



**Audit Committee**  
8 January 2014

**Report from the Chief Finance Officer**

Wards Affected:  
ALL

**2013/14 Mid-Year Treasury Report**

**1. SUMMARY**

- 1.1 This report updates Members on recent treasury activity.

**2. RECOMMENDATION**

- 2.1 The Committee is asked to note the 2013/14 mid-year Treasury report as also submitted to the Council and Executive.

**3. DETAIL**

**BACKGROUND**

- 3.1 The Council's Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.
- 3.2 The Code also recommends that Members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.
- 3.3 Treasury Management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
- 3.4 In addition to reporting on risk management, the Code requires the Authority to report on any financial instruments entered into to manage treasury risks.

**ECONOMIC BACKGROUND**

- 3.5 Growth rates have risen in most major economies in the last six months. The US and Germany continue to grow slowly and the Eurozone as a whole has started to experience slow growth. The UK is now growing comparatively quickly (0.7% growth in the second quarter of 2013) although sustained growth is still to

be delivered. Some developing economies are experiencing reduced growth compared to recent years. However, inflation in the UK is still largely under control with annual growth in the Consumer Price Index currently at 2.7%.

- 3.6 Gilt yields fluctuated in a narrow range for the first half of the year with a slight upward trend but suggestions that the Federal Reserve was on the verge of starting to unwind Quantitative Easing caused interest rates to rise by up to 1% over the summer. The movement in rates at which local authorities can borrow from the Public Works Loans Board (PWLB) is set out in the table below:

Period	March 2013	September 2013
1 year	0.9%	1.1%
5 year	1.6%	2.3%
10 year	2.6%	3.5%

The Federal Reserve's stance seemed to be more influential than the Bank of England's new regime of forward guidance in the short term, as the major moves over the summer reflected developments in the US rather than the UK. Eurozone markets were calm, but the feeling amongst many commentators was that this owed much to the natural summer pause and the (then) approaching election in Germany, and that there are still fundamental problems to be solved in many European economies.

- 3.7 The interest rate the Council receives on money market funds has changed little for 1-12 month maturities during the first half of the year at 0.4%.

#### **DEBT MANAGEMENT**

- 3.8 The Authority continues to qualify for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate). This is reviewed on an annual basis and has been confirmed as applying until 31 October 2014.
- 3.9 Alternative sources of long term funding to long-dated PWLB borrowing are available, but the Council will continue to adopt a cautious and considered approach to funding from the capital markets as the affordability, simplicity and ease of dealing with the PWLB represents a strong advantage. No long term loans have been raised so far this year as is shown in the table below:

	Balance on 01/04/2013 £m	Debt Repaid £m	New Borrowing £m	Balance on 30/09/2013 £m
Short Term Borrowing	0.0	67.0	97.4	30.4
Long Term Borrowing	432.3	2.1	0.0	430.2
<b>TOTAL BORROWING</b>	<b>432.3</b>	<b>69.1</b>	<b>97.4</b>	<b>460.6</b>
Average Rate %	4.69			4.41

- 3.10 Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.
- 3.11 For the Council the use of internal resources in lieu of borrowing has continued to be the most cost effective means of funding capital expenditure. This has lowered overall treasury risk by reducing both external debt and temporary investments. However this position will not be sustainable over the medium term and the Council will need to give careful consideration to its future capital programme and how this is financed in due course. Borrowing options and the

timing of such borrowing will continue to be assessed in conjunction with the Council's treasury advisor, Arlingclose.

- 3.12 No debt rescheduling has been considered in the last half year as present discount rates make the premia involved unattractive.

#### **INVESTMENT ACTIVITY**

- 3.13 The Council gives priority to security and liquidity and aims to achieve a yield commensurate with these principles.

	Balance on 01/04/2013 £m	Investments Made £m	Investments Repaid £m	Balance on 30/09/2013 £m
Short Term Investments	64.7	342.7	305.7	101.7

- 3.14 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14. New investments were made with the following classes of institutions:

A- rated banks;  
AAA rated Money Market Funds;  
Other Local Authorities;  
The UK Debt Management Office.

- 3.15 Counterparty credit quality was assessed and monitored with reference to Credit Ratings (the Council's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, Standard & Poors and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms; potential support from a well-resourced parent institution; share price.

#### **BUDGETED INCOME AND OUTTURN**

- 3.16 The Council's financing charges budget for the year is £26.7m, net of investment income of £0.6m and the latest estimate is that the Council will achieve this figure. The average cash balances, representing the Council's reserves and working balances, were £91m during the period.
- 3.17 The UK Bank Rate has been maintained at 0.5% since March 2009 and is not expected to rise until 2016. Short-term money market rates have remained at very low levels.

#### **ICELANDIC BANK INVESTMENT UPDATE**

##### **Glitnir**

- 3.18 On 16 March 2012 the Council received £4m of its original £5m deposit. A further £1m remains in a ring-fenced account in Icelandic Krone, pending a decision of the Icelandic Central Bank to enable its return. At present the residual deposit is earning interest although the final sum returned to the Council will be affected by currency movements.

##### **Heritable**

- 3.19 The Council received £1.7m in August 2013, which means that only £0.6m of the original £10m deposit now remains outstanding. It is expected that further distributions will be made although there is no indication as to likely amounts.

#### **COMPLIANCE WITH PRUDENTIAL INDICATORS**

- 3.20 Officers confirm that they have complied with its Prudential Indicators for 2013/14, which were set in February 2013 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

#### **OUTLOOK**

- 3.21 At the time of writing this activity report in October 2013, economic growth remains slow but consistent. Tight credit conditions and weak earnings growth, as well as restrictive fiscal policy, are constraining consumer and corporate spending, but growth in real earnings is expected to resume in 2014. The outlook is for official interest rates to remain low for an extended period. Gilt yields rose in response to improved economic news and the prospect of an end to Quantitative Easing in the United States, but only limited rises are anticipated over the next two years. Markets will continue to be affected by the potential for a US sovereign default, although the recent agreement to suspend the debt ceiling until 7 February 2014 provides further time for agreement on the US budget.

#### **SUMMARY**

- 3.22 In compliance with the requirements of the CIPFA Code of Practice this report provides Members with a summary report of the treasury management activity during the first half of 2013/14. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

#### **4. FINANCIAL IMPLICATIONS**

These are covered in the report.

#### **5 DIVERSITY IMPLICATIONS**

None.

#### **6 STAFFING IMPLICATIONS**

None.

#### **7 LEGAL IMPLICATIONS**

None.

#### **8 BACKGROUND**

Annual Treasury Strategy – Report to Full Council as part of the Budget Report – February 2013.

Persons wishing to discuss the above should contact the Anthony Dodridge Treasury and Pension Investments Section, Finance, on 020 8937 1472/74 at Brent Civic Centre.

CONRAD HALL  
Chief Finance Officer

## Appendix 1

### Capital Financing Requirement

Estimates of the Council's cumulative maximum external borrowing requirement for 2013/14 to 2015/16 are shown in the table below (excluding Private Finance Initiative schemes):

	31/03/2013 Actual £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m	31/03/2016 Estimate £m
CFR	559	559	559	552

### Usable Reserves

Estimates of the Council's level of Usable Reserves for 2013/14 to 2015/16 are as follows:

	31/03/2013 Actual £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m	31/03/2016 Estimate £m
Usable Reserves	58	35	24	21

### Prudential Indicator Compliance

#### Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Authorised Borrowing Limit. This is a statutory limit which should not be breached. The Council's Authorised Borrowing Limit was set at £800m for 2013/14. The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2013/14 was set at £700m. The Chief Finance Officer confirms that there were no breaches to the Authorised Limit or the Operational Boundary so far this year; borrowing at its peak was £466m.

#### Upper Limits for Fixed Interest Rate and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2013/14	Maximum during 2013/14
Upper Limit for Fixed Rate Exposure	100%	100%
Upper Limit for Variable Rate Exposure	40%	0%

### Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 30/09/13 £m	% Fixed Rate Borrowing as at 30/09/13	Compliance with Set Limits?
Under 12 months	40	0	34	7	Yes
12 months and within 24 months	20	0	4	1	Yes
24 months and within 5 years	20	0	13	3	Yes
5 years and within 10 years	60	0	25	5	Yes
10 years and above	100	0	385	84	Yes

### Net Debt and the CFR

This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Authority should ensure that the net external borrowing does not exceed the total of the CFR in the preceding year plus the estimates of any additional increases to the CFR for the current and next two financial years.

The Authority had no difficulty meeting this requirement so far in 2013/14, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

### Total principal sums invested for periods longer than 364 days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days.

The limit for 2013/14 was set at £20m.

The Council's practice since the onset of the credit crunch in 2007 has been to keep investment maturities to a maximum of 12 months. At 30 September, the last maturity date in the deposits portfolio was 1 July 2014.

### Credit Risk

This indicator has been incorporated to review the Council's approach to credit risk. The Council confirms it considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not the sole feature in the Authority's assessment of counterparty credit risk. The authority considers the following tools to assess credit risk, with advice and support from our advisers, Arlingclose:

- Published credit ratings of the financial institution and its sovereign;
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, markets sentiment and momentum.

The Council can confirm that all investments were made in line with a minimum long term credit rating of A- or equivalent, as set in the 2013/14 TMSS.

#### **HRA Limit on Indebtedness**

This purpose of this indicator is for the Council to report on the level of the limit imposed at the time of implementation of self-financing by the Department for Communities and Local Government.

HRA Limit on Indebtedness	31/03/2013 Actual £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m	31/03/2016 Estimate £m
HRA CFR	137	141	141	141
HRA Debt Cap (as prescribed by CLG)	199	199	199	199
Difference	62	58	58	58