

STRATEGIC OVERVIEW AND SCRUTINY COMMITTEE

26th November 2012

Agenda Item 4

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**SUBMISSION BY CLLR MJ WILCOX, THE LEADER OF THE COUNCIL & THE CABINET MEMBER FOR
FINANCE, REVENUES & BENEFITS**

Half Year Report on Treasury Management Services and Projected Prudential Indicators 2012/13

1. Purpose of Report

- 1.1 The Treasury Management Strategy for Lichfield has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.
- 1.2 The Code also recommends that members be informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.
- 1.3 Treasury management is defined as: "The management of the local authority's investments and 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 These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and enable those with ultimate responsibility/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.
- 1.5 None of the Prudential indicators have been breached and a prudent approach has been taken to investment activity with priority being given to security and liquidity over yield.
- 1.6 The report is to full Council and is in addition also being submitted to Cabinet.

2. Background

2.1 Treasury Management Advice and the Expected Movement in Interest Rates

- The latest central case forecast for interest rates provided by our Treasury Management advisors Arlingclose compared to the ones used in the calculation of our investment income budgets is shown in the table below:

Projection	Dec 2012	Mar 2013	June 2013	Sept 2013	Dec 2013	Mar 2014	June 2014	Sept 2014	Dec 2014	Mar 2015	Sep 2015	Dec 2015
Treasury Management Strategy 2012-15	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	N/a	N/a
Interest Rate forecast September 2012	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Change	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	N/a	N/a

- This shows that interest rates are likely to remain at a relatively low level for a significant period of time. Lower interest rates together with the need to reduce investment periods to ensure the safe return of investments in the current climate will have an impact on the level of our investment income. We will need to take into account any reduction in the level of our investment income in our Medium Term Financial Strategy.

2.2 Investments and Cash flow

- The investments that the Council had outstanding together with a summary of investment activity throughout the 2012/13 financial year are shown at **APPENDIX A**. The summary of investment activity information shows how restrictive our current list of institutions remains in light of the "credit crunch" and problems in the banking sector.
- However, in order to access alternative investment instruments the Council set up a custody account with King and Shaxson in June 2012. By opening a custody account, the Council now has the ability to use a number of approved investment instruments as outlined in the 2012/13 Treasury Strategy and diversify the investment portfolio. Investment instruments requiring a custodian facility include Treasury Bills, Certificates of Deposit, Gilts, Corporate Bonds and Supranational Bonds.
- Our actual cash flow in 2012/13 closely followed the revised budgeted trend (**APPENDIX A**).
- We project to receive **£95,000** in net investment income in 2012/13 and this compares to a Current Budget of **£113,000**.
- We have undertaken no new external long-term borrowing in 2012/13.

2.3 The Performance of and Training within the Treasury Management Function

- The performance of the Treasury Management function should be measured against our investment objectives of Security (the safe return of our monies), Liquidity (making sure we have sufficient money to pay for our services) and Yield (the return on our investments) and these are shown in detail at **APPENDIX B**.
- Our aim for the risk status of our investments was **A-** and our investments at the 30th September 2012 had a more secure risk status of **AA** based on the length of the investment and **AA+** based on the value of investment.
- We have not needed to temporarily borrow during 2012/13.
- We have achieved an average yield of **0.88%** and this compares to a 7 day London Interbank Bid rate (LIBID) of **0.43%**. In addition, to compare performance with longer-term benchmarks, the average 1 month LIBID rate is **0.49%**, the average 3 month LIBID rate is **0.73%** and the average 6 month LIBID rate is **1.02%**.

2.4 Balance Sheet

- The projected balance sheet and balance sheet summary compared to the estimated balance sheet as at 30th September 2012 are shown at **APPENDIX C**.
- The reasons for the major variances between projections and the estimated balance sheet are also shown at **APPENDIX C**.

2.5 Treasury Position

- Our Treasury Position as at 30th September 2012 is set out at **APPENDIX C**.
- However, we need to keep the Treasury Position under review to take account of changes to budgets and changes in the wider economy specifically in relation to interest rates.

2.6 Prudential indicators 2012/13

- Our projected Prudential Indicators are summarised in the financial implications section of this report and we are compliant with all of our approved Prudential Indicators.
- However, the Council's contribution towards the Friary Outer Development of **£1.9m** is due to be made in this financial year and we assumed that this would be funded by the receipt of **£2.3m** from the Friarsgate Development. However, the Development has not proceeded as planned and this sum will not now be received in 2012/13. The Council does not have sufficient capital resources to fund the contribution; therefore this will mean that our Capital Financing Requirement (underlying need to borrow) will increase and in the short term we can finance this through internal borrowing. The longer term financing of this spend will need to be considered as part of the Council's new Medium Term Financial Forecast.

2.7 Banking Issues at the National Westminster Bank in June 2012

- The Council banks with NatWest Bank which is part of the Royal Bank of Scotland Group (RBS) and on Friday 22nd June 2012 wide-scale banking problems that affected NatWest, RBS and Ulster Bank customers occurred. Customers reported that many were without access to their wages or able to pay vital bills. NatWest reported that a technical 'glitch' had disrupted payments to and from bank accounts since Thursday 21st June 2012. The bank's response was to extend opening hours to assist customers with many branches staying open until 18.00 hours on Saturday 23rd June 2012 with many also open on the following Sunday. NatWest stated that the computer problem had arisen after their staff tried to install a software update on RBS's payment processing system, but ended up corrupting it.
- On 23rd June 2012 NatWest reported that the computer error had been fixed and was working through a long backlog of accounts, and further announced that nobody would be out of pocket as a result of the error.
- During the period of the disruption we held **£1.5m** in deposit call accounts with the RBS Group. Unfortunately on Friday 22nd June 2012 Moody's credit reference agency downgraded the credit rating of both RBS and NatWest. The reduction in the short-term rating meant that the RBS Group could no longer remain on the council's investment counterparty list with the result that the money held on deposit would have to be withdrawn and invested elsewhere. With the problems being encountered in our banking software (Bankline) we were unable to withdraw these funds on the day despite trying until the investment dealing deadlines had passed.
- On Monday 25th June 2012 Bankline was working normally and we were then able to make the £1.5m withdrawals and reinvest the money in our money market funds. The result of this is that for one working day only we were technically in breach of the approved treasury management strategy in allowing the £1.5m to remain invested with the RBS Group. We did discuss the issue with Arlingclose, and they were completely comfortable with us leaving the funds with RBS because of the computer problems being encountered and because they did not consider the RBS Group to have any immediate funding issues.
- We consider our Treasury Management and payment systems as key financial systems and as a consequence we have in place Business Continuity Plans. However, on this occasion it was not necessary to implement the plans although we will review the plans to ensure they can deal with this almost unique type of disruption should it occur again in the future.

3. Community Benefits

- 3.1 Management of the Council's resources is essential in order to ensure economical and efficient delivery of Council services.

4. Financial Implications

- 4.1 The Prudential Indicators are summarised below:

PI	Capital expenditure	2012/13 Original	2012/13 Approved	2012/13 Projected
1	Capital Expenditure (£m)	£5.722m	£7.436m	£5.333m
2	Ratio of Financing Costs to Net Revenue Stream (%)	6%	6%	6%
3	Capital Financing Requirement (£m)	£1.144m	£1.284m	£2.869m
3	Net external borrowing does not exceed the Capital Financing Requirement in the current year and the next two years.	True	True	True
4	Actual External Debt (£m) includes Finance Leases	£1.145m	£1.190m	£0.869m
5	Incremental impact of capital investment decisions on Band D Council Tax (£)	£0.14	£0.14	£0.14
6	Authorised limit (£m) (Maximum)	£11.638m	£11.638m	£1.458m
7	Operational boundary (£m) (Maximum)	£2.948m	£2.948m	£1.458m
8	Adoption of CIPFA Code of Practice in Treasury Management	Yes	Yes	Yes
9	Net Debt	-£6.750m	-£8.265m	-£8.068m
	Interest Rate Exposures (%)			
10	Upper Limit for Investments Fixed Interest Rate Exposure		-100%	
10	Upper Limit for Investments Variable Interest Rate Exposure		-100%	
11	Upper Limit for Borrowings Fixed Interest Rate Exposure		100%	
11	Upper Limit for Borrowings Variable Interest Rate Exposure		30%	
	Maturity Structure of Fixed Rate Borrowing (Upper Limit) (%)			
12	Under 12 months		0% to 100%	
12	12 months and within 24 months		0% to 20%	
12	24 months and within 5 years		0% to 80%	
12	5 years and within 10 years		0% to 40%	
12	10 years and within 20 years		0% to 60%	
12	20 years and within 30 years		0% to 40%	
12	30 years and within 40 years		0% to 40%	
12	40 years and within 50 years		0% to 40%	
12	50 years and above		0% to 20%	
13	Principal sums invested > 364 days (£m)	£1.90m	£1.90m	£1.20m
14	Credit Risk	We consider security; liquidity and yield, in that order, when making investment decisions.		

5. Risk Management Issues

	Risk Description	Likelihood / Impact	Status	Countermeasure
A	Counterparty default	Medium / High	Financial	Investments are restricted to those organisations with the lowest credit risk: <ul style="list-style-type: none"> a) The Debt Management Account Deposit Facility. b) Stable Net Asset Value Money Market Funds with an AAA rating. c) Deposits with other Local Authorities. d) Deposits with UK Banks and Building Societies

				systemically important to the UK banking system. As conditions in the Financial Sector improve, we may diversify the counterparty list based on our advisor's recommendations.
B	Adverse Interest Rate fluctuations	Low / Low	Financial	The budget for investment income will be monitored as part of the Council's budget monitoring procedures.
C	Actual cash flows are different to those that are planned	Low / High	Financial	The Council maintains a comprehensive cash flow model that is updated on a daily basis to reflect both actual and planned cash flows. An element of the Council's investment portfolio will be invested in call accounts.

Background Documents:

CIPFA Code of Practice for Treasury Management in the Public Services
Treasury Management Strategy Report 2012/15 – Cabinet 14th February 2012.
Annual Report on Treasury Management Services and Actual Prudential indicators 2011/12 – Cabinet 4th September 2012
The Prudential Code for Capital Finance in Local Authorities

Investments and Cash flow in 2012/13

Investments at 30th September 2012

The table below shows a breakdown of our investments at the 30th September 2012:

Counterparty	Principal	Matures	Days to Maturity	Rate	Credit Rating ¹ 30/09/12	Foreign Parent
Money Market Funds						
Deutsche Bank	1,400,000	01-Oct-2012	Instant Access	0.50%	AAA	N/A
Ignis	1,470,000	01-Oct-2012	Instant Access	0.60%	AAA	N/A
Legal & General	1,400,000	01-Oct-2012	Instant Access	0.49%	AAA	N/A
Prime Rate	1,450,000	01-Oct-2012	Instant Access	0.58%	AAA	N/A
Insight	1,040,000	01-Oct-2012	Instant Access	0.48%	AAA	N/A
SWIP	1,080,000	01-Oct-2012	Instant Access	0.40%	AAA	N/A
Other Counterparties						
Standard Chartered (Certificate of Deposit)	2,000,000	19-Dec-2012	80	0.92%	A+	No
UK Treasury Bills	500,000	31-Dec-2012	92	0.34%	AAA	No
UK Treasury Bills	196,150	31-Dec-2012	92	0.37%	AAA	No
Nationwide	2,000,000	18-Oct-2012	18	0.61%	A	No
Northumberland County Council	1,200,000	24-Sep-2014	724	0.90%	AAA	No
Barclays Bank	1,000,000	26-Oct-2012	26	0.76%	A	No
Lloyds TSB	2,000,000	01-Nov-2012	32	1.35%	A	No
Santander (UK)	2,000,000	01-Oct-2012	Instant Access	0.75%	A	Yes
Total	18,736,150					

However, the previous table only shows the investment position on one particular day of the financial year, the table below shows a summary for the financial year to date:

Counterparty	Number of Deals	Total Principal Invested £m	Is the Counterparty on our current list ² of institutions?
SWIP	16	£9.52	Yes
Legal & General	11	£8.34	Yes
Blackrock	9	£6.41	Yes
Deutsche Bank	8	£5.04	Yes
Insight	8	£4.88	Yes
J.P. Morgan	7	£6.07	Yes
Barclays Bank	4	£4.00	Yes
Ignis	4	£0.36	Yes
Invesco Aim	3	£2.64	Yes
Lloyds TSB	3	£6.00	Yes
Nationwide	2	£4.00	Yes
Bank of Scotland	2	£2.00	Yes
Treasury Bills	2	£0.70	Yes
Santander (UK)	2	£2.70	Yes
Prime Rate	2	£0.52	Yes
BNY Mellon	2	£1.89	Yes
Debt Management Office	1	£3.00	Yes
Northumberland County Council	1	£1.20	Yes
Standard Chartered	1	£2.00	Yes
NatWest	1	£1.20	Yes ³
Total	89	£72.48	

¹ This is the lowest rating provided by the three credit rating agencies – Moody's, Fitch and Standard and Poor's.

² As at 30th September 2012.

³ National Westminster is the Council's bank and therefore it will remain on our list of approved counterparties even in the event of its credit rating falling below our approved minimum level.

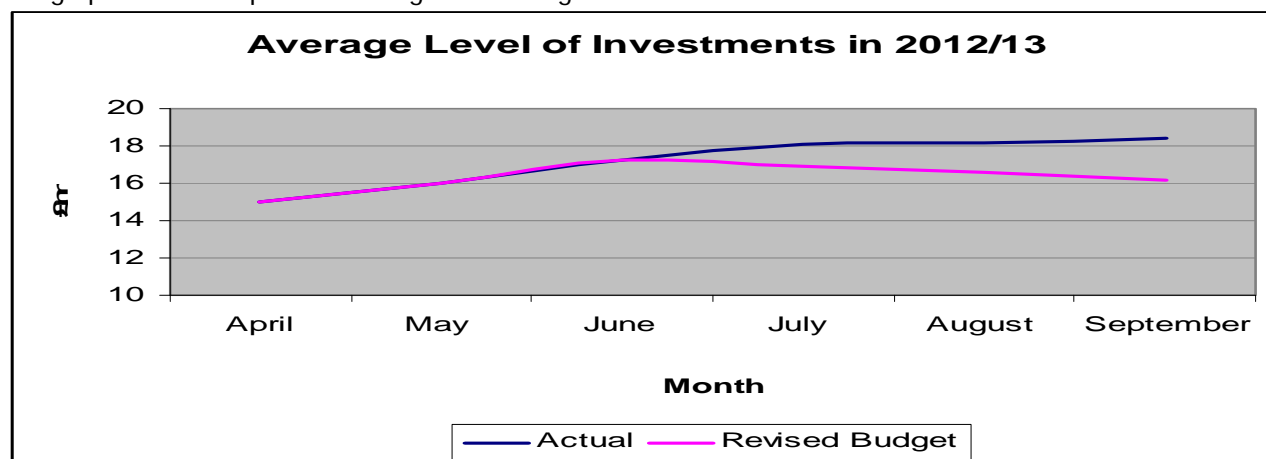
APPENDIX A

The table shows how restrictive our current list of institutions remains in light of the “credit crunch” and problems in the banking sector. This list is reviewed on an ongoing basis and takes account of the following sources of information:

- Advice from our Treasury Management advisors.
- Credit Ratings (A minimum of A- across all three rating agencies).
- Gross Domestic Product of the Country in which the institution operates.
- The Country's net debt as a percentage of Gross Domestic Product.
- UK Sovereign support mechanisms or potential support from a well resourced parent institution.
- Credit Default Swaps (CDS) prices.
- Share Prices.
- Information in the general and financial media.

Cash flow for 2012/13

The graph below compares the budget for average investment levels in 2012/13 with the actual levels.



The graph shows that the actual trend of investments followed the revised budget (after taking account of actual balances at the end of the previous financial year) closely until June 2012 although investments in July to September are higher than we budgeted.

Investment Income Budgets for 2012/13

Net Investment Income

In terms of interest receipts, there are two key risks / sensitivities:

- a) The interest rate receivable.
- b) The amount of money we have available to invest.

The interest rates, amounts of money we had available to invest, interest receipts, interest paid and net investment income is shown in the table below:

Details	2012/13 Approved	2012/13 Projected	2012/13 Variance
Average Amount we had available to Invest (£m)	£13.58m	£15.91m	£2.33m
Annual Average Interest Rate (%)	0.84%	0.76%	(0.12%)
Interest Receipts (£)	£126,000	£108,000	(£18,000)
Other Interest (£)	(£13,000)	(£13,000)	£0
Net Investment Income (£)	£113,000	£95,000	(£18,000)

New Long Term Borrowing Costs

No new long-term borrowing has been undertaken in 2012/13.

Performance of the Treasury Management Function

The performance of the Treasury Management function should be measured against the investment objectives of Security (the safe return of our monies), Liquidity (making sure we have sufficient money to pay for our services) and Yield (the return on our investments).

Security

Our aim for the risk status of our portfolio was **A-** using the lowest rating from the three credit rating agencies as the basis for assessing the risk status.

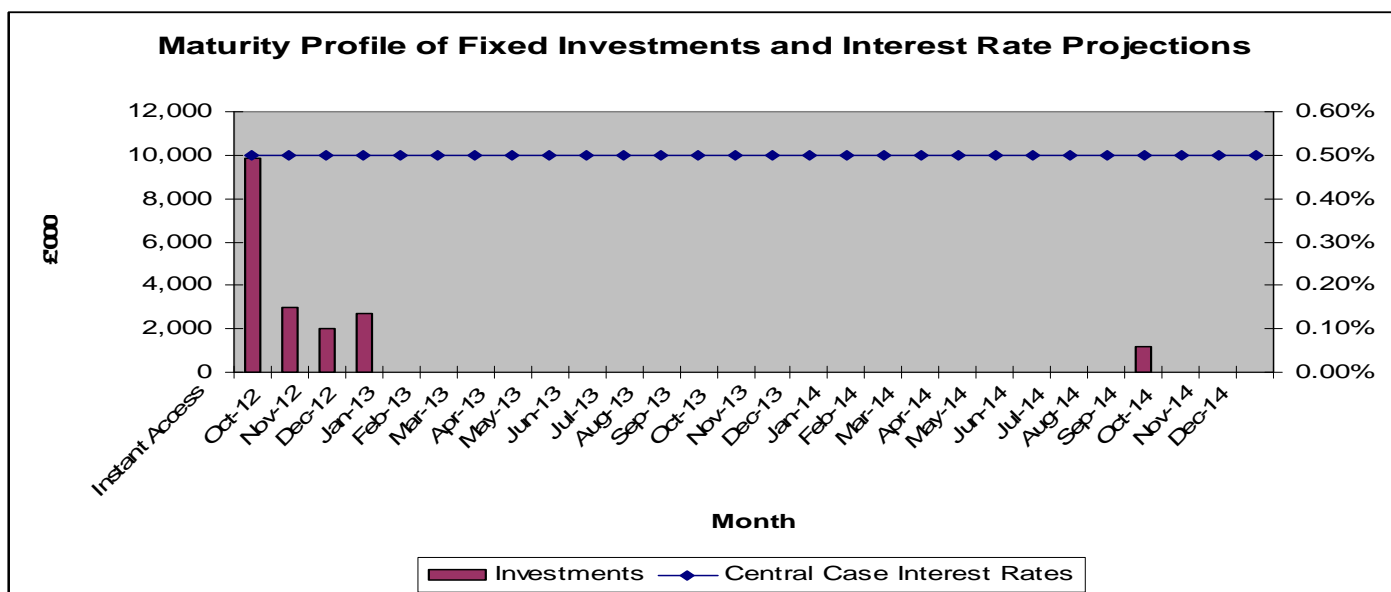
The investments outstanding at the 30th September 2012 had a risk status of **AA+** based on the value of the investment and **AA** based on the length of the investment, which has a more secure risk status, and this is both compliant with our aim and the recommendations from our Treasury Management advisors. The recent history of the security of our investments is shown in the table below:

<u>Date</u>	<u>The Value of the Investment</u>	<u>The Maturity Date of the Investment</u>
31 st March 2012	A+	AA-
30 th June 2012	A+	AA
30 th September 2012	AA+	AA

In addition, we are currently keeping the length of our investments relatively short term to ensure that we can react to changes in counterparty credit risk very easily. Our Treasury Management advisors recommend for each bank or building society the new investment time limit to manage counterparty credit risk. At the 30th September 2012, the investment time limits were:

Bank or Building Society	Investment Time Limit
Santander (UK)	35 days
Lloyds TSB	100 days
Nationwide	100 days
Barclays Bank	100 days
Bank of Scotland	100 days
HSBC	12 months
Standard Chartered	12 months

To manage the interest rate risk where possible we are spreading investment maturities. The average length of investments we have made in 2012/13 is **120 days**. The maturity profile of our investments together with interest rate projections at September 2012 are shown in the graph below.



Liquidity

Measuring the performance in relation to liquidity is a much more difficult task and the easiest way to assess performance is to see how frequently we needed to borrow on a temporary basis during the financial year. In 2012/13 we have not needed to borrow temporarily. Currently we use call accounts and Money Market Funds for short-term liquidity requirements, this gives us same day access to funds if needed.

Yield

To date in 2012/13, we have achieved an average interest rate of **0.88%** and this compares with our performance indicator of the average 7-day London Inter-bank Bid (LIBID) rate, of **0.43%**. In addition, to compare performance with longer-term benchmarks, the average 1 month LIBID rate is **0.49%**, the average 3 month LIBID rate is **0.73%** and the average 6 month LIBID rate is **1.02%**.

Training within the Treasury Management Function

Our Treasury Management Practices (TMP 10) states, "This organisation recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Director of Finance, Revenues and Benefits will recommend and implement the necessary arrangements."

We have one point of access for training:

- Our Treasury Management Advisors run regular courses and we are entitled to two free places on each course.

From the 1st April 2012 to the 30th September 2012, members of the core Treasury Management Team plus officers responsible for authorisation of investments in the wider Finance function have attended no courses because we have attained the required levels of training and competence within the Team.

Balance Sheet Projections

Balance	31 Mar 2012 Actual £m	31 Mar 2013 Estimated £m	31 Mar 2013 Projected £m	Projected Variance £m
1. Property, Plant and Equipment, Investment Property & Intangible Assets	47.892	50.491	50.441	-0.050
4. Long Term Debtors	0.248	0.186	0.227	0.041
Current Assets				
4. Current Assets (including accrued interest)	3.289	5.797	3.289	-2.508
2. Short Term Investments (excluding accrued interest)	4.059	6.728	8.948	2.220
2. Cash and Cash Equivalents	8.857			
Current Liabilities				
3. Short Term Borrowing	-0.004	-0.030	0.000	0.030
3. Finance Leases	-0.503	-0.536	-0.324	0.212
4. Short Term Creditors	-6.753	-7.046	-6.662	0.384
4. Receipts in Advance	-0.039	0.000	-0.025	-0.025
4. Provisions	-0.061	0.000	0.000	0.000
Long Term Liabilities				
3. Finance Leases	-0.810	-0.579	-0.555	0.024
3. Borrowing	-0.033	0.000	0.000	0.000
4. Pension Scheme	-25.037	-20.187	-25.037	-4.850
4. Receipts in Advance	-0.554	0.000	-0.232	-0.232
Total Assets less Liabilities	30.551	34.824	30.070	-4.754

Usable Reserves				
4. Capital Grants Unapplied	-1.269	-0.009	-1.026	-1.017
5. Usable Capital Receipts	-1.443	-0.571	-0.969	-0.398
5. Burntwood Leisure Centre Sinking Fund	-0.538	-0.305	-0.471	-0.166
5. Burntwood Synthetic Pitch Sinking Fund	-0.029	0.000	-0.029	-0.029
5. City Centre Redevelopment Sinking Fund	-0.025	-0.024	-0.025	-0.001
5. King Edwards Leisure Centre Sinking Fund	-0.031	0.000	-0.031	-0.031
5. Lombard Street Car Park Sinking Fund	-0.034	-0.017	-0.044	-0.027
5. Elections	-0.075	-0.095	-0.075	0.020
5. Public Open Spaces	-0.006	-0.007	-0.006	0.001
5. Three Spires Multi Storey Reserve	-1.124	-1.271	-1.280	-0.009
5. Earmarked Reserves	-1.697	-1.353	-1.691	-0.338
5. Grant Aid	-0.046	-0.038	-0.046	-0.008
5. Building Regulations	0.000	-0.006	0.000	0.006
5. General Fund Balance	-3.076	-2.209	-2.030	0.179
Unusable Reserves				
1. Revaluation Reserve	-4.939	-4.932	-4.939	-0.007
1. Capital Adjustment Account	-41.550	-44.414	-42.633	1.781
4. Deferred Credits	-0.010	-0.007	-0.084	-0.077
4. Benefits Payable during Employment	0.296	0.233	0.264	0.031
5. Collection fund	0.008	0.014	0.008	-0.006
4. Pension Scheme	25.037	20.187	25.037	4.850
Total Equity	-30.551	-34.824	-30.070	4.754

Balance Sheet Summary

1. Capital Financing Requirement	1.403	1.145	2.869	1.724
2. Investments	12.916	6.728	8.948	2.220
3. Borrowing and Finance Leases	-1.350	-1.145	-0.879	0.266
4. Net Creditors	-4.853	-0.846	-4.249	-3.403
5. Balances and Reserves	-8.116	-5.882	-6.689	-0.807

Balance Sheet Commentary

Actual Balance Sheet as at 31st March 2012

The main changes to the budget and its assumptions that impacted on the Balance Sheet are detailed below:

Pensions

The triennial valuation of the pension fund took place in 2011/12 using new assumptions such as CPI etc and this valuation has resulted in the Pension scheme liability increasing from **£20.187m** to **£25.037m**.

Debtors

The level of debtors has reduced from a budgeted level of **£5.797m** to an actual level of **£3.289m** because a collection fund (Government) debtor has now become a creditor (ie we budgeted that they would owe the Council money and the Council actually owes them money) and the level of manual sundry debtors has reduced.

Projected Balance Sheet as at 31st March 2013

The Council's contribution towards the Friary Outer Development of **£1.9m** is due to be made in this financial year and is part of the Approved Capital Programme. The Approved Capital Programme also assumed that the funding of **£2.3m** which was to be used to fund this contribution and other capital spend of **£0.4m** would be provided as part of the Friarsgate development. However, the progress in relation to this development has not proceeded as planned and this sum will not now be received in 2012/13.

The Council currently does not have sufficient capital resources to fund the contribution of **£1.9m**; therefore this will mean that our Capital Financing Requirement (underlying need to borrow) will increase in the short term and we can finance this through internal borrowing. As a consequence, the longer term financing of this spend will be considered as part of the Council's new Medium Term Financial Forecast.

Borrowing Requirement and Strategy (Treasury Position)

The Balance Sheet projections can also be used to assess the underlying need to borrow (known as the Capital Financing Requirement). The table below indicates when the Council would need to borrow to fund its capital programme based on latest projections.

31 Mar 2012 Actual £m	Details	31 Mar 2013 Original £m	31 Mar 2013 Projected £m
1.403	The amount of our capital spend that is not financed from capital receipts, revenue, grants and contributions (Capital Financing Requirement)	1.145	2.869
-1.350	Less: current funding provided through finance leases and long term borrowing	-1.145	-0.879
0.053	Projected Borrowing Need⁴	0	1.990
-8.116	Less: the projected level of our balances and reserves we currently hold as investments	-5.882	-6.689
-£8.063m	Our net projected borrowing need (a positive figure indicates when we need to borrow)	-£5.882m	-£4.699m

⁴ The projected borrowing need is represented by £1.896m for the Friary Outer Development, the Telephony Project £0.062m and the Lichfield Garrick £0.032m.