Chorley Council

Report of	Meeting	Date
Director of Transformation (Introduced by the Executive Member for Transformation	Executive Cabinet Audit Committee	11 November 2010 20 January 2011

TREASURY MANAGEMENT ACTIVITY 2010/11

PURPOSE OF REPORT

1. To report to members on
   - Treasury Management activity and performance, up to 30 September 2010
   - Compliance with the Treasury and Investment Strategies.

RECOMMENDATION

2. (1) Cabinet is asked to note the report AND

   (2) Recommend to the Council that the investment limits be increased as follows:
   - Term deposits with the part nationalised banks be limited to £3m
   - Term deposits with other institutions be limited to £2m
   - Deposits in call accounts and Money Market Funds be limited to £3m
   - Deposits with local authorities be limited to £3m
   - No deposit with any one institution shall exceed £3m, and all deposits shall continue to be only with UK institutions

EXECUTIVE SUMMARY OF REPORT

3. The report advises that, on average, the Council had cash balances of £8.2m on which it received a return of 0.66% during the first half of 2010/11. It advises that an additional Money Market Fund is to be opened for the investment of surplus funds and it proposes an increase in the limit on the amount that can be invested with any counterparty. It also includes the commentary of the Council's treasury advisor on the economic background.

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

REASONS FOR RECOMMENDATION(S)
(If the recommendations are accepted)

5. To enable better placement of the Council's cash balances consistent with the overriding priority of security and liquidity, and the need to optimise returns.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

6. None

CORPORATE PRIORITIES

7. This report relates to the following Strategic Objectives:

Put Chorley at the heart of regional economic development in the Central Lancashire sub-region		Develop local solutions to climate change.	
Improving equality of opportunity and life chances		Develop the Character and feel of Chorley as a good place to live	
Involving people in their communities		Ensure Chorley Borough Council is a performing organization	X

INTRODUCTION

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

ECONOMIC BACKGROUND:

9 The headline economic news in the half year was as follows:

- There were sovereign debt crises, centred on Greece but affecting other countries, which resulted in EU and IMF rescue packages
- There was 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 were 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 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.

Sector's view for the next second half of 2010/11

10 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

11 The overall balance of risks is weighted to the downside but the risk of a double dip recession and deleveraging is currently viewed as being small.

12 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.

Sector's interest rate forecast

13 The Council's Treasury Advisers, Sector, have provided the following 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

Review of the Treasury Strategy

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

- Security of Capital
- Liquidity

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

16 Since the start of the financial year Lancashire County Council has equipped itself with resources to invest in a wider range of financial instruments, and it has offered district councils the option to deposit money for pooled investment. This facility has been used, subject to the £2m limit applying to accounts repayable on call.

17 Review of Investment Limits

Our current treasury strategy limits are detailed in Appendix B. They provide that term deposits with any institution should not exceed £1m, but allow, in "exceptional circumstances", for this to be increased to £2m. Deposits "on call" are restricted to £2m.

These limits mean that it is frequently necessary to place large sums at the DMO, this only pays 0.25%.

To give a wider range of counterparties and improve the return, officers are in the process of opening an additional Money Market Fund. This will give an additional "on call" facility.

It is also proposed that the investment limits should be revised as follows

- The limit on term deposits with the part nationalised banks (Lloyds/HBoS and RBS groups) be increased to £3m.
- The limit on deposits with Local Authorities be increased to £3m
- The limit on term deposits with other institutions be increased to £2m (i.e. this can be done currently but only in "exceptional circumstances").
- Increase the limit on call accounts and Money market Funds to £3m BUT
- In no circumstances should the amount placed with any one institution exceed £3m (i.e. money can be placed with one institution on call and for a term, but the total must not exceed £3m) AND
- Investments continue to be restricted to UK institutions only

It is felt that the new limits are clearer, will optimise yield and still be consistent with proper levels of security and liquidity.

TREASURY ACTIVITY

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

	Average Daily investment.	**Earnings**	**Average Rate**
	£'000	£	%
DMO (effectively the Government)	1,459	1,829	0.25
Money market Fund	1,441	3,813	0.53
Call Accounts	4,504	17,241	0.76
Term Deposit	820	4,438	1.08
	8,224	27,321	0.66

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

20 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.

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

	Budget for year	Actual for half year	Forecast for year
	£'000	£'000	£'000
Interest payable	77	88	210
Interest earned			
On current investments	(11)	(27)	(53)
On Landsbanki			(89)
Net cost	66	24	68

The net cost forecast for the year is very close to the budgeted figure.

Icelandic loan

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

BORROWING

23. Two borrowings have taken place during the year. The first, on 24 May, has already been reported. The second, on 20 August, was for £3.146m for 9 years, to be repaid in equal portions every six months during that period. The rate was 1.93%. These borrowings took the Council up to its borrowing limit, although by year end repayments will leave it below that limit.

24 The Comprehensive Spending Review announced an increase in the cost of borrowing from the PWLB. Rates have risen with immediate and ongoing effect by approximately 0.87% across all periods.

PRUDENTIAL INDICATORS

24. 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.

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

Prudential Indicator	2010/11 Indicator £'000	Quarter 2 Actual £'000
Capital Financing Requirement (CFR)	9,979	9,674
Gross borrowing (note 1)	9,400	9,729
Investments (note 2)	Zero by year end	12,700
Net borrowing	9,400	(2,971)
Authorised limit for external debt	9,979	9,979
Operational boundary for external debt (note 1)	9,400	9,400
Limit of fixed interest rates (based on net debt)	9,900	9,900
Limit of variable interest rates (based on net debt)	10,000	10,000
Principal sums invested for periods exceeding 364 days	0	0
Maturity structure of borrowing limits		
Under 12 months	No restriction	1,033
12 months to 2 years	No restriction	350
2 years to 5 years	No restriction	5,200
5 years to 10 years	No restriction	3,146
10 years and above	No restriction	0

Note 1 – gross borrowing will have fallen to £8.871m by year end
Note 2 – The Council receives the majority of its income from council tax and the government in the first ten months of the year. This gives rise to the current cash surplus of £12.7m. This will reduce significantly by year end.

IMPLICATIONS OF REPORT

26. This report has implications in the following areas and the relevant Corporate Directors' comments are included:

Finance	X	Customer Services	
Human Resources		Equality and Diversity	
Legal		No significant implications in this area	

Background Papers			
Document	**Date**	**File**	**Place of Inspection**
Treasury strategy statement	March 2 2010		Town Hall

Report Author	Ext	Date	Doc ID
G Whitehead	5485	22/10/2010	***

Appendix A

Investments held as at 30 September 2010:

Counterparty	Amount	Rate	Period	Sector recommended time limit
	£'000	%		
Call Account – Nat West	2,000	0.80	On call	12 months
Call Account – Santander	2,000	0.70	On call	6 months
Call Account – Bank of Scotland	2,000	0.75	On call	12 months
Call Account – Lancs Cty Council	2,000	0.70	On call	12 months
Money market Fund	2,000	0.51	On call	
Debt Management Office	2,700	0.25	On call	
	12,700			

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).

APPENDIX B

Current list of Financial Institutions and Investment Criteria

Category	Institutions	Sector colour code	Sovereign rating	Max period	Limit per Institution
Sovereign or Sovereign "type"	DMADF Local Authority UK Government backed Money market funds			6 months 1 year n/a instant access	No limit £1m Not used
UK Nationalised Institutions	None (N Rock deposits no longer guaranteed)				
Institutions guaranteed by other governments	None (Irish Banks are guaranteed but have been removed from Chorley's list)				
UK Partly nationalised institutions; with access to the Credit Guarantee Scheme	RBS group (inc Nat West) Lloyds Group (inc HBoS & Lloyds)	Blue Blue	AAA stable from all 3 agencies	1 year 1 year	£1m per group £1m per group
Independent UK Institutions with access to the Credit Guarantee Scheme	HSBC Santander UK Barclays, Nationwide	Orange Moves between red/green Green	AAA stable from all 3 agencies	1 year 6–3 months 3 months	£1m £1m £1m
Money Market Funds	Standard Life Global liquidity MM Fund	Aaa/MR1+		instant access	£2m
Deposit/Call Accounts	Santander, Bank of Scotland, Nat West Lancs CC			Call accounts with instant access	£2m

Note 1 - Under the Credit Guarantee Scheme certain "eligible institutions" have access to liquidity from HM Treasury if required.

Note 2 - 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)

In exceptional circumstances the £1m limit on term deposits can be increased to £2m.

The maximum that can be placed with any institution is £2m (i.e. the £1m term deposit and the £2m call account limits are not cumulative)