AUDIT COMMITTEE	Agenda Item 44 Brighton & Hove City Council

Subject:		**Treasury Management**		
Date of Meeting:		**4 November 2008**		
Report of:		**Director of Finance & Resources**		
Contact Officer:	Name:	**Peter Sargent**	**Tel:**	**29-1241**
	E-mail:	peter.sargent@brighton-hove.gov.uk		
Wards Affected:	All			

FOR GENERAL RELEASE

1. SUMMARY AND POLICY CONTEXT:

1.1 At the meeting of this Committee on 30 September 2008 it was agreed to receive a report on treasury management and, in particular, how increased investment risk resulting from the turmoil in the financial markets is managed within the council's treasury management policy.

1.2 The purpose of this report is to advise Committee Members on the key aspects of treasury management, in particular how investment parameters are determined and how investment counterparties are selected.

1.3 A presentation will be given at the Committee meeting to supplement this report.

2. RECOMMENDATIONS:

The Audit Committee are recommended to:

2.1 Note the framework within which investment risk is managed.

3. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

3.1 Treasury management

3.1.1 Treasury management is subject to a code of practice issued by the Chartered Institute of Public Finance & Accountancy (CIPFA) and investment guidance issued by the Government. Both these documents fall within best practice as determined by the Local Government Act 2003.

3.1.2 Treasury management is defined within the CIPFA code as

"The management of the organisation's cash flows, its bankings, money market and capital market transactions; the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.2 Investments

3.2.1 As part of the annual budget process the council has to determine the level of cash balance, reserves and provisions it requires in setting the council tax, housing rents and capital investment programmes. For the major part of the financial year these balances are supplemented by substantial cash flow surpluses. These surpluses result from income being received prior to spending being incurred – for example income from council tax and business rates falls over a 10-month period whereas major payments such as employee costs fall over a 12-month period. The council has a duty to ensure these balances are invested for the purposes of the prudent management of its financial affairs.

3.2.2 Investments are subject to guidance issued by the Government. The guidance requires full Council to approve an annual investment strategy that gives priority to security and liquidity. Security is assessed by reference to credit ratings issued by rating agencies. The council uses the ratings issued by Fitch.

3.2.3 Investment by the council is subject to the following parameters:

- The rating criteria used by the council to select institutions ensure that investments are made only in banks and building societies with the highest quality names. In the case of building societies where the society is not rated a minimum asset base of £2bn is applied.

- The amount lent to selected institutions is limited in terms of amount and period depending upon the credit worthiness of the individual institution. For example the highest rated institutions have a £10m limit over 2-3 years, whereas an unrated building society will have a £5m limit over a shorter period.

3.2.4 In all cases where the rating for an institution is either revised downwards by the rating agency or is subject to negative review by the agency the investment parameters are adjusted downwards. Negative information from other reputable sources, for example financial newspapers, may also affect the investment parameters for an institution. In some cases the institution is suspended until further clarification is received regarding the financial position of the institution.

3.3 Turmoil in the financial markets

3.3.1 The turmoil in the financial markets has resulted in a substantial reduction in lending by the major banks, both domestically and globally. This has led to significant funding problems within the UK banking sector. Like many organisations with substantial funds to invest the council reviews its investment policies all the time to reflect the rapidly changing market conditions. In response to the current conditions officers have, with effect from 13 October 2008, reduced the maximum period for all new investments to one month. In addition the selection of investment counterparty will be more intensive than present and will not be solely based on a satisfactory credit rating or asset base.

3.4 Borrowing

3.4.1 The majority of council borrowing is on fixed rate terms and therefore is not affected by current market conditions. New borrowing to finance the 2008/09 capital investment programme will be raised on terms that will enable the council to take advantage of improving market conditions in the future.

4. CONSULTATION

4.1 No consultation was necessary in the writing of this report.

5. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

5.1 The financial implications of treasury management decisions are included in the Financing Costs budget. The original budget for 2008/09 was set at £7.929m. The financial crisis has meant short-term interest rates are higher than would normally be the case. These higher rates combined with better than expected council cash-flows has resulted in higher levels of projected investment income to the council of some £800,000 in the current financial year.

The Medium Term Financial Strategy includes investment income for 2009/10 averaging around 5% and for 2010/11 around 5.2%. In October 2008 the Bank of England announced a 50 basis points (½%) cut in official interest rates. This cut is widely expected to be the first of a number of cuts over the next 18-months as the Bank switches its attention from inflation to negative economic growth. The general concensus of forecasts for the Base Rate by March 2010 is 3¼%. Market rates are projected to follow a similar but more dramatic fall as the margin between official rates and market rates narrows. Market rates for 2009/10 are projected to average around 4%. Interest rates in 2010/11 are expected to be marginally above the average for 2009/10.

The projected fall in interest rates will therefore have a substantial adverse impact on investment returns for 2009/10 and 2010/11. Action will be taken, where possible, to minimise any adverse impact of lower interest rates in 2009/10 but the decision taken by officers in October 2008 to reduce new investments for one month may limit the scope for such action if the current uncertainty in the financial markets continues for any considerable period.

Finance Officer Consulted: Peter Sargent Date: 22 October 2008

Legal Implications:

5.2 Treasury management, including investments, must be in accordance with Part I of the Local Government Act 2003 and regulations issued thereunder. Relevant guidance also needs to be taken into account. This report is for information purposes only and as such it is not considered that anyone's rights under the Human Rights Act will be adversely affected by it.

Lawyer Consulted: Abraham Ghebre-Ghiorghis Date: 21 October 2008

Equalities Implications:

5.3 This report is for information and therefore an equalities assessment impact is not required.

Sustainability Implications:

5.4 None directly from this report.

Crime & Disorder Implications:

5.5 None directly from this report.

Risk and Opportunity Management Implications:

5.6 The turmoil in the financial markets has resulted in an increased risk that institutions will not be able to meet debt repayments in full or in a timely manner. The council is managing this risk by investing in only the highest quality names and through constant monitoring of its investment strategy.

5.7 Opportunities to invest at higher interest rates have enabled the council to achieve additional investment income above that previously budgeted.

Corporate / Citywide Implications:

5.8 None directly from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. None

Documents In Members' Rooms

None

Background Documents

1. Annual Treasury Management Policy Statement 2008/09

2. Annual Investment Strategy 2008/09