Appendix 6

TREASURY MANAGEMENT REPORT

1. The investment market place has been volatile for some time now, particularly since the Icelandic Banking crisis. The recent base rate cuts and gloomy prognosis for the coming twelve months by the Bank of England has now had an effect on investment rates. A few weeks ago we were able to make placements at 6.1%, on the morning of 13 November this had tumbled to 4.3%. If the Bank of England is correct these will fall even more in the coming months. Below is a summary of the actions we have been taking in recent times and proposed changes. In light of the impending further rate reductions this item is coming forward as an urgent decision under the constitution Council decisions criteria.

2. The Treasury Management Strategy is approved every year as part of the budget setting process. The strategy is a flexible one with four levels of investment ceilings and timeframes that money can be placed. The four levels are, Upper, Middle, Lower and Lower Limit 2. For many years the practical implementation of the strategy has been straightforward and has attracted little attention. The developments in the banking sector over the last twelve months has meant this is no longer the case.

3. Stockton's practical application of the strategy has been to follow the guidance of the ratings given to each financial institution, in association with additional information from our financial advisors, Butlers, and an in-house prudent approach of putting the facets of security and liquidity before the aim of securing higher rates of return. Nevertheless the function has earned interest returns that have significantly contributed to the Medium Term Financial Plan. This prudent approach meant that at the time of the Icelandic banking crisis all of Stockton's investments were with solely British institutions. (After the two year guarantee from the Irish Government we have placed some money on overnight call with one of the banks covered by that guarantee).

4. Since the Icelandic crisis occurred Stockton has moved to an even more cautious approach with its investments. In this period investments have only been made for a maximum of three months even when the strategy rating would allow a longer period of investment. There are however some factors that mean this approach needs to be changed. As a consequence of the crisis a number of mergers are taking place, limiting the number of organisations available and we may soon run out of those on our list at their maximum limit. In addition we have been avoiding institutions such as the Northern Rock, who now with Government backing could be deemed to be safer than any of the other banks. Finally base interest rates have been substantially cut by the Bank of England, although this has not yet been fully followed by the commercial banks it is inevitable the gap will narrow in the future. While the Commercial banks retain a higher rate we can invest at a higher rate. Once the gap narrows our investments will be at a lower rate. This means that if we follow a strategy of short term placements for all monies the rate we receive will deteriorate substantially.

5. It is therefore proposed that the following actions are taken:

   1. Northern Rock is reinstated as a suitable investment institution on our list.

   2. Where the rating of an institution now allows a longer term investment we take that opportunity, unless we have any intelligence to suggest the rating is incorrect.

   3. The maximum amount for our top rated institutions within the Treasury Management Strategy is amended, Upper Limit Category, is increased from £12.5m to £20m, and for the Middle Limit Category from £10m to £15m. The latter change in particular will allow Stockton to place more funds with the larger more secure Building Societies, some of who have recently subsumed smaller societies we previously invested with.

      a. The change at 3 does mean our money is not as diversely invested as it has been in the past. There is therefore a greater risk should one of the more highly rated institutions that is considered safe collapse. An alternative would be to put money into Government Bonds. These produce an extremely low yield. At present a 1 year Bond is 2.54%, a 3 year 3.01%. We would need to deal via a broker and custody arrangements are estimated to be in the region of £20,000 per annum. The investment though would be extremely safe. The officers who control treasury management do not believe this is the right option, but Members may wish to consider it.

      b. The proposed changes 1 and 2 are allowable without a change to the Treasury Management Strategy they are there to inform Members of a change of direction in applying that strategy. Change number 3 is a divergence from the strategy that would normally require a Council decision but is being brought forward for an urgent decision, as allowed by the constitution, due to the rapidly deteriorating circumstances.

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