

By: John Simmonds, Cabinet Member for Finance
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Procurement

To: Governance and Audit Committee –29 November 2011

Subject: **TREASURY MANAGEMENT 6 MONTH REVIEW
2011/12**

Classification: Unrestricted

Summary: To present the Treasury Management 6 Month Review.

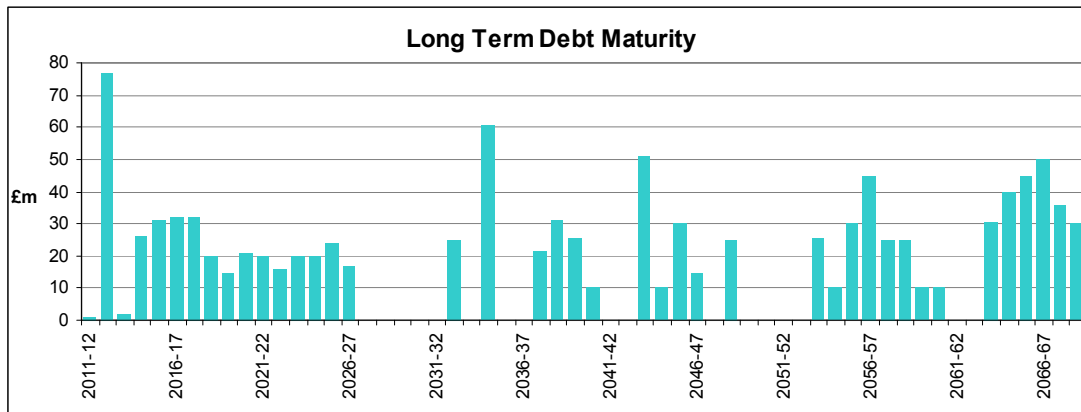
FOR ASSURANCE

1. INTRODUCTION

- 1.1 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.”
- 1.2 This Committee is responsible for the oversight of the Council’s treasury management activities. Council agreed the Treasury Strategy in February and implementation is the responsibility of the Corporate Director of Finance & Procurement in consultation with the Treasury Advisory Group (TAG). TAG is an all party sub-group of Cabinet chaired by the Cabinet Member for Finance. TAG receives a weekly report on deposits and a monthly performance report. The group normally meets quarterly but met twice in July to examine counter party options in detail.
- 1.3 Although formally this report is to 30 September it will cover specific action taken on counterparties in October and on the Icelandic Supreme Court decision on the Council’s deposits in Landsbanki and Glitnir.

2. DEBT MANAGEMENT

- 2.1 As at 30 September the Council had long term borrowing of £1,091m with a maturity profile as follows:



Total external debt includes £46.1m of pre LGP debt relating to Medway Council and £4.2m for other bodies.

- 2.2 The Council has a new borrowing requirement of £7m in 2011/2 but no new borrowing has been undertaken so far in the financial year. Taking new borrowing involves a very significant long term revenue cost to the Council. So even though we anticipate long term interest rates rising from current levels (50 year Public Works Loan Board rate is 4.33%) the very low rates on deposit, the shortage of counter parties and our resilient cash flow position all support not taking new borrowing at the current time.
- 2.3 During August a short term PWLB loan of £50m was refinanced by 2 market loans with RBS which had been arranged in May 2010 at a rate of 3.83%. The new loans are for 46 and 47 years.
- 2.4 There was no rescheduling of existing debt in the quarter.
- 2.5 It is forecast that debt costs for 2011-12 will be £1.2m less than budget as the result of not taking new borrowing. The average rate of interest paid on the Council's debt has however increased by 0.02% to 5.32% due to the re-financing of maturing debt in August.

3. **INVESTMENTS**

- 3.1 A list of the Council's deposits on 4 November is attached in the Appendix.
- 3.2 The Council's overriding objective in determining where to place Cash deposits is the security of the funds. The Council also needs to ensure that it has the liquidity to meet payment requirements. In what are extremely uncertain and fragile financial markets we have to accept that return is an insignificant consideration compared with maintaining the security of principal sums.
- 3.3. The Council's credit criteria is based upon:
 - Credit Ratings (Council's minimum long-term counterparty rating of A+ across all three rating agencies, Fitch, S&P and Moody's)

- Credit Default Swaps
- County exposure eg Sovereign support mechanisms, GDP, the country's net debt as a Percentage of GDP.
- Share Price

The counterparties approved by Cabinet are:

- Debt Management Agency Deposit Fund / Treasury Bills
- Barclays
- HSBC
- Lloyds Banking Group
- Royal Bank of Scotland
- Santander UK
- Standard Chartered
- Clydesdale
- Nationwide

3.4 Of these counter parties:

- Santander UK has unfortunately been suspended since April 2010. Santander UK's credit rating still meets our requirements but the relationship with the Spanish parent and consequently exposure to the Spanish economy and Euro zone means that it is not currently a suitable counter party.
- Standard Chartered – will not take deposits from the Council.
- Clydesdale – never used because of events in Australia and consequent impact on its parent the National Bank of Australia.

3.5 In August Arlingclose reduced their maximum recommended duration for deposits from 12 to 6 months and this was implemented immediately.

3.6 On 7 October Moody's downgraded a number of UK institutions including RBS/ Nat West and Nationwide such that they no longer met our credit rating requirement. Any funds on call were immediately withdrawn. Clydesdale was also downgraded below our minimum level but we had no funds with them.

3.7 The Cabinet Member for Finance and Acting Corporate Director of Finance & Procurement formally reviewed the position on 11 October. The action sheet from the meeting was then updated after Fitch downgraded Lloyds on 12 October – again below our minimum acceptable level. A note of decisions taken was circulated to members of TAG. On 14 October all funds on call with Lloyds were withdrawn.

3.8 Currently the only counter parties available are:

- Debt Management Agency Deposit Fund / Treasury Bills
- Barclays
- HSBC

This is in accordance with Arlingclose's advice.

3.9 To transact business the Council has to use a clearing bank and Nat West is KCC's banker. The Cabinet Member for Finance and the Corporate Director of Finance & Procurement have evaluated the risks and costs of change and have decided that we should retain Nat West. Changing banks would take months to do and potentially we could end up with the same problem of a bank not meeting our counter party requirements. RBS is of course 84% owned by the UK Government.

3.10 Average cash balances were £319m during the period. These included schools balances in the corporate scheme (£56m), KCC working capital (£80m) created by differences in income and expenditure profiles, Iceland deposits (£39m) and other reserves and funds held in trust.

4. ICELAND

4.1 On 28 October the Icelandic Supreme Court confirmed the 1 April District Court decision that UK local authority deposits did count as deposits under Icelandic law and we are therefore preferred creditors. This also applies in the cases concerning the UK Financial Services Compensation Scheme, the Dutch National Bank (on behalf of retail depositors) and Dutch local authorities.

4.2 The position on the two banks is as follows:

- Glitnir – UK local authorities had £219m deposited with Glitnir and 100% of this will be recovered. Negotiations with the Winding Up Board to ensure prompt payment have commenced. Other creditors will receive a significant payout from Glitnir (20-25%).
- Landsbanki – the Winding Up Boards current projected return is 90%. The depositor group has previously met with the Winding Up Board and we expect a large dividend payment soon. It is unlikely any non-preferred creditors will receive any money from Landsbanki.

4.3 The Heritable administration continues to proceed well and we are confident of a final return of at least 85%. To date 65p in the £ has been paid totalling £11.9m.

5. COMPLIANCE WITH PRUDENTIAL INDICATORS

- 5.1 The Council can confirm that it has complied with its Prudential Indicators for 2011/12, which were set as part of the Council's Treasury management Strategy Statement. Details can be found in Appendix 2.

6. RECOMMENDATION

- 6.1 Members are asked to endorse this report and recommended that it is submitted to Council.

Nick Vickers
Head of Financial Services
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KCC Deposits at 04-11-11

Instrument Type	Counterparty	Principal Deposit Amount at 4 Nov 2011	End Date	Interest Rate	Territory
	Total Icelandic Bank Deposits	£38,496,223.97			
Fixed Deposit	Bank of Scotland	£3,000,000.00	16/12/2011	1.25	UK Bank
Fixed Deposit	Barclays Bank	£5,000,000.00	31/05/2013	6.8	UK Bank
Same Day Call Deposit	Barclays Bank	£8,000,000.00	n/a	0.7	UK Bank
Fixed Deposit	Barclays Bank	£2,000,000.00	10/04/2012	1.359	UK Bank
Fixed Deposit	Barclays Bank	£3,000,000.00	09/03/2012	1.28	UK Bank
Fixed Deposit	Barclays Bank	£4,000,000.00	07/11/2011	0.83	UK Bank
Fixed Deposit	Barclays Bank	£5,000,000.00	07/12/2011	0.94	UK Bank
Fixed Deposit	Barclays Bank	£5,000,000.00	08/06/2012	1.37	UK Bank
Fixed Deposit	Barclays Bank	£5,000,000.00	16/03/2012	1.2	UK Bank
Fixed Deposit	Barclays Bank	£3,000,000.00	27/03/2012	1.2	UK Bank
Fixed Deposit	HSBC	£7,250,000.00	21/11/2011	0.4	UK Bank
Fixed Deposit	HSBC	£3,900,000.00	30/03/2012	0.75	UK Bank
Fixed Deposit	HSBC	£4,000,000.00	31/01/2012	0.55	UK Bank
Fixed Deposit	HSBC	£4,000,000.00	29/02/2012	0.65	UK Bank
Fixed Deposit	HSBC	£15,000,000.00	25/11/2011	0.4	UK Bank
Fixed Deposit	HSBC	£5,850,000.00	05/03/2012	0.65	UK Bank
Fixed Deposit	Lloyds TSB	£5,000,000.00	09/01/2012	2	UK Bank
Fixed Deposit	Lloyds TSB	£4,000,000.00	09/02/2012	1.8	UK Bank
Fixed Deposit	Lloyds TSB	£4,000,000.00	08/05/2012	2.1	UK Bank
Fixed Deposit	Lloyds TSB	£5,000,000.00	05/01/2012	1.45	UK Bank
Fixed Deposit	Royal Bank of Scotland	£5,000,000.00	06/01/2012	1.4	UK Bank
LIBOR Fixed Deposit	Royal Bank of Scotland	£5,000,000.00	18/10/2013	1.56825	UK Bank
	Total UK Bank Deposits	£111,000,000.00			
Fixed Deposit	Nationwide Building Society	£5,000,000.00	14/12/2011	1.03	UK Building Society
Fixed Deposit	Nationwide Building Society	£4,600,000.00	25/11/2011	0.93	UK Building Society
Fixed Deposit	Nationwide Building Society	£1,200,000.00	04/05/2012	1.17	UK Building Society
Fixed Deposit	Nationwide Building Society	£4,200,000.00	15/03/2012	1.14	UK Building Society
	Total UK Building Society Deposits	£15,000,000.00			
Fixed Deposit	Debt Management Office	£5,000,000.00	07/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£7,000,000.00	08/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£7,400,000.00	11/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£8,000,000.00	09/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£10,000,000.00	14/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£10,000,000.00	15/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£16,000,000.00	10/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£7,000,000.00	16/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£3,650,000.00	17/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£4,150,000.00	18/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£4,400,000.00	17/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£2,850,000.00	18/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£4,400,000.00	23/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£5,000,000.00	07/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£3,400,000.00	07/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£5,600,000.00	23/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£4,400,000.00	30/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£7,000,000.00	29/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£8,000,000.00	24/11/2011	0.25	UK Govt.
Fixed Deposit	Debt Management Office	£10,000,000.00	28/11/2011	0.25	UK Govt.
	Total UK Govt Deposits	£133,250,000.00			
	Grand Total of All Deposits	£297,746,223.97			

2011-12 October Monitoring of Prudential Indicators

1. Estimate of capital expenditure (excluding PFI)

Actual 2010-11	£377.147m	
Original estimate 2011-12	£305.448m	
Revised estimate 2011-12	£293.974m	(this includes the rolled forward re-phasing from 2010-11)

2. Estimate of capital financing requirement (underlying need to borrow for a capital purpose)

	2010-11 Actual	2011-12 Original Estimate	2011-12 Forecast as at 31.10.11
	£m	£m	£m
Capital Financing Requirement	1,286.518	1,308.640	1,300.801
Annual increase in underlying need to borrow	36.902	35.527	14.283

In the light of current commitments and planned expenditure, forecast net borrowing by the Council will not exceed the Capital Financing Requirement.

3. Estimate of ratio of financing costs to net revenue stream

Actual 2010-11	12.85%
Original estimate 2011-12	11.77%
Revised estimate 2011-12	13.98%

The actual 2010-11 and revised estimate 2011-12 includes PFI Finance Lease costs but these costs were not included in the original estimate calculation.

4. Operational Boundary for External Debt

The operational boundary for debt is determined having regard to actual levels of debt, borrowing anticipated in the capital plan, the requirements of treasury strategy and prudent requirements in relation to day to day cash flow management.

The operational boundary for debt will not be exceeded in 2011-12

(a) Operational boundary for debt relating to KCC assets and activities

	Prudential Indicator 2011-12 £m	Position as at 31.10.11 £m
Borrowing	1,158	1,044
Other Long Term Liabilities	0	0
	1,158	1,044

- (b) Operational boundary for total debt managed by KCC including that relating to Medway Council etc (pre Local Government Reorganisation)

	Prudential Indicator 2011-12 £m	Position as at 31.10.11 £m
Borrowing	1,204	1,090
Other Long Term Liabilities	0	0
	1,204	1,090

5. **Authorised Limit for external debt**

The authorised limit includes additional allowance, over and above the operational boundary to provide for unusual cash movements. It is a statutory limit set and revised by the County Council. The revised limits for 2011-12 are:

- a) Authorised limit for debt relating to KCC assets and activities

	£m
Borrowing	1,198
Other long term liabilities	0
	1,198

- (b) Authorised limit for total debt managed by KCC including that relating to Medway Council etc

	£m
Borrowing	1,204
Other long term liabilities	0
	1,204

The additional allowance over and above the operational boundary has not needed to be utilised and external debt, has and will be maintained well within the authorised limit.

6. **Compliance with CIPFA Code of Practice for Treasury Management in the Public Services**

The Council has adopted the Code of Practice on Treasury Management and has adopted a Treasury Management Policy Statement. Compliance has been tested and validated by our independent professional treasury advisers.

7. **Upper limits of fixed interest rate and variable rate exposures**

The Council has determined the following upper limits for 2011-12

Fixed interest rate exposure	100%
Variable rate exposure	50%

These limits have been complied with in 2011-12.

8. Upper limits for maturity structure of borrowings

	Upper limit	Lower limit	As at 31.10.11
	%	%	%
Under 12 months	25	0	1
12 months and within 24 months	40	0	7
24 months and within 5 years	60	0	5
5 years and within 10 years	80	0	11
10 years and within 20 years	25	10	11
20 years and within 30 years	25	5	16
30 years and within 40 years	25	5	12
40 years and within 50 years	25	10	17
50 years and within 60 years	30	10	21

9. Upper limit for principal sums invested for periods longer than 364 days

Indicator £50m	Actual £10m
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