Report No. RES13021	**London Borough of Bromley**	**Agenda Item No.**

PART 1 - PUBLIC

Decision Maker:	**Resources Portfolio Holder**
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 31st January 2013**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**TREASURY MANAGEMENT - PERFORMANCE Q3 2012/13**
Contact Officer:	Martin Reeves, Principal Accountant (Technical & Control) Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk
Chief Officer:	Director of Resources
Ward:	All

1. Reason for report

1.1 This report summarises treasury management activity during the quarter ended 31st December 2012 and the period 1st April 2012 to 31st December 2012 and updates Members on the Council's investment with Heritable Bank (paragraph 3.12).

RECOMMENDATION(S)

2.1 The PDS Committee and the Portfolio Holder are asked to note the report.

Corporate Policy

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

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 2012/13; currently forecast on target

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.25 fte

2. If from existing staff resources, number of staff hours: 9 hours per week

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Legal

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

2. Call-in: Call-in is applicable

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, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year comparing actual activity to the strategy. In practice, the Finance Director 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-end. The mid-year review for 2012/13 was considered by the PDS Committee on 18th October 2012 and was reported to the Council meeting on 12th November. This report includes details of treasury management activity during the quarter ended 31st December 2012 and the period 1st April 2012 to 31st December 2012. The 2013/14 annual strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, is reported elsewhere on the agenda.

Treasury Performance in the quarter ended 31st December 2012

3.2 **Borrowing:** The Council's healthy cashflow position continued through the whole of 2011/12 and the first three quarters of 2012/13, as a result of which no borrowing was required at all during those periods. In 2010/11, only one small overnight loan (for £800k) was taken out (in March 2011).

3.3 **Investments:** The following table sets out details of investment activity during the latest quarter:-

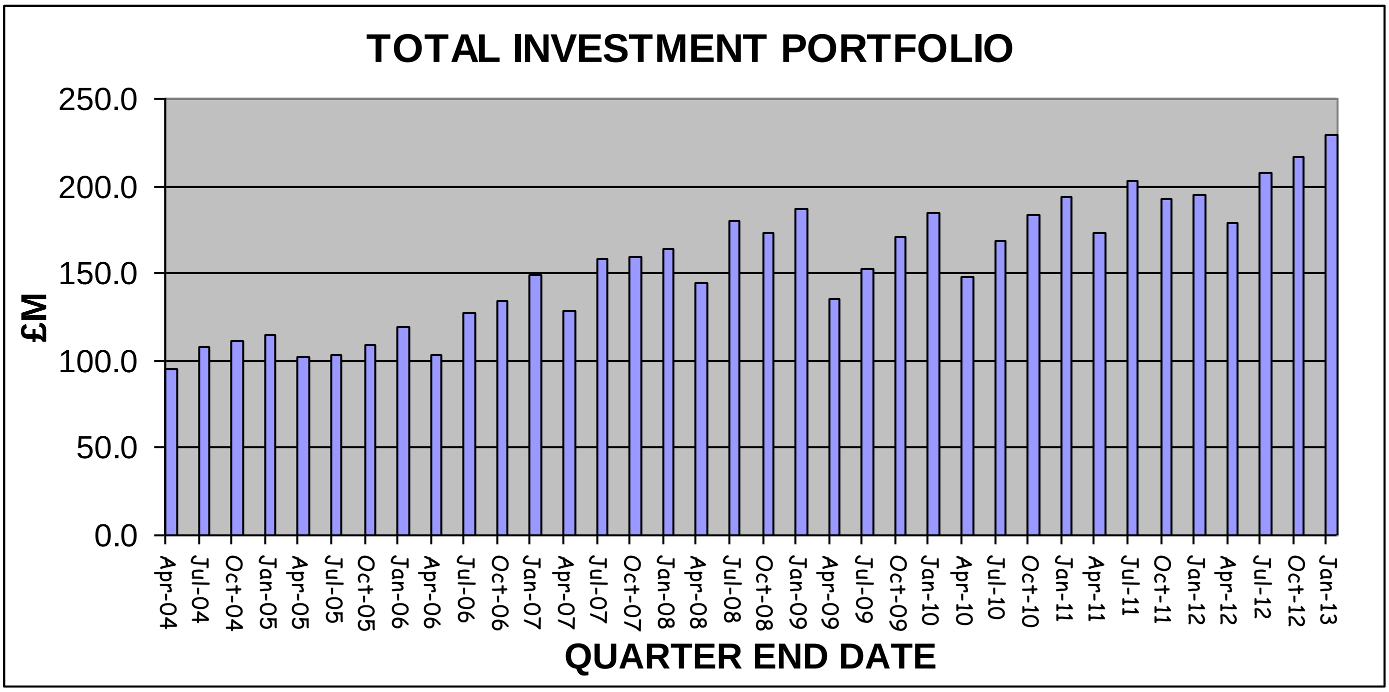
Main investment portfolio	**Deposits £m**	**Ave. Rate %**
Balance of "core" investments as at 30/09/12	140.0	2.05
New investments made in Q3 2012/13	100.0	1.11
Investments redeemed in Q3 2012/13	-90.0	1.52
Total "Core" Investments 31/12/12	150.0	1.93
Money Market Funds/Instant Access	59.4	Para 3.8
Payden Sterling Reserve Fund	15.0	Para 3.10
Total Investments as at 31/12/12	**224.4**	n/a
Heritable deposit – frozen (see para 3.11)	5.0	6.42

3.4 Details of the outstanding investments at 31st December 2012 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 December quarter was 1.11% which may be compared with the average 3 month LIBID rate of 0.40% and the average 7 day rate of 0.36%. The average rate achieved on new investments placed in the period 1st April to 31st December 2012 was 1.22%, compared to the average 3 month LIBID rate of 0.63% and the average 7 day rate of 0.41%.

3.5 Base rate has now been 0.5% since March 2009 and the recently updated forecast by Sector is for it to remain at that level until early in 2015. The estimated date for the next increase in base rate has slipped back a year and a half since January 2012 and it is possible that it will slip further. Reports to previous meetings, most recently to the October meeting, have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited due to bank credit rating downgrades. Changes to lending limits and eligibility criteria have in the past been temporarily successful in alleviating this, but we are now back in the position of not having many investment options other than placing money with instant access accounts at relatively low interest rates. Active UK banks on our list now comprise only Lloyds TSB, RBS, HSBC, Barclays and Nationwide and all of these have recently reduced their interest rates significantly. Our external advisers, Sector, have continued to recommend caution and, since September 2011, have been recommending that no investment be placed for longer than 3 months with any bank other than Lloyds and RBS (a maximum of 1 year was recommended in their case). On 11th January 2013, however, they lifted their temporary investment duration cap due to a perceived improvement in market conditions, namely a reduction in some of the excess fears surrounding the continued existence of the Eurozone and improvements in liquidity in financial markets. This will enable us to invest with some of our eligible UK counterparties for up to 6 months instead of 3, which will have a small beneficial impact on interest earnings.

3.6 Lloyds TSB has consistently offered better rates than other UK banks, but has recently reduced its rates significantly and is currently offering 0.70% for 3 months up to 1.10% for 1 year (they were paying 3.00% for 1 year as recently as July 2012). All the other UK banks and building societies on our lending list are now paying around 0.50% for 3 months (the maximum period Sector have, until recently, been recommending). The “core” investments placed during the first six months of 2012/13 were all placed for between 3 months and a year (in accordance with Sector’s advice) or in instant access money market funds. The Finance Director will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

3.7 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

3.8 Money Market Funds

The Council currently has 7 AAA-rated Money Market Fund accounts, with Fidelity, Prime Rate, Insight, Blackrock, Ignis and Legal & General, all of which have a maximum investment limit of £15m. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years. The Prime Rate fund currently offers the best rate (0.46%), which is around the level currently being offered for 3 months by most of our eligible UK banks and building societies. The total balance held in Money Market Funds (£76.3m as at 17th January 2013) has increased significantly in the past year as bank credit rating downgrades have restricted counterparty eligibility.

Money Market Fund	**Date Account Opened**	**Ave. Rate 2012/13 (to 31/12/12) %**	**Ave. Daily Balance 2012/13 £m**	**Actual Balance 31/12/12 £m**	**Current Balance 17/01/13 £m**	**Current Rate 17/01/13 %**
Prime Rate	15/06/09	0.66	12.0	15.0	15.0	0.46
Ignis	25/01/10	0.66	11.7	15.0	15.0	0.45
Insight	03/07/09	0.57	9.9	15.0	15.0	0.42
Morgan Stan.	01/11/12	0.43	3.0	14.4	15.0	0.44
Legal & Gen.	23/08/12	0.48	4.2	-	15.0	0.36
Blackrock	16/09/09	0.46	3.7	-	1.3	0.32
Fidelity	20/11/02	0.41	0.3	-	-	0.33
TOTAL			44.8	59.4	76.3	

3.9 Notice Accounts

In April 2012, the Council placed £15m in a 35-day notice account with Svenska Handelsbanken (Sweden). The total of £15m remained invested until mid-December when it was withdrawn following a reduction in the interest rate from 0.85% to 0.40%. The average daily balance from April to December 2012 was £10.1m.

3.10 Payden Sterling Reserve Fund

At its meeting on 12th November 2012, the Council approved the addition of corporate bonds (minimum credit rating AA-, maximum period 5 years) and the Payden Sterling Reserve Fund to our lending list. To date, no corporate bond issues have been considered sufficiently attractive in consultation with our external advisers, Sector, but, on 16th November, £15m was invested in the Payden Fund. The longer-term nature of the Payden Fund means that a better return will be secured by holding to maturity, although we could at any time withdraw our money by giving 3 days' notice. In a commentary on the Fund's performance to 31st December 2012, Payden states:

"Since its inception in July 2010, the Fund has remained invested in a diversified range of sterling-denominated, highly-rated and very liquid government agency securities and corporate fixed and floating rate and covered bonds.

During Q4 2012, duration was raised by about 0.2 years to 1.24 years. The portfolio's structure remained broadly unchanged - we continued to favour high yielding, highly-rated quasi-government and corporate securities and covered bonds over Gilts and money market instruments. During the quarter, we reduced our exposure to agency notes somewhat in favour of higher allocations to corporate bonds, commercial paper and asset-backed floating rate notes. This strategy enhanced the Fund's return while ensuring it continued to meet its objectives of capital security and liquidity.

The Fund delivered a positive return over the quarter, in excess of that offered by money market funds and bank deposits. Performance was supported by the Fund's overweight duration positioning and the relatively attractive yields offered by the Fund's holdings of GBP-denominated commercial paper and corporate and covered bonds. Returns were also enhanced by the return generated as the duration of the portfolio's bond holdings shortens over time and these bonds 'roll down' the relatively steep yield curve."

3.11 <u>External Cash Management</u>

External cash managers, Tradition UK Ltd, currently manage £20m of our cash portfolio and provide useful advice and information on treasury management matters. In the first three quarters of 2012/13, Tradition UK achieved a return of 1.58% (mainly as a result of the two longer term investments placed in August 2011 and July 2012 (see table below). Tradition UK have also been constrained by strategy changes approved after the Icelandic Bank crisis and by recent ratings downgrades. 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				
£12.5m	27/03/12	26/03/13	1 year	3 month Libor, subject to cap 1.10% & floor 0.50%
£2.5m	27/07/12	04/07/13	11 months	3.00%
£5m	17/08/11	16/08/13	2 years	2.80%

3.12 <u>Investment with Heritable Bank</u>

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, but Council officers and our external advisers remain hopeful of a better result. An initial dividend was paid to the Council in July 2009 and, since then, a further 12 dividends have been received. To date, 77.3% (£3,931k) of our total claim (£5,087k) has been returned to us, leaving a balance of £1,156k (22.7%).

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 that 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. The improved recovery estimate of between 86% and 90% (previously it was between 79% and 85%) enabled us to reverse a further £730k of the impairment in 2011/12. This left a provision for a net loss of £610k in the accounts as at 31st March 2012, which will potentially reduce or clear depending on the size of the final settlement sum.

Regulatory Framework, Risk and Performance

3.13 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.

3.14 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 2012/13 revenue budget (£2.69m), in line with estimates provided in January 2012 by the Council's external treasury advisers. The average rate obtained on all new investments placed since the budget was agreed (including money market funds and notice accounts) is 1.03%. The Bank of England base rate is still expected to rise, but the expected start of the rise has been put back to early in 2015 and could be even later. The latest financial forecast assumes 1% for new investments in all years from 2013/14 to 2016/17. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £400k pa from 2013/14. At this stage in the year, it is forecast that the 2012/13 outturn will be broadly in line with the budget.

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 Sector Treasury Services