PART A

AGENDA ITEM **7**

Report to: Audit Committee

Date of meeting: 30 September 2010

Report of: Head of Strategic Finance

Title: Treasury Management Quarterly Report

1.0 SUMMARY

1.1 This report provides a half year review of the Council's Treasury Management Strategy and investment performance as at the 7th September 2010 for the financial year 2010/11

2.0 RECOMMENDATIONS

2.1 That the Committee notes the report and approves the ability for the Council to invest up to £10m with the Nat West for short periods of time. This authorisation to be available until such time as the UK Government ceases to fully guarantee such deposits. The approval of the Audit Committee will need to be referred on to Full Council as it will require a change to the Treasury Policy Statement.

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3.0 **Background**

3.1 The Committee received two reports on 13th January 2010 which detailed a Treasury Management, Investment and Practices Strategy for 2010/2011 and a quarterly report upon treasury performance for the eight months ending 30th November 2009. On 30th June a further report detailed the treasury management performance for the financial year 2009/2010 and the operational strategy from 1st April up to the end of June 2010.

4.0 **Treasury Management Practice for 2010/2011**

4.1 It is not the intention to formally revise the Treasury Policy for 2010/2011 although **there is one change that will require Council approval**. The current strategy involves investing in:

- Four of the top six (by size) of building societies, Nationwide, Yorkshire, Coventry and Skipton; (the other two being Britannia—part of the Co-op Bank Group, and Chelsea—subject to a takeover by Yorkshire both of which would contravene restrictions on 'Group' limits). At the present time investment with these building societies is being limited to £3m per institution and that will continue for the foreseeable future (although the Treasury Policy Statement does allow investment up to £5m per institution). At the present time the Council's Portfolio has £12m invested with these four societies which represents 31% of the Council's investment portfolio. There is a current limit of no more than 50% with building societies (with an aspiration to reduce the percentage to 25%).

- Those banks having the necessary credit rating (as per our Treasury Policy Statement). An advantage of the Shared Service with Three Rivers has been that the treasury manager based at Three Rivers has persuaded its bankers, Nat West, to permit Watford to open up a 'call account' at an extremely favourable rate of interest of 0.9%. As a comparator the Council's own bankers, the Co-operative Bank only offer a short term facility at 0.56%. This in turn can be compared to the Government's Debt Management Office where a rate of 0.15% is currently being offered. As a consequence, Watford's short term cash deposits have been largely placed with the Nat West (which is of course guaranteed by the UK Government). By reference to the Council's Portfolio at Appendix 1 it can be seen that Nat West currently have £7m on deposit which exceeds current Treasury Policy limits. It is necessary to regularise this situation and **the Audit Committee is asked to recommend Full Council** to approve the ability for the Council to invest up to £10m on short term deposit with the Nat West for such period as it is covered by UK Government guarantees.

- Money Market Funds which are Triple AAA rated. Our Policy Statement permits such investments and they are highly recommended by our Treasury Fund advisers, Sector, for security of asset and liquidity (investments can be called back same day). In that respect the Council has opened an account with Henderson Liquid Assets Fund (currently has 61 local authority clients). The average rate of return is low (circa 0.5%) but does provide diversification within the Portfolio). No money has been deposited to date.

4.2 The Portfolio is prepared to take a medium risk approach although it is very much governed by the following criteria (listed in highest priority):

- **S** ecurity –reliability of counterparties
- **L** iquidity—ability to get our money back within a reasonable timescale
- **Y** ield—the rate of interest being earned

4.3 In order for a strategy to be totally risk averse then it effectively would need to invest all its portfolio with the Government Debt Management Office where a return of 0.15% is currently offered. To put this in perspective, £38m (our current portfolio) with the DMO would earn £57k of investment interest for the year. Watford's current portfolio geared to £38m should earn £494k investment interest. Treasury Managers can (and should) be criticised for being overly cautious. With regard to Watford's current portfolio, it is reviewed quarterly by independent advisers, Sector, and has received praise for being largely risk averse whilst beating the industry norm by 0.4%. This overachievement has largely been due to the maturity profile followed by Watford rather than any lack of security from its counterparties (and this is discussed later in this report).

4.4 The current Portfolio is attached at Appendix 1 and the following notes may be of assistance to the Audit Committee:

- Cater Allen is fully guaranteed by Santander. Nevertheless, few people will have heard of Cater Allen and it is the intention not to continue the loan of £1m when it matures on 30th September 2010.
- Clydesdale Bank meet our ratings criteria. The investments we have (£3m) are with the local branch (Clarendon Road) and whilst enjoying the full protection of Clydesdale nationally, our money is actually loaned at Clydesdale's risk to local businesses.
- The Nat West account has been set up on the back of the Three Rivers bank contract (as a favour to Watford, but obviously in Watford's name—nevertheless another plus point from Shared Services). It is a same day call account and offers a very good rate of interest (0.9%). It is backed by Government guarantee and will be increasingly used where the Council has temporary cash flow surpluses which cannot be loaned out for any length of

time. In the past we have had to have recourse to overnight facilities at the Co-operative Bank (0.56% rate of interest) but Nat West provides better security and a higher yield.

5.0 For the immediate future, it is likely that any surplus cash will be placed with Santander which meets the Council's criteria and has received the support of our investment advisers, Sector, for up to six months duration. For the Committees information current rates at Santander are 0.98% for 3 month deposits and 1.28% for 6 months duration. My preference would be to place deposits for 6 months, but that is subject to our cash flow forecast for the rest of the year.

5.1 **Maturity Profile**

The Council's strategy has been based upon the fact that no increase in Bank Base rate was anticipated for the foreseeable future and investment in 12 month deposits (where interest rates are higher) has been a primary aim. This strategy has been shown to be correct (so far) as Base Rate has not changed (0.5%) for the past 20 months. As a consequence investments placed 12 to 15 months ago for a 12 month duration has proven to be the correct strategy and the extra investment interest earned has been effectively 'banked'.

5.2 For the future, it is still anticipated that Base Rate will remain unchanged (despite underlying inflationary pressures) as any increase in conjunction with Government austerity measures would be likely to cause a full blown recession.

5.3 The Council's current portfolio at Appendix 1 shows a maturity profile as follows:

* £12m long (12 months until maturity in August 2011).
* £10m medium (maturities in February 2011, these were originally 'long' and have enjoyed excess interest for the past 8 months).
* £16m short (basically capable of calling back within one month).

5.4 This profile has a good balance so that should Base Rates change at the turn of the year then a number of maturities will be available to review current strategies. The Portfolio necessarily has to keep a reasonable percentage in short term deposits because this cash will be needed to finance the Council's Capital Programme (circa £10m likely to be spent between now and year end).

6.0 **Investment Performance**

6.1 The investment portfolio has earned £267k of interest up to 7th September 2010 at an average rate of interest of 1.37%. Current rates of interest are broadly: on call 0.8%; 3 months 0.98%; 6 months 1.28%; 12 months 1.8%. It is likely therefore that for the rest of the financial year, the average rate of interest on Watford's funds will fall to 1.2%. At the same time the size of the portfolio will fall from £38m to a probable £30m.

6.2 The original estimate of general investment interest for 2010/2011 was £696k and was based upon an average 1.6% rate of interest. This estimate was produced in December 2010 when there was an expectation that Base Rates would start to rise. Equally it had not anticipated the portfolio reducing to £30m by year end. The recent Finance Digest considered by Budget Panel on 27th September has reported a probable £200k shortfall on investment interest in 2010/2011 and this has also been reflected within the latest Medium Term Financial Strategy.

7.0 **Mid Year Review of Prudential Indicators**

7.1 There is a new requirement that Audit Committee reviews at mid year the approvals it has given regarding borrowing and investment strategies**.** All aspects relating to investments have been covered earlier in this Report. With regard to borrowing, the report to Audit Committee on 13th January 2010 provided a comprehensive projection of borrowing strategies, prudential indicators, minimum revenue provision and limits to borrowing activity. The Council continues to be debt free and seeks to ensure, through its day to day cash flow, that it does not need to borrow even for short periods.

7.2 Progress in the achievement of the Council's Capital Programme is monitored by Budget Panel and Cabinet and 'lean government' seeks to avoid unnecessary duplication. Paragraph 5.4 above refers to the anticipated effect of financing the capital programme upon the investment portfolio.

7.3 There has, therefore, been no material change to the comprehensive report produced to the January meeting of this Committee.

8.0 **IMPLICATIONS**

8.1 **Financial Issues**
The Head of Strategic Finance comments that all financial comments have been included within the body of the report.

8.2 **Legal Issues** (Monitoring Officer)
The Head of Legal and Property Services comments that there are statutory limitations governing cash fund investments and all proposals within this report ensure continued compliance.

8.3 **Potential Risks**

Potential Risk	**Likelihood**	**Impact**	**Overall score**
Investment with non approved body	1	4	4
Failure to achieve investment interest budget targets	2	3	6
Those risks scoring 9 or above are considered significant and will need specific attention in project management. They will also be added to the service's Risk Register.			

8.4 **Staffing**
None Directly

8.5 **Accommodation**
None Directly

8.6 **Community Safety**
None Directly

8.7 **Sustainability**
None Directly

<u>Background Papers</u>

CIPFA Treasury Management Code of Practice
Audit Commission publication-Risk and Return
Treasury Management Policy, Practice and Strategy (reported to this Committee on 13th January 2010

<u>File Reference</u>

None