.3m is in line with the financing requirements of the capital programme and the revenue costs of this borrowing are fully accounted for in the revenue budget. The current level of borrowing is also in line with the Council's prudential indicators and is prudent, affordable and sustainable.

7.6 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events, with the 50 year PWLB rates moving between 4.04% and 5.43%.

7.7 During quarter three, £15m of new short term borrowings were taken out with Local Authorities for cash flow purposes and £3m was repaid. See Table 2 of Appendix 2.

8. Borrowing – quarter three cumulative position

8.1 The Council's outstanding borrowing as at 31st December 2010 was:

- Southend-on-Sea Borough Council £195.274m
- ECC transferred debt £16.548m

Repayments in the first 9 months of 2010/2011 were:

- Southend-on-Sea Borough Council £10m
- ECC transferred debt £0.7m

8.2 Outstanding debt relating to services transferred from Essex County Council (ECC) on 1st April 1998, remains under the management of ECC. Southend Borough Council reimburses the debt costs incurred by the County.

8.3 The interest payments, excluding transferred debt, during the period from April to December 2010 were £4.088m, compared to the original budget of £4.887m for the same period. It was anticipated that £50m of new loans would be taken out during 2010/11 but so far £40m of new loans were taken out at a lower interest rate. (Also a loan of £10m was taken out to re-finance a loan initially taken out in 2009/10 for a period of one year.) No loans were repaid during the period. Therefore the actual interest payments were lower than budgeted.

8.4 The table below summarises the PWLB borrowing activities over the period from April to December 2010:

Quarter	Borrowing at beginning of quarter (£m)	New borrowing (£m)	Re-financing (£m)	Borrowing repaid (£m)	Borrowing at end of quarter (£m)
April to June 2010	155.3	20	0	0	175.3
July to September 2010	175.3	10	0	0	185.3
October to December 2010	185.3	10	10	(10)	195.3

9 Compliance with Treasury Management Strategy – quarter three

9.1 The Council's investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector (revised in November 2009), which has been implemented in the Annual Investment Strategy approved by the Council on 25th February 2010. The investment activity during the quarter conformed to the approved strategy, and the cash flow was successfully managed to maintain liquidity. See Table 3 of Appendix 2.

10. Other Options

10.1 There are many options available for the operation of the Treasury Management function, with varying degrees of risk associated with them. The Treasury Management Policy aims to effectively control risk to within a prudent level, whilst providing optimum performance consistent with that level of risk.

11. Reasons for Recommendations

11.1 The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2010/11 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

12. Corporate Implications

12.1 Contribution to Council's Vision & Critical Priorities

Treasury Management practices in accordance with statutory requirements, together with compliance with the prudential indicators acknowledge how effective treasury management provides support towards the achievement of the Council's Vision and Critical Priorities.

12.2 Financial Implications

The financial implications of Treasury Management are dealt with throughout this report.

12.3 Legal Implications

This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this code.

12.4 People Implications

None.

12.5 Property Implications

None.

12.6 Consultation

The key Treasury Management decisions are taken in consultation with our Treasury Management advisers.

12.7 Equalities Impact Assessment

None.

12.8 Risk Assessment

The Treasury Management Policy acknowledges that the successful identification, monitoring and management of risk are fundamental to the effectiveness of its activities.

12.9 Value for Money

Treasury Management activities include the pursuit of optimum performance consistent with effective control of the risks associated with those activities.

12.10 Community Safety Implications

None.

12.11 Environmental Impact

None.

13. Background Papers

Background papers are kept in Accountancy Services.

14. Appendices

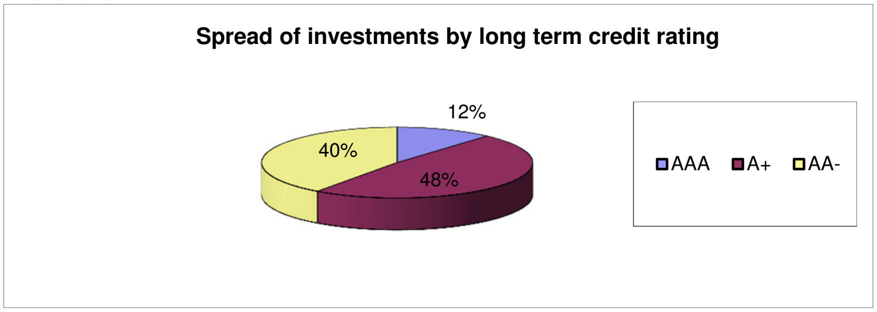
Appendix 1 – Treasury Management Position as at the end of Quarter Three - 2010/11

Appendix 2 – Treasury Management Performance for Quarter Three – 2010/11

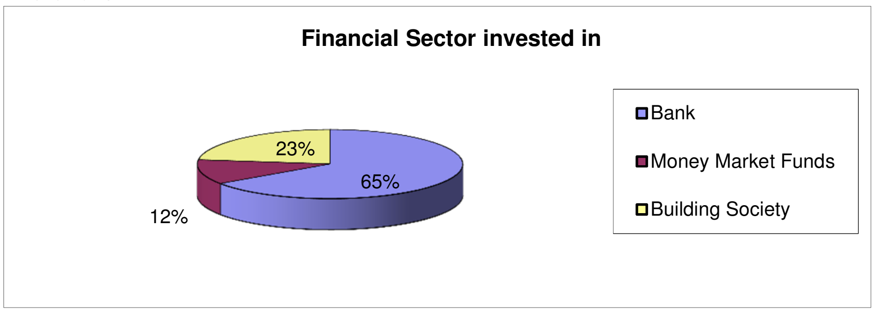
TREASURY MANAGEMENT POSITION AS AT END OF QUARTER THREE - 2010/11

INVESTMENTS - SECURITY AND LIQUIDITY

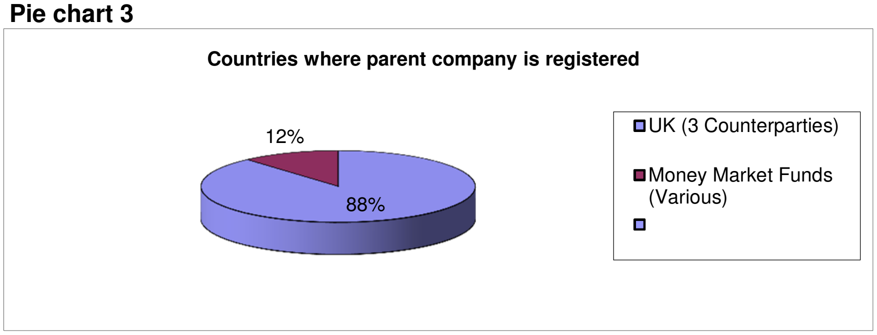
Pie chart 1



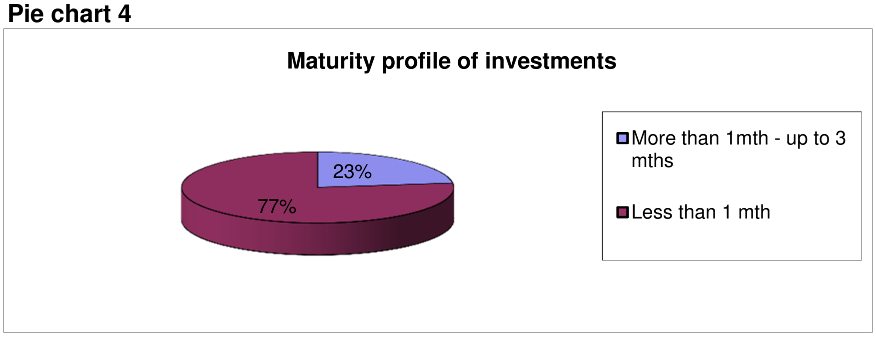
Pie chart 2



Pie chart 3



Pie chart 4



TREASURY MANAGEMENT PERFORMANCE FOR QUARTER THREE - 2010/11

INVESTMENTS - RETURN

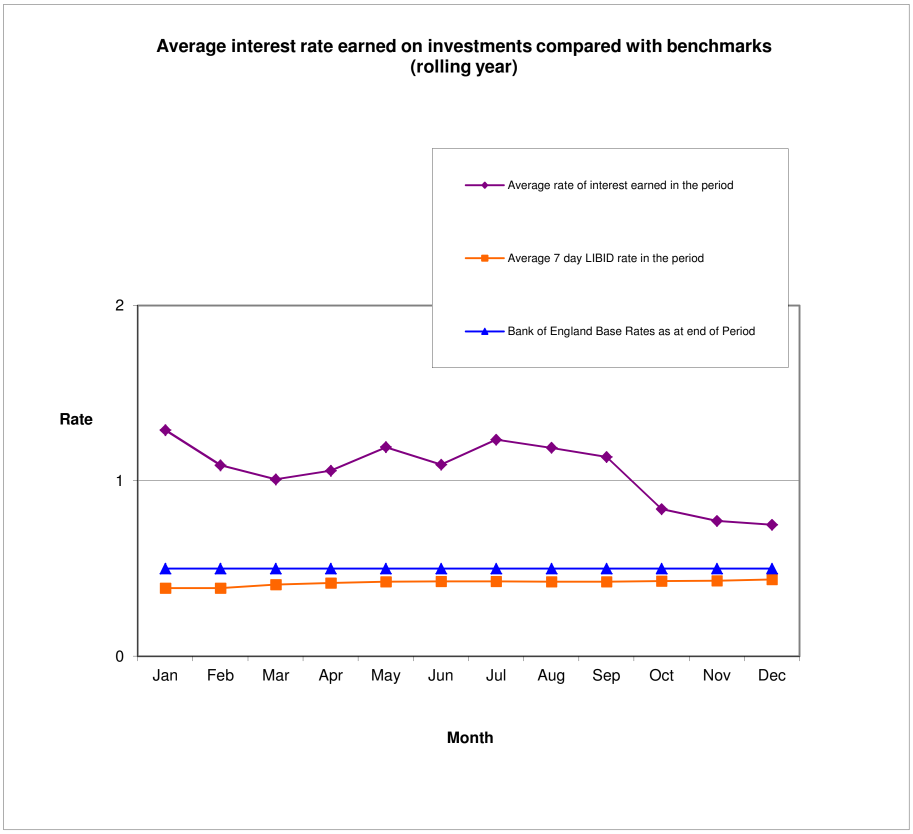


Table 1

FIXED INVESTMENTS	Rate	Amount (£)	From	To
New this Qtr				
Lloyds TSB	1.12%	5,000,000	04/10/2010	04/01/2011
Nationwide Building Society	0.70%	5,000,000	03/12/2010	31/03/2011
Repaid This Quarter				
Lloyds TSB	1.35%	5,000,000	06/05/2010	08/11/2010
Lloyds TSB	1.30%	5,000,000	11/05/2010	11/11/2010
Nationwide Building Society	0.94%	5,000,000	04/06/2010	03/12/2010

TREASURY MANAGEMENT PERFORMANCE FOR QUARTER THREE - 2010/11

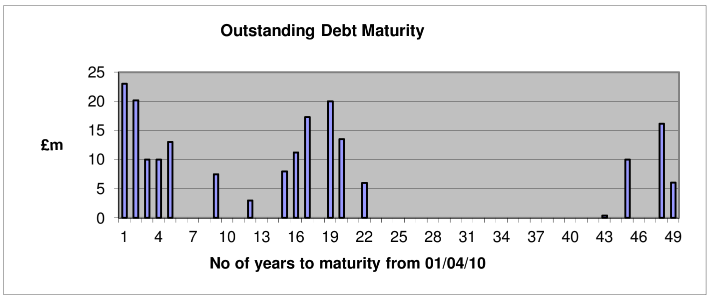
BORROWING

Table 2

SHORT TERM BORROWING	Rate	Amount (£)	From	To
New & repaid in this Quarter				
Shropshire County Council	0.40%	5,000,000	15/10/2010	03/12/2010
Leicestershire City Council	0.35%	5,000,000	15/10/2010	19/11/2010
Wakefield Metropolitan Police	0.40%	5,000,000	15/10/2010	03/12/2010
Repaid this Quarter				
North Lincolnshire Council	0.30%	3,000,000	20/09/2010	20/10/2010

Graph 2

LONG TERM BORROWING - PWLB



New this quarter	Rate	Amount (£)	From	To
	2.95%	10,000,000	16/12/2010	29/12/2014
	1.59%	10,000,000	28/10/2010	28/10/2013
Repaid this quarter				
	0.91%	10,000,000	29/10/2009	29/10/2010
			Lowest	Highest
Range of 50 year PWLB new loan rates this quarter			4.04%	5.43%

COMPLIANCE WITH TREASURY MANAGEMENT STRATEGY

Table 3

All transactions properly authorised	✓
All transactions in accordance with approved policy	✓
All transactions with approved counterparties	✓
Cash flow successfully managed to maintain liquidity	✓
Any recommended changes to procedures:	None required