St Edmundsbury
BOROUGH COUNCIL

E61

Treasury Management Sub-Committee 22 July 2013

Annual Treasury Management Report 2012/2013 and Investment Activity 1 April to 30 June 2013 and Review of the Councils Treasury Management Strategy

1. Summary and Reasons for Recommendations

1.1 CIPFA's revised Code of Practice for Treasury Management (the Code) published in November 2009, was adopted by the Council on 23 February 2010. Given that Treasury Management activities involve the management of significant cashflows and investments, the Code requires that members are provided with regular reports on the performance of the Council's treasury management function, including an annual treasury management and investment strategy (setting out its treasury management policies and strategies for the forthcoming year), a mid year treasury management review and an annual outturn report at the close of the financial year.

1.2 The purpose of this report is to:

(a) present the Council's Annual Treasury Management Investment Report summarising the investment activities for the year 2012/2013;

(b) provide a summary of investment activity for the first three months of the 2013/2014 financial year; and

(c) provide proposals for a forthcoming review of the Council's Treasury Management Strategy, including the appointment of an independent Treasury Management consultant to assist the review process.

2. Recommendations

2.1 The Sub-Committee is asked to:

(1) scrutinise the content of this report, including details of treasury management performance for the first 3 months of the 2013/2014 financial year;

(2) make recommendations as appropriate via the Performance and Audit

Scrutiny Committee to Cabinet and Council regarding the approval of the attached Annual Treasury Management Report for 2012/2013 (Appendix 1 refers); and

(3) approve an extra meeting of the Treasury Management Sub-Committee (in line with paragraphs 4.11 to 4.17) to undertake a review of the Council's current treasury management strategy, including the appointment of PS Live Ltd to provide independent specialist consultancy support and advice to the review process.

Contact Details	**Portfolio Holder**	**Lead Officer**
Name	David Ray	Rachael Mann
Title	Resources & Performance	Head of Resources & Performance
Telephone	01359 250912	01638 719245
E-mail	david.ray@stedsbc.gov.uk	rachael.mann@westsuffolk.gov.uk

3. Corporate Objectives

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

(a) Working together for prosperous and environmentally-responsible communities; and

(b) Working together for an efficient Council.

4. Key Issues

Annual Report 2012-2013

4.1 The Council's Treasury Management Annual Report for 2012/2013 is attached at Appendix 1.

4.2 The total amount invested at 1 April 2012 was £32.0m and at 31 March 2013 £32.9m. The increase in investment balances over this period was due primarily to the net effect of the Council's capital expenditure and asset disposals programmes. The average level of funds available for investment purposes during the year was £40.1m.

4.3 The budgeted income from investments in 2012/2013 was £0.569m. Interest actually earned during the year totalled £0.661m; an overachievement of £0.092m against budget. This was mainly due to the achievement of a higher than projected average rate of interest during the year (i.e. an average rate of retuned of 1.65% against a target rate for the period of 1.5%) which in turn was due primarily to preferential rates of interest obtained on investments with the Bank of Scotland.

4.4 Fluctuations in interest rates and in levels of planned cash flows (e.g. arising from the net effect of capital expenditure and receipts) can have a significant impact on the level of income from investments in any given period, and thereby the Council's overall budget for the year. The establishment of the Interest Equalisation Earmarked Reserve (as agreed by Council in February 2005) was designed to assist in smoothing out year-on-year variations in planned investment returns, the idea being that budgetary surpluses in investment returns in one year could be used to help fund budgetary deficits in another. As at 31 March 2013 the balance on this reserve was £0.227m. In view of the comparatively healthy position of this reserve, the budgetary surplus for the year has been credited to the Council's general reserves to be used to support future years' council tax levels.

4.5 A full list of investments held as at 31 March 2013 is shown at Appendix 2.

Investment Activity: 1 April 2013 to 30 June 2013

4.6 The total amount invested at 1 April 2013 was £32.9m and at 30 June 2013 £38.0m. 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 (i.e. to Suffolk County Council, Suffolk Police and central government).

4.7 The 2013/2014 Annual Treasury Management and Investment Strategy (report D252 refers) set out the Council's projections for the current financial year. The budget for investment income in 2013/2014 is £0.619m which is based on a continuation of the previous year's 1.5% target rate of return on investments.

4.8 As at the end of June 2013 interest actually earned during the first quarter of the financial year amounted to £0.140m against a profiled budget for the period of £0.141m; a budgetary deficit of £0.001m. This modest budgetary deficit was due to a slightly lower average rate of interest then projected during the period (i.e. an average rate of return of 1.39% against a target rate for the period of 1.50%). The reduction in the average interest rate is primarily due to the continued fall in rates being offered on both call accounts (NatWest 95 day notice account rate dropped from 1.25% to 0.80%) and fixed term investments (Bank of Scotland one year rate dropped from 3.00% in June 2012 to 1.01% in June 2013). In the current economic climate it is considered likely that these current low rates will continue for the remainder of this year.

4.9 Most market analysts are predicting that current bank base rates will be held at 0.5% for the remainder of the financial year, with Sector (the Council's treasury management advisers) now projecting that the base rate will remain unchanged until the first quarter of 2015 when a 0.25% increase is predicted. Investment rates have continued to fall over the period, due primarily to the banks' ability to easily access cheap funds from the UK Government via the Funding for Lending Scheme which has decreased their reliance on borrowing wholesale funds (such as local authority investments). If this trend continues for the remainder of the year the budgeted investment income for 2013/2014 may not be achieved. In the event that there is a shortfall in budgeted income, this will be met from the Interest Equalisation Earmarked Reserve. Treasury management performance will continue to be closely monitored with further quarterly performance reports being brought to this sub committee for scrutiny.

4.10 A full list of investments held as at 30 June 2013 is shown at Appendix 2.

Treasury Management Strategy Review

4.11 As part of the work supporting the shared services initiative with Forest Heath District Council, officers are looking, as far as possible, to adopt common procedures and policies, including common treasury management practices and processes.

4.12 The two Councils currently have very different treasury management strategies. St Edmundsbury manages all funds internally, employing a treasury management advisor, Sector, to advise on counterparty risk and credit limits. Forest Heath employs Tradition (cash fund managers) to manage the bulk of its investments, including provision of investment and counterparty advice. Forest Heath's strategy allows for the placing of fixed term investments up to 5 years (compared to St Edmundsbury 2 year maximum duration) and the use of counterparties that Sector would not support (including non rated building societies). This has helped Forest Heath to achieve a higher rate of return than St Edmundsbury (St Edmundsbury target rate for 2013/2014 is 1.5% compared to 2.5% for Forest Heath).

4.13 The differing rates of return being achieved by the two Councils has recently been challenged by the Portfolio Holder for Performance and Resources who has asked the Treasury Management Sub Committee to undertake a review of St Edmundsbury investment strategy to understand the current and future links between risk appetite and investment performance. Following consultation with Sub Committee members, it was agreed that an independent treasury management consultant should be employed to assist the Sub Committee in this review.

4.14 Approaches have been made to a number of local government finance consultants, including the Chartered Institute of Public Finance and Consultancy (CIPFA), Griffiths Morley and John Layton Associates (local government finance consultants). As a result of this exercise costed proposals have been received from two organisations, ie:

(a) **PS Live Ltd** – a specialist risk and treasury management consultancy company which currently works in partnership with CIPFA; and
(b) **Griffiths Morley** – a company specialising in public sector treasury and investment management consultancy.

4.15 Details of these proposals are provided in the exempt appendix (Appendix 3). Both companies have worked closely with CIPFA and are acknowledged as being market leaders in the provision of professional support and advice on public sector treasury management issues. The use of an external advisor provides independent facilitation for the review so there is no bias to the existing strategies.

4.16 On balance, the proposal from PS Live Ltd is recommended for acceptance on the basis of price (PS Live proposal being the cheaper quote) and relevance of recent work experience (PS Live is currently a CIPFA partner organisation for treasury management consultancy).

4.17 Following appointment of the independent consultant it is proposed that an extra meeting of the Treasury Management Sub Committee is arranged to undertake the review. This meeting will be facilitated by the independent consultant and include presentations from both Sector and Tradition. The outcome of this review will be reported to the Performance and Audit Scrutiny Committee with any resulting changes to the Treasury Management Strategy being reported to Cabinet and Council.

5. Other Options Considered

5.1 Options for the management of Council investments are formally considered within the annual treasury management and investment strategy. This includes key strategies in respect of the maintenance of the Council’s debt free status, the continuation of in-house management of funds, and the approach to be adopted in establishing the credit worthiness of potential counterparties. The changing nature of the economic climate requires that these key areas are subject to on-going review.

6. Community Impact

6.1 None

7. Consultation *(refer to the Consultation and Community Engagement Strategy)*

7.1 Treasury management activities are undertaken in consultation with Sector (the Council's appointed Treasury Management advisers) and also takes into account information obtained from investment brokers and other economic commentators. This committee provides for the scrutiny of treasury management strategies and performance, with changes in strategies and policies subject to approval by Cabinet and full Council.

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

8.1 The total interest earned in 2012/2013 from the Council's investments amounted to £0.661m representing income per Council Tax Band D equivalent property of £17.23.

9. Risk / Opportunity Assessment *(potential hazards or opportunities affecting corporate, service or project objectives)*

9.1

Risk area	**Inherent level of Risk** (before controls)	**Controls**	**Residual Risk** (after controls)
	High/Medium/Low		High/Medium/Low
Fluctuations in interest rates or in projected cashflows having significant impact on budgeted investment income.	High	Spread of investments for periods of up to two years. Budget monitoring and quarterly performance reports. Use of interest equalisation reserve to smooth out year-on-year fluctuations.	Medium
Bank / building society failure resulting in loss of Council funds.	High	Use of Sector advice on counterparty credit ratings (based on Fitch and Moody ratings) and the setting of lending limits. Use of non-rated building societies based on asset base and additional credit checks.	Medium

10. Legal or policy implications

10.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2012-2013. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

Wards affected	All
Background Papers	Treasury Management Performance and Annual Treasury Management and Investment Strategy – 2012-2013 (C294) and 2013-2014 (D252)

APPENDIX 1

Annual Treasury Management Report 2012/2013

1 Introduction

1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 (the Code) was adopted by Council on 23 February 2010.

1.2 The primary requirements of the Code are as follows:

a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
c. Receipt by Council of an Annual Treasury Management Strategy Report for the year ahead, a mid year review report (as a minimum) and an annual review report of the previous year.
d. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
e. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Treasury Management Sub-Committee.

1.3 Treasury management in this context is defined as:

'The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

1.4 The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2012-2013.

2 The Council's Debt Free Status

2.1 The Council became debt free in 1992 and since then has refrained from any borrowing apart from the temporary use of overdraft facilities. This was continued in 2012-2013 with the result that the Council had no Prudential Code indicators so far as borrowing was concerned in the year. During the financial year all the Council's investments were managed by in-house staff.

3 Investment Strategy for 2012-2013

3.1 The Council's 2012-2013 Annual Treasury Management and Investment Strategy was approved by full Council on 26 February 2012 (report C294 refers). The investment strategy for 2012-2013 was to give priority to the security and liquidity of investments whilst at the same time seeking to optimise the return on investments.

3.2 The target rate of return for investments for 2012-2013 was 1.5%. This target rate was based upon investment rate projections for the year provided by Sector (the Council's treasury management advisors), together with consideration of the profile of the Council's portfolio of investments (i.e. mixture of liquid and fixed term investments). Based upon the anticipated funds available for investment in the year (taking into account planned capital expenditure and receipts from asset disposals) this gave a target investment income of £0.569m, equivalent to £14.84 for each Council Tax band D property. This figure was used in the preparation of the Council's budget for 2012-2013.

Investment Rates in 2012-202013

3.3 The Bank of England Base Rate remained at its historic low of 0.50% for the whole of 2012-2013. Investment rates steadily dropped throughout the year, due primarily to the banks ability to easily access cheap funds from the UK Government via the Funding for Lending Scheme. The banks ability to access these funds has decreased their reliance on borrowing wholesale funds (such as local authority investments), which has resulted in the dampening of investment rates. The Funding for Lending Scheme was introduced on 13 July 2012 and has recently been extended for one year to allow participants to borrow until January 2015.

The Council's Lending Criteria 2012-2013

3.4 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).

3.5 The unprecedented nature of the current economic and banking crisis has forced local authorities to keep their lending criteria under constant review to ensure that the balance between security of capital, liquidity of investments and yield on investment income is adequately maintained. The Council's original 2012-2013 lending criteria (as set out in the 2012-2013 Annual Treasury Management and Investment Strategy) was subject to review by members of the Treasury Management Sub-Committee during October 2012 and at the Sub Committee's meeting on 5 November 2012. This review was in response to increasing difficulties being experienced in finding sufficient approved counterparties with which to place Council funds. The review resulted in an extension to the credit limits applied to part nationalised banks (i.e. Royal Bank of Scotland and Lloyds banking groups) and banks rated 'Green' by Sector (at the time both Barclays and Santander were in this category). The changes were approved under the delegated authority of the Chief Finance Officer and Portfolio Holder Performance and Resources with effect from 10 October 2010, following consultation with the members of the Treasury Management Sub Committee, with a full report on the changes being made to the Treasury Management Sub Committee meeting of 5 November 2012.

3.6 The below tables shows the credit criteria applicable at the 1 April 2012 and from 10 October 2012:

Credit Criteria: Rated Banks and Institutions

Sector Colour Code Key*	Credit Criteria 1/4/12	Credit Criteria 10/10/12
Purple	Max £10m for max of 2 years (subject to max 30% of portfolio)	No change
Orange	£9m for max of 2 years (subject to max 30% of portfolio)	No change
Red	£8m for max of 1 year (subject to max 25% of portfolio)	No change
Green	£4m for max of 6 months (subject to max 20% of portfolio)	£6m for max of 6 months (subject to max 20% of portfolio)
Blue (nationalised / substantially owned by the UK government)	£12m for max 2 years	£15m for max 2 years

Credit Criteria: Rated Building Societies

Sector Colour Code Key*	Credit Criteria 1/4/12	Credit Criteria 13/12/11
Red	£8m for max of 1 year (subject to max 25% of portfolio)	No change
Green	£4m for max of 1 year (subject to max 20% of portfolio)	No change

Credit Criteria: Non- Rated Building Societies

Asset Base**	Credit Criteria 1/4/12	Credit Criteria 10/12/12
Asset base > £2,500m	£3m for max 6 months	No change
Asset base > £1,000m	£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 a Dun and Bradstreet credit rating.*

4 Compliance with Treasury Limits

4.1 During the financial year the Council operated within the approved Treasury limits and Prudential Indicators (as set out in the Council's Treasury Policy Statement and Annual Treasury Strategy Statement, including the above approved changes to lending limits). No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

5 Investment Outturn 2012-2013

5.1 Investments were made with counterparties that met the agreed lending criteria and investment periods. Investment periods range from overnight to two years (one year for new investments), dependent on the Council's cash flows, the view on interest rates and the actual interest rates on offer.

5.2 Market investments in the year are summarised as follows:

	Value (£m)
Opening balance 1st April 2012	32.00
Add: Investments made during the year (includes 17 transfers to business reserve accounts)	83.75
Sub Total	115.75
Investments realised during the year (includes 33 withdrawals from business reserve accounts)	82.85
Balance at 31st March 2013	32.90

5.3 Where possible, investments were made in fixed term investments in order to lock into interest rates which exceed the Council's budgeted rate and to provide some certainty of return for a proportion of the Council's investments.

5.4 During the year, for cash flow generated balances, use was made of the instant access and 95 day notice business reserve accounts with Barclays, NatWest, Santander, HSBC and the Bank of Scotland. At 31st March 2013, in order to maintain liquidity whilst at the same time achieving earnings in excess of base rate, £12.15m was held in these accounts at interest rates between 0.50% and 1.25%.

5.5 At the financial year end the balance of the portfolio, £20.75m, was held in 10 separate investments maturing before the end of November 2014, in rates varying from 1.01% to 3.1%.

5.6 The average daily investment for the year was £40.01m and ranged from a high of £47.45m in January 2013 to a low of £32.0m in April 2012.

5.7 The total interest earned in 2012-2013 from the Council's investments amounted to £0.661m against a budget of £0.569m, an overachievement of £0.092m against budget. This represented an average return in the period of 1.65% compared to the original target of 1.5%. This level of interest represents an income per Council Tax Band D equivalent property of £17.23 in 2012/13 (compared to a budgeted income of £14.84 per band D property).