
**REPORT TO THE MEETING OF THE EXECUTIVE 10 DECEMBER
2008**

PORTFOLIO HOLDER FOR FINANCE AND RESOURCES

**REPORT FROM THE HEAD OF FINANCE, AUDIT AND
PERFORMANCE MANAGEMENT**

**SUBJECT: INTERIM AMENDMENTS TO TREASURY MANAGEMENT
AND ANNUAL INVESTMENT STRATEGY 2008/09**

1 DECISION BEING RECOMMENDED

- 1.1 To note the interim amendments made by the Head of Finance, Audit and Performance Management, as the Chief Finance Officer for the Authority, to the Treasury Management and Annual Investment Strategy (“the Strategy”) agreed by Council in January 2008.

2 REASON FOR RECOMMENDATION

- 2.1 The current global financial problems and ongoing crises in the banking sector makes it essential that the Chief Finance Officer keeps the Council’s policy on investments under close review and amends it if necessary in response to these exceptional circumstances.
- 2.2 In light of the experience of other authorities who relied mainly on the credit ratings of individual institutions to make investment decisions, it is appropriate to consider other factors when deciding where to place investments.
- 2.3 The Chief Finance Officer is responsible for the proper administration of the Council’s financial affairs.

3 OTHER SALIENT INFORMATION

- 3.1 The Strategy is based on advice from Sector, our financial advisor, and uses credit ratings in order to set the limits for amounts and periods of time that money can be invested with institutions, known as counterparties.
- 3.2 The Chief Finance Officer has authority under the Council’s Financial Regulations to make changes to the Strategy but must act in accordance with the CIPFA “Treasury Management in the Public Services: Code of Practice”.
- 3.3 Our level of investments varies between £12m and £17m, depending on the time of the month, with an average balance of about £14m. This is made up of General Fund Reserves, Capital Receipt reserves, Collection Fund balance and cashflow requirements. An example of cashflow requirements is the monthly precept payments to Essex County Council, Fire and Police for their share of the Council Tax. We have a mix of investments, either for one month to cover short term cashflow requirements or up to one year.

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- 3.4 A number of criteria based on credit ratings are used, against which financial organisations are compared in order to assess the limit of any investment and the maximum duration.
- 3.5 During the summer a number of the credit ratings have fallen which has reduced the number of Institutions we can invest with.
- 3.6 Strict adherence to credit ratings has not proved an effective protection against problems with investments, as evidenced by a number of Local Authorities (although not Rochford) and their recent experience with Icelandic Banks. Changes to the current Strategy have been made to amend the criteria previously used to assess these organisations. We will now take account of Government guarantees and consider the credit status and economic assessments of the country in which the institution is registered.
- 3.7 Banks and building societies are given an individual rating assessed as if they are entirely independent and unable to rely on external support. This ignores the situation where the institution forms part of a group with strong backing. However, institutions also have a rating called a support rating, which indicates the financial support available directly to the body.
- 3.8 Organisations with a lower individual rating are now allowed to remain on the investment list, providing they have the highest possible support rating, and the parent group meets the investment criteria set in the original strategy.
- 3.9 It has been confirmed with our Treasury Advisors that the individual rating has little standing when part of a group. An example of this is Alliance & Leicester who are now part of the Santander group, which is a AA rated Institution in a country which has the highest AAA rating. Under the Strategy agreed by Council in January, we could not place money with Alliance & Leicester, although they are rated as having strong support.
- 3.10 Investments will also be made to any Institution where the national Government is giving a 100% guarantee to cover wholesale deposits. Wholesale deposits cover our investments that would not be covered by a guarantee to retail deposits which are private individuals. An example of this is Northern Rock, which is now backed by a 100% Government guarantee. HM Treasury have said that “reasonable notice, which will not be less than 3 months, will be given by HM Treasury of any termination of these arrangements”. Therefore we have set a limit of 3 months on any deposits with Northern Rock.
- 3.11 For investments in non UK banks, the criteria will now include the credit rating of the country, assessment of the economic situation and Government guarantees.
- 3.12 The Government’s Debt Management Office (DMO) now has a limit above our maximum level of investments. This allows for a worst case scenario where the risks of placing money on the money markets outweigh the lower interest

rates available from the DMO. DMO rates are variable so it is sensible to have a shorter time limit so that the investments are regularly reviewed.

- 3.13 The approved Counterparty list is now determined by the following minimum criteria. The Credit rating criteria are based on a combination of credit rating agencies assessments:-

ORGANISATION	MINIMUM CRITERIA	MAXIMUM AMOUNT	MAXIMUM PERIOD
U.K. Clearing Bank & U.K. Building Society	Minimum F1+ or P1 short term backed up by AAA long-term credit rating, individual rating B	£3M	3 Years
U.K. Clearing Bank & U.K. Building Society	Minimum F1 or P1 short term backed up by AA-long -term credit rating, and individual rating B/C or, if part of a group, support rating of 1. PLUS If part of group – Parent Group - Minimum F1+ short term backed up by AA long-term credit rating and individual rating B	£7M	1 year
U.K. Clearing Bank & U.K. Building Society	Minimum F1 or P1 short term backed up by A long-term credit rating, individual rating B or, if part of a group, support rating of 1 PLUS If part of group – Parent Group - Minimum F1+ short term backed up by A long-term credit rating and individual rating B	£3M	3 Months
Government guaranteed bodies	100% guarantee in place for wholesale deposits Country rating of AAA	£10M	Length of Guarantee period or notice period of termination of guarantee
U.K. Local Authorities		£7M	1 year
Other U.K. Financial Institutions & Government Bodies	Minimum F1+ short term backed up by AA+ long-term credit rating and support rating of 1.	£7M	1 year

ORGANISATION	MINIMUM CRITERIA	MAXIMUM AMOUNT	MAXIMUM PERIOD
Debt Management Office (Government Body)		£20M	3 months
Money Market Funds	Minimum AAA long-term credit rating.	£7M	1 year
Non UK Clearing Bank and Building Society.	Minimum F1 or P1 short term backed up by AA- long-term credit rating, and individual rating of B Country's rating of AAA	£7m	1 year
Non U.K. Clearing Bank & Building Society Part of Group	Minimum F1 or P1 short term backed up by AA long -term credit rating, and support rating of 1. Parent Group - Minimum F1+ short term backed up by AA long-term credit rating and individual rating B Country's rating of AAA	£3m	1 year

4 RISK IMPLICATIONS

- 4.1 The Strategy considers in detail the risks associated with Treasury Management activity and these are summarised below.
- 4.2 There is always a risk that a building society or bank may fail during the duration of an investment but this is considered less likely where the institution has a minimum credit rating as specified in our Investment Strategy. With regard to deposits for more than one year, the advantage from a treasury management point of view is that there is a known rate of return over the period that the monies are invested which aids forward planning. There is however the increased risk due to the longer time span that a) the institution fails or b) interest rates rise in the meantime. Therefore no investments for more than 1 year will be made without the advice of our Treasury Consultants on the likely movement of interest rates over the period of the proposed investment.
- 4.3 Investment income is a material source of income to the Authority. The amount of income generated is dependent upon interest rates and there is always a risk of falling rates but the risk of losing the principal sum must always be the main consideration and outweighs the likely returns.
- 4.4 The Authority is responsible for managing the investment of public funds and must be seen to be adopting a pragmatic and prudent approach.

5 RESOURCE IMPLICATIONS

- 5.1 Interest from investments earned the Authority £1m in 2007/08 and is expected to be about £850,000 for 2008/09, which is equivalent to £27.14 Band D Council tax. Earnings are already falling because of the decline in interest rates which are likely to reduce further. Without these changes to the Strategy, there would be an increased reduction in investment income and we would not be able to benefit from the rates offered by those institutions that are either backed by Government guarantees or strong parent groups. It also encourages an approach that does not have a dogmatic reliance on credit ratings.

I confirm that the above recommendation does not depart from Council policy and that appropriate consideration has been given to any budgetary and legal implications.

SMT Lead Officer Signature: _____

Head of Finance, Audit and Performance Management

Background Papers:-

None

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