

Report

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Report to:	Finance and Information Technology
Date of Meeting:	12 February 2009
Report by:	Executive Director (Finance and Information Technology Resources)

Subject:	Treasury Management Strategy 2009/2010
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1. Purpose of Report

1.1. The purpose of the report is to:-

- ◆ Provide members with the Treasury Management Strategy for 2009/10.

2. Recommendation(s)

2.1. The Committee is asked to approve the following recommendation(s):-

- (1) that the Treasury Management Strategy for 2009/10 is approved.

3. Background

- 3.1. The Council's treasury activities are regulated by statute, and a professional code of practice (the CIPFA Treasury Management in Public Services Code of Practice). It is a requirement of this Code, and the financial regulations of South Lanarkshire Council that a Treasury Management Strategy is approved by Committee every year.
- 3.2. The level of borrowing required to fund the Council's Capital programme, together with the variable nature of interest rates, increases the risks associated with the treasury management function. As a result the Council will take a cautious approach to its Treasury Strategy. The full Treasury Strategy for 2009/10 is detailed at Appendix 1.

4. Strategy Highlights

4.1. The main areas covered by the Strategy are:

- ◆ Debt and investment projections
- ◆ Expected movement in interest rates
- ◆ Borrowing and Investment strategies

4.2. Total external debt is expected to reach £688.941m by the end of 2009/10. Investments of £39.316m are expected.

4.3. In the medium term the cost of borrowing is expected to drop initially, followed by a small rise. The Executive Director (Finance and IT Resources), under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time. This may also include repaying debt, borrowing in advance of need and rescheduling existing debt.

- 4.4. The main consideration when investing surplus funds will be the security of the transaction. The Council must also meet its liquidity requirement and only invest for the period of time that is prudent. Finally, and only after consideration of security and liquidity, the yield that will be gained from the investment will be considered. A counterparty list will be maintained with each approved counterparty meeting an agreed criteria in terms of financial ratings. During this period of uncertainty in the banking sector, the Executive Director, Finance and IT Resources will apply appropriate restrictions to the counterparty list to ensure the security of our deposits.
- 4.5. New investment regulations are expected from the Scottish Government over the coming months. An update to this strategy may be required after these regulations are applied.

5. Employee Implications

- 5.1. None

6. Financial Implications

- 6.1. The financial impact from treasury activity and borrowing for capital expenditure has been built into the long term revenue budget strategy.

7. Other Implications

- 7.1. Not Applicable

8. Equality Impact Assessment and Consultation Arrangements

- 8.1. An Equality Impact Assessment on the Treasury Management Strategy was carried out in November 2008.
- 8.2. The conclusion of the initial equality impact assessment is that there are no adverse impacts on any part of the community covered by equalities legislation, or on community relations. This policy relates to the investment of funds and borrowing of the council which is undertaken using professional guidance
- 8.3. There is no requirement to undertake any consultation in terms of the information contained in this report

Linda Hardie

Executive Director (Finance and Information Technology Resources)

28 January 2009

Link(s) to Council Values and Objectives

- ♦ **Value:** Accountable, efficient and effective

Previous References

- ♦ Report to the Finance and IT Resources Committee 14 February 2008

List of Background Papers

None

Contact for Further Information

If you would like to inspect the background papers or want further information, please contact:-

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Treasury Management Strategy 2009/10 – 2011/12

1. Foreword

- 1.1. The treasury management function is an important part of the overall financial management of the Council's affairs. The treasury management function considers the effective funding of capital investment plans, and works toward ensuring that best practice is followed when making decisions on managing council deposited funds.

The Council's treasury activities are regulated by the Local Government (Scotland) Acts 1975 and 2003, and a professional code of practice (the CIPFA Treasury Management in Public Services Code of Practice). It is a requirement of this Code, and the financial regulations of South Lanarkshire Council, that a Treasury Management Strategy is approved by Committee every year. The Council adopted the Code on 30 April 2002

A key requirement of this strategy is to explain both the risks and the management of these risks associated with the treasury function. A further report will be produced after the year end to report on actual activity during the year.

This strategy covers:

- The Council's debt and investment projections (Section 2);
- The expected movement in interest rates (Section 3);
- The Council's borrowing and investment strategies (Sections 4 and 5);
- Legal and Advisory costs (Section 6);
- Treasury performance indicators (Section 7);
- Scottish Government Investment Regulations (Section 8)

2. Debt and Investment Projections 2009/10 – 2011/12

- 2.1 The expected levels of external borrowing and investment for 2009/10 to 2011/12 are shown in the table below. An updated position for 2008/09 is also shown.

£m	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
External Debt				
Borrowing	£606.266m	£688.941m	£776.981m	£852.502m
Other long term liabilities	£0.072m	£0.0m	£0m	£0m
Debt at 31 March	£606.338m	£688.941m	£776.981m	£852.502m
Investments				
Total Investments at 31 March	£70.681m	£39.316m	£39.316m	£39.316m

3. Expected Movement in Interest Rates

3.1 Short term Interest rates

- 3.1.1 The Bank of England November Inflation Report reported that there had been a marked deterioration in the outlook for domestic and global economic activity, and the official estimates of growth weakened. The Bank of England reported that the prospects for economic growth and inflation are judged to be unusually uncertain.
- 3.1.2 In light of this outlook the bank rate was reduced by 1.5% in November, followed by further cuts in December and January resulting in the current rate of 1.5%. Further

reductions in bank rates have been forecast although these are not a foregone conclusion.

3.2 Medium Term Interest Rates

- 3.2.1 Current projections for medium term interest rates are shown in the table below. The average expected rates for each year is shown for bank rates, and PWLB borrowing (for 5, 20 and 50 year fixed borrowing terms). This shows the impact of the drop in the bank rate in 08/09, with an increase expected into 10/11 and 11/12. A reduction in PWLB borrowing rates is also forecast.

Medium term Interest rates - Annual Averages

	Bank Rate	5 year PWLB	20 year PWLB	50 year PWLB
2008/09	3.9	4.2	4.8	4.5
2009/10	1.0	2.4	3.9	3.8
2010/11	1.7	3.2	4.1	4.0
2011/12	2.4	4.0	4.3	4.1

Provided by Butlers Treasury Consultants

4. Borrowing Strategy

- 4.1. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.
- 4.2. The Executive Director, Finance and IT Resources under delegated powers, will take the most appropriate form of borrowing depending on interest rates at the time, taking into account the risks shown in the forecast above.
- 4.3. The option of postponing borrowing and running down investment balances may be considered. This would reduce our need to deposit cash with our counterparties, and also limit the impact of the current and any further drop in investment returns.
- 4.4. Likewise if borrowing rates deteriorate the timing of our borrowing may be reconsidered. This may include borrowing in advance of future years requirements.
- 4.5. As in previous years rescheduling of our existing debt may be considered
- 4.6. The overall strategy for borrowing will be to monitor interest rates, undertake planned borrowing at the best time, whilst investigating opportunities where possible to improve the management of our existing loan portfolio.
- 4.7. The expected borrowing requirement is shown below :-

	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
Movement in CFR	£53.334m	£101.357m	£88.040m	£75.521m
Maturing Debt	£15.163m	£11.803m	£13.270m	£17.755m
Total borrowing need	£68.497m	£113.160m	£101.310m	£93.276m

5. Investment Strategy

- 5.1. The main principles governing the Council's investment criteria is to ensure the security and liquidity of its investments before considering yield. To do this the Council will :
- Ensure it has sufficient liquidity in its investments. For this purpose it will consider the maximum periods for which funds may prudently be committed.
 - maintain a policy covering the criteria for choosing investment counterparties with adequate security and monitoring their security.
- 5.2. The Executive Director, Finance and IT Resources will maintain a counterparty list and will revise the criteria and submit it to Council for approval as necessary. Further details on the Council's current investment criteria can be found in the report to the Finance and IT Resources Committee on 3 May 2005 entitled 'Criteria for Investment of Temporary Surplus Funds'.
- 5.3. In addition to the above report a supplementary report was approved under Standing Order 36(C) and then presented to the Finance and IT Committee which extended the Counterparty policy to include the Debt Management Office (DMO) Deposit facility provided by HM Treasury. This action was taken to ensure security for our surplus funds through a volatile period for banks.
- 5.4. Therefore the approved criteria for Counterparties is :

Banks/Building Societies

Criteria	Max Amount	Max Period
Minimum F1 short term, backed up by AAA long term, and support rating of 2 or individual rating of B	£15m	364 days
Minimum F1 short term, backed up by AA-long term, and support rating of 2 or individual rating of B	£10m	364 days
Minimum F1 short term, backed up by A-long term, and support rating of 2 or individual rating of B	£5m	364 days

Where a subsidiary of a counterparty is not credit rated in their own right, but has an unconditional guarantee from a parent, the subsidiary will be deemed to possess the same credit rating as the parent.

Local Authorities, Joint Boards and Passenger Transport Executives

Criteria	Max Amount	Max Period
Local Authority, Joint Boards and PTE	£15m	364 days

Debt Management Office Deposit Facility

Criteria	Max Amount	Max Period
Debt Management Office Deposit Facility	£30m	364 days

- 5.5. There is operational difficulty for managing investments during the current period of unrest in the banking sector. Ideally investments would be invested longer to secure better returns, however, uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security. The Executive Director, Finance and IT Resources will restrict the term of deposits as appropriate.
- 5.6. The existing Counterparty policy sets out a sound approach to investment in normal market circumstances. Whilst this policy still stands, under the exceptional current market circumstances the Executive Director, Finance and IT Resources will temporarily restrict investment to those counterparties considered of higher credit quality than the minimum criteria set out in the policy. These restrictions will remain in place until the banking system returns to more normal conditions.
- 5.7. Examples of these restrictions would be greater use of guaranteed deposit facilities (ie Northern Rock), and strongly rated institutions offered support by the UK Government. The DMO account will also be used whenever appropriate.
- 5.8. In addition alternative methods of assessing creditworthiness will be explored and used to ensure that every effort is made to secure our deposits.

6. Legal and Advisory Costs

- 6.1 We will continue all efforts to secure the return of funds currently invested in Icelandic banks and their subsidiaries. In pursuing this to our full ability certain financial advisory and legal costs may be incurred.

7. Performance Indicators

- 7.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Investments – Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Annual Report for 2008/09.

8. Scottish Government Investment Regulations

- 8.1 The Scottish Government is expected to issue Investment Regulations shortly.
- 8.2 The anticipated changes to the investment regime contained within the Regulations should provide greater autonomy for Councils in their investment activities. On issue of the Investment Regulations a revision to this strategy may be required. If required an updated strategy will be presented to committee for approval.