



St Edmundsbury
BOROUGH COUNCIL

B249

Treasury Management Sub-Committee 18 October 2010

Mid Year Treasury Management Performance Report and Investment Activity 1 April to 30 September 2010

1. Introduction

- 1.1 CIPFA's revised Code of Practice for Treasury Management, published in November 2009, was adopted by the Council on 23 February 2010. The revised Code requires a half-yearly update to members, covering performance to date for the current financial year. The half-yearly report also provides an opportunity to revise the strategy in line with the current market and economic environment, and to address any changes in the Council's risk appetite. This report therefore ensures the Council is embracing Best Practice in accordance with CIPFA's 2009 Code of Practice for Treasury Management.

2. Purpose of this Report

- 2.1 The purpose of this report is to:
- a. present the Mid Year Treasury Management Performance Report summarising investment activities for the first six months of the 2010/11 financial year,
 - b. advise the Committee of changes made to the Council's lending criteria since its last meeting on 19 July 2010,
 - c. provide details of proposed changes to the Council's lending criteria, for committee consideration.
- 2.2 The Sub-Committee are asked to:
- a. scrutinise the content of this report, including details of treasury management performance for the first 6 months of the financial year (section 4 refers) and changes made in the lending limit for the Santander UK group (section 6 refers),

- b. make recommendations via the Performance and Audit Scrutiny Committee to Cabinet and Council, regarding the proposals contained in section 7 of this report for further changes to the Council's lending criteria.

3. Investment Strategy 2010/11

3.1 The Council's Annual Treasury Management and Investment Strategy was approved by Full Council on 23 February 2010 (report A496 refers). The investment priorities for 2010/11 are as follows:

- Security of Capital
- Liquidity of investments

3.2 The Council will also aim to achieve the optimum yield on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with a limited number of highly rated banks and building societies (using Sector's suggested creditworthiness approach) and non-rated building societies, subject to their meeting minimum financial criteria (based on asset base size, Dun and Bradstreet ratings, the Government's guarantee scheme for UK financial institutions and the review of published financial information). In addition, for counterparties based in countries outside the UK, our strategy is only to use organisations where the host country has a AAA sovereign rating.

4. Investment Activity: 1 April 2010 to 30 September 2010

4.1 The total amount invested at 1 April 2010 was £35.15m and at 30 September 2010 was £41.95m. The increase in balances over this period was due primarily to timing differences in respect of the collection of local taxes (Council Tax and Non Domestic Rates) and the payment of precepts (ie to Suffolk County Council, Suffolk Police and central government). The average level of funds available for investment purposes in the first six months of 2010/11 was £41.55m.

4.2 The 2010/11 Annual Treasury Management and Investment Strategy set out the Council's projections for the current financial year. The budget for investment income in 2010/11 is £0.566m, equivalent to £14.91 for each Council Tax Band D property. This represented a target rate of return on investments of 1.50%.

4.3 As at the end of September 2010 interest actually earned during the first 6 months of the financial year amounted to £0.264m against the profiled budget for the period of £0.304m, a budgetary deficit of £0.040m. The under achievement of interest on investments during this period was due primarily to lower than expected interest rates. In the six month period covered by this report, the average rate of interest achieved was 1.27% against the target rate of 1.50%. This reflects the maturity of the Council's remaining higher yield

longer term investments and also the continued difficulties being experienced in finding attractive rates of interest with financial institutions that can deliver the required level of security.

4.4 Due to continuing concerns about the economic recession, Sector are currently predicting that the Bank of England's Monetary Policy Committee (MPC) will hold bank base rates at their current historic low of 0.5% through to the end of the 2010/11 financial year. Sector has provided the following interest rate forecasts

Sector's Interest Rate View													
	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.50%	3.00%	3.25%	3.25%
5yr PW LB Rate	2.20%	2.20%	2.20%	2.40%	2.60%	2.80%	3.00%	3.30%	3.60%	3.80%	4.10%	4.40%	4.40%
10yr PW LB View	3.30%	3.30%	3.30%	3.40%	3.70%	3.90%	4.00%	4.30%	4.40%	4.60%	4.60%	4.90%	4.90%
25yr PW LB View	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.70%	4.70%	4.80%	5.00%	5.00%	5.00%	5.00%
50yr PW LB Rate	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.70%	4.70%	4.80%	5.00%	5.00%	5.00%	5.00%

- The forecast is based on moderate economic recovery and moderate MPC concerns about inflation looking 2 years ahead;
- The first Bank Rate increase expected to be in the quarter ending September 2011; and is expected to reach 3.25% by the end of June 2013;
- Long term Public Works Loan Board (PWLB) rates are expected to steadily increase to reach 5% by end of 2012 due to huge gilt issuance, reversal of Quantitative Easing (QE) and investor concerns over inflation;
- There is considerable uncertainty in all forecasts due to the difficulties of forecasting the timing and amounts of QE reversal, the fiscal effect of a general election, speed of recovery of banks profitability and balance sheet position, changes in the consumer saving ratio, rebalancing of the UK economy in terms of export and import etc;

4.5 The issue of low investment rates is compounded by measures taken over the past year, on the recommendations of Sector, to ensure the security of funds during this volatile period by the tightening of the Council's credit criteria. This has had the effect of significantly restricting the number of organisations with which the Council can place funds and considerably reduced the approved duration of investments (ie very few organisations are now cleared for investments greater than one year, with most being restricted to periods between 3 and 12 months). Placing funds with a smaller number of higher rated organisations and for shorter fixed term durations, has served to further reduce the rates that can be achieved on new Council investments. As a result, most new investments are now being made at rates below the average target rate for the year.

4.6 It is apparent therefore that in the short term, as more of the fixed term investments reach maturity, the average return on the Council's portfolio of investments may continue to reduce. This trend is likely to continue until such time as either general interest rates begin to climb, or our current stringent

credit criteria are relaxed. To this end, proposals for the extension of our existing lending limits are set out in sections 5 to 7 below.

- 4.7 If there is no increase in interest rates that can be accessed by the treasury management team within the next 6 months, then the budgeted income from investments for 2010/11 may not be achieved. In this situation, any shortfall in budgeted income will be met from the interest equalisation reserve.
- 4.8 A full list of investments held as at 30 September 2010 is shown at Appendix A.

5. Changes in Lending Criteria

- 5.1 The Council's Annual Treasury Management and Investment Strategy requires that deposits are only placed with a limited number of high quality banks and building societies whose credit rating is independently assessed as sufficiently secure by the Council's treasury advisers (Sector) or, for non rated building societies, subject to their meeting minimum financial criteria (based on asset base size).
- 5.2 The unprecedented nature of the current banking crisis 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). The Council's lending criteria for 2009/10 (as set out in the Annual Treasury Management and Investment Strategy 2009/10 was approved by the Cabinet on 11 February 2009 (paper Z517 refers) were subject to two formal reviews by the Council's Cabinet during the year; in July 2009 (paper A145 refers) and October 2009 (paper A252 refers). The reviews resulted in a significant tightening of the Council's credit worthiness criteria (thereby reducing the number of organisations with which the Council can place investments) together with substantial reductions in the duration and value of investments that can be held with individual institutions (in order to limit and spread credit risk). This resulted in more of the investment portfolio being moved into investment instruments with lower rates of return but higher security and liquidity.
- 5.3 In the current climate of:
- modest economic recovery
 - continued counterparty restrictions
 - reducing returns on investments, and
 - increased pressure on public finances and the need to maximise income from investments,

officers have been in discussion with Sector about the need for the Council to look more critically at our credit risk appetite, and to seek measured and prudent changes in the lending criteria in order to improve current yield levels. As a result of this work, in September officers obtained approval for an extension of

the approved limits applicable to the Santander UK group (details of which are provided in section 6 below). In addition, this report sets out more general proposals for the extension of lending limits for rated banks and building societies (see section 7 below). These measures should ensure that the Council maintains an adequate level of security and liquidity for public funds whilst at the same time providing improved investment opportunities and returns.

6. Santander UK Group – Changes to Lending Criteria: September 2010

- 6.1 The Council had £2m maturing with Cater Allen on 30 September 2010 (currently paying 2.7%) with a further £3m maturing between then and February 2011. During September 2010 Cater Allen were offering 2.5% on one year fixed investments, however the group had previously been downgraded by Sector as a result of a credit watch issued by the Fitch rating agency. As such the recommended investment duration for Santander / Cater Allen had been reduced from 1 year to 6 months.
- 6.2 On the basis of further research that Sector have undertaken regarding the financial standing of the Santander UK group, they have supported the Council in extending the maturity limit for group members (including Santander and Cater Allen) from 6 months to 1 year. However, as Sector were not at this time in a position to change their published counterparty limits for the Santander group, an extension to the Santander limit had to be treated as an exception to our stated Treasury Management Strategy lending criteria.
- 6.3 Following consultation with members of this committee, and the approval of the Chief Finance Officer and Leader of the Council (in the absence of the Portfolio Holder for Resources and Efficiency), approval was obtained for an exception to the agreed Treasury Management Strategy to provide for the extension to the lending duration for Santander UK group members (ie Santander and Cater Allen) from 6 months to 1 year. This enabled the treasury management team to reinvest the £2m maturity with Cater Allen for 12 months at 2.5% (0.6% above the next best available option – representing additional investment income from this one investment of £12,000).

7. Proposed Changes to the Council's Lending Criteria

- 7.1 Sector are continuing to provide support to the treasury management team in balancing the requirement to maintain security and liquidity of funds with the necessity to maximise returns on investment. In re-evaluating our risk appetite, Sector have advised that the preference should be given for extending investment durations and limits with highly rated organisations (ie that existing restrictions on the use of non-rated building societies should be retained for the time being).

- 7.2 With this in mind, it is proposed that with the exception of the nationalised banks (Sector's Blue category - where longer term issues remain regarding the continuation of government financial support), the current limits for all rated banks and building societies should be extended. The below table sets out the proposed new limits and also provides information on the current lending limits (as set out in 2010/11 strategy) and the limits applicable in April 2009 (as set out in the 2009/10 strategy).

Credit Criteria: Rated Banks and Institutions

Sector Colour Code Key*	Credit Criteria 1/4/09	Credit Criteria 1/4/10	Proposed Limits
Purple	£10m for max of 5 years	Max 20% portfolio (approx £9m) for max of 2 years	Max £10m for max of 2 years (subject to max 30% of portfolio)
Orange	£10m for maximum of 2 years	£6m for maximum of 1 year	£9m for max of 2 years (subject to max 30% of portfolio)
Red	£10m for max 1 year	£5m for max 6 months	£8m for max of 1 year (subject to max 30% of portfolio)
Green	£5m for max 3 months	£3m for max 3 months	£4m for max of 6 months (subject to max 20% of portfolio)
Blue (nationalised / substantially owned by the UK government)	n/a	£9m for max 1 years	No change

Credit Criteria: Rated Building Societies

Sector Colour Code Key*	Credit Criteria 1/4/09	Credit Criteria 1/4/10	Proposed Limits
Red	£10m for max 5 years	£5m for max 1 year	£8m for max of 1 year (subject to max 30% of portfolio)
Green	£5m for max 5 years	£3m for max 1 year	£4m for max of 1 year (subject to max 20% of portfolio)

Credit Criteria: Non-Rated Building Societies

Asset Base**	Credit Criteria 1/4/09	Credit Criteria 1/4/10	Proposed Limits
Asset base > £2,500m	£5m for max 3 years	£3m for max 6 months	No change
Asset base > £1,000m	£5m for max 3 years	£2.5m for max 6 months	No change

* In order to simplify the complex system of commercial credit ratings, Sector has developed a system of colour codings which reflect the relative strengths of individual banking institutions. Details of these colour codings are provided in the Council's Annual Treasury Management and Investment Strategy.

** Further restrictions on non-rated building societies include a requirement for societies to be covered by the Government's banking support package.

Appendix A

Council Investments as at 30 September 2010

Principal	Counterparty	Start Date	Maturity Date	Interest Rate (%)
£0	Santander UK Business Reserve Account	Inst/Acc	Inst/Acc	0.6500
£450,000	Bank of Scotland Call A/C	Inst/Acc	Inst/Acc	0.7500
£0	Bank of Scotland BasePLUS Account	Inst/Acc	Inst/Acc	0.5000
£2,500,000	Barclays Reserve Account	Inst/Acc	Inst/Acc	0.8000
£3,000,000	Clydesdale 30 Day Notice Account	30 day	30 day	0.8500
£1,500,000	Kent Reliance Building Society	01/04/2010	01/10/2010	1.1500
£500,000	Nottingham Building Society	15/04/2010	15/10/2010	1.3500
£1,000,000	Leeds Building Society	01/06/2010	15/10/2010	0.7300
£500,000	Newcastle Building Society	01/06/2010	19/10/2010	1.0200
£500,000	Stroud & Swindon Building Society	01/06/2010	19/10/2010	1.0300
£1,500,000	Cumberland Building Society	04/05/2010	04/11/2010	1.2500
£500,000	Nottingham Building Society	04/05/2010	04/11/2010	1.3000
£500,000	Skipton Building Society	04/05/2010	04/11/2010	0.9500
£500,000	Norwich & Peterborough Building Society	15/06/2010	15/11/2010	0.9000
£500,000	Principality Building Society	15/06/2010	15/11/2010	1.0800
£1,000,000	Cater Allen	17/11/2009	17/11/2010	1.8500
£1,000,000	Bank of Scotland	18/11/2009	18/11/2010	1.8200
£1,000,000	Progressive Building Society	01/07/2010	22/11/2010	0.9500
£1,000,000	West Bromwich Building Society	01/07/2010	26/11/2010	1.0000
£1,000,000	Cater Allen	01/12/2009	01/12/2010	2.1000
£1,500,000	Newcastle Building Society	01/07/2010	15/12/2010	1.1200
£1,000,000	Principality Building Society	02/08/2010	21/12/2010	0.9200
£1,000,000	West Bromwich Building Society	02/08/2010	23/12/2010	0.9500
£1,000,000	National Counties Building Society	01/07/2010	04/01/2011	1.3000
£1,000,000	Kent Reliance Building Society	05/07/2010	05/01/2011	1.1000
£500,000	Nottingham Building Society	02/08/2010	17/01/2011	1.1000
£500,000	West Bromwich Building Society	01/09/2010	17/01/2011	0.9500
£1,500,000	Principality Building Society	13/08/2010	20/01/2011	1.0000
£1,000,000	Bank of Scotland	01/02/2010	31/01/2011	1.8200
£1,000,000	Newcastle Building Society	02/08/2010	02/02/2011	1.2500
£1,000,000	Cater Allen	02/08/2010	02/02/2011	1.3300
£1,000,000	Skipton Building Society	27/08/2010	15/02/2011	1.0000
£500,000	Nottingham Building Society	27/08/2010	15/02/2011	1.1200
£1,000,000	Nottingham Building Society	01/09/2010	23/02/2011	1.1500
£1,000,000	Leeds Building Society	01/09/2010	23/02/2011	0.8200
£500,000	Norwich & Peterborough Building Society	01/09/2010	01/03/2011	1.2000
£500,000	Skipton Building Society	01/09/2010	01/03/2011	1.0000
£2,000,000	Royal Bank of Scotland	08/03/2010	07/03/2011	1.2700
£1,000,000	Bank of Scotland	09/03/2010	09/03/2011	1.8500
£1,000,000	Bank of Scotland	05/07/2010	05/07/2011	1.8000
£2,000,000	Bank of Scotland	02/08/2010	02/08/2011	1.9500
£2,000,000	Cater Allen	30/09/2010	29/09/2011	2.5000
<u>£41,950,000</u>	TOTAL			