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	22 January 2015
	CABINET on	6 February 2015
	COUNCIL on	18 February 2015

Treasury management mid-year monitoring report 2014/15

Recommendations

That Audit and Governance Committee:

1. notes the treasury management mid year monitoring report 2014/15, 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. This 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. This report provides details of the treasury activities for the first six months of 2014/15 and an update on the current economic conditions with a view to the remainder of the year.

Strategic objectives

2. An effective treasury management function 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 strategic objectives.

Background

3. The council's treasury activities are strictly regulated by legislation. The CIPFA Prudential Code and CIPFA Code of Practice for Treasury Management requires a monitoring report to be provided mid year to council. The report covers the treasury activity for the period 1 April 2014 to 30 September 2014.

4. The 2014/14 Treasury Management Strategy was approved by council on 19 February 2014. This report provides details on the treasury activity and performance for the first six months of 2014/15 against prudential indicators and benchmarks set for the year. It is also an opportunity to review and revise the limits if required. 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. On the 24 September 2008 the council deposited £1 million with Landsbanki Islands hf at an interest rate of 5.95 per cent. The investment principal and accrued interest (a total sum of £1,004,890.41) was due to be repaid on 24 October 2008 however the bank entered administration on 7 October 2008.

7. To date, the council has received £531,286 under the winding up process in part repayment of the original debt. The Icelandic Supreme Court had found in favour of UK local authorities to be paid before non-priority creditors of Landsbanki and so previously the council had expected to receive 100 per cent of the money deposited with the bank. Subsequently, there has been uncertainty over possible changes to legislation in Iceland which may prohibit funds being released outside of the country.

8. Due to this uncertainty over the timing and access to the balance owed, as at the end of September 2014 the council is, in common with other local authority creditors of Landsbanki, considering the sale of its remaining interest in the debt via the financial markets. Any such disposal is highly likely to be made at a discount to the face value although the final value potentially achievable will depend on a number of market factors. This discount will however be offset by the certainty of return and the time value of money.

Investments

9. The council's investments at 30 September 2014 (not including that with Landsbanki) are shown in Table 1, below.

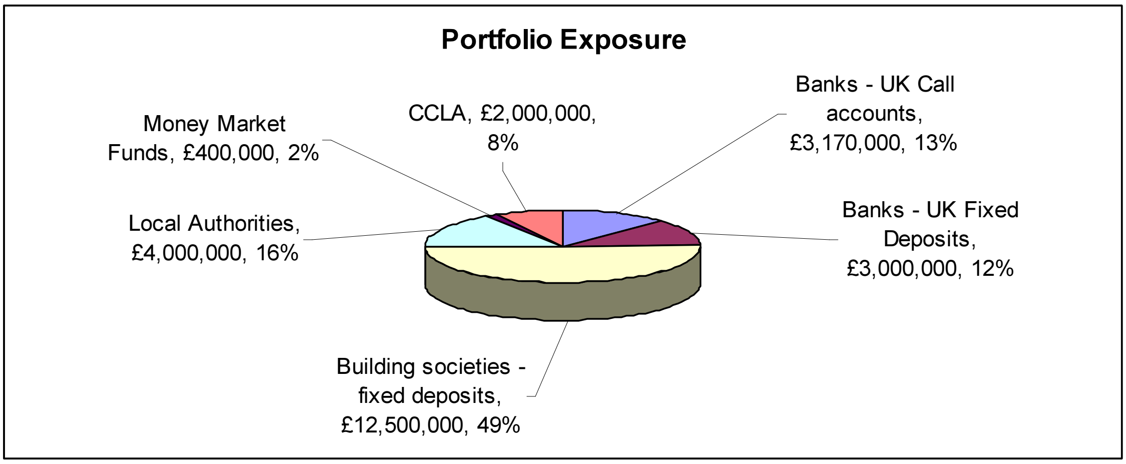
Table 1: maturity structure of investments:				
	Classification of investment at deal date		Classification as at 30/09/14	
	£'000		£'000	
Call	3,170	13%	3,170	13%
Money market fund	400	2%	400	2%
Less than 6 months	2,000	8%	11,500	46%
6 months to 1 year	13,500	54%	4,000	16%
1 year + (loans to other local authorities)	4,000	16%	4,000	16%
CCLA - property fund	2,000	8%	2,000	8%
Total investments	**25,070**	**100%**	**25,070**	**100%**

10. In 2013/14 the council invested £2 million in a pooled property fund with the CCLA. Although the intention remains to hold monies in the fund for the longer term, this pooled property fund holding could be sold quickly if required for liquidity purposes.

11. The council continues to hold 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.

12. Money market rates have remained low in the financial year to date. The Funding for Lending Scheme (FLS) provided access to low rate, government funded borrowing for both banks and building societies, allowing participants to borrow from the FLS until January 2015. This has reduced the demand within the money markets significantly and has had a real impact on investment rates. It continues to be challenging to find re-investment opportunities which also meet the security and risk criteria at the same rates as previously obtained.

13. The chart below shows in percentage terms how the portfolio is spread across the types of investments.



14. The investment income earned for the first six months of 2014/15 is shown in table 2 below.

Table 2: Investment interest earned by investment type Interest earned April 2014 - September 2014				
Investment type	**Annual budget £000**	**Actual to date £000**	**Annual forecast £000**	**Forecast variation £000**
Call accounts	132	41	68	(64)
Cash deposits	104	122	221	117
MMFs	0	3	4	4
CCLA	120	60	119	(1)
	356	**226**	**412**	**56**

Treasury activity

15. The Funding for Lending Scheme (FLS) lowered funding costs for banks and building societies. This access to cheaper borrowing is a key factor in the fall in market rates currently available. Longer term investment rates with high quality counterparties remain low, restricting the ability to place investments of greater than 12 months duration.

16. As at the end of September 2014, the weighted average maturity period of investments was 464 days. This is higher than that at the equivalent period last year, reflecting the change from balances held in call accounts and the placing in January 2014 of a seven year investment with Kingston upon Hull City Council. As a result of the many banking downgrades, there are now fewer financial institutions that meet the council's investment criteria. When it is possible, investments will be placed with high rated institutions for a longer duration with a view to spreading the council's risk exposure whilst maintaining the weighted average maturity of the portfolio.

17. Despite the challenging market conditions, interest earned in the first six months of the year totalled £226,000. The forecast for the year is now estimated at £412,000 (2013/14 actual outturn £478,000).

Performance measurement

18. A list of investments as at 30 September is shown in appendix B. All investments were with approved counterparties. 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
	%	%	%	
Total investments	0.42%	1.48%	1.06%	3 month LIBID

Treasury management limits on activity

19. 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 2014/15

20. During the first six months of 2014/15 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 long term up to the maximum limits for the achievement of its service objectives and the annual Treasury Management Strategy (TMS) also permits short-term borrowing if such a need arose for the cash flow management requirements of the authority.

Financial implications

21. Recent economic data has shown continued growth in UK GDP, improving sentiment in the services and construction sectors and falling levels of unemployment. Despite this, the Bank of England's Monetary Policy Committee continues to take a cautious view on rates and the projection from the council's treasury advisors (Capita Asset Services) is that falling rates of inflation have reduced the likelihood of a rise in official rates before the second quarter of 2015. It is estimated that when rates do rise, they will do so slowly due to concerns over the sustainability of the recovery and the continuing levels of high personal indebtedness.

22. Investments made early in 2014 should increase the interest earned on investments for 2014/15 by over £50,000. The level of uncertainty over the strength of the economic recovery to a rise in official rates will continue to

suppress investment income returns going forward and this will be reflected in the council's medium term financial plan.

Legal implications

23. 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 and the CLG Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

Conclusion

24. This report provides details of the treasury management activities for the period 1 April 2014 to 30 September 2014 and the mid year prudential indicators to council.

25. 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 (2011 edition)
- Various committee reports, principally:-

    I. Treasury Management Investment Strategy 2014/15 (cabinet 7 February 2014, council 19 February 2014)

Appendices

A – Economic update and interest rates
B – List of investments as at 30.9.14
C – Prudential Indicators

Economic Update and interest rates

1. There was strong growth in UK Gross Domestic Product in quarters 2-4 of the 2013 calendar year. Quarter 1 and 2 of 2014 continued this trend and surveys in the services and construction sector have revealed encouraging business sentiment.

2. The overall strong growth has seen unemployment fall below the threshold of 7% originally earmarked by the Bank of England Monetary Police Committee (MPC) as the level below which unemployment had to fall before it would consider an increase in the bank base rate.

3. The MPC subsequently broadened its forward guidance by looking at a much broader range of indicators in order to form a view on when rates should rise. The MPC is particularly concerned that wage inflation needs to rise above the level of general inflation (a real terms rise in wages) for the economic recovery to be sustainable.

4. Growth is expected to peak in 2014 and tail off slightly into 2015 and 2016. Unemployment is expected to continue on a downward trend and this is expected to significant increases in pay rates at some point in the next three years.

5. In the global economy, the United States demonstrated disappointing quarter 1 GDP figures, but quarter 2 figures rebounded strongly. On the other hand, the Eurozone area is facing an increasing threat from deflation. Greece continues to struggle with implementing fiscal controls and the second and third largest European economies – France and Italy – are struggling to enforce their own austerity programmes.

6. In the UK, inflation has also fallen (Consumer Price Inflation fell to 1.2% in September 2014 from 1.5% in August), reflecting cheaper transport costs, lower energy and food prices. In reaction to this data and uncertainty in the Middle East, UK government bond prices rose to their highest level in over a year as investors sought a safe haven. Bond yields have fallen accordingly, with 10-year gilts falling from 2.13% to under 2% - the lowest since June 2013.

7. The fall in UK inflation and the weakening in the Eurozone area has increased market speculation that any move to increase Bank of England base rates will now be delayed until later in 2015.

8. Concerns over investment counterparty risk remain because of the wider economic conditions. However the council's current treasury management policy aims to manage this risk down to a low level.

Interest rates

9. The bank rate remained unchanged at 0.5 per cent throughout the first half of 2014/15. The council's treasury advisor, Capita Asset Services, has undertaken a review of interest rate forecasts. The current period of strong economic growth in the UK remains vulnerable to a downturn in the Eurozone area and there are concerns that UK growth is currently over dependent on consumer spending and the strength of the housing market. Consequently, whilst the expectation remains that bank rates will rise in the next financial year, the latest projection from Capita Asset Services is that the first increase in bank rate will not happen until the second quarter of 2015.

10. The Governor of the Bank of England has signalled that any increase in base rates will be slow and gradual as the MPC is concerned about the impact that increases will have on heavily indebted consumers, especially given that wage inflation is running significantly below the rate of CPI inflation.

11. Capita Asset Service’s forecast of the expected movement in medium term interest rates is shown in the table below:

	NOW	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
BANK RATE	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	2.00	2.25	2.50
3 month LIBID	0.50	0.50	0.60	0.80	0.90	1.10	1.30	1.40	1.60	1.90	2.10	2.10	2.30	2.40	2.60
6 month LIBID	0.65	0.70	0.80	1.00	1.10	1.20	1.40	1.50	1.80	2.00	2.20	2.30	2.50	2.70	2.80
12 month LIBID	0.93	0.90	1.00	1.20	1.30	1.40	1.70	1.80	2.10	2.20	2.30	2.40	2.60	2.80	3.00
5 yr PWLB	2.40	2.50	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.50	3.50	3.50
10 yr PWLB	3.00	3.20	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.10	4.10	4.20	4.20	4.30	4.30
25 yr PWLB	3.70	3.90	4.00	4.10	4.30	4.40	4.50	4.60	4.70	4.70	4.80	4.80	4.90	4.90	5.00
50 yr PWLB	3.70	3.90	4.00	4.10	4.30	4.40	4.50	4.60	4.70	4.70	4.80	4.80	4.90	4.90	5.00

Appendix B

Investments as at 30 September 2014					
Counterparty	**Deposit type**	**Maturity date**	**Total investment duration in days**	**Principal**	**Rate**
Progressive Building Society	Fixed	03/10/2014	304	1,500,000	0.85%
Manchester Building Society	Fixed	24/10/2014	273	2,000,000	0.90%
Close Brothers Ltd	Fixed	18/11/2014	364	1,000,000	1.05%
Skipton Building Society	Fixed	19/11/2014	174	2,000,000	0.62%
Lloyds Bank PLC	Fixed	04/12/2014	364	2,000,000	0.98%
Principality Building Society	Fixed	14/01/2015	364	2,000,000	0.88%
National Counties Building Society	Fixed	23/03/2015	276	1,000,000	0.82%
West Bromwich Building Society	Fixed	30/06/2015	365	3,000,000	1.05%
Progressive Building Society	Fixed	01/07/2015	303	1,000,000	0.85%
Santander	Call *			2,670,000	0.90%
Lloyds Bank PLC	Call *			500,000	0.40%
Goldman Sachs	MMF *			400,000	0.41%
Total short term cash investments (<1 yr duration)				**19,070,000**	
Kingston Upon Hull City Council	Fixed	19/08/2020	2,557	2,000,000	2.70%
Kingston Upon Hull City Council	Fixed	15/01/2021	2,557	2,000,000	2.50%
Total long-term cash investments (>1 yr duration)				**4,000,000**	
CCLA	Property			2,000,000	variable
Total Investments				**25,070,000**	

** Rates are variable. Returns shown represent prevailing rates at end Q2 2014.*

Above figures exclude balance outstanding from Landsbanki

Prudential indicators as at 30th September 2014	2014/15 Original estimate £m	Actual as at 30-Sep £m
Debt		
Authorised limit for external debt		
Borrowing	30	0
Other long term liabilities	5	0
	35	**0**
Operational boundary for external debt		
Borrowing	25	0
Other long term liabilities	0	0
	25	**0**
Interest rate exposures		
Maximum fixed rate borrowing	100%	**0**
Maximum variable rate borrowing	100%	**0**
Investments		
Interest rate exposures		
Limits on fixed interest rates	60	19.5
Limits on variable interest rates	30	5.5
Principal sums invested > 364 days		
Upper limit for principal sums invested >364 days	30	6