Part I
Release to Press

Stevenage
BOROUGH COUNCIL

Meeting: **COUNCIL**

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Agenda Item:
11

REVIEW OF THE COUNCIL'S TREASURY MANAGEMENT STRATEGY

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1 PURPOSE

To update Members on the amendments to the Treasury Management procedures as a result of the current economic climate and the affect this has had on the banking sector.

2 RECOMMENDATIONS

2.1 That Members note the amendments to the Treasury Management procedures put into place to safeguard the Council's investments.

2.2 That the Audit Committee propose to Council the adoption of the revisions to the Treasury Management Strategy as referred to in Section 4 paragraph 4.3.

3 BACKGROUND

3.1 Since September 2007, the banking sector has been hit by a number of high profile casualties, culminating in the collapse and subsequent nationalisation of Northern Rock. Since then the uncertainty in the sector has increased, fuelled by 'sub-prime' mortgage debt in America. This led to large scale defaults on debts which had been bundled up and sold to banks and other organisations around the world, including British banks. As a result, banks have been unwilling to lend to each other as they are uncertain as to how much sub-prime debt each bank had taken on. Over the last few weeks, this has led to the Government lending money to several British Banks and Building Societies amalgamating. One of the most significant risks to Councils' came with the collapse of the Icelandic banks which British Councils' had £850Million invested in. (*source Public Servant November 2008*)

4 REASONS FOR RECOMMENDED COURSE OF ACTIONS AND OTHER OPTIONS

4.1 Stevenage Borough Council did not have any funds with Icelandic Banks, however there is still cause for concern that other banks may collapse and nervousness in the markets continues. Banks are still not willing to lend to each other, the rates currently offered are well above the Base Rate of 4.5%. Typically they are 1% above base for one month and higher for longer periods. (*24 October 2008, base rate 4.5%, one month rate 5.9%).*

4.2 In order to safeguard the Council's investment a complete review was undertaken of the Council's investment portfolio in conjunction with the Head of Finance and Strategic Director (Resources). The results of that review showed that the Council had £41.6Million investments of which there were only two term deposits with foreign institutions which were not guaranteed by their Government, these being £2Million with Depfa Bank fixed until November 2008 and £2.8Million with CIC group France, fixed until May 2009. There is a further £6.75m with other Irish banks, which are guaranteed by the Irish Government. The remaining portfolio was held in British banks and Building Societies.

4.3 Due to the urgency of the situation the Strategic Director (Resources) implemented the following changes:

- With immediate effect from the 10 October (the first weekly Treasury Management meeting).
- The investment limits held with any one banking group was lowered from £7.5Million to £5Million for any new investments, with the exception of call accounts which remain at £7.5Million. Call accounts are used for cash flow purposes and will change on a daily basis, so the balance will fluctuate between £1Million and £7.5Million. The upper limit of £5Million cannot be applied retrospectively as we are unable to recall monies on fixed deposits without incurring punitive charges.
- As well as reducing the maximum lent to any one banking group, the length of investment has been reduced to 365 day money until further notice. This is to ensure that the Council limits its exposure to any one banking institution.

4.4 Should there be a ratings downturn of institutions with which the Council has deposits, the Strategic Director and Head of Finance are now immediately advised verbally by the Treasury Management team and this is followed up by an email which includes the notification which has been received.

4.5 The current investment criteria used is considered prudent and this remains unchanged. This not only restricts the countries, but also the rating of the bank or building society (Appendix 1 and Appendix 2). These factors are considered in conjunction with any adverse publicity or update bulletins from our advisers. The list used is based on Fitch and Moody's ratings and is formally updated each month. In addition, there are updates whenever an institution's rating is altered whether up or down. Sometimes a rating isn't altered but an institution may be put on 'negative watch' i.e. there is a potential for the rating to be reduced.

4.6 In addition to the measure introduced above, an account is being opened with the Debt Management Office (DMO), this is a Government account and therefore a safe haven for funds. However, the interest rate is very low, usually about 1.5% less than base rate. Investment interest is an important source of funding for the Council, but it is important to balance risk and return.

4.7 The Council's new External Auditors (Grant Thornton) have asked officers about the measures the Council was taking to avoid being exposed to unacceptable risks during the current problems. The response was favourable stating the Council's current position was comprehensive.

4.8 As a result of the failure of the Icelandic Banks, the Local Government Association (LGA) is calling for an enquiry led by the Financial Services Authority into the credit rating agencies. Up until 30 September 2008, Landsbankii had a sufficiently high rating that many Councils would have met many Councils' criteria. The LGA is calling for an enquiry as to how the ratings stayed so high until a few days before the collapse.

Action taken by other Local Authorities is detailed in Appendix 3.

5 IMPLICATIONS

5.1 Financial Implications

As the report is of a financial nature, the financial implications are contained within the body of the report. The Treasury Management Code of Practice to which the Council adheres states that the avoidance of all risk is "neither appropriate or possible are being made to safeguard the Council's funds."

5.2 Legal Implications

None

BACKGROUND PAPERS

- Local Government Association Statement 14 October 2008
- Sector Bulletins
- Sector colour matrix
- Fitch credit rating definitions
- Local Government Chronicle 30 October 2008
- Public Servant November 2008

APPENDICES

- Appendix 1 Extract from Treasury Management Policy
- Appendix 2 Colour matrices for investments
- Appendix 3 Action taken by other Councils