Appendix 3

Treasury Management Update Report

1 Changes in the external environment

1.1 Economic Outlook

Financial markets are volatile at the moment. The stresses are most extreme in Europe where the lack of real progress in resolving the sovereign debt problem is affecting even the stronger countries. The debt problems have been well publicised with the situation in Greece being the most difficult but with significant risks also facing the Portuguese, Italian and Spanish economies.

2 Risk

2.1 The greatest risk is that one party to an investment (called a counterparty) will fail to repay an investment, causing a loss to the other party. The Council manages this risk by monitoring the banks it invests with constantly and stops dealing with any bank which is causing credit concerns.

2.2 Following the recent economic turmoil in the Eurozone, the Chief Finance Officer decided to limit its exposure to 7 days for all new investments with the UK banks which it invests with as listed below. The decision was made because of concerns about the exposure of UK banks to European countries.

Barclays Bank
Nationwide BS
Royal Bank of Scotland Plc / NatWest Bank Plc
Lloyds TSB Bank Plc / Bank of Scotland Plc

The Chief Finance Officer also decided to stop using Santander UK Bank because of fears over the stability of its Spanish parent.

2.3 The Council will however use the UK Government's Debt Management Office to invest with where this facility is able to match the money market 7 day returns or as the last resort if safe limits have been reached with financial institutions.

2.4 The Council does not believe that there are any solvency issues with the banks listed above. However, this is a prudent response to safeguard the Council's investments.

2.5 One of the rating agencies, Moody's, has recently downgraded Natwest Bank Plc to the minimum rating which the Council can invest with. The Council banks with Natwest Plc and it was agreed in the Treasury Management Strategy Statement 2012/13 that even if the credit rating was to fall below the Council's minimum criteria Natwest Plc would continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

2.6 In view of the limited number of banks which are available now for new investments, the Council intends to reduce its investment balances and to use temporary borrowing as a means of funding short term cash flow requirements.

3 Activity

3.1 Borrowing

The Council's current total long term borrowing is £134.39m at an average rate of 5.75% which is all in the form of fixed rate loans from the PWLB which vary in length from 1 year up to 50 years.

3.2 Investments

The council's investments outstanding currently stand at £22m at an average rate of 0.76%. The maturity profile of the Council's investments is limited to 7 days at the moment which is why all of the investments shown in the table below are within the 0-1 month band.

Maturity Band	Amount (£m)	% of Portfolio
0-1 Month	22.00	100.00
1-3 Months	0.00	0.00
3-6 Months	0.00	0.00
6-9 Months	0.00	0.00
9-12 Months	0.00	0.00
Total	**22.00**	**100.00**

3.3 Investment Returns

The financial markets remain extremely volatile and this continues to limit the number of institutions with which the council can invest and the length of investments the council can make. Both of these issues limit the returns the council can achieve. Since March 2009, the Bank of England base rate has remained at 0.5%. Before March 2009, the Council was able to achieve an average rate in excess of 5%. This has had a significant impact on the investment return the Council has been able to achieve on its investments. To put this into context, in 2008 the council could expect to earn around £2.5m in interest on investments (the council typically has between £20-£30m to invest). This year the yield is likely to be one tenth of what was earned before the banking crisis. The impact on the Capital Financing Budget will be mitigated to some extent by saving on borrowing costs as a result of the policy not to undertake new borrowing.

The council's treasury strategy puts the safety of investments ahead of yield though prudent options are always considered if appropriate. The action the council has taken over the last year demonstrates this. During the course of the last year, the council limited investments with banks from one year to six months. It was then reduced further to 90 days. More recently this was reduced to 30 days and in the past few weeks the council has opted to limit almost all deposits to one day. With the current instability in the Eurozone and the potential for contagion if a significant bank were to fail or a country were to default, the council's current investment strategy is likely to continue for the medium term

4 Controls

4.1 Prudential Indicators

The TM officers are also required to comply with treasury limits and prudential indicators which are set annually in the TM Policy and Strategy Statement which is approved by full Council each year. The Council has remained within all of its borrowing and investment limits for 2012/13 agreed by Council in February 2012. The Council has not deviated from the Capital related indicators either.

4.2 Audit Reviews

The Internal Audit review undertaken in February 2012 concluded that TM processes and procedures are robust, well established and followed meticulously. The audit report also stated that key risks are effectively managed, with only a few low risk areas for improvement identified. The report listed the following key areas which are managed well:

- Full Council approved the TM strategy and policy. TM activity is closely scrutinised and reported to the Corporate Governance Committee.

- Separation of duties and hierarchy approval procedures exist throughout the process.

- Duty rotas and up to date written procedures strengthen resilience and aid business continuity.

- Checklists maintain quality assurance and ensure strategy compliance.

5 Future

5.1 TM Strategy for next six months

As stated above, the Council intends to reduce its investment balances and to use temporary borrowing as a means of funding short term cash flow requirements.

5.2 Reports

The next reports will be a further update in November and the Treasury Management Strategy Statement and Prudential Indicators 2013/14 which will be reported to the Corporate Governance Committee and Council in February.