



Audit Committee
29 September 2014

Report from the Chief Finance Officer

Wards Affected:
ALL

2014/15 Mid-Year Treasury Report

1. SUMMARY

- 1.1 This report updates Members on treasury activity during the 2014/15 financial year.

2. RECOMMENDATION

- 2.1 The Committee is asked to note the 2014/15 mid-year Treasury report, which will also be submitted to the Cabinet and Full Council.

3. DETAIL

BACKGROUND

- 3.1 The Council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management ("the Code"), which requires authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year.
- 3.2 The Council has borrowed money over the long term to support investment in the Council's infrastructure and also invests balances held for short periods. It is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

ECONOMIC BACKGROUND

- 3.3 Growth in the UK continues, with unemployment falling and inflation remaining below the Monetary Policy Committee's (MPC) target. However, growth is not felt to be robust, as real pay is still not increasing, productivity shows no sign of rising and the balance of payments remains high by historical standards. Outside of the UK growth is still erratic in the US and the Eurozone is struggling to grow at all, with the malaise now having spread to the core economies. Doubts remain over the path of the Chinese economy and geopolitical risk has increased significantly over the last year.

- 3.4 Gilt yields (the rate of interest on UK government borrowing) fluctuated in response to events for the first half of the year. In the United States the Federal Reserve continued to withdraw Quantitative Easing, but other events have produced downward pressure over the spring and 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	31 March 2014	1 September 2014
1 year	1.3%	1.3%
5 year	2.8%	2.6%
10 year	3.7%	3.2%

- 3.5 The interest rate that the Council receives on money market deposits has risen gradually for deposits of between 1-12 months. Rates range from 0.35% at the shortest maturities to a little below 1% for one year.

DEBT MANAGEMENT

- 3.6 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.
- 3.7 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 loans have been raised so far this year as is shown in the table below and only Equal Instalment of Premium (EIP) amounts maturing have been repaid:

	Balance on 01/04/2014 £m	Debt Repaid £m	New Borrowing £m	Balance on 01/09/2014 £m
Long Term Borrowing	428.0	1.6	0.0	426.4
Average Rate %	4.69			4.70

- 3.8 At 1 September 2014 the Council had £426 million of long-term borrowing, to finance its previous years' capital programmes. With short-term interest rates being much lower than long-term rates, it continues to be more cost effective in the short-term to use internal resources, rather than undertake further long-term borrowing. By doing so, the Council is able to minimise net borrowing costs and reduce overall treasury risk.
- 3.9 The Treasury Management Strategy approved by the Council in March 2014 includes provision for borrowing to progress towards CFR over a period of 2 – 3 years. The rate of progress will depend on the perceived risks of lending surplus cash, the Council's cash flow and the prospective path of interest rates. Any borrowing options will continue to be assessed in conjunction with the Council's treasury advisor, Arlingclose.
- 3.10 No debt rescheduling has been undertaken in during the financial year as present discount rates make the costs involved unattractive.

INVESTMENT ACTIVITY

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

	Balance on 01/04/2014 £m	Investments Made £m	Investments Repaid £m	Balance on 1/09/2014 £m
Short Term Investments	110.7	615.1	561.8	164.0

- 3.12 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014/15. 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.

- 3.13 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

- 3.14 The Council's financing charges budget for the year is £26.3m, 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 £158m during the period, though the average for the whole year will be less than this because substantial government grants were received in April.

ICELANDIC BANK INVESTMENT UPDATE

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- 3.15 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

- 3.16 The Council's last receipt was £1.7m in August 2013, which means that only £0.6m of the original £10m deposit now remains outstanding. It is anticipated that a further distribution will be made during the autumn, although there is no indication as to likely amount or date.

COMPLIANCE WITH PRUDENTIAL INDICATORS

- 3.17 Officers confirm that they have complied with its Prudential Indicators for 2014/15, which were set in March 2014 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

4. FINANCIAL IMPLICATIONS

- 4.1 The report confirms that the Council's treasury management activity during the current financial year has been in accordance with the strategy and budget approved by the Council in 2014/15.

- 4.2 Opportunities to minimise current and longer-term costs will continue to be sought, commensurate with the overriding need to safeguard the Council's resources.

5 DIVERSITY IMPLICATIONS

- 5.1 No specific implications arising from this report.

6 STAFFING IMPLICATIONS

- 6.1 No specific implications arising from this report.

7 LEGAL IMPLICATIONS

- 7.1 Under section 12 of the Local Government Act 2003, a local authority may invest:
(a) for any purpose relevant to its functions under any enactment, or
(b) for the purposes of the prudent management of its financial affairs.
- 7.2 Under section 15(1) of the Local Government Act 2003, when carrying out its functions under Chapter 1 of the 2003 Act in relation to capital finance, a local authority shall have regard to such guidance as the Secretary of State may issue and such other guidance as the Secretary of State may by regulations specify for the purposes of this provision.
- 7.3 Under sections 3 (in relation to the Council's borrowing powers) and 15 (in relation to the Council's investment powers) of the 2003 Act, "The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003" (Statutory Instrument - SI: 3146/2003) were laid in Parliament and these regulations set out the limits, controls and powers in relation to borrowing and investments by local authorities. These regulations also require local authorities to have regard to the CIPFA Prudential Code for Capital Finance and have regard to the "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes", which are also published by the CIPFA.
- 7.4 The CIPFA Treasury Management Code of Practice recommends that local authorities receive reports on its treasury management policies and activities, including, as a minimum, an annual strategy. Under Table 3 in Part 4 of the Council's Constitution (Functions not to be the sole responsibility of the Executive), the Cabinet is responsible for formulating or preparing the plans listed in that Table and then submitting them to the Full Council for consideration and adoption or approval. Those plans include, amongst others, "A plan or strategy for the control of the authority's borrowing investments or capital expenditure or for determining the authority's minimum revenue provisions".

8 BACKGROUND

Annual Treasury Strategy – Report to Full Council as part of the Budget Report – March 2014.

9 CONTACT OFFICER

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Appendix 1

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 £790m for 2014/15. 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 2014/15 was set at £690m. 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 £428m.

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 2014/15	Maximum during 2014/15
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. As is now normal practice, debt which has an option to recall debt or change the rate is shown at the earliest date on which the option can be exercised

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 1/09/14 £m	% Fixed Rate Borrowing as at 30/09/14	Compliance with Set Limits?
Under 12 months	40	0	19	5	Yes
12 months and within 24 months	20	0	50	12	Yes
24 months and within 5 years	20	0	43	10	Yes
5 years and within 10 years	60	0	25	6	Yes
10 years and above	100	0	289	67	Yes

Net Debt and the Capital Finance Requirement

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 2014/15, 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 2014/15 was set at £20m. A deposit of £5m was made with another local authority for 18 months, but this is now less than a year to maturity. At 1 September 2014, the last maturity date in the deposits portfolio was 28 August 2015.

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 2014/15 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	31/03/2014 Actual £m	31/03/2015 Estimate £m	31/03/2016 Estimate £m	31/03/2017 Estimate £m
HRA CFR	137	137	137	137
HRA Debt Cap (as prescribed by CLG)	199	199	199	199
Difference	62	62	62	62