St Edmundsbury
BOROUGH COUNCIL

A252

Cabinet
21 October 2009

Treasury Management 2009/2010:
1 April to 30 September 2009

1. Summary and Reasons for Recommendations

1.1 The Council's treasury management activities generate a substantial amount of income and therefore warrant regular member consideration. The purpose of this report is to:-

(a) provide a summary of investment activity for the first six months of the 2009/2010 financial year;
(b) advise Members of on-going measures being taken by the Chief Finance Officer to mitigate the risks associated with the current banking crises, whilst at the same time seeking to maximise financial returns on Council investments; and
(c) seek approval for proposed changes in the Council's lending criteria.

1.2 Despite the credit crunch and international banking crises, the Council's treasury management activities have continued to exceed budgeted rates of return on investments. Furthermore, the Council has not, to date, suffered any loss arising from the failure of a financial institution.

1.3 At the end of September 2009 interest earned amounted to £0.611m against the budget for the period of £0.421m, a surplus of £0.190m. The over achievement of interest on investments during this period was due to the achievement of higher than budgeted rates of return on investments and to re-scheduling of the capital programme. The target investment rate for the year is 2.20%. In the six month period covered by this report, the average rate of interest achieved was 2.54%.

1.4 The budget for investment income for the 2009/2010 financial year is £0.751m, equivalent to £19.87 for each Council Tax Band D property.

2. Recommendations

2.1 It is recommended that:-

(a) information on the Treasury Management function for the period 1 April to 30 September 2009 be noted; and
(b) changes in the Council's lending criteria, detailed in paragraphs 4.10 to 4.14 of this report, are approved.

3. Corporate Objectives

3.1 The recommendations meet the following corporate objectives, as contained within the Corporate Plan:-

(a) Corporate Priority : '*To raise corporate standards and efficiency*'; and
(b) Cabinet Commitment : '*Improving Efficiency and Value for Money*'.

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4. Background

4.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, adopted by the Council in March 2002, requires that the Cabinet receives regular progress reports on treasury management activity. This report outlines the Council's investment position for the current financial year to 30 September 2009.

Investment Activity: 1 April 2009 to 30 September 2009

4.2 The total amount invested at 1 April 2009 was £46.550m. As at 30 September 2009 the total amount invested was £47m.

4.3 The budget for investment income in 2009/2010 is £0.751m, equivalent to £19.87 for each Council Tax Band D property. At the end of September 2009 interest earned amounted to £0.611m against the profiled budget for the period of £0.421m, a surplus of £0.190m. The over achievement of interest on investments during this period was due to higher than expected interest rates and to the rescheduling of the capital programme. The target investment rate for the year is 2.20%. In the six month period covered by this report, the average rate of interest achieved has been 2.54%. Furthermore, as at 30 September 2009 £4.76m had been spent out of the full year's original capital programme budget of £25.39m.

4.4 The target investment rate of 2.20% was set in February 2009 as part of the budget setting process and was based on interest projections provided by the Council's external treasury advisors (Sector) together with an assessment of the returns achievable on fixed term investments with different maturity dates. The financial year commenced with an interest base rate of just 0.5%, an historic low, and has remained at this level. Due to continuing concerns about the current economic recession, Sector are currently predicting that the Bank of England's Monetary Policy Committee will hold rates at this historic low for some time. As a result, investments are currently being made at rates below the average target rate for the year (which takes into account the higher rates of returns being gained on some of the Council's fixed term investments). As more of the Council's fixed term investments reach maturity, the average return on the Council's portfolio of investments is likely to reduce. However, provided there is not a further reduction in the value of investment returns, and conditional upon the achievement of the current capital expenditure and capital disposals programme, then the budgeted income from investments for 2009/2010 will continue to be exceeded. Based on the current profile of investments it is projected that a year-end budgetary surplus on investment income in the region of £0.20m to £0.25m should be achievable.

Review of the Council's Credit Rating Criteria and Lending Limits

4.5 The unprecedented nature of the current banking crisis has forced all local authorities to actively review their lending criteria (ie their approach to assessing the credit-worthiness of banks and financial institutions together with the maximum duration and value of investments).

4.6 The Council's original lending criteria for 2009/2010 was set out in the Annual Treasury Management and Investment Strategy 2009/2010 which was approved by the Cabinet on 11 February 2009 (Paper Z517 refers). The criteria were reviewed during the first quarter of this financial year in response to continuing difficulties within the banking sector and to advice received by Sector (who recommended a further tightening of the Council's credit worthiness criteria, including significant reductions in the maximum duration and value of investments that can be held with individual institutions).

4.7 The outcomes of this review process were reported to Cabinet on 29 July 2009 (Paper A145 refers). The maximum maturity periods for Council investments were substantially reduced (from 5 years to 1 year), and the maximum value of investments with individual rated organisations meeting the required credit criteria were halved (from £10m to £5m). For non-rated building societies, the previous reliance purely on asset base size as a measure of creditworthiness was enhanced by the introduction of the following additional measures:-

(a) the maximum cumulative value of investments placed with any one building society was reduced from £5m to £2.5m, with maximum investment durations reduced from 3 years to 6 months;
(b) only building societies specifically covered by the provisions of the Government's banking support package to be used;
(c) a commercial credit rating organisation, Dun and Bradstreet, to be used to provide credit rating reports on building societies, prior to the placing of funds, to ensure that the proposed investment values are within recommended credit limits;
(d) latest available accounts to be obtained and reviewed by in-house staff to establish key trends and to ensure that Dun and Bradstreet recommendations are based on latest available financial results; and
(e) review of available media coverage for any advance negative warnings regarding the stability of individual building societies.

Full details of the Sector credit rating system and the Council's original and revised lending limits are provided at Appendix 1 to this report.

4.8 The report to Cabinet in July 2009 stated that the Chief Finance Officer, in consultation with the Portfolio Holder Resources and Efficiency, will continue to monitor the adequacy of the above revised arrangements and make changes as necessary to respond to the changing economic climate and external advice (including advice and guidance from the central government, Sector, the Chartered Institute of Public Finance and Accountancy and the Audit Commission). It was also agreed that details of any further changes in the treasury management function, including changes to the Council's lending criteria will be reported to Cabinet as part of the quarterly treasury management report.

Approved Changes in Lending Criteria – September 2009

4.9 The only change in lending criteria approved by the Chief Finance Officer and Portfolio Holder Resources and Efficiency since the July 2009 Treasury Management report was made in September 2009 in respect of a specific deal involving a £2m one year fixed rate investment with the Cater Allen bank, which is part of the Santander Group. Cater Allen offered a 2.7% return on a 1 year fixed rate investment with a closing date of 2 October. The offered rate was approximately 1% above the best alternative rates currently available (through the unrated building society sector) equating to an additional £20k for the £2m invested sum. In order to take advantage of this deal the lending criteria for the Santander Group had to be extended (ie maximum duration increased from 6 months to 1 year, and maximum sum invested within the group extended from £5m to £6m). The decision to extend the limit in this case was taken in consultation with Sector who confirmed that they were looking to extend the recommended time durations for investments in the near future (which would cover the Cater Allen investment) but that at the time of our enquiry this decision had yet to be made "official". Sector were also in the process of undertaking a review of the Council's lending list which, they confirmed, would recommend increases in our lending limits sufficient to cover this investment.

Review of Lending Criteria

Rated Banks and Institutions:

4.10 Sector have recently completed their review of the Council's lending criteria and have made recommendations for increasing the maximum value and duration of investments with rated financial institutions. The proposals below for changes in the Council's lending criteria are in accordance with Sector's recommendations.

Lending Criteria: Rated Banks and Institutions

Sector Colour Code Key*	Current Lending Criteria	Proposed Lending Criteria
Purple	£5m for max 1 year	Max 20% portfolio (approx £9m) for max 2 years
Orange	£5m for max 6 months	£6m for max 1 year
Red	£5m for max 3 months	£5m for max 6 months
Green	£2.5m for max 1 month	£3m for max 2 months
Blue **	£5m for max 1 year	£9m for max 2 years

* In order to simplify the complex system of commercial credit ratings, Sector has developed a system of colour codings which reflect the relative strength of individual banking institutions. Details of these colour codings are provided at Appendix 1 to this report.

** The Blue colour coding relates to banks that are either nationalised or substantially owned by the UK Government. The substantial increase in lending value reflects the fact that this sector is now considered to have the highest possible credit rating (ie equivalent to the UK government). Sector have emphasized that this rating is subject to continued government support.

Rated Building Societies

4.11 The lending criteria for rated building societies is based on the same Sector colour coding system as the rated banks. However, in recognition of their mutual status and the increased regulatory framework governing such societies, the Council's strategy allows for longer investment durations than comparable banks.

Lending Criteria – Rated Building Societies

Key	Current Lending Criteria	Proposed Lending Criteria
Red	£5m for max 1 year	£5m for max 1 year
Green	£2.5m for max 1 year	£3m for max 1 year

Note – No UK building society is currently rated above Red

Non-Rated Building Societies

4.12 Sector do not provide guidance on lending criteria for non-rated organisations (mainly building societies) and have been generally very cautious about recommending investments in this sector. However, they are broadly supportive of the improvements made to the Council's approach to establishing the creditworthiness of non-rated societies, ie *"It is a welcomed approach that the Authority is looking at other criteria as well as asset size and in the face of things this seems a sensible approach".* In the light of Sector's comments, and the extended lending criteria recommended for rated organisations, approval is sought for the following increase in lending criteria for non-rated building societies.

Lending Criteria: Non Rated Building Societies

	Current	Future
Building Societies – Asset base > £1,000m	£2.5m for max 6 months	£2.5m for max 6 months (ie no change)
Building Societies – Asset base > £2,500m	£2.5m for max 6 months	£3m for max 6 months

4.13 The above recommendation introduces a tiered approach to non rated building societies based upon their asset base size (subject also to the Council's additional credit-worthiness checks detailed in paragraph 4.7 above). No change is recommended in respect of non-rated building societies with asset bases between £1,000m and £2,500m, but a £0.5m increase is sought in the lending limit for societies with asset bases in excess of £2,500m. This is considered a prudent approach in the light of the current economic climate.

4.14 The Chief Finance Officer, in consultation with the Portfolio Holder Resources and Efficiency, will continue to monitor the adequacy of the above revised arrangements and make changes as necessary to respond to the changing economic climate and external advice. Details of any changes made within the treasury management function will be reported to Cabinet as part of the quarterly treasury management report.

5. Other Options considered

5.1 The CIPFA Code of Practice requires that the Cabinet receives periodic progress reports on treasury management activities during the course of the year and an annual review report after the end of the financial year.

6. Community impact *(including Section 17 of the Crime and Disorder Act 1998 and diversity issues)*

General

6.1 The level of interest earned on investments reduces the demand on the Council Tax payer to fund the cost of service provision.

Diversity

6.2 All Council Taxpayers in the St Edmundsbury area will benefit from the interest achieved on investments.

7. Consultation

7.1 The Council's treasury management advisers (Sector), provide guidance on all aspects of the treasury management function, including the development of investment policies and strategies, investment products, the training of staff and the credit worthiness of investment counterparties. The Portfolio Holder for Resources and Efficiency is consulted on all proposed amendments to the Council's lending criteria.

8. Resource implications *(including asset management implications)*

8.1 Budgeted investment income for 2009/2010 is £0.751m, equivalent to £19.87 for each Council Tax band D property.

9. Risk Assessment *(including Health & Safety, potential hazards or opportunities affecting corporate, service or project objectives)*

9.1 Active measures are taken to minimise the Council's exposure to the unpredictability of financial markets and to protect the financial resources available to fund services. Investment activities are carried out in accordance with the approved Annual Strategy and comply with the CIPFA Code of Practice. The treasury management function is supported by external advisors (Sector) who provide on-going advice on investment strategies and policies together with daily updates on the credit rating of individual banks and building societies.

9.2 Investment activities are carried out in accordance with the approved Annual Strategy and comply with the CIPFA Code of Practice. The Council has a high level of capital receipts. The interest obtained on these receipts is significant and helps to support the annual level of Council Tax. As fluctuations in interest rates and levels of capital expenditure and receipts can impact considerably on the Council's budget the Council has established an Interest Equalisation Reserve which can be used to help smooth out year-on-year variances in investment returns. In addition the portfolio of investments includes loans for varying periods of duration of up to five years at fixed rates of interest and these give some certainty of return for a proportion of the investments.

Risk area	**Inherent level of Risk** (before controls)	**Controls**	**Residual Risk** (after controls)
Economic (fluctuations in interest rates)	Medium	Spread of investments for periods of up to five years and utilisation of the Interest Equalisation reserve.	Low
Failure of financial institutions with which the Council invests.	High	Use of Sector Treasury Service for on-going assessment of creditworthiness of financial institutions. Spread of investments across a range of financial institutions with varying durations.	Low

10. Legal or policy implications

10.1 Consideration of the report complies with Council policy and the CIPFA Code of Practice on Treasury Management.

Wards affected	All	**Portfolio Holder**	Resources and Efficiency
Background Papers		**Subject Area** Finance	

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Appendix 1

Explanation of Sector's Credit-Worthiness Matrix

Although no combinations of ratings can be viewed as completely fail-safe, Sector has developed and refined matrices to illustrate examples of the relative degrees of security afforded by the combinations of Fitch ratings. A perspective of an institution's overall credit worthiness can be gained from:

- Long-term and Short-term ratings (the capacity to service and repay punctually senior debt obligations)
- Individual rating (the intrinsic soundness of an institution based on a stand-alone basis)
- Support rating (the assessment of the presence of a lender of last resort) which should form the basis of setting credit policy.

Lending up to 1 year to banks and building societies

Short-term rating: ***F1+***
Long-term rating: ***AAA, AA+, AA, AA-***

Individual	Support			
	1	2	3	4
A	Red	Red	Red	
A/B	Red	Red	Green	
B	Red	Red	Green	
B/C	Red	Red	Green	
C	Red	Red	Green	
C/D				
D				

Short-term rating: ***F1***
Long-term rating:A+, A

Individual	Support			
	1	2	3	4
A	Red	Red	Green	
A/B	Red	Red	Green	
B	Red	Red	Green	
B/C	Green	Green		
C	Green	Green		
C/D				
D				

Lending longer than 1 year (where permitted)
Short-term rating: ***F1+***
Long-term rating: ***AAA, AA+, AA***

Individual	Support			
	1	2	3	4
A	Purple	Purple		
A/B	Purple	Purple		
B	Purple	Purple		
B/C	Purple	Purple		
C				
C/D				
D				

Short-term rating: ***F1+***
Long-term rating:AA-

Individual	Support			
	1	2	3	4
A	Orange	Orange		
A/B	Orange	Orange		
B	Orange	Orange		
B/C	Orange	Orange		
C				
C/D				
D				

Each colour has a suggested duration as follows:

Colour	Current Investment Duration	Revised Investment Durations *
Green	1 month	2 months
Red	3 months	6 months
Orange	6 months	1 year
Purple	1 year	2 years

* Revised investment durations are in accordance with recent recommendations provided by Sector.

A new colour, blue, has also been added and this denotes a bank or group of banks that is partially owned by the UK Government. Sector have recently extended the recommended duration for this category, but have emphasized that this limit is subject to continued Government support.

Details of St Edmundsbury's Lending Criteria

Rated Banks and Institutions – Based on Sector's Colour Coding Matrix

The below table provides details of the Council's lending criteria for rated banks and building societies based on Sector's colour coding matrix. It shows the limits approved by the Cabinet in Feb 2009 as part of the Annual Treasury Management Strategy (paper Z517 refers); the revised limits reported to Cabinet in July 2009 (paper A145 refers), and the proposed limits outlined within this report.

Lending Criteria – Rated Banks and Institutions

Key	Limits approved Feb 2009	Revised Limits: July 2009	Proposed Limits: Oct 2009
Purple	£10m for max 5 yrs	£5m for max 1 yr	Max 20% portfolio (approx £9m) for 2 years
Orange	£10m for max 2 yrs	£5m for max 6 months	£6m for max 1 year
Red	£10m for max 1yr	£5m for max 3 months	£5m for max 6 months
Green	£5m for max 3 months	£2.5m for max 1 month	£3m for max 2 months
Blue	n/a	£5m for max 1 year	Max 20% portfolio (approx £9m) for max 2 years

Building Societies

The lending criteria for non-rated building societies is based on a combination of asset base size together with the following additional considerations:

- Only building societies specifically covered by the provisions of the government's banking support package to be used
- A commercial credit rating organisation, Dun and Bradstreet, to be used to provide credit rating reports on building societies, prior to the placing of funds, to ensure that the proposed investment values are within recommended credit limits
- Latest available accounts to be obtained and reviewed by in-house staff to establish key trends and to ensure that Dun and Bradstreet recommendations are based on latest available financial results
- Review of available media coverage for any advance negative warnings regarding the stability of individual building societies.

Lending Criteria – Non-Rated Building Societies

	Limits approved Feb 2009	Revised Limits: July 2009	Proposed Limits: Oct 2009
Building Societies – Asset base > £1,000m to £2,500m	£5m for max 3 years	£2.5m for max 6 months	£2.5m for max 6 months (ie no change)
Building Societies – Asset base > £2,500m	N/A	N/A	£3m for max 6 months

The lending criteria for rated building societies is based on the same Sector colour coding system as the rated banks. However, in recognition of their mutual status and the increased regulatory framework governing such societies, they are given longer investment durations than comparable banks.

Lending Criteria – Rated Building Societies

Key	Limits approved Feb 2009	Revised Limits: July 2009	Proposed Limits: Oct 2009
Red	£10m for max 5years	£5m for max 1 year	£5m for max 1 year
Green	£5m for max 5 years	£2.5m for max 1 year	£3m for max 1 year

Note – No UK building society is currently rated above Red