

**Appendices**

10

Item No.



**NORTHAMPTON**  
BOROUGH COUNCIL

**CABINET REPORT**

<b>Report Title</b>	TREASURY MANAGEMENT MID YEAR REPORT 2012-13
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**AGENDA STATUS: PUBLIC**

<b>Cabinet Meeting Date:</b>	14 November 2012
<b>Key Decision:</b>	NO
<b>Listed on Forward Plan:</b>	YES
<b>Within Policy:</b>	YES
<b>Policy Document:</b>	NO
<b>Directorate:</b>	Finance and Support
<b>Accountable Cabinet Member:</b>	Alan Bottwood
<b>Ward(s)</b>	Not Applicable

## **1. Purpose**

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1.1 To inform the Cabinet of

- a) The Council's performance in relation to its treasury management activities, including its borrowing and investment strategy, for the period 1 April to 30 September 2012.
- b) Changes to investment and counterparty lending limits, to enable the effective management of risk in relation to investments, approved by the Chief Finance Officer under discretions set out in the Council's Schedules to Treasury Management Practices and Treasury Strategy for 2012-13.

## 2. Recommendations

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2.1 That Cabinet recommend to Council that they note

- a) The Council's treasury management activities and performance for the period 1 April to 30 September 2012.
- b) The increase in maximum value for any single investment transaction in the Schedule to TMP 1 (Risk Management), from £7m to £10m, approved by the Council's Chief Finance Officer.
- c) The increase in the maximum level of investment with any counterparty or group of counterparties in the Schedule to TMP 1 (Risk Management), from £15m to £20m, approved by the Council's Chief Finance Officer.
- d) The change to the counterparty limits in the Treasury Strategy to increase the maximum values for UK nationalised or part nationalised banking institutions to £20m from the existing £15m, approved by the Council's Chief Finance Officer.

## 3. Issues and Choices

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### 3.1 Report Background

- 3.1.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes ("the Treasury Management Code of Practice").
- 3.1.2 The Treasury Management Code of Practice and the associated guidance notes for local authorities include recommendations on reporting requirements, including the requirement for an annual mid year report on treasury activities. The table below shows how the specific reporting requirements of the Treasury Management Code of Practice have been incorporated into this report.

Reporting Requirement	Reference
Activities undertaken	3.2.2 – 3.2.21 Appendices B,C,D,E,F
Variations (if any) from agreed policies and practices	3.2.22 – 3.2.30
Interim performance report	3.2.31 – 3.2.33 Appendix G
Regular monitoring	3.2.34 – 3.2.38 Appendix H,I,J
Monitoring of treasury management indicators for local authorities	3.2.37 Appendix H

3.1.3 The following topics are also covered in this report

<b>Topic</b>	<b>Reference</b>
Economic environment and interest rates	3.2.1 Appendix A
Monitoring of prudential indicators for local authorities	3.2.37 Appendix I
Monitoring of debt financing budget	3.2.38 Appendix J

## **3.2 Issues and Choices**

### **Economic Environment and Interest Rates**

3.2.1 An analysis of the economic position as at the end of September 2012, including the latest interest rate forecasts, is attached at **Appendix A**. This information has been provided by Sector, the Council's treasury management advisors.

#### **Activities undertaken**

##### ***Investments***

3.2.2 **Appendix B** shows the Council's investment balances at 30 September 2012.

3.2.3 Cashflow balances available for investment come from working capital, amounts in provisions and reserves, and funds, such as capital grants, received in advance of expenditure. The Council's overall investment figure as at 30 September 2012 was £54m; average balances for the six-month period to 30 September were £52m. The lowest and highest balances during the period were £37m and £70m respectively.

3.2.4 Since the start of the year, 12 new fixed term deposits have been entered into ranging in value between £1m and £5m, at rates between 0.60% and 2.85%, and for periods between 74 and 730 days. The average value of each fixed term investment was £3m, and the weighted average interest rate achieved for fixed term deposits was 1.41%. The average investment period was 237 days.

3.2.5 Fixed term deposits make up an average of 52% of the Council's investment portfolio, the remainder being balances held in instant access deposit accounts, call accounts and money market funds.

3.2.6 Deposit accounts, call accounts and money market funds have been used extensively during the first half of the year, in order to maintain liquidity and security of funds. The average balance held in deposit accounts, including notice accounts was £6m, around 12% of the Council's average investment

portfolio. The average balance held in instant access money market funds was £19m, around 36% of the Council's average investment portfolio.

- 3.2.7 The Council has opened a new AAA rated money market fund with LGIM (Legal and General Investment Management) during this financial year, bringing the total number of money market funds in use to three. Money market funds offer a high degree of liquidity, with instant access to funds, and have a high security rating due to their diversification. Rates are comparable to those available from short term investments (of up to three months). Greater use of money market funds in place of deposit accounts creates increased capacity with investment counterparties, and enables more use to be made of direct deals at enhanced rates.
- 3.2.8 The Council has recently entered into an agreement with Sungard Limited for access to its Money Market Fund Portal, which enables arrangements for money market trades to be made electronically rather than by telephone.
- 3.2.9 **Appendix C** shows the maturity profile of the Council's investments at 30 September 2012. Due to ongoing market concerns and uncertainty, and with the recommendation of Sector, the Council's treasury management advisers, the majority of investments (80%) have been made for relatively short periods, of up to six months duration, to reduce exposure to risk.
- 3.2.10 Sector has advised that the Council's historic risk of default on its investment portfolio as at 30 September 2012 is 0.026%. This is a proxy for the average % risk for each investment based on over 30 years of data provided by Fitch, Moody's and S&P. It provides a calculation of the possibility of average default against the historical default rates, adjusted for the time period within each year according to the maturity of the investment.
- 3.2.11 In September 2012 a custody and dealing account was opened with King and Shaxon Ltd. This will open up further investment opportunities for the Council, including the opportunity to invest in Callable Deposits (CDs) and Gilts. Charges to the Council for using this service are met through a marginal reduction to the investment rate on individual transactions. In order to benefit from zero account set up fees the Council will make its first trade before 31 December 2012. Before doing so the Chief Finance Officer will put in place procedures and limits for controlling exposure to such investment instruments, which may be subject to fluctuations in market value.
- 3.2.12 Investment activity is carried out within the Council's counterparty policies and criteria, and with a clear strategy of risk management in line with the Council's treasury strategy for 2012-13. This ensures that the principle of considering security, liquidity and yield, in that order (SLY), is consistently applied. Any variations to agreed policies and practices are reported to Cabinet and Council (See paragraphs 3.2.22 to 3.2.30 below).

### ***Borrowing***

- 3.2.13 **Appendix D** shows outstanding long-term borrowing at 30 September 2012 at amortised cost. The total long-term debt outstanding, including non-current

finance leases, is £216m. Of this amount, 88% is in the form of PWLB borrowing, 11% is money market LOBO loans, and the remaining 1% consists of the long-term element of an annuity loan with the Homes and Communities Agency (HCA) and non-current finance leases.

3.2.14 Following the introduction of the HRA self-financing reforms on 28 March 2012, the Council operates a two pool approach whereby all long term borrowing is allocated to either the General Fund or the HRA. As shown at **Appendix D**, £193m (89%) of long term debt is attributable to the HRA, with the balance of £23m (11%) attributable to the General Fund.

3.2.15 No loans have been repaid since April 2012 other than the principal element (£19k) of the HCA annuity payment made in September, and annual amounts due on some finance leases.

3.2.16 No rescheduling of loans took place in the first half of the year.

3.2.17 No new borrowing was taken out in the first six months of 2012-13. The Council's policy during 2012-13 is to use internal borrowing (ie from cash flow balances) to fund capital programme expenditure financed by borrowing, subject to external borrowing rates remaining at high levels relative to investment rates.

3.2.18 **Appendix E** shows the Council's long-term debt maturity profile of external debt at cash value as at 30 September 2012. Five General Fund loans are due for repayment during the next five years; two LOBO loans totalling £15.6m mature in 2014-15, and PWLB loans totalling £8m mature in the following two years. Options for the repayment and replacement (if appropriate) of these loans are under active consideration, with advice being taken from the Council's external treasury management advisors, Sector. The Council will keep its options open until nearer the maturity dates.

3.2.19 **Appendix F** shows outstanding balances and applicable rates for short-term borrowing. The total outstanding at 30 September 2012 was £299k.

3.2.20 The Council has long-standing agreements with two local organisations, Billing Parish Council and Northampton Volunteering Centre, for the short-term deposit of funds with the Council. Accounting regulations require that these be treated in the accounts as short-term borrowing. The interest rate applicable on these accounts is set quarterly using the Council's average investment rate for the previous quarter, less 0.5% to cover administrative costs. The range of balances in these accounts during the period April to September 2012 was between £90k and £239k, at interest rates between 0.53% (in quarter 1) and 0.75% (in quarter 2).

3.2.21 For consistency with accounting requirements:

- The principal element of the HCA annuity repayment due within 12 months (£20k) is included as short term borrowing

- Current commitments on finance leases – i.e. amounts due within the current financial year – are not included in the short term borrowing balances shown.

### **Variations (if any) from or to agreed policies and practices**

3.2.22 Compliance with agreed policies and practices has been monitored during the year to date.

3.2.23 An investment of £1m was made with Royal Bank of Scotland on 1 May 2012 for a period of two years (730 days). Whilst this investment was within the Council's own duration limits for the counterparty, it exceeded the Sector temporary duration limit in place for the counterparty, which is one year (364 days). The Chief Finance Officer regards the risk of default during the period of the investment, which is with a UK government nationalised/part nationalised bank, as minimal, being measured by Sector at a historic risk of default at 0.186%, using the methodology outlined at paragraph 3.2.10.

3.2.24 The Council's counterparty policies and strategy for 2012-13 are set out in the Treasury Management Strategy 2012-13 to 2014-15 report agreed by Council on 29 February 2012. The Chief Financial Officer has discretion during the financial year to:

- Adjust the maximum lending limits in Schedule 1 to the Treasury Management Practices (TMPs) to enable the effective management of risk in relation to investment
- Lift or increase the restrictions on the counterparty list and/or to adjust the associated lending limits on values and periods in the Treasury Strategy should it become necessary to enable the effective management of risk in relation to investments. At all times the Council's minimum level of credit risk, as set out at the Schedule to TMP 1, will be met.

3.2.25 The Chief Financial Officer has exercised those discretions as follows:

3.2.26 In the current economic climate, there are temporary restrictions in place on the duration of investments with individual counterparties, as advised by the Council's treasury advisers. As a result the Council is severely limited in its ability to place amounts for periods of over 3 months duration, and it was not possible to meet budgeted plans to place up to £10m of additional earmarked HRA funds for a period of up to two years without disadvantaging the General Fund.

3.2.27 Additionally it has been identified that the £7m limit in place for any single investment transaction does not meet the Council's needs in the current market, where funds over and above this amount regularly need to be placed in Money Market Funds or deposit accounts. It has been identified that the existing limit has been exceeded on a five occasions this financial year, with no increase to the risk level of the Council's investment portfolio.

3.2.28 In order to redress these issues the Chief Financial Officer has

- Amended the maximum value for any single investment transaction from £7m to £10m
- Amended the maximum level of investment with any counterparty or group of counterparties, set out in the Schedules to the TMPs, from £15m to £20m.
- Amended the counterparty limits in the Treasury Strategy to increase the maximum values for UK nationalised or part nationalised banking institutions to £20m from the existing £15m. This allows for an additional £5m to be placed with counterparties falling into this category without breaching the duration limits advised by the Council’s treasury advisers.

3.2.29 The revised counterparty limits continue to meet the requirements of the Council’s minimum level of credit risk, as set out at the Schedule to TMP 1. The following table sets out the Council’s revised counterparty policies for 2012-13.

<b>Investments may be placed with counterparties recommended by the Council’s external treasury advisors, and which meet the following criteria:</b>	<b>Additional limits</b>
<b>(1)</b> UK counterparties	NBC <b>additional limits</b> in force will be £15m and a maximum of 2 years (729 days)
<i>Or</i>	
<b>(2)</b> UK nationalised or part nationalised banking institutions	NBC <b>additional limits</b> in force will be £20m and a maximum of 2 years (729 days)
<i>Or</i>	
<b>(3)</b> Non UK counterparties having a sovereign rating of AAA	NBC <b>additional limits</b> in force will be £15m and a maximum of 2 years (729 days)

3.2.30 Cabinet are asked to recommend to Council that they note the changes to the Council’s Schedules to the Treasury Management Practices and the Treasury Strategy for 2012-13

**Interim performance report**

3.2.31 Investment performance to 30 September 2012 is attached at **Appendix G**. The monthly rate of return on investments has remained fairly steady throughout the year to date, averaging 1.24% over the period.

3.2.32 The variance between the Council’s monthly rate of return on investments and the average 7-day Libid rate (at the time of investment) is used as a measure of treasury performance, where a positive variance reflects an enhanced level of performance.

3.2.33 Variance to the 7-day libid rate has averaged 0.80% during the year to date, against a target of 0.50%. The performance has mainly been achieved by taking a number of direct deals at enhanced rates with UK nationalised/part nationalised banks for periods in excess of 6 months.

### **Regular monitoring**

3.2.34 An investment register is maintained, and updated on a daily basis, showing current investments and deposit account balances with counterparties used, investment durations and interest rates achieved.

3.2.35 Monthly reconciliations are completed for outstanding investment principal, interest received, outstanding borrowing principal and interest paid to ensure all transactions have been made and recorded accurately.

3.2.36 The Chief Finance Officer receives monthly treasury investment performance data and minutes from monthly treasury management meetings.

3.2.37 Prudential and treasury indicators are monitored on a regular basis. Any variances or breaches of the indicators are reported to Cabinet and Council on a timely basis. **Appendix H** contains treasury management indicator monitoring information at 30 September 2012. **Appendix I** contains prudential indicator monitoring information at 30 September 2012. Where appropriate figures include borrowings arising from finance leases. There have been no breaches of any indicators during the first half of the financial year.

3.2.38 The debt financing and debt management budgets have been monitored monthly since the start of the year, with any significant variances feeding into the dashboard reports to Cabinet. The debt financing budget forecast as at 30 September 2012 is attached at **Appendix J**. A net underspend of £218k is currently forecast for debt financing in 2012-13. The main components of this figure are made up as below:

- £325k - Reduced MRP (Minimum Revenue Provision) requirement, mainly due to capital financing decisions made in 2011-12 (the use of capital receipts instead of borrowing and changes from planned financing leading to MRP savings), and the carry forward of capital expenditure delaying MRP impact to future years.
- £21k – Savings on interest on finance leases, where actual liability is less than the amount budgeted.

Less

- £58k – Reduction in investment interest, due to the Council carrying lower overall cash balances than in previous years, largely as a result of more timely capital programme spend in 2011-12 and 2012-13 than in previous years.
- £73k - Recharge income from the HRA is forecast to be less than budgeted, due both to an increase in the levels of forecast average HRA balances, and the achievement of a higher than budgeted rate of return on investments.



## **4. Implications (including financial implications)**

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### **4.1 Policy**

4.1.1 The Council is required to adopt the latest CIPFA Treasury Management Code of Practice, and to set and agree the following policy and strategy documents:

- a) Treasury Management Policy Statement
- b) Treasury Management Practices (TMPs) and TMP Schedules
- c) An annual Treasury Strategy incorporating:
  - (i) The Capital Financing and Borrowing Strategy for the year including:
    - The Council's policy on the making of Minimum Revenue Provision (MRP) for the repayment of debt, as required by the Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008.
    - The Affordable Borrowing Limit for the year as required by the Local Government Act 2003.
  - (ii) The Investment Strategy for the year as required by the CLG Guidance on Local Government Investments issued in 2004, and updated in 2010.
- d) A mid-year review report and an annual review report of the previous year.

Items (a) to (c) are reported to Cabinet and Council as part of the budget setting process. The Council's Treasury Strategy for 2012-13 was approved by Council at its meeting on 29 February 2012.

4.1.2 The CIPFA Treasury Management Code of Practice requires the Council to place nominate a body (such as an audit or scrutiny committee) responsible for ensuring effective scrutiny of the treasury management strategy, policies and practices. The Audit Committee has been nominated for this role, which includes the review of all treasury management policies and procedures, the review of all treasury management reports to Cabinet and Council, and for making recommendations to Council.

### **4.2 Resources and Risk**

4.2.1 The resources required for the Council's debt management and debt financing budgets are agreed annually through the Council's budget setting process. The debt financing budget position as at 30 September 2012 is shown at paragraph 3.2.38 and **Appendix J**.

4.2.2 The risk management of the treasury function is an integral part of day-to-day treasury activities. It is also specifically covered in the Council's Treasury Management Practices (TMPs), which are reviewed annually.

### **4.3 Legal**

4.3.1 The Council is obliged to carry out its treasury management activities in line with statutory requirements and associated regulations and professional guidance. The relevant legislative and regulatory documents are referred to within the report and listed in the background papers.

### **4.4 Equality**

4.4.1 An Equalities Impact Assessment (EIA) has been carried out on the Council's Treasury Management Strategy for 2012-13, and the associated Treasury Management Practices (TMPs) and Schedules to the TMPs.

4.4.2 The EIA assessment is that a full impact assessment is not necessary, as no direct or indirect relevance to equality and diversity duties has been identified.

### **4.5 Consultees (Internal and External)**

4.5.1 Consultation on treasury management matters is undertaken as appropriate with the Council's treasury management advisor, Sector, and with the Portfolio holder for Finance.

4.5.2 The Audit Committee has been nominated by Council as the body responsible for ensuring effective scrutiny of the treasury management strategy, policies and practices. This role includes the review of all treasury management policies and procedures, the review of all treasury management reports to Cabinet and Council, and the making of recommendations to Council. Audit Committee reviewed and noted the draft treasury management mid-year report and Appendixes at their meeting on 5 November 2012.

### **4.6 How the Proposals deliver Priority Outcomes**

4.6.1 Management of performance in relation to treasury management activities supports the Council's priority of providing quality services.

### **4.7 Other Implications**

4.7.1 No other implications have been identified

## **5. Background Papers**

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### **Statute, Regulation and Guidance**

Local Government Act 2003

Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

CIPFA Prudential Code for Capital Finance in Local Authorities – Fully Revised Guidance Notes for Practitioners 2007

The Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008

CIPFA Prudential Code for Capital Finance in Local Authorities - 2011 Edition

CIPFA Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes - 2011 Edition

CIPFA Treasury Management in the Public Services - Guidance Notes for Local Authorities including Police Authorities and Fire Authorities – 2011 Edition

CLG Guidance on Minimum Revenue Provision (11 March 2010)

CLG Guidance on Local Authority Investments (11 March 2010)

Localism Act 2011

### **Reports to Cabinet & Council**

Treasury Strategy 2012-13 to 2014-15 – Report to Cabinet 22 February 2012 & Council 29 February 2012

Prudential Indicators for Capital Finance 2012-13 to 2014-15 – Report to Cabinet 22 February 2012 & Council 29 February 2012

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