CITY COUNCIL - 13 DECEMBER 2010

REPORT OF THE DEPUTY LEADER

TREASURY MANAGEMENT – 2010/11 STRATEGY CHANGES

1 SUMMARY

1.1 This report seeks approval for changes to the 2010/11 treasury management strategy and revised Prudential Indicators associated with treasury management activity in the current financial year.

2 RECOMMENDATIONS

IT IS RECOMMENDED that:

2.1 The proposals relating to the inclusion of the European Investment Bank as a non-specified investment counterparty for 2010/11 are approved.

2.2 The revised list of eligible counterparties for investment (**Appendix 1**) be approved

2.3 The revised schedule of Prudential Indicators for 2010/11 (**Appendix 2**) be approved.

3 REASONS FOR RECOMMENDATIONS (INCLUDING OUTCOMES OF CONSULTATION)

3.1 To ensure compliance with the Code of Practice on Treasury Management in Public Services (the Code) adopted by the City Council in February 2002.

4 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

4.1 Options for management of the City Council's debt and investment portfolio are continually reviewed. The overall aim is to minimise the net revenue costs of our debt whilst maintaining an even debt profile in future years, and to maximise investment returns within stated security and liquidity guidelines.

4.2 The approval of the revised Prudential Indicators is a requirement of the Code.

5 BACKGROUND

5.1 Treasury management is the management of the organisation’s cash flows, including its borrowings and investments. It is regulated by the Code.

5.2 Any changes to the treasury management strategy during the financial year are required to be reported to and approved by a full meeting of the Council.

5.3 The Code also requires the preparation, annual approval by councillors and ongoing monitoring of a series of Prudential Indicators (financial indicators of treasury management, debt and capital expenditure). The indicators may be revised at any time, following due process, with any changes being approved at a meeting of the full City Council.

5.4 On 16 November 2010, Executive Board considered a report on treasury management activity to 30 September 2010. The report endorsed the inclusion of the European Investment Bank in the list of counterparties for investment and detailed changes to some of the Prudential Indicators for the year. The Code requires this to be approved at a meeting of the City Council.

Consideration of alternative investment opportunities, to enhance returns on deposits whilst maintaining high levels of security and liquidity, is an active part of the treasury management strategy. Our external advisors have identified bonds issued by the European Investment Bank (EIB) as a means of protecting investments against prolonged periods of low interest rates. The EIB, which has a AAA credit rating from all 3 rating agencies, is owned by the 27 member states of the EU and provides development funding through the issuance of bonds. Our advisors’ current view on this investment option is: *“the joint and individual pan-European government guarantees in place on these bonds provide security of the principal invested. Even at the lower yields likely to be in force, the return on these bonds will provide certainty of income against an outlook of low official interest rates”*

EIB bonds are for a minimum period of one year and are therefore classified as non-specified investments and require a custodial account to be set up with a third-party bank. Limits of 1 year and £20m will be imposed on any deposits in this instrument. **Appendix 1** provides details of the amended list of total approved counterparties for external investment.

5.4 The Executive Board report also endorsed changes to the 2010/11 Prudential Indicators, to update the figures for capital expenditure, the Capital Financing Requirement (the Council's underlying need to borrow) and external debt, and reflect the latest forecasts to the Capital Programme. In addition, an increase in the variable rate debt limit from 30% to 50% is proposed, to accommodate potential debt rescheduling activity. **Appendix 2** details the revised Prudential Indicators for 2010/11, with the indicators recommended for approval to change shown shaded in grey.

6 FINANCIAL IMPLICATIONS (INCLUDING VALUE FOR MONEY)

6.1 There are no direct financial implications or value for money issues arising from this report

7 RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS, CRIME AND DISORDER ACT IMPLICATIONS AND EQUALITY AND DIVERSITY IMPLICATIONS)

7.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is prepared for the treasury function.

8 LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

8.1 Treasury management working papers.

9 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

9.1 Executive Board report and minutes, 16 November 2010

COUNCILLOR CHAPMAN
DEPUTY LEADER

Appendix 1

ELIGIBLE COUNTERPARTIES FOR INVESTMENT 2010/11				
INSTRUMENT	**COUNTRY**	**COUNTERPARTY**	**MAX. SUM**	**MAX. PERIOD DAYS**
Term deposit / Call account	U.K.	Debt Management Office	No limit	364
		UK local authorities	No limit	364
		Bank of Scotland / Lloyds TSB Bank	£20m	364
		Barclays Bank	£20m	364
		Co-Operative Bank (the Council's bank)	No limit	5
		Clydesdale Bank	£20m	31
		HSBC Bank	£20m	364
		Nationwide Building society	£20m	364
		Royal Bank of Scotland	£20m	364
		Santander UK (Abbey National)	£20m	364
	Australia	Australia & NZ Banking Group	£5m	183
		Commonwealth Bank of Australia	£5m	183
		National Australia Bank Ltd	£5m	183
		Westpac Banking Corporation	£5m	183
	Canada	Bank of Montreal	£5m	183
		Bank of Nova Scotia	£5m	183
		Canadian Imp. Bank of Commerce	£5m	183
		Royal Bank of Canada	£5m	183
		Toronto-Dominion Bank	£5m	183
	Finland	Nordea Bank Finland	£5m	183
	France	BNP Paribas	£5m	183
		Calyon	£5m	183
		Credit Agricole SA	£5m	183
	Germany	Deutsche Bank AG	£5m	183
	Netherlands	Rabobank	£5m	183

SUSPENDED	Spain	Banco Bilbao Vizcaya Argentaria	£5m	183
		Banco Santander SA	£5m	183
	Switzerland	Credit Suisse	£5m	183
	USA	JP Morgan	£5m	183
Money Market Funds		AAA-rated funds (Constant Net Asset Value)	£10m per fund	N/A
Supranational Bonds (>364 days)		European Investment Bank	£20m	1 year

IMPORTANT NOTES:

<u>Credit Rating Definitions</u>

Short Term Ratings

Fitch F1

Highest credit quality, indicating the strongest capacity or timely payment of commitments.

Standard & Poor's A-1

Strong capacity to meet its financial commitments.

Moody's P-1

Offers superior credit quality and a very strong capacity for timely payment of short-term deposit obligations.

Long Term Ratings

Fitch A+

High credit quality. 'A' ratings denote expectations of low credit risk. They indicate strong capacity for payment of financial commitments. The '+' denotes the relative status within the category.

Standard & Poor's A+

An obligor rated 'A' has strong capacity to meet its financial commitments. The '+' denotes the relative status within the category.

Moody's A1

Banks rated A are considered upper-medium grade and are subject to low credit risk. The modifier 1 indicates that the rating is in the higher end of its generic rating category.

Limiting Factors

Co-operative Bank – *the City Council's own bank does not meet the City Council's applied criteria. They are included on the counterparty list, with a maximum period of investment of 5 days, for cash flow purposes.*

Groups *- where more than one institution is included within a banking group, the individual limit will apply to the total investment in that group*

Countries *- a maximum of 10% of the investment portfolio to be invested in any one country (excluding the UK) at the time of investment, with a maximum of 25% of the portfolio, at the time of investment, in non-UK banks in total.*

Money Market Funds *– a limit of £40m in all MMFs is to be applied at all times.*

European Investment Bank bonds– *a maximum period of 1 year*

APPENDIX 2

PRUDENTIAL INDICATORS				
PI	**Statutory Indicators**	**Actual 2009/10**	**2010/11 Approved March 2010**	**2010/11 Revised Approval *(i)***
Prudential indicators of affordability				
P1	Ratio of financing costs to net revenue stream - GF	6.08%	7.88%	**7.88%**
P2	Ratio of financing costs to net revenue stream - HRA	14.52%	15.93%	**15.93%**
P3	Estimates of the incremental impact of new capital investment decisions on Council Tax	+£0.04	+£1.26	**+£1.26**
P4	Estimates of the incremental impact of new capital investment decisions on rents	-	+£0.01	**£+0.01**
P5	Authorised limit for external debt *(ii)*	£552.8m	£748.5m	**£752.3m**
P6	Operational Boundary for external debt *(ii)*	£552.8m	£738.5m	**£742.3m**
Prudential indicators for prudence				
P7	Capital Expenditure - GF	£165.2m	£125.1m	**£144.2m**
P8	Capital Expenditure - HRA	£51.4m	£59.3m	**£61.9m**
P9	Capital Financing Requirement – GF *(ii)*	£316.0m	£405.9m	**£398.9m**

P10	Capital Financing Requirement – HRA *(ii)*	£284.8m	£322.2m	**£323.4m**
P11	External Debt – borrowing & other debt *(ii)*	£539.3m	£718.5m	**£722.3m**

PRUDENTIAL INDICATORS (continued)				
PI	**Statistical Indicators**	**Actual 2009/10**	**2010/11**	
Prudential Indicators for Treasury Management				
P12	Limit on variable interest rates	16.63%	0 – 30%	**0 – 50%**
P13	Limit on fixed interest rates	83.37%	30 – 70%	**50 – 100%**
P14	Fixed debt maturity structure • Under 12 months • 12 months to 2 years • 2 to 5 years • 5 to 10 years • 10 to 25 years • 25 to 40 years • 40 years and above	7.46% 5.72% 13.56% 12.97%	0 – 20% 0 – 20% 0 – 25% 0 – 25% 0 – 50% 0 – 25% 0 – 75%	**0 – 20%** **0 – 20%** **0 – 25%** **0 – 25%** **0 – 50%** **0 – 25%** **0 – 75%**
P15	Sums invested for > 364 days – in house limit	£15m	£40m	**£40m**

i) Only those shaded items are seeking approval for change
ii) Includes notional debt in respect of PFI schemes