By:	Cabinet Member for Finance and Business Support Corporate Director of Finance & Procurement
To:	Governance and Audit Committee – 19 December 2012
Subject:	**TREASURY MANAGEMENT 6 MONTH REVIEW 2012/13**
Classification:	Unrestricted

Summary: To present the Treasury Management 6 Month Review.

FOR DECISION

INTRODUCTION

1. This is a 6 month update on treasury management issues.

BACKGROUND

2. The Treasury Management Strategy for 2012/13 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.

3. The Code also recommends that members are informed of Treasury Management activities at least twice a year-in fact we report to each meeting of this committee. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

4. 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."

5. Although formally this report is to 30 September it covers developments in the period since up to the date of this report.

6. If agreed by members this 6 month report will then go on to Council.

DEBT MANAGEMENT

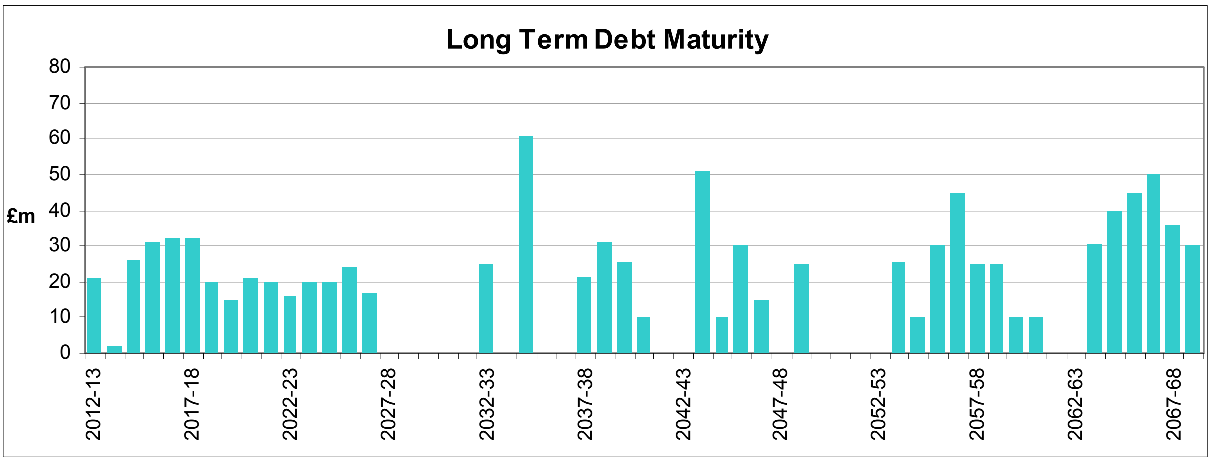
7. The PWLB remains the preferred source of borrowing for the Council as it offers flexibility and control. From 1 November 2012, the Government reduced by 20 basis points (0.2%) the interest rates on loans from the

PWLB to principal local authorities who provided the required information on their plans for long-term borrowing and associated capital spending. KCC completed the information request and, as a consequence, qualifies to receive the certainty rate discount on PWLB loans from 1 November 2012 to 31 October 2013.

8. The large downward move in gilt yields in the second quarter resulted in PWLB rates falling across all maturities. However taking new borrowing still involves a very significant long term revenue cost to the Council. For the Council the use of internal resources in lieu of borrowing has continued to be the most cost effective means of funding capital expenditure. This has lowered overall treasury risk by reducing both external debt and temporary investments.

9. During August a £55m PWLB loan was repaid using the Council's cash balances and there was no rescheduling of existing debt in the 6 months.

10. As at 30 September the Council had long term borrowings of £1,033million with a maturity profile as follows:



Total external debt included £44.3m of pre LGR debt relating to Medway Council and £2.7m for other bodies.

11. In November a further £20m PWLB loan was repaid using cash in hand.

12. As a result of repaying the loans the average portfolio interest rate for 2012-13 has increased by 0.14% to 5.44% and the average life of the portfolio from 30.13 years to 30.83 years.

13. It is forecast that debt costs for 2012-13 will be £2.8m less than budget due to deferring borrowing in 2011-12 and no new borrowing being taken in 2012-13.

INVESTMENTS

14. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield

commensurate with these principles. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13.

15. The Council's criteria for the selection of counterparties are:

- A strong likelihood of Government intervention in the event of liquidity issues based on the systemic importance to the UK economy.
- Publicised credit ratings for institutions (the Council's minimum long-term counterparty rating is A- or equivalent).
- Other financial information e.g. Credit Default Swaps, share price, corporate developments, news, articles, market sentiment, momentum.
- Country exposure e.g. Sovereign support mechanisms, GDP, net debts as a percentage of GDP.
- Exposure to other parts of the same banking group.
- Reputational issues.

16. New investments have been made in Term Deposits and Certificates of Deposit (CDs) with the following UK Banks and Building Societies systemically important to the UK:

- Barclays
- HSBC
- Lloyds Banking Group
- Royal Bank of Scotland
- NatWest
- Santander UK
- Standard Chartered
- Nationwide

and in T-Bills and DMADF (Debt Management Office) deposits

17. In June Moody's completed its review of banks with global capital market operations, downgrading the long-term ratings of all of them by between one to three notches. The banks on the Council's lending list which were affected by the ratings downgrades were Barclays, HSBC, Royal Bank of Scotland. Separately, the agency also downgraded the ratings of Lloyds Bank, Bank of Scotland, National Westminster Bank and Santander UK plc. None of the long-term ratings of the banks on the Council's lending list were downgraded to below the Council's minimum A- credit rating threshold.

18. As a result of the ratings downgrades deposit durations were shortened in June. They were then extended at the end of July having taken account of advice from Arlingclose whose assessment of the creditworthiness of the financial institutions had shown continued signs of stabilisation, and in some cases, considerable improvement. At the present time the maximum durations advised by Arlingclose for UK institutions are:

- Santander UK for a maximum period of **100 days**;
- Royal Bank of Scotland, National Westminster, Lloyds TSB and Bank of Scotland for a maximum period of **6 months**;
- HSBC Bank, Standard Chartered, Nationwide BS and Barclays for a maximum period of **12 months**.

The Council's maximum maturities for new investments are:

- Royal Bank of Scotland, National Westminster, Santander UK **- overnight**
- Lloyds TSB, Bank of Scotland, Barclays and Nationwide BS for a maximum period of **100 days**
- HSBC Bank and Standard Chartered for a maximum period of **12 months**.

19. At its meeting in September Cabinet approved the use of the following Australian and Canadian counterparties. At the current time not all of the banks listed take deposits and rates are quite low. However, we now have alternative options to using the DMO in the event of further downgrades of UK financial institutions.

- Australia and New Zealand Banking Group
- National Australia Bank
- Westpac Banking Corp
- Commonwealth Bank of Australia
- Bank of Montreal
- Bank of Nova Scotia
- Canadian Imperial Bank of Commerce
- Royal Bank of Canada
- Toronto Dominion Bank

The maximum duration is 12 months and the maximum limit with any one bank is £25m with the maximum exposure to either country being £50m. To date no deposits have been made with these counterparties.

20. A list of the Council's deposits on 16 November is attached at Appendix 1.

21. The average cash balances during the 6 months were £325m representing the Council's reserves, working cash balances, capital receipts and schools balances etc. This figure will come down with the debt repayment of £75m. Cash balances are expected to be lower towards the end of the financial year.

22. The UK Bank Rate has been maintained at 0.5% since March 2009 and is not expected to rise until 2015/2016. New investments were made at an average rate of 0.84%. The Council anticipates an investment outturn of £2.57m / 0.86% for the whole year.

ICELAND

23. Current recoveries from Icelandic banks are £37.7m comprising:

- Heritable dividends totalling 74.56p in £ or £13.7m
- Landsbanki - 3 dividends of £8.1m, 47.63% of the total due
- Glitnir – in March 2012 a full recovery was made.

COMPLIANCE WITH PRUDENTIAL INDICATORS

24. The Council can confirm that it has complied with its Prudential Indicators for 2012/13 set as part of the Council's Treasury management Strategy Statement. Details can be found in Appendix 2.

RECOMMENDATION

25. Members are asked to endorse this report and recommend that it is submitted to Council.

Alison Mings
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Appendix 1

KCC Deposits as at 16 November 2012

Instrument Type	Counterparty	Principal Amount	End Date	Interest Rate	Territory
		£		%	
Fixed Deposit	Bank of Scotland	5,000,000	07/05/2013	1.6	UK Bank
Fixed Deposit	Bank of Scotland	5,000,000	06/02/2013	1.3	UK Bank
Fixed Deposit	Barclays Bank	5,000,000	31/05/2013	6.8	UK Bank
Same day Call Deposit	Barclays Bank (FIBCA)	20,000,000	n/a	0.7	UK Bank
Same Day Call Deposit	Lloyds TSB	6,250,000	n/a	0.75	UK Bank
Fixed Deposit	Lloyds TSB	5,000,000	01/02/2013	1.3	UK Bank
Fixed Deposit	Lloyds TSB	5,000,000	03/05/2013	1.6	UK Bank
Same Day Call Deposit	NatWest	23,350,000	n/a	1.15	UK Bank
LIBOR Fixed Deposit	Royal Bank of Scotland	5,000,000	18/10/2013	1.1325	UK Bank
Same Day Call Deposit	Royal Bank of Scotland	45,000,000	n/a	1.25	UK Bank
Same Day Call Deposit	Santander UK	25,000,000	n/a	0.8	UK Bank
Certificate of Deposit	Standard Chartered	10,000,000	22/11/2012	0.85	UK Bank
Certificate of Deposit	Standard Chartered	10,000,000	30/11/2012	0.92	UK Bank
Certificate of Deposit	Standard Chartered	20,000,000	03/12/2012	0.92	UK Bank
Certificate of Deposit	Standard Chartered	10,000,000	12/12/2012	0.92	UK Bank
	Total UK Bank Deposits	**199,600,000**			
Fixed Deposit	Nationwide Building Society	900,000	19/11/2012	0.35	UK Building Society
	Total UK Building Society Deposits	**900,000**			
Treasury Bill	Debt Management Office	20,000,000	03/12/2012	0.338	UK Government
	Total UK Govt. Deposits	**20,000,000**			
	Total Icelandic Bank Deposits	**16,840,924**			Iceland Bank
	Grand Total of All Deposits	**237,340,924**			

Appendix 2

2012-13 Qtr 2 Monitoring of Prudential Indicators

1. Estimate of capital expenditure (excluding PFI)

Actual 2011-12 £265.761m

Original estimate 2012-13 £278.885m

Revised estimate 2012-13 £256.344m (this includes the rolled forward re-phasing from 2011-12)

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

	2011-12 Actual £m	2012-13 Original Estimate £m	2012-13 Forecast as at 31-10-12 £m
Capital Financing Requirement	1,495.873	1,538.083	1,521.559
Annual increase in underlying need to borrow	22.273	21.939	25.686

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 2011-12 12.85%
Original estimate 2012-13 11.77%
Revised estimate 2012-13 14.06%

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 2012-13

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

	Prudential Indicator 2012-13 £m	Position as at 31.10.12 £m
Borrowing	1,154	989
Other Long Term Liabilities	0	0
	1,154	989

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

	Prudential Indicator 2012-13 £m	Position as at 31.10.12 £m
Borrowing	1,198	1,033
Other Long Term Liabilities	0	0
	1,198	1,033

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 2012-13 are:

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

	£m
Borrowing	1,195
Other long term liabilities	0
	1,195

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

	£m
Borrowing	1,238
Other long term liabilities	0
	1,238

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 2012-13

Fixed interest rate exposure	100%
Variable rate exposure	50%

These limits have been complied with in 2012-13.

8. Upper limits for maturity structure of borrowings

	Upper limit %	Lower limit %	As at 31.10.12 %
Under 12 months	10	0	2
12 months and within 24 months	25	0	0.2
24 months and within 5 years	40	0	8.6
5 years and within 10 years	30	0	10.4
10 years and within 20 years	30	10	11.8
20 years and within 30 years	30	5	14.4
30 years and within 40 years	30	5	12.7
40 years and within 50 years	40	10	17.5
50 years and within 60 years	40	10	22.4

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

Indicator	Actual
£50m	£10m