

## WAVERLEY BOROUGH COUNCIL

### EXECUTIVE

4 SEPTEMBER 2012

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**Title:**

**TREASURY MANAGEMENT PERFORMANCE**

**[Portfolio Holder for Finance: Cllr Mike Band]**

**[Wards Affected: N/A]**

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**Summary and purpose:**

The purpose of this report is to summarise Waverley's investment performance for the year 2011/2012, and for the period 1<sup>st</sup> April 2012 to date, in accordance with Waverley's Treasury Management Policy and the Code of Practice on Treasury Management in Local Authorities and to propose amendments to current investment limits.

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**How this report relates to the Council's Corporate Priorities:**

The management of Waverley's finances is a key function that helps ensure sufficient funds are available to provide services and pay the Council's commitments. Regular monitoring reports demonstrate that the Council's financial resources have been properly managed and used in support of the Council's key objective of providing good value for money.

**Equality and Diversity Implications:**

There are no implications arising from this report.

**Resource and legal Implications:**

There are no direct resource implications and any financial areas are covered in the report.

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**Introduction and Background**

1. Waverley's Treasury Management Strategy was subject to a fundamental review in February 2010 and further amended in the light of the revised CIPFA Treasury Management Code of Practice, issued in November 2011. Waverley's Treasury Management Policy accords with the current CIPFA Code of Practice on Treasury Management in the Public Services. The Corporate Overview and Scrutiny Committee is charged with reviewing Treasury Management operations periodically.
2. Members will recall that the refinancing of the HRA on 27<sup>th</sup> March 2012 required Waverley to buy itself out of the previous subsidy system by making payment to the Government of some £188m. This was largely financed by PWLB borrowing over a range of terms but the need to borrow externally was reduced by a £5m internal long-term borrowing by the HRA from the General Fund. This action has several benefits including reduced interest charges and increased flexibility for the HRA and reduced counterparty risk for Waverley as a whole.

- This report covers the period 1 April 2011 to 31 March 2012 and also includes the period from 1 April 2012 to date.

### **Investment rate of return %**

- Members have identified the 3-month Sterling LIBOR rate, published by the Government's National Office of Statistics, as the appropriate target rate. A 3-month comparison is in line with Waverley's typical activity.
- The Local Performance Indicator LI8, which relates to investment performance, is shown below. Despite the static base rate, the 3 month LIBOR rate increased regularly during 2011/12 making it more difficult to achieve target because, while the 'notional' LIBOR rate increased, actual market rates for a 3 month term did not increase to match. During the first 4 months of 2012/13 the LIBOR rate has started to gradually reduce but counterparty rates are also reducing.

### **Average rate of return on external investments compared to target rate**

2011/12 Target	2011/12 Actual	2012/13 Target	2012/13 Actual to date
0.50% above the average 3 month Sterling LIBOR rate	0.22% above the average 3 month Sterling LIBOR rate	0.25% above the average 3 month Sterling LIBOR rate	0.1% above the average 3 month Sterling LIBOR rate

- The rate of return on the Council's external investments for 2011/2012 was 1.19%. At 31 March 2012 the typical rate offered for a 3 month term by most counterparties on Waverley's lending list varied from around 0.90% to 1.00%. The LIBOR rate in March 2012 was 1.08% having risen from 0.80% in April 2011 and averaged 0.97% over the year. As at July 31 2012 the rate of return being achieved was 1.08% and 3 month rates from approved counterparties ranged from around 0.55% to 0.70%. The LIBOR rate, however, has averaged 0.98%.

### **Yield**

- Waverley set a budget of £350,000 for investment income in 2011/12 in anticipation of low market-interest rates continuing over both the short and medium term. The improvements identified in the budget monitoring forecasts have been achieved and actual investment income of £427,000 was achieved in 2011/12. Members may recall that in 2008/09 in excess of £2m was achieved.
- The average daily investment in 2011/2012 was around £35,800,000 substantially more than the £31,800,000 in 2010/11.
- Waverley's 2012/13 budget for interest receipts on all investments was set at £275,000. This included a 'notional' allowance from the HRA which recognized the possibility of internal borrowing. The most recent budget monitoring process identifies that the General Fund element is likely to show an improvement over budget of around £140,000 at the year end. The HRA internal investment interest is now known to be £170,000 for 2012/13 and this has been included as a cost in the HRA business plan but effectively contributes to an improvement in the overall interest receipt budget.

9. At 30 July 2012 the average daily external investment was around £28,700,000.

### **Security of investment**

10. Waverley's policy and practice is to put security of investment at the highest priority followed by liquidity and finally rate of return/yield. The cornerstones of recent policy/practice are: (1) to restrict lending to only those institutions which fit the Council's policy in terms of financial standing, credit ratings etc (2) to opt for short-term investments or lend to cover precept dates and (3) to fix financial limits to each institution depending the quality of their financial ratings. These restrictions inevitably have a negative impact on the rate of return achievable but are necessary to maintain the approved level of security on investment. The relatively small number of financial institutions that meet Waverley's counterparty criteria was the most significant factor in day-to-day Treasury Management. Waverley did not invest with the Debt Management Office where rates are significantly below market rates.
11. As at 31 March 2012, Waverley had 10 external investments all with specified investors i.e. only counterparties with a formal credit rating of A or above. By way of comparison, as at 30 June 2008 (just before the start of the credit crunch) Waverley had 23 external investments 16 of which were with non-specified institutions. This demonstrates the changing practice in respect of preferred counterparties and mitigation of risk.
12. On 31 March 2012 Waverley had £23,500,000 invested externally and no investment had a remaining maturity period exceeding 4 months.
13. On 30 July 2012 Waverley had £30,000,000 invested externally none of which had a remaining maturity period exceeding 3 months. This represented 10 external investments all of which were A rated (or better) counterparties.

### **Risk**

14. Waverley's approach to management of risk in respect of investments is set out most recently in the Treasury Management report to the Executive on 7<sup>th</sup> February 2012. Whereas that report is, strictly, the 2012/13 strategy, practice during 2011/12 was largely the same as the 2012/13 strategy sets out. That report sets out 8 identified risk categories and the means of managing those risks. The mitigation of risk is touched on a number of times in this report but the following brief comments relate to the 3 most commonly identified risks.
15. Exposure to interest rate fluctuation risk is minimised by having a realistic but prudent approach to budgeting and by using only fixed term instruments – generally on a short (3 month) term.
16. Counterparty and credit risk is managed by a number of processes including having a 'preferred investor' list consisting currently of only 'A' rated institutions, by constant monitoring of credit ratings and by having organisational investment limits (both financial and time) which reflect a prudent approach to the market. During 2011/12 Waverley contracted with external Treasury Management specialists Arlingclose. They were employed principally to assist with the borrowing required

under the HRA reform but also to assist with investment strategy and, more particularly, with compiling our 'preferred investor' list.

17. Waverley operates investment activity only in GBP Sterling, as a matter of policy, and only in fixed term deposits as a matter of practice. Its policies deliberately avoid the more speculative and complex types of financial instruments which are often associated with exchange rate risk specifically and increased risk generally.

### **General cash management**

18. Waverley's primary objective is to manage daily cash balances to meet cash flow commitments and to minimise investment risk. Recent market conditions mean that it can be more economic to borrow short-term, to meet expenditure commitments, than for Waverley to recall its investments. During 2011/12 Waverley made one short-term borrowing of £500,000 at a cost of £49 in interest charges. No temporary borrowing has occurred in 2012/13 to date but is becoming an increasingly attractive option given the low borrowing costs.
19. In 2011/12 Waverley's turnover on outgoing investments was £129m and £133m for incoming investments. The average daily balance in Waverley's general bank accounts at the close of business was around £7,500.
20. The table below shows the total transactions during 2011/12:

	Balance at 1 April 2011 £	Total lent £	Total repaid £	Balance at 31 March 2012 £
Temporary investments	27,200,000	129,000,000	132,700,000	23,500,000

21. During 2012/13 Waverley has invested £29,500,000 and £23,000,000 has matured and been repaid. As at 30 June 2012 the average daily balance in Waverley's General and Payments accounts was overdrawn by £2,400. However, the impact of a restricted lending list and Waverley's generally improving cash position has meant increasing use of Waverley's HSBC Savings account which, in 2012/13, has averaged a balance in excess of £3m per day.

### **Long term borrowing:**

22. Waverley has generally been debt free for some years. However, a long term borrowing was approved in February 2011. That borrowing was to re-finance externally some HRA internal borrowing. In accordance with Council approval, Waverley borrowed £3.238m at 5.36% for a period of 29.5 years repayable on maturity. In addition, the HRA reform in March 2012 required Waverley to borrow some £189m largely from the PWLB although, as previously mentioned, £5m was met by internal borrowing. This borrowing was profiled to match the repayment capacity within the HRA business plan over the next 30 years. A series of loans was taken from PWLB with repayment terms from 5.5 years to 23.5 years at interest rates varying between 1.37% and 3.41%. These loans were taken on 27 March 2012 so the financial impact in 2011/12 was minor.

23. The first interest repayment on these loans is due at the end of September 2012 in the sum of £2.7m. Cash flow forecasting ensures that Waverley has the resources to meet such commitments as they arise.

## **PROPOSAL FOR AMENDMENT TO TREASURY MANAGEMENT STRATEGY**

24. Waverley's Treasury Management 2012/13 strategy was approved at 7 February 2012 Executive. This document was prepared, taking advice from Waverley's external treasury advisers, based on the scope of a potential investment portfolio of £30m – which was the level of investment at the time. This strategy allows for the Executive to agree changes to the investment limits during the year.
  25. As a result of changing circumstances, principally the increasing cash surpluses generated by the HRA re-financing reforms, Waverley's investment potential now exceeds £40m and is likely to continue to increase. In view of the particular circumstances on 1st August 2012, after consultation between the Deputy Chief Executive and the Finance Portfolio Holder, the Chief Executive authorised group limits to be extended to £10m (£5m max per name) on an instant access basis only and that this change should be temporary until considered by the Executive. It was further agreed that any permanent changes to the Treasury Management Strategy which are considered necessary in the light of current economic conditions should also be reported to the Executive for approval.
  26. Officers are also looking to extend the range of investment opportunities by investing in a Money Market Fund (MMF) fund for the first time. A triple A rated sterling fund has been identified through Waverley's brokers and external treasury advisers which offers instant access and competitive rates of return. The fund is FSA regulated and is easily accessible on a daily basis via our brokers. Officers expect this fund to be used initially instead of the HSBC savings account with a suggested maximum limit of £5m. The use of such MMF funds is included in Waverley's existing Annual Investment Strategy 2012/13.
  27. The group investment limits, as approved in the original TM Strategy, are based on 25% of total external investments in order to promote diversity of counterparties. However, they are explicit in that they are set at a specific limit of £7.5m - based on the previous total investment level of £30m. Combined with the very short list of approved counterparties, the existing group limits make it very difficult to manage Waverley's cash surpluses effectively. For example there are occasions when Waverley has more cash surpluses than the total value of the approved counterparties multiplied by their £limits. It is appropriate, therefore, to review the existing group limits now and it is suggested that these group limits be changed so as to be expressed as 25% of an increased investment capacity - and to confirm that this change be applicable to fixed term investments and instant access accounts. Assuming an investment potential pool of, say, £45,000,000 and the use of the MMF fund for £5m, the 25% limit on the remaining balance equates to a limit of £10,000,000 per group and it is further suggested that the individual limit be changed to £7,500,000 (£ limited) - subject still of course to an overall £10,000,000 group limit. This change will add some flexibility to the current operation and will assist in improving return and rates of return. These limits will be subject to continual review in the light of market conditions.
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## **Recommendation**

It is recommended that the Executive:

- i) notes the Treasury Management Performance for 2011/12 and 2012/13 to date;
- ii) endorses the approach to Treasury Management activity; and
- iii) approves the following changes to the Treasury Management Strategy 2012/13
  - a) to change the group investment limit to £10,000,000;
  - b) that this limit apply to fixed term deposit counterparties and to instant access counterparties;
  - c) that, within that overall limit, individuals within the group be restricted to £7,500,000 per individual; and
  - d) that officers make appropriate use of suitable MMF funds.

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### **Background Papers** (Deputy Chief Executive)

There are no background papers (as defined by Section 100D(5) of the Local Government Act 1972) relating to this report.

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