Southend-on-Sea Borough Council

Agenda Item No.

Report of Corporate Director of Support Services
to
Cabinet
on
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Report prepared by:
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Mid-Year Treasury Management Report – 2012/13
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 Mid-Year Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for both quarter two and the period from April to September 2012.

2. Recommendations

2.1 That the Mid-Year Treasury Management Report for 2012/13 be approved.

That the following is noted:

2.2 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 September 2012.

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

2.4 An average of £40.6m of investments were managed in-house. These earned £0.14m of interest during this six month period at an average rate of 0.69%. This is 0.26% over the average 7 day LIBID (London Interbank Bid Rate) and 0.19% over bank base rate.

2.5 An average of £24.2m of investments were managed by fund managers. These earned £0.22m of interest during this six month period at an average rate of 1.79%. This is 1.36% over the average 7 day LIBID and 1.29% over bank base rate.

2.6 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) decreased from £241.8m to £231.8m (HRA: £82.3m, GF: £149.5m) during the period from April to September 2012.

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 Current guidance is that authorities should report formally at least twice a year and preferably quarterly. The Treasury Management Policy Statement for 2012/13 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation. This is the second quarter report for the financial year 2012/13.

3.3 Appendix 1 shows the treasury management position at the end of quarter two of 2012/13.

3.4 Appendix 2 shows the treasury management performance specifically for quarter two of 2012/13.

4. National Context

4.1 The UK economy has been in recession for a while now and the Government has taken steps to reduce the country's large fiscal deficit. The economy did show signs of tentative economic recovery, but then fell back into recession, which was the 'double-dip' feared by economists.

4.2 The Bank of England has kept the bank base rate at its historic low of 0.5% and continued with its policy of quantative easing, keeping the level at £375 billion.

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 further downgraded the credit ratings of many financial institutions, so we have a further reduced list of counterparties (i.e. people we can invest with) that still meet our prudent investment criteria.

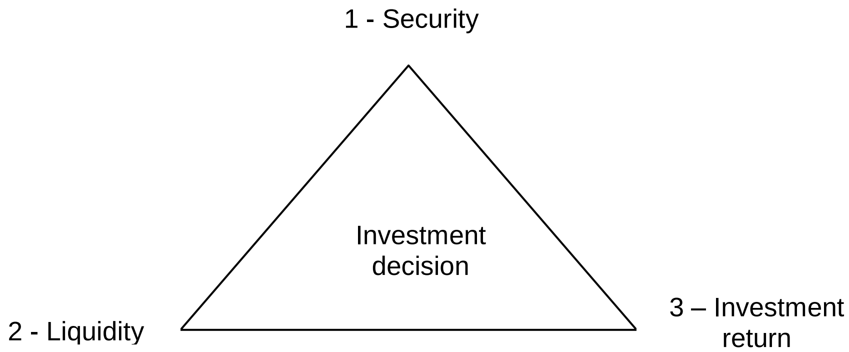
4.4 However, with a restricted list of counterparties and the increased focus on counterparty risk following the Icelandic Banks collapse, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.

4.5 Low interest rates prevailed throughout the period from April to September 2012 and this led to low investment income earnings from all our investments.

5. Investments – quarter two (July to September)

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 July to September 2012 investment deposits were limited to those who met the criteria in the Annual Investment Strategy 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 principal of all monies is minimised through the Annual Investment Strategy.

5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter one 22% of our in-house investments were placed with financial institutions with a long term rating of AAA and 78% with a rating of A.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 78% being placed directly with banks and 22% 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 Our in-house monies were available on an instant access basis at the end of quarter two, except for £10m which has been placed in a 100 day notice account. The maturity profile of our investments is shown in pie chart 4 of Appendix 1.

Investment return:

5.8 During the quarter the Council continued to use the fund manager Scottish Widows Investment Partnership Limited to manage monies on our behalf. An average of £24.3m was invested in this fund throughout the quarter earning an average rate of 1.90%.

5.9 The Council had an average of £41.7m of investments managed in-house over the period from July to September, and these earned an average interest rate of 0.70%. Of the in-house managed funds:

- an average of £10m was held in a 100 day notice account that earned an average interest rate of 0.87%.

- use was also made of call accounts during the year, because they provide instant access to funds while paying base rate or better. An average of £16.1m was held in these accounts and earned an average return of 0.76% over the quarter.

- an average of £15.6m was held in money market funds earning an average of 0.53% 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.

5.10 In accordance with the Treasury Management Strategy the performance during the quarter is compared to the average 7 day LIBID. Overall, performance on all types of investment was higher than the average 7 day LIBID and higher than the average base rate for the quarter. The bank base rate stayed at 0.50% throughout the period from July to September 2012, whilst the average 7 day LIBID rate for the quarter was 0.42%. Performance is shown in Graph 1 of Appendix 2.

6. Investments – quarter two cumulative position

6.1 During the period from April to September 2012 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 six month period with the support of its treasury management advisers.

6.3 The table on the next page summarises the Council's investment position for the period from April to September 2012:

Table 1: Investment position

	April to September 2012	
	Average Balance (£000s)	Average Rate (%)
Variable rate investments managed in-house	40,633	0.69
Investments managed by external fund managers	24,226	1.79
Total investments	**64,859**	**1.10**

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 six month period monies were placed 14 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)
Barclays Bank	UK	1	10
Goldman Sachs	Money Market Fund (Various Counterparties)	7	46
BlackRock	Money Market Fund (Various Counterparties)	6	36

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 unexpected cash flow events to avoid having to pay higher rates to borrow from the market. During the period from April to September 2012 an average of £16.5m was held in such accounts.

7. Borrowing – quarter two

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)

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 new PWLB loans were taken out during the quarter and none were repaid on maturity.

7.3 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) remained at £231.8m during the quarter. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

7.4 The level of PWLB borrowing at £231.8m 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.

7.5 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events, with the 50 year PWLB rates peaking at 4.32% and falling to a low of 4.01%.

7.6 During quarter two, there was no short term borrowing activity undertaken for cash flow purposes.

8. Borrowing – quarter two cumulative position

8.1 The Council's outstanding borrowing as at 30th September 2012 was:

- Southend-on-Sea Borough Council £231.816m
- ECC transferred debt £15.730m

Repayments in the first 6 months of 2012/2013 were:

- Southend-on-Sea Borough Council £10m
- ECC transferred debt £ 0m

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 for PWLB and excluding transferred debt, during the period from April to September 2012 were £5.138m, compared to the original budget of £5.095m for the same period. These interest payments include those relating to the loans taken out relating to the HRA self-financing. Excluding these loans, the interest payments are lower than budgeted. It was anticipated that £41m of new loans would be taken out during 2012/13 (£13m of this was to re-finance loans that matured in April and October), but due to the reasons set out in paragraph 7.2, no new loans were taken during the period.

8.4 The table below summarises the PWLB borrowing activities over the period from April to September 2012:

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 2012	241.8	0	0	(10)	231.8
July to September 2012	231.8	0	0	(0)	231.8*

* General Fund £149.5m; Housing Revenue Account £82.3m.

9. Compliance with Treasury Management Strategy – quarter two

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 1st March 2012. The cash flow was successfully managed to maintain liquidity.

9.2 As an update to that reported in quarter one, on 6th September Cabinet approved a revised Annual Investment Strategy which added the Council's bank back to its counterparty list, even if it fails the investment criteria of the credit rating matrix.

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 2012/13 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 and Diversity Implications

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

None.

14. Appendices

Appendix 1 – Treasury Management Position as at the end of Quarter Two - 2012/13

Appendix 2 – Treasury Management Performance for Quarter Two – 2012/13