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To: Governance and Audit Committee –24 September 2013

Subject: **TREASURY MANAGEMENT UPDATE**

Classification: Unrestricted

Summary: To report a summary of Treasury Management activity

STATUS FOR ASSURANCE

INTRODUCTION

1. This is a quarterly update on treasury management issues.

BACKGROUND

2. The Treasury Management Strategy for 2013/14 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. 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. In addition to reporting on risk management related to treasury activities, the Treasury Management Code also requires the Council to report on any financial instruments entered into to manage treasury risks.

MONTHLY PERFORMANCE REPORT

6. The Treasury & Investments Manager produces a monthly report for all members of the Treasury Advisory Group. The June report is attached in Appendix 1.

STATEMENT OF DEPOSITS

7. A statement of deposits as at 30 August is attached in Appendix 2. This statement is circulated to members of Treasury Advisory Group every Friday.

INVESTMENT ACTIVITY

8. Security of capital has remained the Council's main investment objective and this has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14. During the quarter the use of its approved counterparties and the maximum duration of the Council's investments have taken account of changes to ratings and growing concern over economic developments in Europe. Our current policy is:
 - (1) Cash deposits, call accounts and Certificates of Deposit (CDs) with the following:
 - Barclays Bank Plc
 - HSBC bank Plc
 - Lloyds Banking Group – Lloyds TSB / HBOS
 - RBS Group – Royal Bank of Scotland / NatWest
 - Santander UK Plc
 - Nationwide Building Society
 - Standard Chartered Bank Plc
 - (2) T-Bills and cash deposits with the Debt Management Office.
 - (3) Deposits in a number of Australian and Canadian banks are permitted but none have been made.
 - (4) The maximum permitted duration of deposits is 12 months.

COUNTERPARTY UPDATE

9. Counterparty credit quality is assessed and monitored with reference to Credit Ratings (the Authority's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms / potential support from a well-resourced parent institution; share price.
10. In April Fitch downgraded the UK's long-term sovereign rating by one notch from AAA to AA+, the second of the rating agencies to do so (Moody's had downgraded the UK's ratings in February to Aa1).
11. The proposed sale of 632 Lloyds' branches to the Co-op Bank fell through in April and Lloyds now instead plans to sell the branches in an Initial Public Offering (IPO) later this year.
12. In the Chancellor's Mansion House speech on 19th June he signalled his intention to sell the government's stake in the Lloyds Banking Group. UKFI, the

body responsible for managing the government's holdings in Lloyds, has recently appointed a range of investment banks and advisors to manage the re-privatisation of the bank and speculation is mounting that the government could sell off up to a quarter of its 39% stake in the bank sometime in September 2013.

13. Moody's placed Royal Bank of Scotland plc's and National Westminster Bank plc's long-term and standalone bank financial strength ratings on review for downgrade. This followed the announcement by the Chancellor on 19th June of the commencement of a cost-benefit review to evaluate the merit of breaking up RBS in order to achieve the government's goals of (1) promoting economic growth; (2) maximizing value for taxpayers; and (3) accelerating RBS's return to the private sector.
14. Following advice from Arlingclose the maximum duration of term deposits has been reduced to 3 months with Lloyds and restricted to overnight call accounts with RBS and NatWest.
15. Standard Chartered is a UK bank which generates more than three-quarters of its earnings in Asia and in June its CDS rose some 62% in price peaking on 24 June. This movement was more pronounced than that of its peers including HSBC and a number of Australian banks. The bank's share price has also fallen since March. These movements were mainly due to the bank being one of 20 censured for attempting to manipulate a selection of key benchmark interest rates, including SIBOR (Singapore InterBank Offered Rate). Singapore regulators have ordered Standard Chartered to set aside approximately £250m. Taking account of Arlingclose's advice KCC suspended the bank from its approved counterparty list for 3 weeks, recently reinstating them but maintaining a maximum duration of 6 months for purchases of CDs.
16. The Treasury Advisory Group met with Arlingclose on 31 July. The meeting received a presentation on the current economic situation which was of particular benefit to new members of the group and agreed that a recommendation for diversifying the Council's investment portfolio should go to Cabinet at its September meeting.
17. 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.
18. Following the receipt of a substantial dividend from Heritable in August (16.7p in the pound, £3.1m), and a 4th dividend from Landsbanki in early September (5.02p in the pound, £0.9m), the total recovery to date from Icelandic banks including interest is now £42m. Details as follows:
 - Heritable – dividends received are equal to 94p in the pound, £17.3million. The recovery is now predicted to be close to 100%.
 - Landsbanki - 4 dividends received totalling £8.8million. The forecast recovery is 100%
 - Glitnir - paid in full in March 2012

RECOMMENDATION

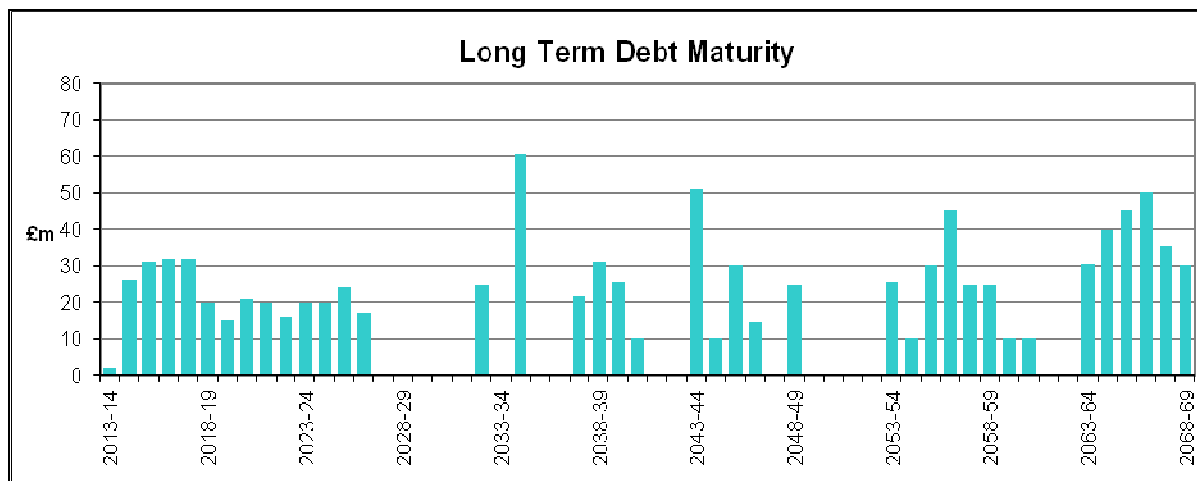
19. Members are asked to note this report for assurance.

Alison Mings
Treasury and Investments Manager
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Treasury Management Report for the month of June 2013

1. Long Term Borrowing

The Council's strategy continues to be to fund its capital expenditure from internal resources as well as consider borrowing at advantageous points in interest rate cycles. The total amount of debt outstanding at the end of June was unchanged at £1,012.29 million, with the maturity profile being as follows.

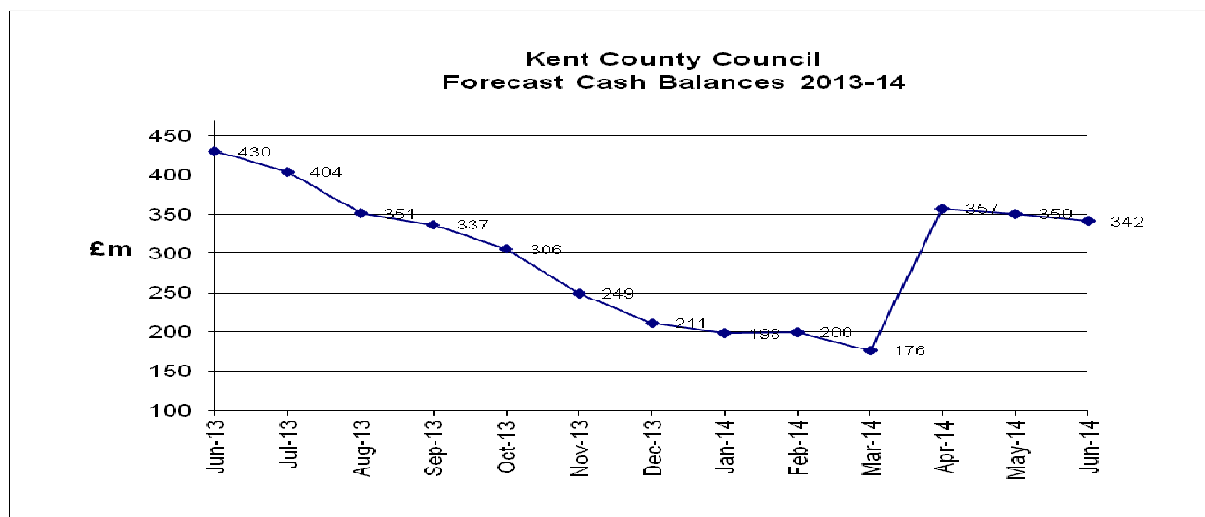


Total external debt includes £43.13m pre-LGR debt managed by KCC on behalf of Medway Council. Also included is pre-1990 debt managed on behalf of the Further Education Funding Council (£1.76m) and Magistrates Courts (£0.745m).

2. Investments

2.1 Cash Balances

During June the total value of cash under management fell as expected by £18.5m to £430.1m. Balances are expected to continue to fall through 2013-14 and rise again next April.

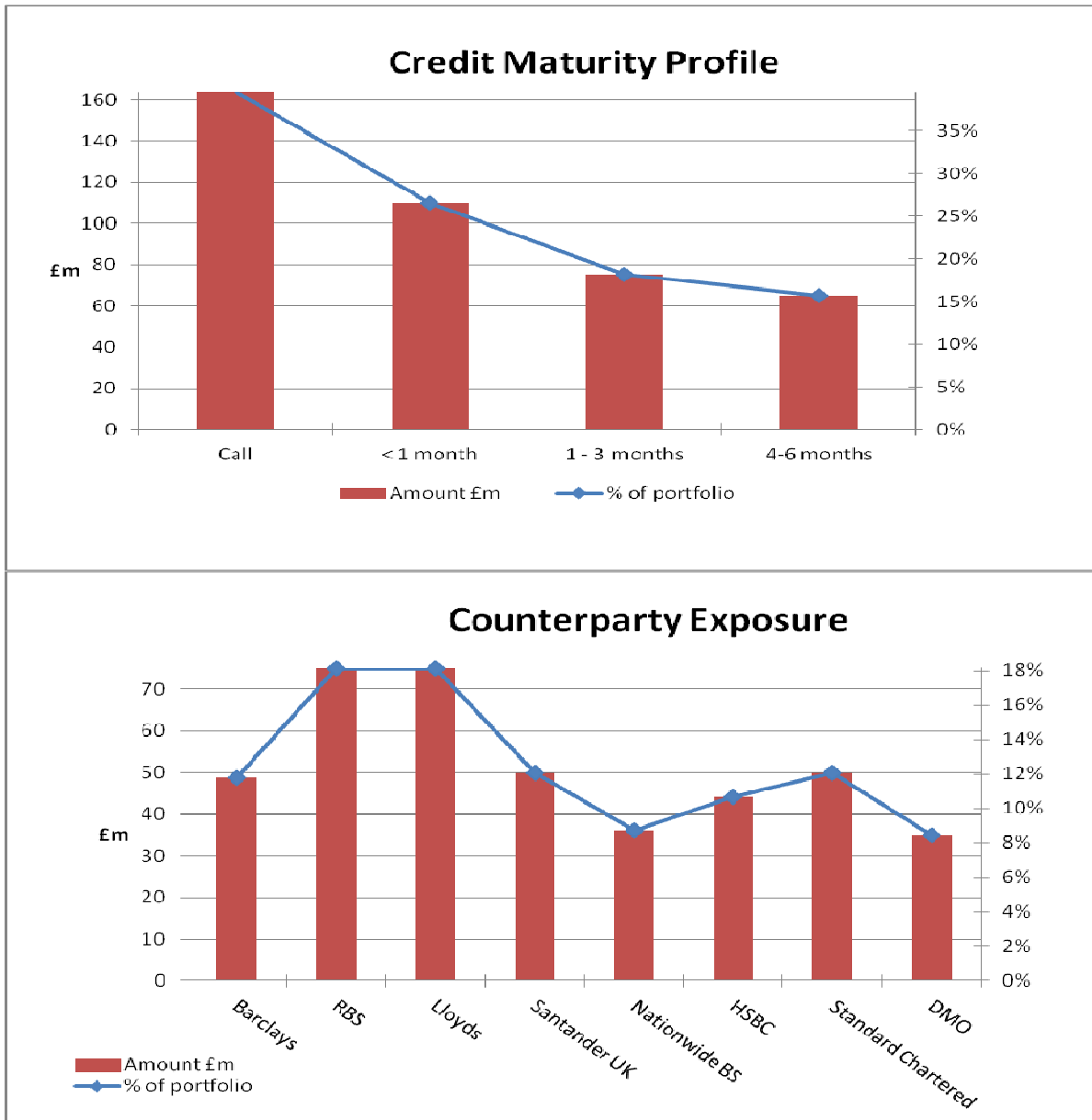


2.2 Average return on new deposits

The average return on new deposits in June was 0.5633 % vs 7 day LIBID 0.3613%. Interest rates on call accounts and short term deposits have continued to fall as banks have access to cheaper sources of finance.

2.3 Credit maturity profile and counterparty exposure

The following charts show the credit maturity profile and counterparty exposure as at the month end.



2.4 Credit Score matrix

	May 2013		June 2013	
	Credit Rating	Credit Risk Score	Credit Rating	Credit Risk Score
Value Weighted Average	A+	5.06	A+	5.22
Time Weighted Average	A+	4.81	A+	4.66

Credit risk scored 1 – 10; 1 = strongest rating lowest risk, i.e. AAA, through to 15 = lowest credit rating, highest risk, i.e. D

Alison Mings, 15 July 2013

Statement of Deposits at 30 August 2013

Counterparty	Principal Amount	End Date	Interest Rate	Territory
Bank of Scotland	£10,000,000	n/a	0.4	UK Bank
Bank of Scotland	£5,000,000	30/09/2013	0.8	UK Bank
Bank of Scotland	£5,000,000	07/11/2013	0.8	UK Bank
Bank of Scotland	£5,000,000	22/10/2013	0.7	UK Bank
Lloyds TSB	£10,000,000	n/a	0.4	UK Bank
Lloyds TSB	£5,000,000	27/09/2013	0.8	UK Bank
Lloyds TSB	£5,000,000	22/10/2013	0.8	UK Bank
Lloyds TSB	£5,000,000	04/11/2013	0.8	UK Bank
Lloyds TSB	£5,000,000	15/11/2013	0.8	UK Bank
Lloyds TSB	£5,000,000	27/09/2013	0.7	UK Bank
Lloyds TSB	£5,000,000	15/11/2013	0.7	UK Bank
Lloyds TSB	£5,000,000	19/11/2013	0.7	UK Bank
Lloyds TSB	£5,000,000	21/11/2013	0.7	UK Bank
Barclays Bank	£1,030,000	n/a	0.35	UK Bank
Barclays FIBCA	£40,000,000	n/a	0.7	UK Bank
HSBC	£3,290,000	25/09/2013	0.35	UK Bank
HSBC	£23,400,000	25/09/2013	0.35	UK Bank
NatWest	£25,000,000	n/a	0.6	UK Bank
Royal Bank of Scotland	£5,000,000	18/10/2013	1.1096	UK Bank
Royal Bank of Scotland	£20,000,000	n/a	0.85	UK Bank
Royal Bank of Scotland Notice Acc	£25,000,000	14/10/2013	1.05	UK Bank
Santander UK	£50,000,000	n/a	0.8	UK Bank
Standard Chartered	£10,000,000	02/10/2013	0.5	UK Bank
Standard Chartered	£10,000,000	02/01/2014	0.53	UK Bank
Standard Chartered	£10,000,000	06/01/2014	0.54	UK Bank
Standard Chartered	£10,000,000	05/02/2014	0.56	UK Bank
Standard Chartered	£10,000,000	12/02/2014	0.56	UK Bank
Total UK Bank Deposits	£317,720,000			
Debt Management Office	£10,000,000	21/10/2013	0.29	UK Govt.
Debt Management Office	£10,000,000	11/11/2013	0.3	UK Govt.
Debt Management Office	£5,000,000	02/09/2013	0.29	UK Govt.
Debt Management Office	£5,000,000	25/11/2013	0.305	UK Govt.
Debt Management Office	£10,000,000	21/10/2013	0.278	UK Govt.
Total UK Govt. Deposits	£40,000,000			
Total Icelandic Bank Deposits	£13,270,880			
Grand Total of All Deposits	£370,990,880			