

# Southend-on-Sea Borough Council

Report of Corporate Director of Corporate Services  
to  
**Cabinet**  
on  
**18 March 2014**

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Head of Finance and Resources

## Agenda

Item No.

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**Quarter Three Treasury Management Report – 2013/14**  
**Policy and Resources Scrutiny Committee**  
**Executive Councillor: Councillor Andrew Moring**  
***A Part 1 Public Agenda Item***

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### **1. Purpose of Report**

- 1.1 The Quarter Three Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for both quarter three and the period from April to December 2013.

### **2. Recommendations**

- 2.1 **That the Quarter Three Treasury Management Report for 2013/14 be approved.**

**That the following is noted:**

- 2.2 **Treasury management activities were carried out in accordance with the CIPFA (The Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Sector during the period from April to December 2013.**
- 2.3 **The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.**
- 2.4 **An average of £54.4m of investments were managed in-house. These earned £0.20m of interest during this nine month period at an average rate of 0.49%. This is 0.13% over the average 7 day LIBID and 0.01% under bank base rate.**
- 2.5 **An average of £24.5m of investments were managed by fund managers. These earned £ 0.14m of interest during this nine month period at an average rate of 0.76%. This is 0.40% over the average 7 day LIBID and 0.26% over bank base rate.**

**2.6 The level of borrowing from the Public Works Loan Board (PWLB) (excluding debt relating to services transferred from Essex County Council on 1<sup>st</sup> April 1998) decreased from £246.8m to £241.8m (HRA: £84.5m, GF: £157.3m) during the period from April to December 2013.**

### **3. Background**

3.1 This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this code. The code recommends that local authorities submit reports regularly as part of its Governance arrangements.

3.2 Current guidance is that authorities should report formally at least twice a year and preferably quarterly. The Treasury Management Policy Statement for 2013/14 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation. This is the third quarter report for the financial year 2013/14.

3.3 Appendix 1 shows the treasury management position at the end of quarter three of 2013/14.

3.4 Appendix 2 shows the treasury management performance specifically for quarter three of 2013/14.

### **4 National Context**

4.1 As 2013 came to a close the UK economy continued to improve and there is further optimism as 2014 progresses.

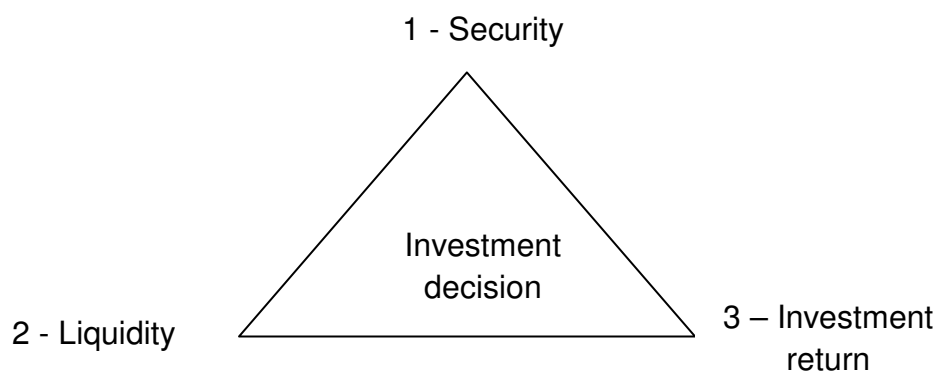
4.2 GDP growth in the three months to December remained strong at 0.7%, just slightly less than the GDP growth of 0.8% in the three months to September. Financial and business growth made the largest contribution to growth with business surveys pointing to further acceleration of growth this quarter. Consumer spending, which had been a main driver of growth earlier in the year, had slowed.

4.3 The Bank of England has kept the bank base rate at its historic low of 0.5% and continued with its policy of quantitative easing, keeping the level at £375 billion. The Bank of England introduced its new policy of forward guidance saying it would not raise official interest rates until the unemployment rate falls to 7%. The unemployment rate fell sharply to 7.1% in the quarter to October. As the unemployment claimant count fell again between October and November, the rate looked set to continue to fall, however it rose unexpectedly in the three months to December to 7.2%. If the unemployment rate falls in future quarters, the Bank of England could reduce the level of the unemployment rate threshold or adopt new forms of forward guidance.

- 4.4 CPI inflation fell to 2.1% in November and has now, for the first time in over four years, fallen below the Bank of England's 2% target. The Office of Budget Responsibility upwardly revised their UK growth forecast for 2014 from 1.8% to 2.4%. Although the UK and US economies have gathered strength throughout 2013, there are on-going problems in the Eurozone, which is a major market for exporters in both countries.
- 4.5 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. The ratings agencies had downgraded the credit ratings of some financial institutions and the sovereign ratings of some countries, and we have not yet started to see previous downgrades being reversed. Therefore we continue with a reduced list of counterparties (i.e. people we can invest with) that still meet our prudent investment criteria.
- 4.6 However, with a restricted list of counterparties and the increased focus on counterparty risk following the Icelandic Banks collapse, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.
- 4.7 Low interest rates have prevailed throughout the period from April to December 2013 and this led to low investment income earnings from all our investments.

**5 Investments – quarter three (October to December)**

- 5.1 A prime objective of our investment activities is the security of the principal sums invested. To ensure this security before a deposit is made an organisation is tested against a matrix of credit criteria and then other relevant information is considered. During the period from October to December 2013 investment deposits were limited to those who met the criteria in the Annual Investment Strategy when the deposit was placed.
- 5.2 Other investment objectives are to maintain liquidity (i.e. adequate cash resources to allow the council to operate) and to optimise the investment income generated by surplus cash in a way that is consistent with a prudent level of risk. Investment decisions are made with reference to these objectives, with security and liquidity being placed ahead of the investment return. This is shown in the diagram below:



#### Security:

- 5.3 To maintain the security of sums invested, we seek to lower counterparty risk by investing in financial institutions with good credit ratings, across a range of sectors and countries. The risk of loss of monies invested is minimised through the Annual Investment Strategy.
- 5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter three; 14% of our in-house investments were placed with financial institutions with a long term credit rating of AAA and 74% with a long term rating of A and 12% with a long term rating of A-.
- 5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 86% being placed directly with banks and 14% placed with a range of counterparties via money market funds.
- 5.6 Pie chart 3 of Appendix 1 shows the range of countries where the parent company of the financial institution with which we have monies invested is registered. For money market funds there are various counterparties spread across many countries. The cumulative balance of funds held with any one institution was kept within agreed limits.

#### Liquidity:

- 5.7 Our in-house monies were available on an instant access basis at the end of quarter three, except for £10m which had been placed in a 100 day notice account. The maturity profile of our investments is shown in pie chart 4 of Appendix 1.

#### Investment return:

- 5.8 During the quarter the Council continued to use the external fund manager Scottish Widows Investment Partnership Limited to manage monies on our behalf. An average balance of £24.6m was invested in these funds during the quarter earning an average rate of 0.93%.
- 5.9 The Council had an average of £46.4m of investments managed in-house over the period from October to December 2013, and these earned an average interest rate of 0.51%. Of the in-house managed funds:
- an average of £10m was held in a 100 day notice account that earned an average interest rate of 0.62%.
  - use was also made of call accounts during the quarter, because they provide instant access to funds while paying base rate or better. An average of £21.4m was held in these accounts and earned an average return of 0.56% over the quarter.

- an average of £15.0m was held in money market funds earning an average of 0.36% over the quarter. These work in the same way as a deposit account but the money in the overall fund is invested in a number of counterparties, therefore spreading the counterparty risk.

5.10 In accordance with the Treasury Management Strategy the performance during the quarter is compared to the average 7 day LIBID (London Interbank Bid Rate). Overall, performance on our investments was higher than the average 7 day LIBID and higher than the average base rate for the quarter. The bank base rate remained at 0.50% throughout the period from October to December 2013, and the 7 day LIBID rate fluctuated between 0.34% and 0.36%. Performance is shown in Graph 1 of Appendix 2.

## 6 Investments – quarter three cumulative position

6.1 During the period from April to December 2013 the Council complied with all of the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of the Code of Practice for Treasury Management means its treasury practices demonstrate a low risk approach.

6.2 The Council is aware of the risks of passive management of the treasury portfolio and has proactively managed levels of debt and investments over the nine month period with the support of its treasury management advisers.

6.3 The table below summarises the Council’s investment position for the period from April to December 2013:

Table 1: Investment position

	At 31 March 2013	At 31 December 2013	April to December 2013	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
100 day notice account	10,000	10,000	10,000	0.62
Call accounts	17,032	20,989	21,526	0.55
Money market funds	8,000	5,000	22,829	0.37
<b>Total investments managed in-house</b>	<b>35,032</b>	<b>35,989</b>	<b>54,355</b>	<b>0.49</b>
Investments managed by external fund managers	24,440	24,581	24,514	0.76
<b>Total investments</b>	<b>59,472</b>	<b>60,570</b>	<b>78,869</b>	<b>0.58</b>

- 6.4 The majority of the cash balances held by the Council are required to meet short term cash flow requirements and therefore throughout the nine month period monies were placed 30 times for periods of one year or less. The table on the next page shows the most used counterparties overall and the countries in which they are based. All deals are in sterling despite the country the counterparties are based in.

Table 2: Counterparties used

Counterparty	Country	No. of Deals	Value of Deals (£m)
BlackRock	Money Market Fund (Various Counterparties)	15	82
Goldman Sachs	Money Market Fund (Various Counterparties)	15	74

- 6.5 In addition to the above, use was also made of call accounts during the year, because they provide instant access or 7-day notice to funds while paying bank base rate or better. This meant that funds were available for cash flow movements to avoid having to pay higher rates to borrow from the market. During the period from April to December 2013 an average of £21.5m was held in such accounts.

## 7. Borrowing – quarter three

- 7.1 The Capital Financing Requirement (CFR) is the Council's theoretical need to borrow but the Section 151 Officer can manage the Council's actual borrowing position by either:

- 1 - Borrowing to the CFR;
- 2 - Choosing to use temporary cash flow funds instead of borrowing (internal borrowing) or;
- 3 - Borrowing for future increases in the CFR (borrowing in advance of need).

The Council began the quarter in scenario 2.

- 7.2 This, together with the Council's cash flow, the prevailing Public Works Loans Board (PWLB) interest rates and the future requirements of the capital programme, were taken into account when deciding the amount and timing of any loans. No debt restructuring was carried out during the quarter.
- 7.3 During quarter three, one new loan was taken out for £5m for a period of 15 years. £10m of loans were repaid on maturity during the quarter.

- 7.4 The level of PWLB borrowing (excluding debt relating to services transferred from Essex County Council on 1<sup>st</sup> April 1998) decreased from £246.8m to £241.8m during quarter three. The average rate of borrowing at the end of the quarter was 4.45%. A profile of the repayment dates is shown in Graph 2 of Appendix 2.
- 7.5 The level of PWLB borrowing at £241.8m is in line with the financing requirements of the capital programme and the revenue costs of this borrowing are fully accounted for in the revenue budget. The current level of borrowing is also in line with the Council's prudential indicators and is Prudent, Affordable and Sustainable.
- 7.6 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 3.63% and 4.16%; 25 year PWLB rates between 4.37% and 4.68% and 50 year PWLB rates between 4.37% and 4.63%. These rates are before any concessionary discounts.
- 7.7 No short term borrowing for cash flow purposes was taken out or repaid during the quarter. See Table 1 of Appendix 2.

## **8. Borrowing – quarter three cumulative position**

8.1 The Council's outstanding borrowing as at 31<sup>st</sup> December 2013 was:

- |                                   |         |
|-----------------------------------|---------|
| • Southend-on-Sea Borough Council | £241.8m |
| • ECC transferred debt            | £14.4m  |

Repayments in the first 9 months of 2013/2014 were:

- |                                   |        |
|-----------------------------------|--------|
| • Southend-on-Sea Borough Council | £10m   |
| • ECC transferred debt            | £0.63m |

- 8.2 Outstanding debt relating to services transferred from Essex County Council (ECC) on 1<sup>st</sup> April 1998, remains under the management of ECC. Southend Borough Council reimburses the debt costs incurred by the County.
- 8.3 The interest payments, excluding transferred debt, during the period from April to December 2013 were £7.350m, compared to the original budget of £7.954m for the same period. The interest payments are lower than budgeted as it was anticipated that £22m of new loans would be taken out during 2013/14 (£5m of this was to re-finance a loan that matured in October), but £5m of new loans were taken out during the period. Therefore the actual interest payments were lower than budgeted.

8.4 The table below summarises the PWLB borrowing activities over the period from April to December 2013:

Quarter	Borrowing at beginning of quarter (£m)	New borrowing (£m)	Re-financing (£m)	Borrowing repaid (£m)	Borrowing at end of quarter (£m)
April to June 2013	246.8	0	0	(0)	246.8
July to September 2013	246.8	0	0	(0)	246.8
October to December 2013	246.8	0	5	(10)	241.8*

\* General Fund £157.3m; Housing Revenue Account £84.5m

## 9 Compliance with Treasury Management Strategy – quarter three

9.1 The Council's investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector (revised in November 2009), which has been implemented in the Annual Investment Strategy approved by the Council on 28<sup>th</sup> February 2013. The investment activity during the quarter conformed to the approved strategy, and the cash flow was successfully managed to maintain liquidity. See Table 2 of Appendix 2.

## 10. Other Options

10.1 There are many options available for the operation of the Treasury Management function, with varying degrees of risk associated with them. The Treasury Management Policy aims to effectively control risk to within a prudent level, whilst providing optimum performance consistent with that level of risk.

## 11. Reasons for Recommendations

11.1 The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2013/14 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

## 12. Corporate Implications

### 12.1 Contribution to Council's Vision & Critical Priorities

Treasury Management practices in accordance with statutory requirements, together with compliance with the prudential indicators acknowledge how effective treasury management provides support towards the achievement of the Council's Vision and Critical Priorities.



## 12.2 Financial Implications

The financial implications of Treasury Management are dealt with throughout this report.

## 12.3 Legal Implications

This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this code.

## 12.4 People Implications

None.

## 12.5 Property Implications

None.

## 12.6 Consultation

The key Treasury Management decisions are taken in consultation with our Treasury Management advisers.

## 12.7 Equalities Impact Assessment

None.

## 12.8 Risk Assessment

The Treasury Management Policy acknowledges that the successful identification, monitoring and management of risk are fundamental to the effectiveness of its activities.

## 12.9 Value for Money

Treasury Management activities include the pursuit of optimum performance consistent with effective control of the risks associated with those activities.

## 12.10 Community Safety Implications

None.

## 12.11 Environmental Impact

None.

### **13. Background Papers**

None.

### **14. Appendices**

Appendix 1 – Treasury Management Position as at the end of Quarter Three - 2013/14

Appendix 2 – Treasury Management Performance for Quarter Three – 2013/14