Report No. RES11117	London Borough of Bromley PART 1 - PUBLIC	Agenda Item No.

Decision Maker:	**Executive** **Council**		
Date:	**Executive on 19th October 2011** **Council on 24th October 2011**		
Decision Type:	Urgent	Executive	Non-Key
Title:	**TREASURY MANAGEMENT - Q1 PERFORMANCE 2011/12**		
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Chief Officer:	Director of Resources		
Ward:	All		

1. Reason for report

1.1 This report summarises treasury management activity during the first quarter of the financial year 2011/12 and provides a general update on interest rates and on the current economic climate. The report also includes an update on the Council's investment with Heritable Bank (paragraph 3.15) and proposes a change to the investment criteria that form part of the Council's Annual Investment Strategy that will require the approval of full Council. Treasury management performance is usually reported quarterly to the Executive & Resources PDS Committee for decision by the Resources Portfolio Holder, but there is an urgent need for this matter to be considered at full Council on 24th October. For this reason, the 1st quarterly report of 2011/12 is being reported to the Executive.

RECOMMENDATION(S)

The Executive is requested to:

(a) Note the report and

(b) Recommend to Council that the proposed increase in the investment limit for the part-nationalised banks, Lloyds TSB and the Royal Bank of Scotland, from £40m to £60m be approved (see paragraph 3.18).

Council is requested to:

(a) Note the report;

(b) Consider comments from the Executive and

(c) Approve an increase in the investment limit for the part-nationalised banks, Lloyds TSB and the Royal Bank of Scotland, from £40m to £60m.

Corporate Policy

1. Policy Status: Existing policy. To seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £2.691m (net) in 2011/12; surplus of £700k currently forecast

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.4 fte

2. If from existing staff resources, number of staff hours:

Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable Changes to the Annual Investment Strategy require Council approval

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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments:

3. COMMENTARY

General

3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year describing the activity compared to the strategy. In practice, the Director of Resources has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year. This report includes details of treasury management activity during the first quarter of the financial year 2011/12 and includes details of investments in place as at 30th June 2011 (Appendices 1 and 2) together with commentaries from our external advisers, Sector Treasury Services Ltd, on the economic background in the June quarter (Appendix 3) and a summary of their outlook (Appendix 4) and their thoughts on future interest rates (Appendix 5). A change to the investment limit for the part-nationalised banks, Lloyds TSB and the Royal Bank of Scotland, is proposed (paragraph 3.18) and the Executive is asked to recommend this to full Council.

Annual Investment Strategy

3.2 The Treasury Management Strategy Statement (TMSS) for 2011/12, which includes the Annual Investment Strategy, was approved by the Council on 28th February 2011. It sets out the Council's investment priorities in the following order:

- Security of Capital;
- Liquidity; and
- Yield.

3.3 The Council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate, it is considered appropriate to keep investments short term to cover short term cash flow needs but also to seek out value available in significantly higher rates in periods up to 2 years with nationalised and part-nationalised UK banks and up to 1 year with highly credit rated financial institutions. This strategy was approved by full Council in February 2011 and, although there remains the potential for further financial difficulties, both in the Eurozone and further afield, it is not recommended that this "core" strategy be amended at this time. Officers will, however, continue to monitor the position and will consider external advice and any other information available before determining the lending period with individual institutions. Proposed changes to counterparty limits are outlined in paragraph 3.18 below.

3.4 Investment rates available in the market have continued at historically low levels. The average level of funds available for investment purposes during the quarter was £198.2m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

3.5 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30th June 2011.

Treasury Performance in the quarter 1st April 2011 to 30th June 2011

3.6 **Borrowing:** The Council's healthy cashflow position has continued into 2011/12, as a result of which there was no borrowing during the first three months of the year. In 2009/10, only four loans were taken out to cover short-term cashflow shortages and, in 2010/11, only one small overnight loan (for £800k) was taken out in March 2011.

3.7 **<u>Investments:</u>** The following table sets out details of investment activity during the first three months of the year:-

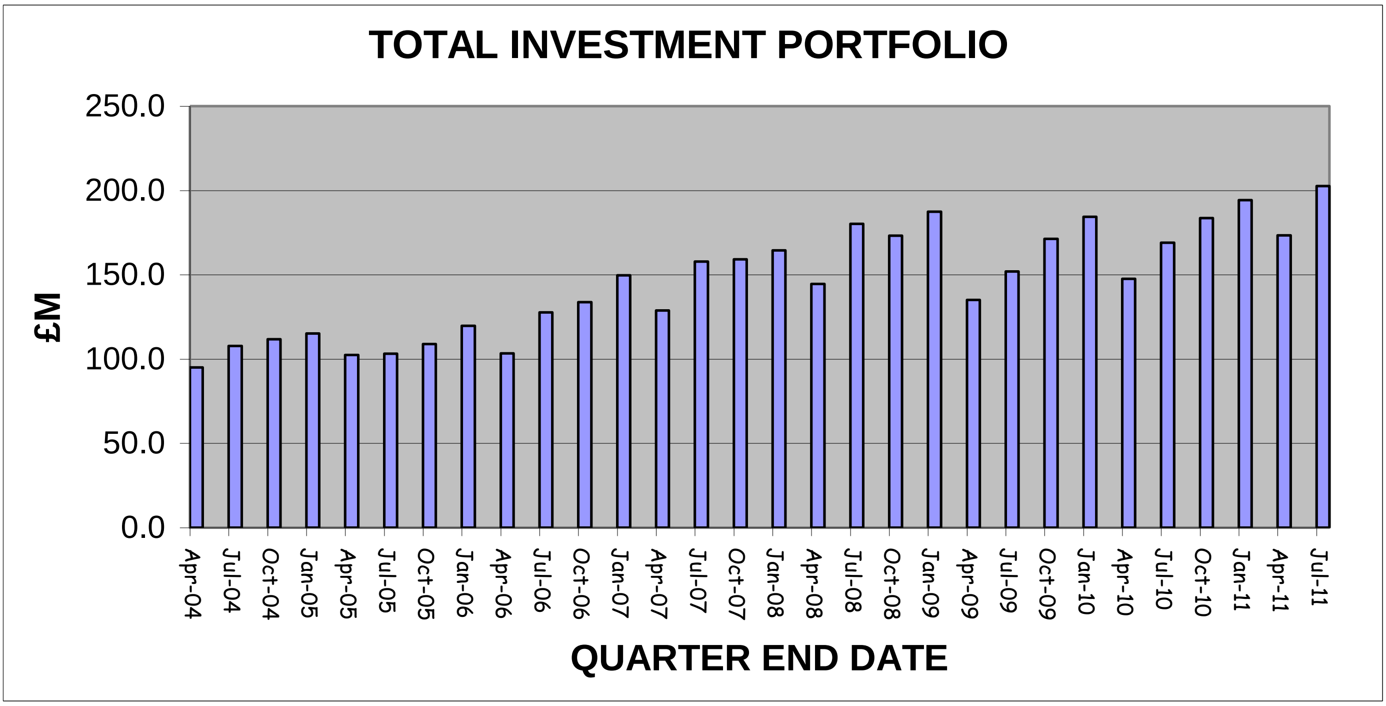
Main investment portfolio	**Deposits £m**	**Ave. Rate %**
"Core" investments as at 31/03/11	161.5	1.86
Investments made in Q1 2011/12	32.5	1.59
Investments redeemed in Q1 2011/12	-32.5	1.55
Total "Core" Investments 30/06/11	161.5	1.96
35-day notice – Svenska Handelsbanken	15.0	
Money Market Funds/Instant Access	21.0	
Total Investments as at 30/06/11	**197.5**	
Heritable deposit – frozen (see para 3.15)	5.0	6.42

3.8 Details of the outstanding investments at 30th June 2011 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. The average return on all new "core" investments during the June quarter was 1.59% which may be compared with the average 3 month LIBID rate of 0.70% and the average 7 day rate of 0.46%.

3.9 Credit ratings changes, particularly since the Icelandic banking crash in October 2008, resulted in the removal of many of our established counterparties from our lending list and it has since been difficult to identify institutions to place money with. As a result, much greater use has been made of Money Market Funds, which provide a safe haven and instant access, but offer considerably lower interest rates.

3.10 Base rate has now been 0.5% since March 2009 and the latest forecast by Sector is for it to remain at that level until the end of 2012. This estimate has slipped back a year in the space of the last 4 or 5 months. Most of the institutions that remain on our lending list at this time are offering around 0.90% for 3 months up to 1.7% for 1 year, which are both slightly higher than in July. Better rates (around 1.25% for 3 months up to 2.2% for a year) are available from Lloyds TSB, while Santander are currently offering 1.26% and 2.1% respectively. In February 2010, the Portfolio Holder agreed changes to the Council's investment strategy, which permitted investment for up to 2 years with the largely-government owned Lloyds TSB and Royal Bank of Scotland (since November 2008, following the Icelandic banking crash, investments had been limited to a maximum period of 1 year). The "core" investments placed during the first quarter of 2011/12 were placed for between 6 months and a year (at that time anticipating no rise in interest rates until mid-2011 at the earliest) or in instant access money market funds. One investment was, however, placed for two years when it began to appear likely that the forecast upturn in rates would be delayed. The Finance Director will continue to monitor rates and counterparty quality prior to any investment decisions.

3.11 The graph below shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years, largely due to increased and earlier government funding. This has been a significant contributor to the over-achievement of investment income against budget in recent years, although this has now been fully factored into the revenue budget.



Other accounts

3.12 Money Market Funds

The Council currently has 6 Money Market Fund accounts, with Aviva, Fidelity, Prime Rate, Insight, Blackrock and Ignis. The Prime Rate, Blackrock and Ignis accounts were opened during 2009/10 in order to provide a degree of added flexibility and following consultation with our external advisers. In common with market rates for fixed-term investments, interest rates on money market funds have also fallen considerably. In November 2008, Aviva changed the valuation arrangement for its fund, moving from a constant net asset value of £1 per share to a mark-to-market basis (i.e. a variable net asset value). The Council has not invested in the fund at all since then and will not do so while this valuation arrangement continues, as there is a potential for loss of principal sums. Following the changes to the investment strategy approved by Council in October 2009, in February 2010 and, more recently, in October 2010, investments were moved away from money market funds into fixed term deposits, enabling the Council to improve returns. As expected, the balance in these funds reduced considerably during the last two months of 2010/11 as funds were withdrawn to cover diminishing Council Tax receipts and increasing expenditure in the final quarter, but, in the first quarter of 2011/12, balances have again been high.

Money Market Fund	Date Account Opened	Ave. Rate 2011/12 (to 30/6/11) %	Ave. Daily Balance 2011/12 £m	Actual Balance 30/06/11 £m	Current Balance 10/10/11 £m	Current Rate 10/10/11 %
Prime Rate	15/06/09	0.78	3.1	11.2	15.0	0.87
Ignis	25/01/10	0.77	2.7	9.8	15.0	0.83
Insight	03/07/09	0.66	0.4	-	0.5	0.69
Blackrock	16/09/09	-	-	-	-	0.59
Fidelity	20/11/02	-	-	-	-	0.59

3.13 Notice Accounts

In April 2011, the Council placed £15m in a 35-day notice account with Svenska Handelsbanken (Sweden). The total of £15m is still currently invested and has earned interest at a rate of 0.85% and the average daily balance in the first quarter of 2011/12 was £3.0m.

3.14 External Cash Management

External cash managers, Tradition UK Ltd and Sterling International Brokers Ltd, were both appointed to manage £10m of our cash portfolio in August 2003. The Portfolio Holder agreed, in February 2010, that the arrangement with one of the two external cash managers, Sterling International Brokers Ltd, be terminated and that their £10m fund be transferred as investments mature to Tradition UK, bringing their total up to £20m. This followed a detailed review of the relative performance of both cash managers and the Council's in-house treasury team. At the time of writing this report (22nd September 2011), Tradition UK had achieved a return of 1.54% since 1st April 2011 (mainly bolstered by the two longer term investments placed in May and August (see table below). Tradition UK, like the Council's in-house team, have been constrained by strategy changes approved after the Icelandic Bank crisis. Details of externally managed funds placed on deposit as at the time of writing this report are shown below.

Sum	Start Date	Maturity	Period	Rate
Tradition UK				
£2.5m	17/05/11	22/03/12	10 months	1.25%
£5m	10/06/11	22/03/12	9.5 months	1.23%
£5m	12/08/11	27/03/12	7.5 months	1.20%
£2.5m	17/05/11	27/07/12	14.5 months	2.65%
£5m	17/08/11	16/08/13	2 years	2.80%

3.15 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki, when it was placed in administration in early-October 2008 at which time our investment was, and still is, frozen. The latest estimate given by the administrators, Ernst & Young, late in September 2011 indicates a likely return of between 86% and 90% of our claim. This latest estimate is a significant improvement on the previous estimate of between 79% and 85% and Council officers and our external advisers remain hopeful of an even better result. An initial dividend of 16.13p in the pound (£820k) was paid to the Council in July 2009 and, since then, a further seven dividends have been received. As a result, around 60% of our claim (£3,073k) has been returned to us so far.

For information, the claim we were obliged to submit consisted of the principal sum (£5m) plus interest due to the date on which Heritable was placed in administration (around £87,000). We were not able to lodge a claim for the full amount of interest (£321,000) that would have been due at the original investment maturity date (29/6/09). In accordance with proper accounting practice and guidance from CIPFA, we made provision in our 2008/09 accounts for an impairment loss of £1.64m and met this from the General Fund in the year. In line with revised guidance from CIPFA relating to the 2009/10 accounts, we were able to reduce the impairment by £300k and this sum was credited to the General Fund. Although we could have made a further reduction to the impairment loss in 2010/11, we decided to err on the side of caution and made no further adjustments to the accounts. The recent increased recovery estimate of between 86% and 90% would potentially enable us to reverse a further £0.7m of the impairment, which would be credited to the General Fund as additional interest income.

Proposed changes to counterparty limits

3.16 Since the Icelandic banking crisis in October 2008, ratings downgrades and other factors have caused the Council's lending list to contract significantly and it has, on occasions, been difficult to identify a counterparty to invest with. Prior to October 2008, we were able to invest for up to 5 years with a large number of banks and, significantly, a large number of building societies. In setting eligibility criteria for the inclusion of counterparties on our list, a number of factors are taken into account, the main one of which was, and still is, credit ratings. Since October 2008, the credit ratings agencies have all taken a very cautious approach to ratings, as a result of which we have only been able to invest in a handful of UK clearing banks (primarily HSBC, Barclays, Lloyds TSB, RBS, Santander and Clydesdale) and just one building society (Nationwide).

3.17 Limits for these institutions are nearly always fully utilised and investments are only placed as and when maturities occur. Surplus cash over and above the sums invested with these institutions is placed in instant access money market funds or in 30 to 35-day notice accounts earning relatively poor interest rates. The restrictions on our lending list have resulted in large sums being placed in low interest accounts and this has had a significant impact on the Council's interest earnings. Around £25m is currently invested at an average rate of around 0.85% (£210k in a full year) and we could broadly expect to double this if we were able to place more with eligible UK banks and building societies.

3.18 As is outlined above, the continuing problem of counterparty availability is severely limiting our options for investing money and for maximising return at minimum additional risk. In October 2010, as an interim solution, the Council agreed that investment limits be increased as follows for the UK banks and building societies that remain on our lending list.

Lloyds TSB & RBS – increased from £30m to £40m (c.20% of current portfolio total of £200m)
Barclays & HSBC – increased from £25m to £30m
Santander, Clydesdale & Nationwide – increased from £15m to £20m

This has provided a temporary solution, although we are currently full to our limit with most of these institutions. The market remains uncertain and advisers remain cautious about financial institutions in general and, in particular, about building societies. Following recent discussions with Sector, ***it is now proposed that the total investment limit for the two part-nationalised banks, Lloyds TSB and Royal Bank of Scotland, be increased to £60m***. This would represent around 30% of our current investment portfolio and would enable us to invest more money with both and, consequently, less money with low-interest instant access accounts. Sector advise that this would be prudent in the current economic climate. No changes to the maximum investment duration periods are proposed at this stage, although officers will continue to monitor the position in respect of maturing investments and will consider external advice as appropriate. The changes will require the approval of full Council.

Regulatory Framework, Risk and Performance

3.19 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;

- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;

- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.20 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

5. FINANCIAL IMPLICATIONS

5.1 An average rate of 1.5% was assumed for interest on new investments in the 2011/12 revenue budget (£2.69m), in line with estimates provided in January 2011 by the Council's external treasury advisers. The average rate obtained on all new investments placed since the budget was agreed is slightly above this at around 1.70%. Rates are still expected to rise, but the expected start of the rise has been put back to the end of 2012 at the earliest. The latest financial forecast assumes 1.5% in 2012/13, 2.00% in 2013/14, 2.5% in 2014/15 and 3.0% in 2015/16. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £400k pa from 2012/13. The latest forecast for 2010/11 is for a surplus of £700k as a result of the recent improvement in the Heritable administrator's recovery estimate (see paragraph 3.15).

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Butlers and Sector