Chorley Council

Report of	Meeting	Date
Chief Executive and Section 151 Officer	Audit Committee	29 September 2011

TREASURY STRATEGIES AND PRUDENTIAL INDICATORS 2011/12 TO 2013/14

PURPOSE OF REPORT

1. To review the Treasury and Investment Strategies approved by the Council on March 1 2011, and to report on performance in the first half of the year and compliance with prudential indicators. This report will go to Council on 15 November 2011.

RECOMMENDATION(S)

2. Audit Committee is asked

- To note the report, and
- Note that the maximum period for deposits with institutions other than the nationalised banks is currently restricted to 3 months.

EXECUTIVE SUMMARY OF REPORT

3. This report includes investment activity to 5 September 2011. It advises that, on average, the Council had surplus cash balances of £18.2m on which it received a return of 1.13% during the first five months of 2011/12.
In response to the turbulence in the financial markets the Council's Treasury Advisor, Sector, has recommended restricting deposit periods to three months for all institutions excepting the part nationalised banks.
It confirms compliance with the prudential indicators specified in the Treasury Strategy

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

4. The Code of Practice for Treasury Management specifies that Councils should review their treasury strategy and activity half yearly. This report meets that requirement.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

5. None

CORPORATE PRIORITIES

6. This report relates to the following Strategic Objectives:

Strong Family Support		Education and Jobs	
Being Healthy		Pride in Quality Homes and Clean Neighbourhoods	
Safe Respectful Communities		Quality Community Services and Spaces	
Vibrant Local Economy		Thriving Town Centre, Local Attractions and Villages	
A Council that is a consistently Top Performing Organisation and Delivers Excellent Value for Money			✓

INTEREST RATE FORECAST

7 The following table shows the interest rate forecast of the Council's treasury advisors, Sector.

	Now %	Dec 2011 %	Mar 2012 %	June 2012 %	Sep 2012 %	Mar 2013 %	June 2013 %	Dec 2013 %	Mar 2014 %
Base rate	0.50	0.50	0.50	0.50	0.75	1.25	1.50	2.50	3.00
5 yr PWLB	2.45	2.70	2.90	3.00	3.10	3.40	3.60	4.00	4.10
10 yr PWLB	3.75	4.00	4.10	4.30	4.40	4.60	4.70	4.90	5.00
25 yr PWLB	4.90	5.00	5.10	5.10	5.10	5.20	5.30	5.40	5.50
50 yr PWLB	4.95	5.00	5.10	5.10	5.10	5.20	5.30	5.40	5.50

Comparison with the forecast of six months ago, when the Treasury Strategy was drafted, shows that the timing of the first increase in base rate has slipped nine months. It also shows that rates now at 5 and 10 years have fallen by 0.75%. All these factors indicate the concerns about economic factors at home and abroad.

REVIEW OF THE TREASURY STRATEGY:

8 The Treasury Management and Investment Strategy for 2010/11 was approved by Council on 2 March 2011. It defined the Council's investment priorities as being:

- 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.

9 The strategy 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 B.

10 Consideration has been given, in light of the turbulence, uncertainty and fear in financial markets, as to whether any changes in the list or the limits are required, and the advice of our Treasury Advisors has been sought. They have replied that:

"Sector sees no imminent concerns with any of the institutions, durations and limits that are currently set out in your Treasury Strategy. Sector would suggest keeping investments short dated (no longer than 3 months), but with regard to the rates offered by Bank of Scotland and Lloyds for longer periods (up to 12 months) would make an exception as the likelihood of these institutions coming under any significant threat is highly unlikely due to the fact that they are part nationalised.
In the current economic climate Sector also suggest placing investments with Money Market Funds --- since they offer diversification amongst a range of different asset classes and counterparties"

The implications of this guidance is that Santander and Nationwide, which would have a time limit of 6 months based on the normal credit assessment, have been reduced to a three months. Barclays time limit based on the normal credit assessment is only three months, so no reduction is necessary.

All existing investments meet the restricted limits.

TREASURY ACTIVITY

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

	Average Daily investment. £'000	Earnings to 22/8/2011 £	Average Rate %
DMO	308	334	0.25
Other fixed term deposits	4,772	37,745	1.83
Call accounts	7,532	24,672	0.76
Money Market Fund	401	1,018	0.59
	13,013	63,769	1.13

The above table excludes the Icelandic investment. In paragraph 9 details of the ongoing legal action is shown. Until the legal position is resolved, for reasons of prudence, interest receipts accruing are being excluded from budget forecasts.

A full list of investments currently held is shown at Appendix A.

The interest earning benchmark is the LIBID 7 day rate. This was 0.48% as at 05/9/2011. The authority has outperformed the benchmark.

12 The following table compares the budgets for interest receivable against the latest projection. It will be seen that the net cost is forecast to fall by £19k.

	Budget for year £'000	Actual to 05/9/2011 £'000	Forecast for year £'000
Interest paid	201	45	204
Interest earned			
On current investments	(106)	(64)	(128)
On Icelandic loans	0	0	0
Net cost/(surplus)	95	(19)	76

ICELANDIC LOAN

13 The Council has a single deposit of £2m in the failed Icelandic bank, Landsbanki. The Icelandic courts have previously upheld the Council's status as a priority creditor, but an appeal against that judgement will be heard by the Icelandic Supreme Court on September 14 and 15, with a decision to be announced within the following month.

BORROWING:

14 The Treasury Strategy commented as follows on borrowing

"The Council's cash resources are expected to be virtually eliminated by 31 March 2012 and thereafter there will increasingly be times when it may need to borrow. There are two borrowing strategies:

- The modest borrowings anticipated in later years could probably be avoided for most of the year by taking advantage of seasonal revenue cash flows (i.e. the Council usually receives its income in the first ten months thus creating a cash surplus which unwinds in the last two months of the year). Temporary borrowing would be taken if and when there was a shortfall. This may offer the cheapest short term solution.

- Alternatively longer term, more strategic borrowings will be considered in light of anticipated movements in interest rates"

15 Borrowing costs have fallen as a result of the "flight to quality" in financial markets. Despite this it is still felt to be advantageous to avoid borrowing long term monies, relying instead on the seasonal cash surpluses that the Council enjoys for ten months of the year. If and when there was a cash shortfall cheaper temporary borrowing would be taken.

PRUDENTIAL INDICATORS:

16 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	March 2011 Indicator £'000	Actual £'000
Capital Financing Requirement (CFR) March 2011	9,224	5,917
Gross borrowing (actual as at 31/3/11)	8,872	8,872
Investments (note 1) (actual as at 5/9/11)	(6.193)	(15,464)
Net borrowing/(investments) actual at 5/9/11	2,679	(6,592)
Authorised limit for external debt (note 2)	9,013	9,013
Operational boundary for external debt (note 2)	8,885	8,885
Limit of fixed interest rates (based on net debt)	10,000	10,000
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	Max 50%	10%
12 months to 2 years	Max 50%	6%
2 years to 5 years	Max 100%	72%
5 years to 10 years	Max 50%	12%
10 years and above	0	0

Note 1 - The prudential indicators assumed investments, excluding outstanding Icelandic loans, of £6.193m at March 2011 falling to £0.400m at March 2012. The actual value at March 2011 was £9.2m and is currently £15.5m. This is expected to fall significantly by year end.

Note 2 – The figures shown for both the operational boundary and the authorised limit are at 31/3/11. There is no need to change these and actual are within these limits.

Note 3 – The limits on fixed rate rate debt is unchanged at £10m. Actual debt is below this figure

IMPLICATIONS OF REPORT

17. This report affects the following areas. The relevant Directors' comments are attached:

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

COMMENTS OF THE STATUTORY FINANCE OFFICER

13. This report meets statutory requirements. Its statistical content is consistent with the assumptions made in the revenue and capital budgets. The criteria it recommends will direct the Council's treasury operations in 2011/12.

GARY HALL
CHIEF EXECUTIVE AND SECTION 151 OFFICER

Document	Inspection
Financial Strategy/Budget and Council Tax 2011/12 Treasury Management in the Public Services: Code of Practice CIPFA Prudential Code for Capital Finance in Local Authorities	Town Hall

Report Author	Ext	Date	Doc ID
G Whitehead	5485	9/9/2011	Treasury Strategy

Appendix A

List of investments as at September 5th 2011

Counterparty	Type	Amount £'000	Rate %	Date	Maturity
Bank of Scotland	Term deposit	2,000	2.05	14/2/11	13/2/12
Bank of Scotland	Term deposit	1,000	2.05	04/3/11	02/3/12
North Tyneside MBC	Term deposit	2,000	1.45	19/4/11	17/4/12
National Westminster	Call account	3,000	0.80		
Santander	Call account	3,000	0.75		
Lancashire County Council	Call account	3,000	0.70		

Current list of Financial Institutions and Investment Criteria **Appendix B**
(Council 1 March 2011)

Category	Institutions	Sector colour code	Sovereign rating	Max period	Limit per Institution
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
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 the 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	£3m per group £3m per group
Independent UK Institutions with access to the Credit Guarantee Scheme	HSBC Santander UK Barclays, Nationwide	Orange Moves between red and green	AAA stable from all 3 agencies	1 year 6–3 months	£2m £2m
Money Market Funds	Standard Life Global liquidity MM Fund	Aaa/MR1+		instant access	£3m
Deposit/Call Accounts	Santander, Bank of Scotland, Nat West Lancs CC			Call accounts with instant access	£3m less value of term deposits

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

Note – Deposits with any one institution shall not exceed £3m