Haringey Council

NOTICE OF MEETING

# Special General Purposes Committee

TUESDAY, 7TH JULY, 2009 at 19:00 HRS - CIVIC CENTRE, HIGH ROAD, WOOD GREEN, N22 8LE.

MEMBERS: Councillors Meehan (Chair), Griffith (Vice-Chair), Rahman Khan, Aitken, Bloch, Bull and Davies

## AGENDA

**1. APOLOGIES FOR ABSENCE (IF ANY)**

**2. URGENT BUSINESS**

It being a special meeting of the Committee, under the Council's Constitution, Part 4, Section B, Paragraph 17, no other business shall be considered at the meeting.

**3. DECLARATIONS OF INTEREST**

A member with a personal interest in a matter who attends a meeting of the authority at which the matter is considered must disclose to that meeting the existence and nature of that interest at the commencement of that consideration, or when the interest becomes apparent.

A member with a personal interest in a matter also has a prejudicial interest in that matter if the interest is one which a member of the public with knowledge of the relevant facts would reasonably regard as so significant that it is likely to prejudice the member's judgment of the public interest **and** if this interest affects their financial position or the financial position of a person or body as described in paragraph 8 of the Code of Conduct **and/or** if it relates to the determining of any approval, consent, licence, permission or registration in relation to them or any person or body described in paragraph 8 of the Code of Conduct.

## 4. TREASURY MANAGEMENT – 1ST QUARTERLY REVIEW REPORT (PAGES 1 - 26)

To receive the report of the Chief Financial Officer updating the Committee on the Council's treasury management activities for the first quarter of 2009/10.

**It being a special meeting of the Committee, under the Council's Constitution, Part 4, Section B, Paragraph 17, no other business shall be considered at the meeting.**


Yuniea Semambo
Head of Local Democracy and Member Services
5th Floor
River Park House
225 High Road
Wood Green
London N22 8HQ

Natalie Cole
Principal Committee Co-ordinator
Tel No: 020 8489 2919
Fax No: 0208 489 2660
Email: natalie.cole@haringey.gov.uk


Monday 29th June 2009

Agenda Item 4

Haringey Council

Agenda item:

**General Purposes Committee** On 7 July 2009

| | |
|---|---|
| Report Title. | **Treasury Management – 1st Quarter 2009/10 Performance Update** |
| Report of: <br> Signed : | **Chief Financial Officer** <br> Kevin Bartle <br> for **Gerald Almeroth** |
| Contact Officer : | **Kevin Bartle, Head of Corporate Finance** <br> **Telephone 020 8489 3743** |
| Wards(s) affected: **All** | Report for: **Non Key Decision** |

## 1. Purpose of the report

1.1. To update the committee on the Council's treasury management activities for the first quarter of 2009/10 and to make recommendations to revise the council's approved Treasury Management Strategy Statement (TMSS).

## 2. Recommendations

2.1 That Council is recommended to revise the Treasury Management Strategy Statement (TMSS) to include the Clydesdale Bank as a permitted institution for investment purposes on the same terms as the other institutions already on the approved list i.e. a maximum exposure of £20m and a duration of up to 12 months.

2.2 That Members note the proposed use of the following Treasury Management actions which are already approved or contained within the TMSS:-

2.2.1 The Council's Treasury Management advisors will be asked to identify a minimum of two and a maximum of four AAAm Money Market Funds allowing total investments of up to £10m in accordance with the current TMSS.

2.2.2 Investments will be made of up to £10m in bonds issued by the European Investment Bank with redemptions due in December 2010 and March 2011.

2.2.3 The premature repayment of PWLB loans of up to £25m will be made on favourable terms as approved by the Chief Financial Officer.

2.2.4 The use of available cash balances to fund, in the short or medium term, a number of approved capital schemes in 2009/10.

**3. Reason for recommendation(s)**

3.1. To enable further secure investments to be made with the objective of optimising investment returns.

**4. Summary**

4.1. This report sets out the Council's Treasury Management activity and performance for the first quarter of 2009/10 and makes recommendations for a change to the Council's Treasury Management Strategy Statement (TMSS).

**5. Head of Legal Services Comments**

5.1 The Head of Legal Services has been consulted on the content of this report and comments that the recommendations are within the policy agreed by Council and consistent with the purposes of Financial Regulations. In considering the recommendations Members must take into account the expert financial advice available in the report and any further advice given at the meeting of the Committee in relation to the level of risk inherent in the proposals.

**6. Use of appendices**

- Appendix A - Extract from the Council's TMSS – February 2009
- Appendix B - Investments Performance Indicator;
- Appendix C - Interest Rate Outlook;

- Appendix D - Summary of Certificates of Deposit (CDs);
- Appendix E - Recommendations of PwC review into Icelandic Investments;
- Appendix F - Recommendations of Audit Commission concerning Icelandic investments.

**7. Local Government (Access to Information) Act 1985**

The following background papers were used in the preparation of this report:

- Financial Planning Report for 2009/10 to 2011/12 reported to Council and agreed on 23 February 2009.
- Report on Money Market Funds by KAPCO Ltd.

For access to the background papers or any further information please contact Kevin Bartle, Head of Corporate Finance, on 0208 489 3743.

**8. Background**

8.1 In accordance with the recommendations contained in the Treasury Management Strategy Statement (TMSS) and approved by the Council on 23 February 2009, there is a requirement to report to members on the Treasury Management activity on a half yearly basis. However, following the report of PwC into the Council's Icelandic investments, and in view of the continuing developments in this area, it is now proposed to report to GP Committee on a quarterly basis on all significant matters affecting the operation of the TMSS. This first report outlines the Council's treasury management activities for the period ending 30 June 2009 and will cover:

- The investment of surplus balances and the effect of changes to the counterparty list;
- An update on the response to the recommendations contained in PwC's report into the Icelandic investments;
- An update on the recovery of monies invested in the Icelandic Banks.

**9. Treasury Management Activities for the Quarter Ended 30 June 2009**

9.1 In October 2008, the Chief Financial Officer undertook a risk assessment into the institutions holding council deposits, the results of which prompted a move to revise the Council's approved counterparty list.

9.2 The revised counterparty list was included in the 2009/10 TMSS, was ratified by full Council in February 2009 and incorporates the following:

'The Council will only invest (on a term or certificate basis) in UK banks and building societies that have a minimum AA- long term and F1+ short term credit rating AND are participants in the UK Government's Credit Guarantee Scheme (CGS).'

9.3 This formalised the action already taken to limit the Council's investment activity to the following banks:-

- Abbey National;
- Barclays;
- HSBC;
- Lloyds Banking Group;
- Royal Bank of Scotland; and the following Building Society;
- Nationwide.

In addition investments in the above institutions are restricted to a maximum limit of £20m per institution with a maximum duration of 12 months. Furthermore, investment activity, and thus the counterparty limit, is also limited to the Group concerned. The Council, could not, for example invest £20m in each of Lloyds Bank and the Bank of Scotland given their group relationship. The list of permitted investments and instruments is included within an extract of the Council's current TMSS which is attached as Appendix A to this report.

9.4 The effect of adopting the revised lending list is set out in Table 1 below which compares the investment portfolio reported by the Chief Financial Officer in October 2008 to the current portfolio profile at 25 June 2009 as follows:

**Table 1**

| Institution | Value Oct 2008 £m | Maturity dates | Value 25 June 2009 £m | Maturity dates |
|---|---|---|---|---|
| UK Banks | 1.5 | Oct 08 | 80.0 | Jun 09 – Dec 09 |
| UK Building Societies | 58.7 | Oct 08 – Aug 09 | 27.0 | Jun 09 – Nov 09 |
| Irish Banks | 61.1 | Oct 08 – Jun 09 | 5.0 | Jun 09 |
| Irish Building Societies | 12.0 | Oct 08 – Feb 09 | 0 | n/a |
| Other Non – UK Banks | 23.4 | Oct 08 – Nov 09 | 0 | n/a |
| Debt Management Office: DMADF | 0 | | 1.1 | 26 Jun 09 |
| **TOTAL** | **156.7** | | **113.1** | |

9.5 It can be seen from the table, the significant impact that the revisions to the TMSS has had. This includes eliminating the exposure to Irish building societies and other non-UK banks and reducing the exposure to Irish banks to £5m (from £61.1m). In addition, investments in UK building societies have been reduced by £31.7m to £27m. These reductions have been matched by compensating increases in the exposure to UK banks and the government's Debt Management Office (DMO). The DMO's Debt Management Account Deposit Facility (DMADF) is an investment facility operated by the UK government which has the highest security rating but conversely pays a very low interest rate in comparison to other institutions. A list of all outstanding deposits is set out at Appendix B.

9.6 At the time of preparing this report only 3 investments, totalling £12m, remain in place that do not achieve the Council's minimum current credit rating criteria. These investments, that were placed before October 2008, are:

**Table 2**

| Institution | Principal £M | Date Placed | Maturity |
|---|---|---|---|
| DEPFA Bank Plc | 5 | 30/06/2008 | 30/06/2009 |
| Skipton BS | 2 | 24/07/2008 | 23/07/2009 |
| Chelsea BS | 5 | 29/08/2008 | 28/08/2009 |
| **Total** | 12 | | |

9.7 It will be seen that the longest maturity date on these outstanding deposits is 28 August 2009. At the time that the above investments were made they accorded with the approved credit rating criteria then prevailing. Subsequently, these institutions have been subject to a number of rating down grades by the credit rating agencies. The Council, has, nevertheless, undertaken risk assessments on these remaining institutions and considers the risk of non return small. The DEPFA Bank is based in Ireland but is covered by the German's government's guarantee while the two Building Societies are on the UK government's Credit Guarantee Scheme.

9.8 The security of investments remains the principal investment objective for this authority. Officers have worked with the Council's treasury management advisors to produce a performance indicator which is a credit rating based objective scoring analysis. This is provided in Appendix B to this report.

9.9 The credit risk scores of 4.3 (value weighted average) and 4.3 (time weighted average) indicate a low level of security risk based on the methodology adopted by our treasury advisors as set out at the foot of the table as follows:

Above target (AAA to AA+, Score 0-2)
Target score (AA to A+, Score 3-5)
Below target (below A+, Score over 5)

9.10 On this basis, Haringey is at the lower end of the target range. It is likely that the scores indicated will improve at the date of the next quarterly report following restoration of the monies currently on deposit with the DEPFA Bank plc and the Skipton and Chelsea Building Societies.

9.11 Although the Council has adopted a more prudent stance in respect of the treasury management function it has still been possible to out perform the investment performance indicator over the first two months of 2009/10 as follows:

| | |
|---|---|
| Target: | 0.5% above Base Rate |
| Actual Investment performance: | 0.77% above Base Rate |

**Interest Rate Outlook**

9.12 The TMSS is predicated on interest rate forecasts provided by the Council's Treasury Management advisors, currently Arlingclose. The latest forecast compared to the version used in the estimates is attached as Appendix C. It can be seen that the base rate is now forecast to remain constant during 2009/10 at 0.5% but could rise by a series of phased increases to 1.75% by March 2011. The interest rate outlook is important because it affects the term of future investments and hence the capacity to maximise interest earned. The Council would not, for example, want to invest for long periods now given that the rates are likely to improve in the medium term.

**Interest Earned in the Quarter ended 30 June 2009**

9.13 The interest earnings in the first quarter are forecast to amount to £0.682m. The budget for investment income in 2009/10 is £2 million. Whilst interest earnings are currently on target to achieve this sum a number of factors may conspire against achieving this estimate. Principal among these is the pattern of investment replacement i.e. new deposits are being made at lower rates than those maturing. Members will be kept informed of the position in future quarterly reports.

**The Counterparty List**

9.14 When investing its treasury balances the Council adheres to the core principles governing the investment of public monies: security, followed by liquidity followed by return with commensurate risk.

9.15 The returns on the Council's investments are important in relation to the Council's financial strategy both in the short and longer terms; stability of year-on-year returns is therefore important in achieving this objective.

9.16 Since the implementation of the current lending list (consisting of five banks and one building society, each with a maximum exposure of £20m) it has become increasingly difficult to find counterparties offering competitive rates of interest. In fact one institution, HSBC, is not in the market for investments of the size and duration currently being offered by the Council, consequently the Council has no investments in this institution. Given the extent of Council surplus balances at any one time and restricted lending list, investments to individual counterparties are likely to be at or close to the maximum limit of £20m.

9.17 As a result of these necessary constraints, and in order not to compromise security, increasing use is being made of the DMADF which enables investments to be made with the UK Government via HM Treasury for periods up to six months. At the time of writing this report £1.1m is deposited with the DMADF, although this fluctuates on a daily basis; recent DMADF investments have reached levels in excess of £30m. Although the DMADF has a AAA credit rating it offers an extremely uncompetitive rate of return, currently 0.3% for overnight investments.

9.18 Consequently, consideration has been given to a number of options to improve the returns achieved on the investment portfolio whilst balancing risk. These include actions already approved in the Council's TMSS and those that are not:

***Approved TMSS options***
- the use of Certificates of Deposit;
- the use of Money Market Funds;
- investing in Bonds issued by Multilateral Development Banks;
- repaying some fixed interest long-term debt to the PWLB ensuring the financial implications are judged acceptable, this option would also reduce treasury risk by reducing the available cash for investment; and,
- providing short/medium term finance for Capital projects.

***Options that would require a revision to the TMSS***
- increasing the current maximum limit of £20m placed on UK banks and the Nationwide Building Society;
- adding other institutions to the approved lending list;

Consideration of the above options is set out below.

**Certificates of Deposits (CDs)**

9.19 The main advantage of CDs lies in their liquidity. Unlike fixed term deposits they can be sold before maturity thus providing opportunities for re-aligning the portfolio ahead of perceived interest rate changes or in the event of credit rating changes. However, to introduce a CD programme at this stage would hamper the existing treasury operation as CDs will compete for space within our available counterparty limits. It is not recommended, therefore, that we move to investing in CDs at the current time. A summary of the main features of CD's is attached for information as Appendix D.

**Increasing the UK Bank and Building Society limit from £20m**

9.20 Consideration has been given to this option, however given the continuing fragility in the banking sector, it is suggested that diversification rather than increasing the limit offers greater capital protection at this stage. At present, therefore, it is not proposed to seek any widening of the current investment limits applicable to individual institutions.

**Adding other Institutions to the approved Lending List**

9.21 A review has been undertaken in conjunction with our treasury advisors into the possibility of adding further institutions to the lending list. It is essential that security of capital is not compromised for the sake of investment return and only institutions meeting the minimum requirements of AA- long term credit rating and F1+ short term rating AND are eligible to be participants in the UK Government's Credit Guarantee Scheme were considered, in line with the TMSS.

9.22 The only institution currently meeting the above criteria that is presently not on the Council's approved list is Clydesdale Bank. It is recommended therefore that Clydesdale Bank be added to the eligible banks on the same terms i.e. a maximum exposure of £20m and a duration of up to 12 months.

**The use of Money Market Funds (MMFs)**

9.23 The TMSS currently permits the use of MMFs 'with a AAAm rating and operating on a constant net asset value basis (CNAV)'. The Council has approved investments up to £10m in money market funds but has a maximum exposure limit to any one fund of £5m. At the current time no use has been made of this facility until further due diligence had been undertaken prior to recommending the use of this type of investment vehicle.

9.24 Although MMFs have as their primary objective the preservation of capital it should be explained at the outset that AAAm status does not refer to the credit rating of the individual investments contained within funds but is an assessment of the way in which funds themselves are constructed and managed.

9.25 The rating criteria broadly comprise four main areas of analysis that systematically address a fund's operating principles comprising its credit quality, portfolio construction, fund management and regular post-rating inspection by rating agencies. In order to better understand all of the implications of investing in these funds, the Chief Financial Officer recently commissioned a report on this issue from an independent consultant; Mr Andrew Philpott of KAPCO Limited.

9.26 The interest earned on MMF investments are likely to be broadly in line with those obtained currently by the Council on its fixed term deposits with UK banks and the Nationwide Building Society and are currently in the order of 1.3% pa. This compares very favourably with deposits with the DMADF which are presently earning an overnight rate of 0.3% pa.

9.27 Although it is suggested that MMFs offer a useful additional outlet for investment, and are a further means of risk diversification, it is understood that there is a perceived but, in the view of Council officers and its Treasury Management advisors, acceptable counterparty risk. This arises because it is not possible to carry out a risk assessment of every institution contained on a MMF manager's lending list. This minor risk can be further reduced by investing in funds with the following features: -

- systemic and reputational risk in the event of failure i.e. the market impact of failure would be so great that Group support could reasonably be assumed e.g. a money market fund operated by Barclays plc;
- lack of investor domination. A large investor base ensures that liquidity is not impaired by fund withdrawals;
- a large number of individual investments with strict maximum limits on any one investment; and,
- investments only in funds that adopt our minimum investment criteria of AA- long-term and F1+ short-term on individual counterparties.

Subject to meeting the above criteria, it is recommended, that in conjunction with our treasury advisors, a minimum of two and a maximum of four AAAm funds be identified with a view to making total investments of up to £10m in accordance with the TMSS.

**Investing in bonds issued by Multi Lateral Development Banks**

9.28 These bonds which are issued by the European Investment Bank (EIB) are AAA rated and are highly liquid, i.e. can be traded in the market at any time. At present, the number of uncertainties in financial markets, not least of which is the impact of the policy of quantative easing, makes the economic outlook and its impact on interest rates difficult to forecast. In these circumstances, it may be considered prudent to invest up to £10m in bonds issued by the EIB by making two investments on the following terms:

| Proposed Investment | Indicative Yield | Redemption date |
|---|---|---|
| £m | % | |
| 5 | 1.4 | December 2010 |
| 5 | 1.9 | March 2011 |

These two investments have been chosen on terms that should reduce interest rate risk having regard to the forecast interest rate rise profile provided by Arlingclose and attached as Appendix C. It should be noted, however, in the unlikely event that it is decided to trade these bonds sooner than the redemption dates then yields will be lower and a capital variation (favourable or unfavourable) could take place.

**Repaying some long-term debt to the PWLB**

9.29 By prematurely repaying debt to the PWLB on neutral terms it is possible to eliminate all treasury risk in respect of the commensurate reduction in the available monies for investment. 'Neutral terms' within the context of this action means making a premature loan repayment without incurring a penalty in respect of an interest rate mismatch i.e. the interest rate currently applied to debt issued by the PWLB for loans of similar duration. In addition, the financial implications of repayment have been assessed and there will be no adverse impact on the general fund or HRA, in fact there will be a general fund saving on the interest payments budget in 2009/10. In consultation with the treasury advisors, a suitable PWLB loan has been identified in the debt portfolio which has the appropriate characteristics as follows:-

| Loan outstanding | Coupon rate | Years to maturity | Discount |
|---|---|---|---|
| £m | % | | £ |
| 25 | 4.45 | 26 | 76,353 |

For the reasons discussed, and subject to the constraints identified, it is proposed that premature repayment of part or all of the PWLB loan set out above is made as required.

**Providing medium term finance for Capital Projects**

9.30 There are a number of 2009/10 approved capital schemes that are intended to be financed by capital receipts which will be obtained from sales of council properties. In the current economic environment commercial property prices remain severely depressed. It is proposed therefore that consideration be given to funding part or all of certain schemes initially from available surplus cash balances. This will allow properties to be sold at a later date in a more buoyant market following advice from the Head of Corporate Property Services. This will again eliminate all treasury risk for the sums involved due to the commensurate reduction in the available monies for investment.

10. **Reviews of Treasury Management Operations**

10.1 Given the national attention given to Treasury Management activities and operations since the Icelandic banking crisis, there have been a number of national and local reviews undertaken.

10.2 The recent Internal Audit report to the Council's Audit Committee in April 2009 contains a number of recommendations which were made by PwC following their review of Haringey Council's Treasury Management procedures (Appendix E) and the Audit Commission's national report on Treasury Management (Appendix F). The column headed 'timescale' shows that many of the recommendations have already been implemented and the remainder are scheduled to be put in place during the remainder of 2009. Arrangements are in place to ensure that all of the recommendations are adopted within the stated timescales.

**11. Update on the Recovery of Monies Invested in the Icelandic Banks**

11.1 The administration process for the Icelandic banks in which Council deposits of £36.957m have been frozen is continuing. In order to expedite recovery, the Chief Financial Officer is a member of the Heritable Bank statutory creditors committee; the bank were established and registered under Scottish Law. The details of all Icelandic related investments is as follows:-

| **Bank** | **Start date** | **Maturity Date** | **Interest Rate** | **Principal** |
|---|---|---|---|---|
| | | | **%** | **£** |
| Glitnir | 10/12/07 | 08/08/08 | 6.45 | 2,000,000 |
| Heritable | 15/08/08 | 30/03/09 | 6.06 | 6,000,000 |
| Heritable | 23/09/08 | 14/11/08 | 6.00 | 3,200,000 |
| Heritable | 29/09/08 | 14/11/08 | 6.10 | 2,100,000 |
| Heritable | 12/09/08 | 16/10/08 | 5.44 | 3,000,000 |
| Heritable | 19/09/08 | 17/10/08 | 5.91 | 3,000,000 |
| Heritable | 11/09/08 | 21/10/08 | 5.48 | 2,500,000 |
| Landsbanki | 25/02/08 | 23/02/09 | 5.70 | 3,500,000 |
| Landsbanki | 30/05/08 | 27/02/09 | 6.10 | 3,000,000 |
| Landsbanki | 16/06/08 | 13/02/09 | 6.31 | 1,100,000 |
| Landsbanki | 29/09/08 | 07/10/08 | 5.70 | 2,257,000 |
| Landsbanki | 19/08/08 | 20/10/08 | 5.60 | 5,300,000 |
| | | | | |
| **Total** | | | | **36,957,000** |

11.2 The government has issued a regulation to allow authorities to defer accounting for the net loss until later years. CIPFA has recently issued further accounting guidance for authorities on the assumptions for deferred impairments in the 2008/09 accounts and based on the latest position, this recommends assuming recovery of 87.2% of the capital sum. The Council has, however, accounted for interest not received in relation to these investments in 2008/09.

## 12. The House of Commons Communities and Local Government report on Local Authority Investments – June 2009

12.1 The above report was published on 11 June 2009. The report's conclusions and recommendations cover the complete range of stakeholders; from local authority officials and members through to the Audit Commission, CIPFA and central government. All are criticised to a greater or lesser extent in the report but no new information has emerged which requires any additional action by this authority.

## 13. Conclusions

13.1 The Council's actions following the Icelandic crisis and the consequent implementation of the revised 2009/10 TMSS has had a significant impact on the dispersion of the Council's invested balances. Table 1 in paragraph 9.4 shows that investments made in UK banks and the DMO have substantially increased and investments in both UK & non UK building societies and non UK banks (including Ireland) have reduced significantly. Under the 2009/10 TMSS new investments are only made in UK banks and building societies with a minimum rating of AA- and are also members of the CGS.

13.2 The proposals recommended in this report, namely, the addition of Clydesdale Bank to the lending list, the use of money market funds, making investments in the EIB, prematurely repaying PWLB debt, and providing medium-term finance for a number of capital schemes further underpin this prudent process.

13.3 The above proposals have been formulated after considerable dialogue between the Council's external treasury advisors and Council officers. The focus of this dialogue has been with the security of capital as paramount, coupled with a secondary objective of achieving an appropriate investment return.

13.4 Future reports will monitor the implementation of the proposals now recommended, if approved, and will continue to identify opportunities to further underpin the prudent implementation of the TMSS.

**Appendix A**

**Extract from the Council's TMSS – February 2009**

## 6. <u>Investment Policy and Strategy</u>

### Background

6.1 Guidance from the then ODPM (now DCLG) on Local Government Investments in England requires, similarly, that an Annual Investment Strategy (AIS) be set. The Guidance permits the TMSS and the AIS to be combined into one document.

### Investment Policy

6.2 The Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- an optimum yield which is commensurate with security and liquidity.

The speculative procedure of borrowing purely in order to invest is unlawful.

6.3 The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The Council has reviewed its approach and will access and assess a wider range of indicators of credit strength than the pure reliance upon credit ratings. This includes a range of objective indicators (such as credit default swaps, share price movements and sovereign credit ratings, individual, financial strength, support ratings and economic indicators) as well as a subjective overlay. The use of Bloomberg reporting will be developed to assist in this.

6.4 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the ODPM Guidance.

6.5 Specified Investments will be those that meet the criteria in the ODPM Guidance, i.e. the investment

- is sterling denominated;
- has a maximum maturity of 1 year;
- meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland;.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

6.6 The Council's investments will be in the following investment instruments classified as Specified Investments:

- fixed term deposits in banks and building societies;
- certificates of deposit with banks and building societies;
- other local authorities;
- money market funds with a AAAm rating and a constant net asset value;
- UK Government bonds (Gilts); and,
- UK Treasury Bills;
- UK Government Debt Management Deposit Account Facility (DMADF).

6.7 Non-Specified Investments will satisfy all the criteria of Specified Investments with one exception, they will have a maximum maturity of 6 years and the maximum exposure will be £60m. They will cover the following investments:

- Bonds issued by Multilateral Development Banks (i.e. European Investment Bank, World Bank);
- Bonds issued by institutions with an explicit UK Government Guarantee; and,
- UK Government bonds (Gilts); and,
- Other local authorities.

6.8 The Chief Financial Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Cabinet as appropriate.

6.9 All investment activity will comply with the accounting requirements of the local authority SORP.

**Investment Counterparties**

6.10 Financial markets and financial institutions remain in a state of heightened risk as the impact of the credit crunch continues to adversely affect the global economy with particular volatility in the financial and banking sectors. In order to reduce risk the Council has considered adopting a more tiered approach to limits and ratings, including the use of sovereign ratings. However, this strategy is recommending an approach that goes further than this. The Council's investment activities have been restricted as a consequence in order to demonstrably address the prevailing higher risk backdrop and it is proposed to continue to restrict this and at the same time take advantage of more AAA rated government backed instruments. This will apply to all new transactions.

6.11 The Council is able to invest in the investment instruments outlined in 6.6 and 6.7 above but it is proposed that investments in banks and building societies (on a term or certificate of deposit basis) are limited to UK banks and building societies that have a minimum AA- long term credit rating and F1+ short term rating and are participants in the UK Government's Credit Guarantee Scheme (CGS).

This will limit activity to the following banks:

- Abbey National
- Barclays
- HSBC
- Lloyds Banking Group
- Royal Bank of Scotland

and the following Building Society:

- Nationwide

The CGS effectively provides a UK Government Guarantee for these institutions, some of whom such as Lloyds Banking Group and Royal Bank of Scotland have effectively been partially nationalised by the UK Government.

It is proposed that deposits with these banks and building society are allowed for periods up to 12 months duration and £20m exposure limit per institution applies at a group level.

Given current conditions and the possibility of downgrade to the UK and its banks the Chief Financial Officer retains delegated power to allow the continuation of use of these six institutions even if they suffer downgrades below a long-term rating of AA- and a short-term rating of F1+, whilst the UK Government Guarantee remains in place.

The previous strategy allowed for the use of non-UK banks and building societies that had minimum ratings of A and F1.

6.12 The Council has an account with the Debt Management Deposit Account Facility (DMADF). This facility allows the Council to invest with the UK Government via HM Treasury for periods up to 6 months. There is no exposure limit on the DMADF as an investment counterparty.

6.13 The Council can utilise Money Market Funds with a AAAm rating and operating on a constant net asset value basis (CNAV). The Council can invest up to £10m in money market funds but has a maximum exposure limit to any one Fund of £5m.

6.14 Investments in other UK local authorities are permitted. There is a £30m exposure limit on each local authority as investment counterparties.

6.15 The Council is permitted to invest in sterling denominated bonds issued by HM Government (Gilts), bonds issued with a HM Government Guarantee and bonds issued by Multi Lateral Development Banks (i.e. European Investment Bank, World Bank). Investments in these bonds will be for periods of up to 6 years. The Council will look to utilise more of this highly secure government backed instruments.

6.16 The permitted investments can be summarised as follows:

| Investment | Maximum Counterparty Limit | Maximum Length of Investment | Criteria |
|---|---|---|---|
| Banks and Building Societies | £20m | 1 year | Min AA- long term and F1+ rating plus CGS (or equivalent) |
| Local Authorities | £30m | 5 years | |
| Money Market Funds | £5m | n/a | AAAm and CNAV |
| HM Government (DMADF ) | Unlimited | 6 months | |
| HM Government (Gilts and Treasury Bills) | Unlimited | 6 years | |
| Bonds issued by Multilateral Development Banks | £60m | 6 years | |
| Bonds issued with HM Government Guarantee | £60m | 6 years | |

The Chief Financial Officer will assess whether to restrict further within these limits based on the latest available market information and advice.

**Investment Strategy**

6.17 With short term interest rates sharply lower and expected to decrease further in 2009, investment strategy would typically result in a lengthening of investment periods, where cash flow permits, in order to lock-in higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.

6.18 Investment strategy will include investment for longer periods (up to 6 years) in bonds issued by HM Government, Multilateral Development Banks and bonds with a HM Government Guarantee to secure a level of acceptable risk adjusted return that should span the period of sharply lower interest rates. The bonds satisfy the investment objectives of the Council and as Non Specified Investments any investment will be limited to a maximum of £60m.

Remaining investments will be placed with the other approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return.

Appendix B

**Investment Performance Indicator**

25/06/2009

| **INSTITUTION:** | **GROUP:** | Principal | Effective maturity | Days to maturity | Rate | **Credit rating** (source Bloomberg) | **Credit Risk Score** |
|---|---|---|---|---|---|---|---|
| **(a) Outstanding deposits** | | | | | | | |
| Abbey | Santander Group | £6,100,000.00 | 27/08/2009 | 63 | 1.21% | AA- | 4 |
| Abbey | Santander Group | £4,350,000.00 | 02/07/2009 | 7 | 1.58% | AA- | 4 |
| Abbey | Santander Group | £4,500,000.00 | 31/07/2009 | 36 | 1.38% | AA- | 4 |
| Abbey | Santander Group | £5,000,000.00 | 24/07/2009 | 29 | 1.42% | AA- | 4 |
| Barclays | | £5,000,000.00 | 08/09/2009 | 75 | 1.14% | AA- | 4 |
| Barclays | | £15,000,000.00 | 15/07/2009 | 20 | 1.30% | AA- | 4 |
| Chelsea BS | | £5,000,000.00 | 28/08/2009 | 64 | 6.05% | BBB+ | 8 |
| DEPFA Bank plc | Hypo Real Group | £5,000,000.00 | 30/06/2009 | 5 | 6.43% | A- | 7 |
| DMO | | £1,100,000.00 | 26/06/2009 | 1 | 0.30% | AAA | 1 |
| Lloyds TSB | Lloyds Banking Group | £5,000,000.00 | 02/07/2009 | 7 | 1.70% | AA- | 4 |
| Lloyds TSB | Lloyds Banking Group | £5,000,000.00 | 31/07/2009 | 36 | 1.38% | AA- | 4 |
| Lloyds TSB | Lloyds Banking Group | £10,000,000.00 | 07/07/2009 | 12 | 1.45% | AA- | 4 |
| Nationwide BS | | £11,500,000.00 | 02/11/2009 | 130 | 5.65% | AA- | 4 |
| Nationwide BS | | £8,500,000.00 | 05/11/2009 | 133 | 1.61% | AA- | 4 |
| RBS | RBS | £5,000,000.00 | 11/12/2009 | 169 | 3.70% | AA- | 4 |
| RBS | RBS | £5,000,000.00 | 13/08/2009 | 49 | 2.30% | AA- | 4 |
| RBS | RBS | £10,000,000.00 | 17/12/2009 | 175 | 1.43% | AA- | 4 |
| Skipton BS | | £2,000,000.00 | 23/07/2009 | 28 | 6.20% | A*- | 7 |
| **Total** | | **£ 113,050,000** | | 31/08/2009 | 2.483% | | |
| Number of deposits | | **18** | | | | | |
| **Value Weighted Average** | | £ 6,280,556 | | | | **AA-** | **4.3** |
| **Time Weighted Average** | | | | 67 | | **AA-** | **4.3** |

*- means Rating Watch Negative

Credit risk scored 1 - 10 : 1 = strongest rating lowest risk, i.e. AAA, through to 15 = lowest credit rating, highest risk, i.e. D

Non-rated, non-guaranteed institutions score 11

Above Target (AAA to AA+ Score 0-2)
Target (AA to A+, Score 3-5)
Below Target (Anything less than A+, Score above 5)
On this basis, Haringey is currently at the lower end of its target range

**Appendix C**

## Interest Rate Outlook

The TMSS is predicated on interest rate assumptions provided by Arlingclose. The table below provides the current forecast compared with the earlier forecast as follows:

| | Jun-09 | Sep-09 | Dec-09 | Mar-10 | Jun-10 | Sep-10 | Dec-10 | Mar-11 |
|---|---|---|---|---|---|---|---|---|
| **Official Bank Rate** | | | | | | | | |
| Upside risk | | | | +0.25 | +0.50 | +0.50 | +0.50 | +0.50 |
| **Central case** | **0.50** | **0.50** | **0.50** | **0.50** | **0.75** | **1.00** | **1.25** | **1.75** |
| Downside risk | | | | | -0.25 | -0.50 | -0.50 | -0.50 |
| **1-yr LIBID** | | | | | | | | |
| Upside risk | | +0.25 | +0.25 | +0.25 | +0.50 | +0.50 | +0.50 | +0.50 |
| **Central case** | **1.50** | **1.50** | **1.75** | **2.00** | **2.00** | **2.25** | **2.50** | **2.75** |
| Downside risk | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 | -0.25 |

Arlingclose's forecast for interest rates (December 2008)

| | Mar-09 | Jun-09 | Sep-09 | Dec-09 | Mar-10 | Jun-10 | Sep-10 | Dec-10 | Mar-11 |
|---|---|---|---|---|---|---|---|---|---|
| **Official Bank Rate** | | | | | | | | | |
| Upside risk | | | | | | | +0.25 | +0.25 | +0.25 |
| **Central case** | **1.00** | **1.00** | **1.00** | **1.00** | **1.00** | **1.50** | **2.00** | **2.50** | **2.50** |
| Downside risk | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.50 | -0.50 | -0.50 | -0.50 |
| **1-yr LIBID** | | | | | | | | | |
| Upside risk | | | | | | | | | |
| **Central case** | **2.50** | **1.75** | **1.50** | **1.50** | **1.50** | **1.75** | **2.00** | **2.75** | **3.00** |
| Downside risk | -0.25 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 |
| **5-yr gilt** | | | | | | | | | |
| Upside risk | | | | | | | | | |
| **Central case** | **3.00** | **2.75** | **2.50** | **2.00** | **2.00** | **2.50** | **2.75** | **3.00** | **4.00** |
| Downside risk | | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | | | |
| **10-yr gilt** | | | | | | | | | |
| Upside risk | | | | | | | | | |
| **Central case** | **3.40** | **3.10** | **3.00** | **3.00** | **3.00** | **3.50** | **3.75** | **4.00** | **4.50** |
| Downside risk | -0.25 | -0.25 | -0.50 | -0.50 | -0.50 | -0.50 | | | |
| **20-yr gilt** | | | | | | | | | |
| Upside risk | | +0.10 | +0.10 | +0.10 | +0.10 | +0.10 | | | |
| **Central case** | **4.00** | **4.00** | **4.00** | **4.25** | **4.25** | **4.50** | **4.75** | **4.75** | **4.75** |
| Downside risk | | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 | | | |
| **50-yr gilt** | | | | | | | | | |
| Upside risk | +0.10 | +0.10 | +0.10 | +0.10 | +0.10 | +0.10 | +0.10 | +0.10 | +0.10 |
| **Central case** | **3.90** | **3.90** | **4.00** | **4.00** | **4.25** | **4.50** | **4.50** | **4.50** | **4.50** |
| Downside risk | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 |

It will be seen that base rate is now forecast to remain constant at 0.5% during 2009/10 but could rise by a series of phased increase to 1.75% by March 2011.

**Appendix D**

## Certificates of Deposit

### Definition

A Certificate of Deposit (CD) is a negotiable receipt issued by a deposit taking institution in respect of a specified sum of money deposited with that institution at a fixed rate of interest, with an undertaking to repay to the bearer of the certificate at a specified date the sum deposited with interest outstanding.

### Principal features

- CD's are issued for a minimum period of 1 day and a maximum period of 5 years
- CD's are issued in various denominations
- Rates are quoted as a yield to maturity on the purchase cost of the CD
- Interest is paid gross
- For CD's issued for less than a year interest is payable on maturity
- For CD's issued for longer than a year, interest is paid annually on the anniversary of the date of issue and for the remaining period at maturity
- CD's are bearer instruments
- Title to a CD change on delivery and there is no contingent liability after sale.

**Appendix E-** Recommendations of PWC review into Icelandic Investments

| Ref | Recommendation | Management Response | Responsibility | Timescale |
|---|---|---|---|---|
| **Treasury Management Strategy and criteria for lending** | | | | |
| 1.1 | The Council should consider the extent to which it invests in financial institutions that are placed on Negative Outlook or Ratings Watch by credit ratings agencies, regardless of whether they meet the other minimum lending criteria at the time of the investment decision. | The new Treasury Management Strategy (TMS) was approved by Full Council on 10 February 2009. The new strategy requires significantly more restrictive practices regarding investments and requires them to be placed only with banks and building societies (on a term or certificate of deposit basis) that have a minimum AA- long term credit rating and F1+ short term rating and are participants in the UK Government's Credit Guarantee Scheme (CGS).<br>In relation to institutions placed on 'negative rating watch' or 'outlook', whilst a blanket approach to not placing deposits with institutions with this flag is preferable, the Council's practice will be to undertake an individual assessment and consideration will then be given at a senior level before any investment decision is made. This will apply to the individual rating of the institution too. This will take into account other factors such as government support and level of existing rating. The Chief Financial Officer will consider these assessments. | Head of Finance – Treasury and Pensions | In place |
| 1.2 | The Council should consider using a matrix of | The Council's new TMS goes further | Head of Finance | In place |

| Ref | Recommendation | Management Response | Responsibility | Timescale |
|---|---|---|---|---|
| | counterparty limits dependent on the credit ratings of institutions. | than this recommendation is suggesting by only investing with banks and building societies (on a term or certificate of deposit basis) that have a minimum AA- long term credit rating and F1+ short term rating and are participants in the UK Government's Credit Guarantee Scheme (CGS). | – Treasury and Pensions | |
| 1.3 | The geographical concentration of investments should be considered with thresholds stipulated as part of the Council's investment policy. | As 1.2 above, the Council's new TMS goes further than this recommendation is suggesting by limiting investments to those covered by the UK Government's CGS. | Head of Finance – Treasury and Pensions | In place |
| 1.4 | The Treasury Management Strategy should be formally reviewed on a quarterly basis and meetings should be held between the lead Member and the Chief Financial Officer as part of this review. | Future reviews of the TMS will take this into account. This practice is now agreed and the first of the new quarterly review reports will be taken to the Council's General Purposes Committee on 7th July 2009. | Head of Corporate Finance/Chief Financial Officer | July 09 |
| **Process for review and consideration of information to inform risk and investment decisions** | | | | |
| 1.5 | A formal process for reviewing Sector Treasury Services Limited ("Sector") communications on a daily basis should be established; this process should be documented and a record or log should be maintained to demonstrate that Sector advice has been considered by officers with comments, where appropriate, noting the Council's response to the advice received. | The Council is now working with a new Treasury Management Adviser; Arlingclose. This recommendation, therefore, is deemed to refer now to this company. A formal review and logging process for Arlingclose communications is in place. | Head of Finance – Treasury and Pensions | In place |
| **Recognition of banking groups in forming the counterparty list** | | | | |

| Ref | Recommendation | Management Response | Responsibility | Timescale |
|---|---|---|---|---|
| 1.6 | The Council should consider applying the current counterparty limit to the collective banks within a group, rather than to individual institutions. | The Council's new TMS ensures that group arrangements are taken account of. | Head of Finance – Treasury and Pensions | In place |
| 1.7 | The interdependencies between groups of banks should be identified and recorded so that counterparty limits can be applied by officers, independently from the advice received from Sector. | The Council's new TM advisers, Arlingclose, provide a daily update of the current status of the permitted institutions. This update includes group and interdependency information. Notwithstanding this, the current TMS requires these factors to be taken account of when making investments. | Head of Finance – Treasury and Pensions | In place |
| **Treasury management/investment function** | | | | |
| 1.8 | A review of the treasury management function should be undertaken to assess the increased role it has to play in the Council as a source of income generation and the heightened financial risks attached to this activity.<br>A review of the skills and competencies required in the department for those who are investing public money on a daily basis should be performed. An individual with the relevant experience and knowledge to interpret market data and information (in addition to credit ratings) that reflect the creditworthiness of an institution could potentially add to the skills set within the treasury management function. Alternatively, external advice which would bring such knowledge should be sought. | The Chief Financial Officer is carrying out a skills and competency review of the current treasury function and the Treasury and Pensions Team within Corporate Finance. | Chief Financial Officer | July 2009 |
| **Compliance with daily authorisation limits** | | | | |
| 1.9 | Compliance with daily authorisation limits | A revised process is now in place | Head of Finance | In place |

| Ref | Recommendation | Management Response | Responsibility | Timescale |
| --- | --- | --- | --- | --- |
| | should be checked on a daily basis.<br>Officers should maintain compliance with the daily authorisation limits which are set out in the Council's documented procedures. Where the lending limit is exceeded by a particular deal(s) on a given day, retrospective countersignatures should be sought as soon as possible by an officer with sufficient delegated authorisation. | which requires officers to certify they have checked and are complying with daily authorisation limits. An audit trail exists for this process. | – Treasury and Pensions | |

**Appendix F-** Recommendations of Audit Commission concerning Icelandic Investments

| Ref | Recommendation | Management Response | Responsibility | Timescale |
|---|---|---|---|---|
| 2.1 | The Council should set the treasury management framework so that the organisation is explicit about the level of risk it accepts and the balance between security and liquidity and the yield to be achieved. At the highest level, the organisation should decide whether it has:<br>• appetite and capability to be able to manage risk by placing funds with financial institutions; or<br>• no appetite and/or sufficient capability to manage the risk of placing funds in the market, and should instead place funds with the UK government's Debt Management Office. | The Council's new Treasury Management Strategy (TMS) was approved by Full Council on 10 February 2009. The new strategy requires restrictive practices regarding investments and requires them to be placed only with banks and building societies (on a term or certificate of deposit basis) that have a minimum AA- long term credit rating and F1+ short term rating <u>and</u> are participants in the UK Government's Credit Guarantee Scheme (CGS). Use of the Debt Management Office is specifically allowed in the strategy. The issue of risk has been fully addressed in the new TMS and in consultation with our advisers Arlingclose. On-going review of the suitability of the strategy is currently in place. | Head of Corporate Finance/Chief Financial Officer | In place |
| 2.2 | The Council should ensure that treasury management policies:<br>• follow the revised CIPFA code of practice;<br>• are scrutinised in detail by a specialist committee, usually the audit committee, before being accepted by the authority; and<br>• are monitored regularly. | The new TMS fully complies with the current CIPFA code of practice but will be revised in light of the new code to be issued by CIPFA later this year. | Head of Corporate Finance/Chief Financial Officer | October 2009 |

| Ref | Recommendation | Management Response | Responsibility | Timescale |
|---|---|---|---|---|
| 2.3 | The Council should ensure that elected Members receive regular updates on the full range of risks being run. | The Council has now instituted a process of quarterly Treasury Management review reports which will be taken to the Council's General Purposes Committee. The first of these review reports will be presented at the committee meeting scheduled for 7th July 2009. | Head of Corporate Finance/Chief Financial Officer | July 2009 |
| 2.4 | The Council should ensure that the treasury management function is appropriately resourced, commensurate with the risks involved. Staff should have the right skills and have access to information and external advice. | The Chief Financial Officer is carrying out a skills and competency review of the current Treasury and Pensions Team. Additionally, the Council's new Treasury Management adviser, Arlingclose, is running workshops for the Council's staff and attends regular meetings with Council officers providing appropriate advice. | Chief Financial Officer | August 2009 |
| 2.5 | The Council should ensure that the elected Members of authorities who have accountability for thee stewardship of public money are trained so that they are able to scrutinise effectively and be accountable for the treasury management function. | It is planned to institute a member training module on Treasury Management that will be provided on a suitably regular basis. | Head of Corporate Finance | July 2009 |
| 2.6 | The Council should ensure that the full range of options for managing funds is considered, and note that early repayment of loans, or not borrowing money ahead of need may reduce risks. | The Council is considering the full range of options for managing funds on the advice of the new Treasury Management advisers. Full consideration of options is being undertaken. | Head of Corporate Finance/Chief Financial Officer | On-going |
| 2.7 | The Council should ensure that the fullest range of information is used before deciding where to deposit funds. | The TMS provides for this and the new contract with Arlingclose also incorporates additional information requirements. | Head of Finance – Treasury and Pensions | In place |

| Ref | Recommendation | Management Response | Responsibility | Timescale |
|---|---|---|---|---|
| 2.8 | The Council should ensure that the roles of external advisers are clear and that it is recognised that local authorities remain accountable for decisions made. | The Council recognises in the TMS that it is accountable for investment decisions made. The Council's new treasury management advisors provide advice and information and this is set out specifically in the contract. | Chief Financial Officer | In place |
| 2.9 | The Council should ensure that economies of scale are sought by sharing resources between authorities or with pension funds, while maintaining separation of those funds. | Consideration will be given in the Chief Financial Officer's review (see 1.8 above) of the Council's Pensions and Treasury Management function. This may involve partnership working with other Local Authorities. | Chief Financial Officer | August 2009 |