Appendix A

Update on Treasury Management activity

Background

At the meeting of Cabinet on 9 July 2009, it was agreed that in order to strengthen members' oversight of the County Council's treasury management activities, the Audit Committee should receive regular updates on treasury management issues and that members of the Audit Committee should receive more detailed training in order to enable effective oversight of the County Council's treasury management activities.

Reports on treasury activity are discussed on a monthly basis with the County Treasurer and the content of these reports is used as a basis for this report to the Committee. This report covers the 3rd quarter of the 2011/12 financial year.

Economic Overview and Interest Rate Forecasts

The perilous economic situation has been well documented in previous TM reports to the Audit Committee. Unfortunately there is little sign of improvement over the third quarter of the financial year.

The economic background to the County Council's treasury activity is characterised by:

1. Sovereign debt risks in the Euro area.
2. Concern over the potential spread of these risks from the periphery to the central European governments
3. A continuing increase in bank credit risk and the possibility of a renewed liquidity crisis.
4. The Bank of England's monetary policy committee suggesting that interest rates will stay at the current low levels for some time to come.

The significant risks which remain in the financial markets reinforce the need for the County Council to actively manage both its investments and borrowings in the interest of the long term security of capital.

There is no change to the interest rate forecast, as shown below, since the last report. The positioning of the investment and debt portfolios to anticipate low interest rates for an extended period remains the most appropriate strategy at the current time.

Year	End Period	Bank Rate	Money Rates (BBA LIBOR)		PWLB Rates		
			3 mth	12 mth	5yr	20 yr	50 yr
2011	Mar	0.50	0.8	1.7	4.2	5.4	5.3
	Jun	0.50	0.8	1.6	3.3	5.2	5.2
	Aug-26	*0.50*	*0.8*	*1.6*	*2.6*	*4.6*	*4.7*
	Sep	0.50	0.8	1.6	2.5	4.6	4.7
	Dec	0.50	0.8	1.6	2.5	4.7	4.8
2012	Mar	0.50	0.8	1.6	2.6	4.8	4.9
	Jun	0.50	0.8	1.7	2.9	5.0	5.2
	Sep	0.50	0.8	1.7	3.1	5.2	5.4
	Dec	0.50	0.8	1.8	3.3	5.4	5.5
2013	Mar	0.75	0.9	2.0	3.5	5.5	5.5

Investments

The assessment of the economic background outlined above and the risks inherent therein determine the overall strategy for investment management. In response LCC will:

1. Continue to take the most defensive position possible.
2. Continue to avoid bank credit risk including not replacing the £60m fixed deposits that mature over the next month.
3. Concentrate investment activity on UK Treasury government guaranteed bonds (gilts) with continued active portfolio management to control risks.

Below is a summary of the investment activity which took place since the last report:

	Call	Fixed	Structured	LA Bond	Gilts	Supras	Total
	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Balance 30th Sept	**63.55**	**211.00**	**125.36**	**35.60**	**162.90**	**53.44**	**651.85**
Maturities and Sales	(711.73)	(160.40)	-	-	(1,351.24)	(25.74)	**(2,249.12)**
New Investment	665.53	150.00	-	-	1,401.81	12.78	**2,230.12**
Change in Fair Value	-	-	(1.52)	(0.06)	(0.11)	(1.41)	**(3.10)**
Balance 31st Dec	**17.35**	**200.60**	**123.84**	**35.54**	**213.36**	**39.07**	**629.75**

During the quarter Prime Rate Sterling Liquidity Fund was placed on a negative rating watch and in consequence the funds held at the time were called back. New investment of £30m in Ignis money market fund and £30m in a Svenska Handelsbanken call account were made. A fixed deposit with Cater Allen

(Santander) matured and was not replaced.

The change in fair value to structured deposits and the local authority bonds are not buying or selling transactions but accounting valuation adjustments. The value of these instruments changes when an interest payment is made because there are now fewer remaining interest payments to accrue, and this adjustment is designed to reflect the change even though the instruments have not been sold

Most activity in the period centred on the Gilt portfolio where the purchases and sales made were as part of the active portfolio management strategy.
In the supranational portfolio we made an additional investment in Nordic Investment Bank bonds, but sold European Investment Bank to reduce exposure to the European sovereign debt crisis.

A separate report on the management of the bond portfolio was considered by the cabinet on 5th January 2012 and can be accessed at the following link:

http://mgintranet/ieListDocuments.aspx?CId=122&MId=514&Ver=4

Significant transactions which will take place over the coming month depend upon market conditions, but there are 2 fixed deposit maturities of £30m each which will not be replaced.

Borrowing

Current market conditions continue to enable the County Council to take advantage of short term market borrowing following the repayment of £293m of long term fixed debt in 2010.

The table below shows the borrowing activity which has taken place over the last two months.

	PWLB FXD	PWLB VAR	LOBO	LA	DCs	POL	FIRE	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Balance 30 Sept	213.10	195.75	50.77	364.95	7.80	35.43	29.94	897.74
Maturities	-	(10.00)		(260.15)	(22.95)	(65.53)	(11.71)	(421.11)
New Borrowings	-	-	0.31	241.70	44.65	53.98	9.86	401.26
Balance 31 Dec	213.10	185.75	51.08	346.50	29.50	23.88	28.09	877.89

The overall borrowing level has fallen slightly over the period. It is the County Council's strategy to restrict borrowing to the level of the capital financing requirement which requires a reduction in the level of borrowing over the coming months. This will be achieved by using the £60m of fixed deposits maturing during the month to reduce short term local authority borrowing.

Accordingly the two £30m investment maturities will be used to further reduce the amount of local authority borrowing taken in January.

Revenue Budget Monitoring

The financing charges budget has been set at £37.125m for 2011/12. The current forecast year end position is -£10.868m, a surplus of £47.593m against the budget. The breakdown of the budget monitoring position is shown in the table below. A separate report on this was provided to cabinet on 5th January.

	Revenue Budget 2011/12 £m	Forecast for the year as at November 2011 £m	Variance £m	Variance %
Minimum Revenue Provision	28.567	26.532	(2.035)	
Interest Paid	16.292	17.100	0.808	
Interest Earned	(7.734)	(54.100)	(46.366)	
Grants Received	(0.400)	(0.400)	-	
Total	36.725	(10.868)	(47.593)	(129.59)

Prudential Indicators Monitoring

The Local Government Act 2003 and supporting regulations require the County Council to have regard to the prudential code and to set prudential indicators to ensure the County Council's capital investment plans are affordable, prudent and sustainable.

A comparison of the actual position at 31 December 2011 compared to the prudential indicators set in the treasury management strategy for 2011/12 is set out below.

Treasury Management Prudential Indicators	**2011/12 Strategy £M**	**31 Dec 2011 Actual £M**
1. **Adoption of the CIPFA Code of Practice for Treasury Management**	This has been fully adopted	
2. **Authorised limit for external debt** - A prudent estimate of debt, which reflects the Authority's capital expenditure plans and allows sufficient headroom for unusual cash movements.		

Borrowing	1,000	792
Other long-term liabilities(eg PFI schemes)	400	191
TOTAL	1,400	983
3. Operational boundary for external debt - A prudent estimate of debt, but no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the County Council's current plans.		
Borrowing	950	792
Other long-term liabilities	390	191
TOTAL	1,340	983
4. Upper limit for fixed interest rate debt	90%	24%
5. Upper limit for variable rate debt	90%	76%
6. Upper limit for total principal sums invested for over 364 days (per original period to Limit)	75%	24%

7. Maturity structure of debt

	Lower Limit % 2011/12	Upper Limit % 2011/12	Actual % 31 Dec 2011
Under 12 months	-	75	48.75
12 months and within 2 years	-	75	2.28
2 years and within 5 years	-	75	-
5 years and within 10 years	-	75	22.13
10 years and above	25	100	26.84

Although as at the 31st December all amounts are within the prudential indicator limits, between 1st and 24th of November the County Council did exceed the operational borrowing limit. This was mainly due to an unexpected surge in the popularity of the Lancashire shared investment scheme following the significant increase in investment credit risk during the autumn. Action was taken at the earliest opportunity to allow existing short term borrowing to mature without replacement and by the end of November borrowing was back within the agreed limits. At no point was the authorised limit breached.

Landsbanki

The Icelandic Supreme Court has finally found in favour of local authorities as priority creditors and there are now no further appeals allowed regarding this decision. The judgement means that local authorities can expect to recover up to 98 per cent of the deposit and contractual interest that they are owed. Currently arrangements are being made to receive the first distribution early in the new year. This will be in a basket of currencies, sterling, euros, US dollars and Icelandic krona. The amounts will be paid in their respective currencies into foreign currency bank accounts rather than have them converted at spot rate by the bank and paid into the sterling account. This will enable treasury management to achieve a better foreign exchange conversion rate. However, due to foreign currency restrictions in Iceland itself, the amount denominated in Icelandic krona (ISK) is being held in an escrow (trust) account whilst the appropriate licences to remove the ISK from the country are arranged. It has not yet been decided whether the ISK will be converted into GBP (sterling).

The committee will be kept informed of developments.

Recommendation

The Committee is asked to note the above report on treasury activity.