Report to:

Audit & Governance Committee
Cabinet
Council

Report of Head of Finance

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Wards affected: all

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To:	AUDIT & GOVERNANCE COMMITTEE on	27 January 2014
	CABINET on	7 February 2014
	COUNCIL on	19 February 2014

Treasury management mid-year monitoring report 2013/14

Recommendations

That Audit and Governance Committee:

1. notes the treasury management mid year monitoring report 2013/14, and

2. is satisfied that the treasury activities are carried out in accordance with the treasury management strategy and policy.

That Cabinet:

3. considers any comments from Audit & Governance Committee and recommends council to approve the report.

Purpose of report

1. The report fulfils the legislative requirements to ensure the adequate monitoring of the treasury management activities and that the council's prudential indicators are reported to council in year. The report provides details of the treasury activities for

the first six months of 2013/14 and an update on the current economic conditions with a view to the remainder of the year.

Strategic objectives

2. An effective treasury management is required in order to meet our strategic objective of managing our business effectively. Managing the finances of the authority in accordance with the treasury management strategy will help to ensure that resources are available to deliver its services and meet the council's other strategic objectives.

Background

3. The council's treasury activities are strictly regulated by legislation. The CIPFA Prudential Code and CIPFA Treasury Management Code of Practice requires a monitoring report to be provided mid year to council. The report covers the treasury activity for the period 1 April 2013 to 30 September 2013.

4. The 2013/14 Treasury Management Strategy was approved by council on 20 February 2013. This report provides details on the treasury activity and performance for the first six months of 2013/14 against prudential indicators and benchmarks set for the year. It is also an opportunity to review and revise the limits if required. Full council is required to approve this report and amendments to the Treasury Management Strategy.

The economy and interest rates

5. An update on the economic conditions and interest rate forecasts is in appendix A.

Icelandic banks – Landsbanki

6. The council has now received £531,286 in respect of the claim for £1 million (plus interest due of £4,890) from the investment made with the failed Icelandic bank Landsbanki Islands hf. The Icelandic Supreme Court found in favour of UK local authorities to be paid before non-priority creditors and the council now expects to get back 100 per cent of the money deposited in Landsbanki.

Investments

7. The council's investments at 30 September 2013 were as follows (not including that with Landsbanki as above):

Table 1: maturity structure of investments at 30 September 2013:		
Call	13,000	29%
Money market fund	8,735	20%
Up to 4 months	6,000	14%
5-6 months	8,500	19%
6 months to 1 year	4,000	9%
Local authority	2,000	5%
CCLA - property fund	2,000	5%
Total investments	**44,235**	**100%**

8. The council currently holds the majority of its investments in the form of cash deposits, most of which have been placed for fixed terms with a fixed investment return. Almost half of the investment portfolio is currently held in call accounts.

9. During the first half of the year £2 million was placed in a pooled property fund with the CCLA. Moving cash invested directly in fixed cash deposits improves investment spread across sectors. Although the intention is to hold monies in the fund for the longer term, the property fund could be sold quickly if required for liquidity purposes.

10. Money market rates have fallen significantly. One year rates have dropped by over one and quarter per cent. The government's Funding for Lending Scheme (FLS) has provided access to cheap borrowing for both banks and building societies. This has reduced the demand within the money markets significantly and had a real impact on the investment rates. It has been difficult to find re-investment opportunities which also meet the security and risk criteria at the same rates as previously obtained.

11. The investment income earned for the first six months is shown in table 2 below.

Table 2: Investment interest earned by investment type
Interest earned April 2013 - September 2013

Investment type	**Annual budget £000**	**Actual to date £000**	**Annual forecast £000**	**Forecast variation £000**
Call accounts	132	35	102	(30)
Cash deposits	104	70	216	112
MMFs	0	1	1	1
CCLA	120	14	110	(10)
	356	**120**	**429**	**73**

Treasury activity

12. Interest earned in the first six months of the year totalled £120,000 on an average balance of £43 million. The forecast for the year is now estimated at £429,000. This equates to an average rate of return of 1.73 per cent. The benchmark for the period (3 month LIBID) was equivalent to an annual rate of 0.38 per cent.

13. Market rates are significantly lower than they were a year ago. The government's Funding for Lending Scheme (FLS) has lowered bank funding costs and has been

extended to building societies. This access to cheaper borrowing is a key factor in the fall in market rates now available.

14. In order to widen the investment portfolio, officers have been seeking longer term investment opportunities with local authorities. In August 2013, a loan was agreed with Kingston upon Hull City Council for a period of seven years.

15. The weighted average maturity period of investments is now 189 days. As a result of the many banking downgrades, there are now fewer financial institutions meeting the council's investment criteria. When it is possible, investments will be placed with highly rated institutions with a view to increasing the weighted average maturity of the portfolio.

Performance measurement

16. A list of investments as at 30 September is shown in appendix B. All investments were with approved counterparties. The average level of investments held was £43 million and the average return on these investments is shown below in table 3. This shows in summary the performance of the council's investments against the benchmarks set out in the Treasury Management Strategy. These benchmarks are used to assess and monitor the council's investment performance for each type of investment.

Table 3: investment returns achieved against benchmark

	Benchmark return	Actual return	Growth (below)/above benchmark	Benchmarks
	%	%	%	
Bank & building society deposits	0.38%	1.73%	1.35%	3 month LIBID

Treasury management limits on activity

17. The council is required by the Prudential Code to report on the limits set each year in the Treasury Management Strategy. The purpose of these limits is to ensure that the activity of the treasury function remains within certain parameters, thereby mitigating risk and reducing the impact of an adverse movement in interest rates. However, if these limits are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The limits and our performance are shown in appendix C.

Debt activity during 2013/14

18. During the first six months of 2013/14 there has been no need for the council to borrow. The council will continue to take a prudent approach to its debt strategy. The prudential indicators and limits set out in appendix C provide the scope and flexibility for the council to borrow in the short-term up to the maximum limits if

such a need arose within the cash flow management activities of the authority for the achievement of its service objectives.

Financial implications

19. A year ago, forecasts were that inflationary pressures would mean that interest rates would have to start rising towards the end of 2013. This has not happened and the current outlook for growth for the UK economy means interest rates are very low and likely to remain so. Investments made early in 2013 should increase the interest earned on investments for 2013/14 by over £70,000. However from 2014, income may reduce for a year or so until market rates rise. This will be reflected in the council's medium term financial plan.

Legal implications

20. There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services, the DCLG Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

Conclusion

21. This report provides details of the treasury management activities for the period 1 April 2013 to 30 September 2013 and the mid year prudential indicators to council.

22. These details confirm that treasury activities have operated within the agreed parameters set out in the approved treasury management strategy and provides the monitoring information for audit and governance committee to fulfil the role of scrutinising treasury management activity.

Background papers

- CIPFA Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes (revised 2011)
- CIPFA Prudential Code for Capital Finance in Local Authorities
- Various committee reports, principally:-

    I. Treasury Management Investment Strategy 2013/14 (cabinet 8 February 2013, council 20 February 2013)

Appendices

A – Economic update and interest rates
B – List of investments as at 30.9.13
C – Prudential Indicators

Economic Update and interest rates

1. UK is in a period of sustained growth in 2013 as the economic recovery since 2008 had been the worst and slowest in recent history. All three main sectors, construction, services and manufacturing contributed to this upturn.

2. Growth is expected to be strong in the immediate future. One downside is that wage increases continue to remain significantly below CPI inflation so disposable income and living standards are under pressure.

3. The Euro region returned to growth in 2013, ending seven quarters of recession. However, growth is still weak but the ECB has declared it would do whatever it takes to stabilise the Eurozone including buying unlimited amounts of bonds of countries asking for a bailout.

4. The government's 'Funding for Lending Scheme' (FLS) has been introduced to improve access to mortgages at lower rates. The FLS certainly seems to be having a positive effect in terms of encouraging house purchases. While there have been concerns that these schemes are creating a bubble in the housing market, the house price increases outside of London and the south-east have been minimal. However bank lending to small and medium enterprises still remains weak as banks continue to repair their balance sheets and anticipating tightening of regulatory requirements.

5. Investor demand in UK gilts as a 'safe haven' continues to keep yield increases down. Long term rates will eventually rise, mainly due to the fact that high volumes of gilts have been issued already in the UK and also in other major western countries. Increasing investor confidence is also likely to compound the effect.

6. The Bank of England issued forward guidance in August which said that the Bank will not start to consider raising interest rates until the jobless rate has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years in August, but revised to possibly quarter 4 2014 in November.

7. Concerns over investment counterparty risk remain because of the volatile economic conditions. However the council's current treasury management policy manages this risk down to a low level.

Interest rates

8. The Bank of England changed its forecast significantly in the August Inflation report and upgraded growth predictions from 1.2% to 1.6% in 2013 and 1.7% to 2.8% in 2014.

9. Bank rate remained unchanged at 0.5% throughout the first half of 2013/14. The earlier forecast of a rate rise in Q4 of 2014 has been postponed until Q2 in 2016.

10. Deposits rates have fluctuated in a very narrow range during the first six months of the financial year. Investment rates have remained flat with a range between 0.5 per cent to around 1.0 per cent for up to a year's maturity. This has dropped significantly as banks and building societies were offered further cheap cash supply via the FLS. The short term rates from one month to six months offer very little differential with six month rates ranging between 0.37 per cent and 0.55 per cent.

11. Sector's forecast of the expected movement in medium term interest rates:

	NOW	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3 month LIBID	0.39	0.40	0.50	0.50	0.50	0.50	0.50	0.50
6 month LIBID	0.47	0.50	0.60	0.60	0.60	0.60	0.60	0.60
12 month LIBID	0.74	0.80	0.80	0.80	0.80	0.80	0.80	0.80
5 yr PWLB	2.20	2.20	2.50	2.50	2.60	2.70	2.70	2.80
10 yr PWLB	3.40	3.30	3.60	3.60	3.70	3.80	3.80	3.90
25 yr PWLB	4.30	4.20	4.40	4.40	4.50	4.50	4.60	4.60
50 yr PWLB	4.30	4.30	4.40	4.40	4.50	4.50	4.60	4.70
	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
BANK RATE	0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.25
3 month LIBID	0.50	0.50	0.50	0.50	0.60	0.70	0.90	1.30
6 month LIBID	0.60	0.60	0.60	0.70	0.80	1.00	1.20	1.40
12 month LIBID	0.80	1.00	1.20	1.40	1.60	1.80	2.00	2.30
5 yr PWLB	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.40
10 yr PWLB	3.90	4.00	4.10	4.20	4.30	4.30	4.40	4.50
25 yr PWLB	4.70	4.80	4.90	5.00	5.10	5.10	5.10	5.10
50 yr PWLB	4.80	4.90	5.00	5.10	5.20	5.20	5.20	5.20

Investments as at 30 September 2013			
Counterparty	**Deposit type**	**Principal**	**Rate**
West Bromwich Building Society	Fixed	3,000,000	1.00%
Newcastle Building Society	Fixed	2,000,000	0.90%
Manchester Building Society	Fixed	2,000,000	0.90%
Nottingham Building Society	Fixed	2,000,000	0.85%
National Counties Building Society	Fixed	1,500,000	0.90%
Tipton & Coseley Building Society	Fixed	1,000,000	0.61%
West Bromwich Building Society	Fixed	1,000,000	0.60%
Market Harborough Building Society	Fixed	2,000,000	0.61%
Lloyds TSB Bank Plc	Fixed	3,000,000	1.01%
Kingston upon Hull City Council	Fixed	2,000,000	2.70%
National Counties Building Society	Fixed	1,000,000	1.00%
Royal Bank of Scotland	Call	10,000,000	1.05%
Santander	Call	3,000,000	0.80%
Goldman Sachs	MMF	8,735,000	Variable
CCLA	Property	2,000,000	Variable
Total Investments		44,235,000	

Prudential indicators as at 30th September 2013		
	2013/14 Original estimate	Actual as at 30-Sep
Debt	**£m**	**£m**
Authorised limit for external debt		
Borrowing	10	0
Other long term liabilities	5	0
	15	**0**
Operational boundary for external debt		
Borrowing	2	0
Other long term liabilities	.	0
	2	**0**
Interest rate exposures		
Maximum fixed rate borrowing	0	**0**
Maximum variable rate borrowing	0	**0**
Investments		
Interest rate exposures		
Limits on fixed interest rates	40	34
Limits on variable interest rates	30	11
Principal sums invested > 364 days		
Upper limit for principal sums invested >364 days	30	2