

Treasury Management

Recommendation:

That:

- (i) the treasury management performance for the period 1 April 2008 to 31 October 2008 be noted
- (ii) the change to prudential indicators described in paragraph 6 be approved.
- (iii) the application of the Treasury Management Strategy as set out in paragraph 3.3 and as implemented by the Treasurer be supported

1 Summary

Treasury management performance is above the budget target:

- Interest receipts are forecast to exceed the target by more than £804,000
- Savings on interest payments are forecast to exceed £161,000

2. Interest Receipts

The Treasury Management report for September 2008 reported that interest receipts would exceed the budget forecast by more than £400,000. The latest forecast is that receipts will be £804,000 more than the budgeted level. The reasons for the increase are:

- The continued lack of liquidity means that market rates have remained well above base rates for the first 8 months of the year
- Cash balances continue to exceed the forecasts included in the original cashflow model. This reflects budget monitoring profiles for the Force where more spending is shown in the second half of the year as new initiatives have taken some time to implement

The impact of the reduction in base rates by 1.5% on 6 November has been reflected in the forecast. Information on investment performance is provided in Annex 1.

3.0 Action Taken to Maximise the Security of Deposits

- 3.1 The Police Authority Treasury Management Strategy gives priority to security rather than yield, although in practice returns above the benchmark have been achieved. The approach used to maximise the security of deposits involves setting appropriate credit rating thresholds for counter parties on the Police Authority counter party list and actively reviewing the list based on market and other intelligence.

- 3.2 The collapse of Lehman Brothers and the subsequent uncertainty with regard to the ongoing viability of banking institutions in general caused a review of the Police Authority's use of counter parties. No changes could be made to existing long term deposits held within the Devon and Cornwall Police Investment Fund (it should be noted that there are no immediate concerns about existing counter parties) but action could be taken with regard to daily cash dealings and future deposits. In September, all counter parties other than the Debt Management Office (an Executive Agency of Her Majesty's Treasury) were temporarily suspended from the Police Authority's counter party list. On 26 September the Police Authority approved an increase in the lending limit with the Debt Management Office from £10m to £25m to give the capacity to absorb the additional funds. In early October the Irish Government gave comprehensive guarantees covering deposits in Irish banks and it was decided the two Irish banks on the counter party list could be used in addition to the Debt Management Office.
- 3.3 The principles to be used to construct the counterparty list are set out in the Treasury Management Strategy approved by the Police Authority in February 2008. Short-term action was taken to restrict the list (as outlined in paragraph 3.2) this resulted in a much-curtailed lending list. It is now proposed that the list be substantially reviewed to give a longer list than used under the temporary arrangements but a higher level of security than the previous list. Annex 2 set out the revised limits.
- 3.4 Instructions have been given to the Police Authority's external fund manager to limit deposits to UK banks only on a temporary basis. Approval will be given to specific deposits with overseas banks on the Police Authority's lending list on a case by case basis.
- 3.5 Additional precautions taken to safeguard cash deposits have had an impact on the returns available. Interest paid by the Debt Management Office is significantly below the market rates. Action has been taken to mitigate the losses, for example, the use of Irish Banks on the counter party list.
- 3.6 As part of the preparation of the Treasury Management Strategy for 2009/10 further consideration will be given to the management of the Police Authority's counterparty lists with the aim of maximising the security of deposits.

4.0 Performance of the External Investment Manager

- 4.0 The budget included a target of a 5% annual return on the fund managed by Investec, the Police Authority's external investment fund manager. The rate of return actually achieved to 31 October is 3.29%; this compares to the benchmark of 3.0%. The current forecast annual return within the range 5.75% to 6.0%.

5.0 Performance of the Devon and Cornwall Investment Fund

- 5.1 The budget included a target return of 5.4% based on existing fixed rate deposits and forecast new deposits. The return achieved to 31 October is

3.5%; this compares to the benchmark of 3.0%. The current forecast annual return is 5.9%. Full details of the investment decisions are provided in Annex 3 and the current holdings are listed in Annex 4.

6.0 Borrowing

6.1 The original capital programme contained proposed borrowing of £12m for the year to fund the capital programme. This consists of £11.233m new borrowing and £0.767m of minimum revenue provision. This was to be drawn down with due regard to interest rates and progress on spending. Borrowing rates for the first half of the year have not been favourable and for this reason no new borrowing has been undertaken. The delay in the timing of borrowing has resulted in a combined saving of approximately £161,000 on the budgets for interest paid and the minimum revenue provision to be set aside to repay debt.

7.0 Limit on Investments to Mature Beyond 31 March 2009

7.1 The prudential indicator for investments to mature beyond 31 March 2009 was set at £10.0m in February 2008. This threshold is part of a set of indicators laid out in the CIPFA Prudential Code. It involves taking a snapshot view of investments at a point in time some months in the future.

7.2 The Treasury Management Strategy sets limits for the amount of the fund that can be invested for more than 1 year as follows:

- Devon and Cornwall Investment Fund – no more than 50%
- External Fund Manager – no more than 30%

An upper limit of £10.0m is not sufficient to cover the level of investments that will mature beyond 31 March 2009 if the rules above are applied. For this reason it is proposed that the prudential indicators of the investment that will mature beyond 31 March 2009 is raised to £25m.

8.0 Conclusion

8.1 The crisis in the banking sector has created a lot of uncertainty with regard to the security of deposits held by public bodies. To date the Police Authority's Treasury Management Strategy allied with careful monitoring of individual counter parties has proved to be sound. In addition the strategy has continued to yield significant surpluses for re-investment in services. There is however little justification for complacency. Base rates have fallen significantly and future yields will therefore be lower. In addition there is a need to review the Treasury management Strategy to ensure that it provides the correct level of security for funds on an ongoing basis.

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Overall Performance and Budgetary Impact			
	Revised Budget £000	Latest Forecast £000	Variance £000
Interest receipts	(2,045)	(2,849)	(804)
Cost of Borrowing for Capital Investment and Minimum Revenue Provision	1,906	1,745	(161)
Total Capital Financing	(139)	(1,104)	(965)

Performance Against Benchmark			
Period 1 April 2008 to 31 October 2008 % return on investment after fees			
	Benchmark %	Actual %	Difference %
Investec	3.0	3.29	0.21
Devon and Cornwall Police Investment Fund	3.0	3.50	0.50

Forecast Return on Investment for Period 1 April 2008 to 31 March 2009	
	Rate of Return %
Investec	Within the range 5.75 to 6.00
Devon and Cornwall Police Investment Fund	5.9

Application of Treasury Management Strategy

The Treasury Management Strategy approved on 15 February 2008 set out the principles that would be applied to construct the Police Authority's counterparty list. Following the recent events within the banking sector action has been taken to restrict the use of the list with the objective of increasing the security of deposits. Foreign banks with the exception of banks based in the Republic of Ireland have been suspended from the list. The credit limits for all UK banks have been revised downwards from £5.0m to £3.0m. The credit limit for the Debt Management Office has been increased to £25.0m. Credit limits for local authorities and building societies have been revised downwards, only local authorities that do not have deposits with Icelandic Banks (as disclosed on the LGA list) will be used. Money Market Funds have been removed from the list because of the uncertainty with regard the underlying deposits within the funds.

The revised limits are as follows:

<u>Counterparty Type</u>	<u>Short Term Rating</u>	<u>Long Term Rating *</u>	<u>Credit Limit</u>
UK banks rated F1	F1	AA and above	£3 million
UK banks rated F1+	F1+	AA and above	£3 million
Building Societies, Assets greater than £50 billion **	N/A	N/A	£3 million
Building Societies, Assets less than £50 billion **	N/A	N/A	£1 million
Foreign banks F1+ (excluding banks based in the Republic of Ireland)	F1+	AA	Suspended from the list
Banks based in the Republic of Ireland	F1+	AA	£ 3 million
Larger Local Authorities	N/A	N/A	£3 million
Smaller local Authorities	N/A	N/A	£1 million
Debt Management Account (central government)	N/A	N/A	£25 million
Money Market Funds	AAA	AAA	Suspended from the list

*Credit ratings can be graded AA-, AA and AA+ and A-, A and A+ . All institutions within the cohort AA or A will be included on the counterparty list.

** Building societies are graded on the list according to their level of assets. Some building societies do have credit ratings. For those that have credit ratings they will only be included on the list if their credit rating is A or above.

Individual institutions may be suspended from the list should that be deemed appropriate

The counterparty list following these changes is shown overleaf

Devon and Cornwall Police Approved List of Borrowers

	Counterparty £ millions	Group Limit £ millions
UK Clearing Banks & Subsidiaries		
Barclays Bank	3	
HSBC Bank	3	
Lloyds TSB Bank	3 }	
HBOS Bank of Scotland	3 }	3
HBOS Bank of Scotland (Ireland)	3 }	
Northern Rock (maximum maturity 3 months)	3	
Royal Bank of Scotland	3 }	
Ulster Bank	3 }	3
Ulster Bank Ireland	3 }	
Building Societies		
Nationwide	3 }	
Cheshire (No further new deposits)	3 }	3
Derbyshire (No further new deposits)	3 }	
Britannia	1	
Chelsea	1	
Coventry	1	
Cumberland	1	
Dunfermline	1	
Kent Reliance	1	
Leeds	1	
National Counties	1	
Newcastle	1	
Norwich & Peterborough	1	
Nottingham	1	
Principality	1	
Progressive	1	
Skipton	1 }	1
Scarborough	1 }	
Stroud & Swindon	1	
West Bromwich	1	
Yorkshire	1	
Local Authorities		
County Councils	3	
Metropolitan Authorities	3	
London Boroughs	3	
English Unitaries	3	
Scottish Unitaries	3	
District Councils	1	
Welsh Unitaries	1	
Other Authorities (Eg. Police, Fire, Etc.)	1	
Overseas Banks (& subsidiaries operating in London)		
Allied Irish Bank	3	
Bank of Ireland	3	
Debt Management Office (central Government)		
DMA Deposit Facility (DMADF)	25	

Devon and Cornwall Police Authority Investment Fund – Investment Decisions

Date	Decision
3 October 2008	Three twelve month deposits with value of £8.0m mature. Cashflow model indicates that up to £10m is available for up to three months. The Irish government provides a comprehensive guarantee to depositors in Irish Banks. Loans made to two Irish Banks on the Police Authority counter party list. £5.0m loaned to Allied Irish Bank for three months at 6.45% and £5.0m to Bank of Ireland for one month at 6.04%

Devon Investment Fund Holdings

	Start Date	Maturity Date	Length	Rate (%)	03-Oct-08	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
					£000	03-Nov-08	15-Dec-08	02-Jan-09	05-Jan-09	02-Mar-09	01-May-09
						£000	£000	£000	£000	£000	£000
DEPFA	03/10/2007	05/11/2007	1 mth	6.05%	0	0	0	0	0	0	0
Newcastle Building Society	03/10/2007	04/01/2008	3 mths	6.24%	0	0	0	0	0	0	0
Alliance & Leicester	03/10/2007	03/10/2008	1 year	6.06%	0	0	0	0	0	0	0
Yorkshire Building Society	03/10/2007	03/10/2008	1 year	6.08%	0	0	0	0	0	0	0
Bradford & Bingley	03/10/2007	03/10/2008	1 year	6.05%	0	0	0	0	0	0	0
Coventry Building Society	22/10/2007	01/10/2009	2 years	6.12%	2500	2500	2500	2500	2500	2500	2500
Skipton Building Society	05/11/2007	03/11/2008	1 year	6.12%	2000	0	0	0	0	0	0
West Bromwich Building Soc	05/12/2007	01/02/2008	2 mths	6.70%	0	0	0	0	0	0	0
Chelsea Building Society	18/12/2007	03/03/2008	2.5 mths	6.41%	0	0	0	0	0	0	0
Principality Building Society	21/01/2008	01/03/2010	25 mths	5.15%	3000	3000	3000	3000	3000	3000	3000
Chelsea Building Society	21/01/2008	01/03/2010	25 mths	5.15%	1000	1000	1000	1000	1000	1000	1000
West Bromwich Building Soc	01/02/2008	01/03/2010	25 mths	5.10%	1000	1000	1000	1000	1000	1000	1000
Derbyshire Building Society	20/03/2008	01/05/2008	1.5 mths	5.80%	0	0	0	0	0	0	0
Stroud & Swindon Building Society	20/03/2008	02/06/2008	2.5 mths	5.92%	0	0	0	0	0	0	0
Skipton Building Society	20/03/2008	01/07/2008	3.5 mths	6.00%	0	0	0	0	0	0	0
Derbyshire Building Society	01/05/2008	01/05/2009	1 year	6.00%	1000	1000	1000	1000	1000	1000	0
Derbyshire Building Society	13/05/2008	01/05/2009	1 year	5.90%	1000	1000	1000	1000	1000	1000	0
Derbyshire Building Society	02/06/2008	01/06/2009	1 year	6.35%	1000	1000	1000	1000	1000	1000	1000
Bank of Scotland	11/06/2008	11/06/2009	1 year	6.70%	1000	1000	1000	1000	1000	1000	1000
National Counties Building Society	27/06/2008	02/01/2009	6 mths	6.20%	1000	1000	1000	0	0	0	0
National Counties Building Society	27/06/2008	02/03/2009	8 mths	6.30%	1000	1000	1000	1000	1000	0	0
West Bromwich Building Soc	27/06/2008	01/07/2009	1 year	6.60%	1500	1500	1500	1500	1500	1500	1500
Newcastle Building Society	27/06/2008	01/07/2010	2 years	6.73%	2500	2500	2500	2500	2500	2500	2500
National Counties Building Society	21/07/2008	15/12/2008	5 mths	6.00%	1000	1000	0	0	0	0	0
Kent Reliance Building Society	21/07/2008	15/12/2008	5 mths	6.00%	1000	1000	0	0	0	0	0
Allied Irish Bank	03/10/2008	05/01/2009	3 mths	6.45%	5000	5000	5000	5000	0	0	0
Bank of Ireland	03/10/2008	03/11/2008	1 mth	6.04%	5000	0	0	0	0	0	0
Total					31500	24500	22500	21500	16500	15500	13500