29 October 2014

Finance and Resources Committee

Treasury Management Mid-Year Review Report 2014/15

Report of: *Jo-Anne Ireland, Acting Chief Executive*

Wards Affected: *All*

This report is: *Public*

1. Executive Summary

1.1 The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Council on 5 March 2014.

1.2 The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a Code of Practice for Treasury Management. The Code suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Authority is embracing best practice and meeting the statutory requirements.

1.3 The legal status of the Code is derived from regulations issued under the Local Government Act 2003 which require local authorities to "have regard to guidance that the Secretary of State may by regulations specify." The Code and the CIPFA Prudential Code fall into this category.

2. Recommendation(s)

2.1 To note the treasury activity for the period 1 April 2014 to 30 September 2014.

2.2 To approve changes to the credit methodology where viability, financial strength and support ratings will not be considered as key criteria in the choice of investment counterparties.

3. Introduction and Background

3.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was formally adopted by

Council on 5 March 2014. The primary requirements of the Code are as follows:

- The creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- The creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- To provide full council with the following reports:
    a. an Annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead,
    b. a **Mid-year Review Report**.
    c. an Annual Report (stewardship report) covering activities during the previous year.
- The delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

3.2 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2014/15 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2014/15;
- A review of the Council's borrowing strategy for 2014/15;
- The Council's capital expenditure (prudential indicators);
- A review of compliance with Treasury and Prudential Limits for 2014/15.

3.3 A recommended key change to the Treasury and Capital Strategies is to amend the credit methodology in order to remove the following criteria:

- Viability / financial strength – C (Fitch / Moody's only)
- Support – 3 (Fitch only)

Further details of the changes are provided in sections 4.4 to 4.9 of the report.

4 Issues, Options and Analysis of Options

Economic update

4.1 UK GDP growth continued in the first six months of 2014 and forecasts indicate this will continue, however to remain sustainable in the long-term there needs to be sustainable growth in exports, combined with a reduced reliance on consumer spending and growth in the housing market. Weak economic growth in the UK's main trading partners – the EU and the US could inhibit the economic recovery in the UK.

Key indicators / movements for the UK:

- Strong growth has resulted in unemployment falling faster than the initial 7% threshold set by the Monetary Policy Committee (MPC). As a result the MPC is now looking at a much wider range of approx. 18 indicators to form a view on the economy, and when to raise interest rates. Particular focus is on wage inflation and the amount of disposal income consumers have available, in order to sustain the levels of spending and growth.

- Inflation (CPI) has fallen sharply to 1.5% in May, the lowest rate since July 2009. Forecasts indicate this may fall further.

- A rise in geopolitical concerns, over the Ukraine and the Middle East, has caused a flight into safe haven investments such as gilts, this has increased PWLB rates and the cost of borrowing.

- British manufacturing growth has slowed down to the slowest rate in 17 months, partly due to the strength of sterling and weak demand in Europe.

- The financial markets expect the first increase in Bank Rate to be in the first six months of 2015.

Interest Rate Forecast

4.2 The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%
10yr PWLB rate	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%
25yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%
50yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%

Treasury Management Strategy Statement and Annual Investment Strategy

4.3 The Treasury Management Strategy Statement (TMSS) for 2014/15, which includes the Annual Investment Strategy, was approved by the Council on 5 March 2014. In line with CLG investment guidance it sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

4.4 The underlying TMSS approved for 2014/15 requires revision in the light of rating agency changes. The main Rating agencies (Fitch, Moody's and Standard & Poor's) have historically provided some institutions with a rating uplift due to implied levels of sovereign support. As the regulatory regime changes, these implied sovereign support levels are going to be removed. This will make the Support, Financial Strength and Viability ratings redundant. Therefore changes to the credit methodology will be required to remove the following criteria:

- Viability / financial strength – C (Fitch / Moody's only)
- Support – 3 (Fitch only)

4.5 As a result of these rating agency changes, our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be considered where it relates to these categories. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise other information, such as Credit Default Swaps(CDS) prices, as an overlay to ratings in the revised methodology.

4.6 The revised criteria continues to follow the previously approved minimum rating criteria which uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, then the institution will fall outside the lending criteria.

4.7 Credit rating information is supplied by Capita Asset Services on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

4.8 The criteria for providing a pool of high quality investment counterparties with the time and monetary limits for institutions on the Council's counterparty list are summarised in Table 1:

Table 1: Counterparty minimum criteria			
	Fitch Long Term Rating (or equivalent)	**Money Limit £m**	**Time Limit**
Banks 1 Higher Quality: Credit Suisse International HSBC Bank plc MBNA Bank plc MBNA Europe Bank Standard Chartered Bank UBS Ltd	F1, A	£3m	1yr
Banks 2 Part Nationalised:	N/A		
Bank of Scotland plc		£5m	1yr
Lloyds TSB Bank		£3m	1yr
Royal Bank of Scotland		£5m	1yr
National Westminster Bank		£3m	1yr
UK Building Societies:	A		
Nationwide Building Society		£5m	1yr
Banks 3 Councils Banker (not meeting Banks 1): Co-Operative Bank	F1, A	£3m	1 day
Debt Management Account Deposit Facility (DMADF)	AAA	Unlimited	6 months
Local Authorities	N/A	£5m	1yr
Money Markey Funds	AAA	£3m	1yr

4.9 Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for CDS, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Investment Portfolio 2014/15

4.10 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. The investment market remains very difficult in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

4.11 In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in higher rates in periods up to 12 months, with highly credit rated financial institutions.

4.12 The Council held £5.6m of investments as at 30 September 2014 (£0.5m at 31 March 2014). During the period 1 April to 30 September 2014, the Council placed the following investments:

Table 2: Investments held as at 30 September 2014				
Date Invested	**Date to be Repaid**	**Invested in**	**Investment Amount £**	**Interest Rate %**
28.08.2014	Call	Bank of Scotland	600,000	0.40
19.06.2014	Call	Royal Bank of Scotland	22,000	0.25
29.09.2014	Call	Royal Bank of Scotland	300,000	0.25
16.09.2014	Call	Royal Bank of Scotland	200,000	0.25
16.05.2014	02.02.2015	Nationwide Building Society	2,000,000	0.69
01.07.2014	19.01.2015	Nationwide Building Society	2,500,000	0.65
TOTAL			**5,622 ,000**	

4.13 Surplus funds were held in call accounts held with Bank of Scotland and Royal Bank of Scotland for cash flow purposes.

4.14 As part of the approved Investment Strategy, the Council has approval to use its own banker for transactional purposes. The Council is in the process of changing banks for operational purposes from Co-Op Bank to Lloyds Bank Plc. During this period of change, the Council has not placed any deposits with the Co-Op Bank and has kept any current account balances to a minimum level.

4.15 The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2014/15.

Investment Income

4.16 The Council's budgeted investment return for 2014/15 is £63,000, and performance for the year to date is £2,500 below budget. The interest is lower due to a reduction in rates payable on investments and the call accounts.

Table 3: Investment income earned as at 30 September 2014				
Original Estimate £	**Actual at 30 Sept £**	**% at 30 Sept**	**Estimated Outturn £**	**Outturn Variance**
63,000	29,000	46%	63,000	0

Borrowing

4.17 During the period 1 April to 30 September 2014, no new external loans were taken. Details of all loans held by the Council as at 30 September 2014 are shown in Table 4 :

Table 4: Debt held as at 30 September 2014					
Repayment Date	**Period of Loan (Years)**	**Type of loan**	**Fixed / Variable**	**Interest Rate %**	**Amount Outstanding £**
28/03/2017	5	Maturity	Fixed	1.240%	5,000,000
28/03/2022	10	Maturity	Fixed	2.400%	5,000,000
28/03/2027	15	Maturity	Fixed	3.010%	10,000,000
28/03/2032	20	Maturity	Fixed	3.300%	15,000,000
08/01/2028	25	Maturity	Fixed	4.875%	400,000
28/03/2037	25	Maturity	Fixed	3.440%	15,000,000
28/03/2042	30	Maturity	Fixed	3.500%	14,166,000
24/02/2055	60	Maturity	Fixed	8.875%	800,000
30/04/2055	60	Maturity	Fixed	8.875%	800,000
Total					**66,166,000**

4.18 It is anticipated that further borrowing will not be undertaken during this financial year.

The Council's Capital Position (Prudential Indicators)

4.19 This part of the report provides an update on:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of any changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

4.20 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

4.21 Table 5 below shows the actual capital expenditure together with the expected financing:

Table 5 :Capital Expenditure	2014/15 Original Estimate £m	Current Budget £m	Current Spend 30 Sept £m	At 30 Sept %	2014/15 Estimated Outturn £m
Non HRA	6.676	7.456	0.824	11.1%	3.087
HRA	2.803	3.662	0.905	24.7%	3.662
Total expenditure	**9.479**	**11.118**	**1.729**	**15.6%**	**6.749**
Financed by:					
Capital receipts, grants and contributions	9.479	11.118	1.729	15.6%	6.749
Borrowing for HRA	0	0	0		0
Total financing	**9.479**	**11.118**	**1.729**	**15.6%**	**6.749**
Borrowing need	**0**	**0**	**0**		**0**

The Authorised Limit - is the “affordable borrowing limit” required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level.

The Operational Boundary – the Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Table 6 : Prudential Indicators - Affordability	2014/15 Original Estimate £m	2014/15 Revised Estimate £m
Authorised Limit	**87.0**	**87.0**
Operational Boundary	**85.0**	**85.0**

4.22 Table 7 shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period.

Table 7 :Capital Financing Requirement / External Debt	2014/15 Original Estimate £m	Current Position 30 Sept £m	2014/15 Revised Estimate £m
CFR -Non HRA	7.857	7.857	7.857
CFR -HRA	70.347	70.347	70.347
Total CFR	**78.204**	**78.204**	**78.204**
Borrowing	66.166	66.166	66.166
Other long term liabilities	0.183	0.183	0.183
Total debt @ 31 March	**66.349**	**66.349**	**66.349**
Under/(over) borrowing	**11.855**	**11.855**	**11.855**

4.23 The Council's projected capital financing requirement (CFR) for 2014/15 is £78.204m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 4 shows the Council has borrowings of £66.166m and has utilised approximately £12m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

Summary

4.24 In compliance with the requirements of the CIPFA Code of Practice of Treasury Management, this report provides members with a half year report of the treasury management activities for 2014/15. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken so far, with priority being given to security and liquidity over yield.

4.25 Whilst investment returns are still low as a consequence of the fall in interest rates, the Authority is anticipating that investment returns will meet those originally budgeted. The Council maintains a positive Capital Financing Requirement and any funding issues associated with this position will be managed in accordance with the approved Treasury Management Strategy Statement (TMSS).

5 Reasons for Recommendation

5.1 This report meets the requirements of the CIPFA Code of Practice of Treasury Management.

6 Consultation

6.1 None.

7 References to Corporate Plan

7.1 Sound financial management underpins all of the priorities within the Corporate Plan.

8 Implications

Financial Implications
Name & Title: Jo-Anne Ireland, Acting Chief Executive
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8.1 The financial implications are outlined in the report.

Legal Implications
Name & Title: Chris Potter, Monitoring Officer
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8.2 There are no direct legal implications arising from this report.

9 Background Papers (include their location and identify whether any are exempt or protected by copyright)

9.1 5 March 2014 Treasury Management Strategy Statement 2014/15.

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