Southend-on-Sea Borough Council

Agenda
Item No.

Report of Corporate Director of Corporate Services
to
Cabinet
on
17 March 2015

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Quarter Three Treasury Management Report – 2014/15
Policy and Resources Scrutiny Committee
Executive Councillor: Councillor Woodley
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 2014.

2. Recommendations

2.1 That the Quarter Three Treasury Management Report for 2014/15 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 2014.

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 £72.1m of investments were managed in-house. These earned £0.30m of interest during this nine month period at an average rate of 0.55%. This is 0.20% over the average 7 day LIBID and 0.05% over bank base rate.

2.5 An average of £24.7m of investments were managed by fund managers. These earned £ 0.17m of interest during this nine month period at an average rate of 0.90%. This is 0.55% over the average 7 day LIBID and 0.40% 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 1st April 1998) decreased from £250.8m to £240.8m (HRA: £81.7m, GF: £159.1m) during the period from April to December 2014.

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 2014/15 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 2014/15.

3.3 Appendix 1 shows the treasury management position at the end of quarter three of 2014/15

3.4 Appendix 2 shows the treasury management performance specifically for quarter three of 2014/15.

4 National Context

4.1 As 2014 came to a close the UK economy continued to grow and there is further optimism as 2015 progresses.

4.2 After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then growth in 2014 of 0.6% in Q1, 0.8% Q2, 0.7% in Q3 and 0.5% in Q4 (annual rate for 2014 of 2.6%), there are good grounds for optimism that growth could pick up again during 2015 after cooling towards the end of 2014. This would be due to the positive effects from the fall in the price of oil feeding through to consumers and other parts of the economy. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent performance. There has been a sharp fall in inflation (CPI), reaching 1.0% in November 2014 and then halving to 0.5% in December, the lowest rate since May 2000.

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 overall strong GDP growth has resulted in unemployment falling much faster than expected. The MPC is not expected to raise interest rates for at least the first half of 2015 as inflation could even turn negative in this period. The MPC will keep this under review, especially as unemployment continues to fall. It will also be monitoring how strong a stimulative effect the drop in oil prices has on the economy as falling inflation may be comfortably exceeded by wage increases meaning that the disposable incomes of consumers would recover strongly during 2015.

4.4 Concern in financial markets for the Eurozone had subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy. The general election in Greece on 25 January has brought to power a coalition which is anti EU imposed austerity. Although it is not certain that Greece will leave the Euro, the recent issue of finding a negotiated compromise with the new Greek government leaves this as a real possibility.

4.5 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. There have not been substantial changes in the credit ratings of financial institutions so we continue to have a restricted list of counterparties (i.e. people we can invest with) that still meet our prudent investment criteria.

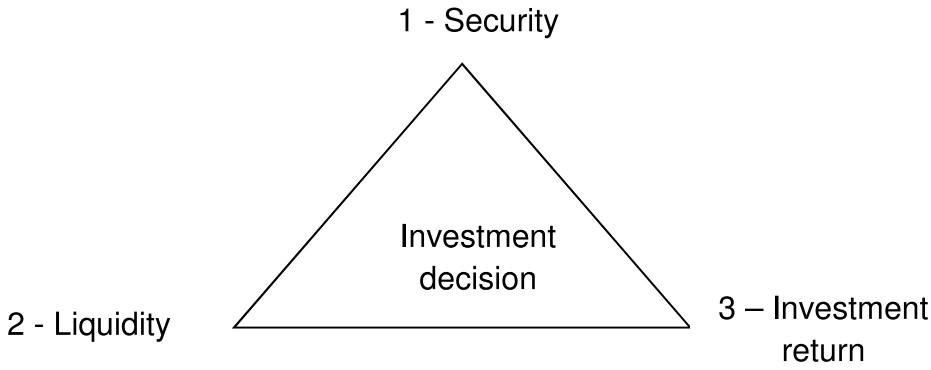
4.6 However, with a restricted list of counterparties and the increased focus on counterparty risk following the Icelandic Banks collapse, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.

4.7 Low interest rates have prevailed throughout the period from April to December 2014 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 2014 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; 56% of our in-house investments were placed with financial institutions with a long term credit rating of AAA and 44% with a long term rating of A.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 44% being placed directly with banks and 56% 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 Aberdeen Asset Management to manage monies on our behalf. An average balance of £24.8m was invested in these funds during the quarter earning an average rate of 0.97%.

5.9 The Council had an average of £64.8m of investments managed in-house over the period from October to December 2014, and these earned an average interest rate of 0.55%. Of the in-house managed funds:

- an average of £12.6m was held in notice accounts that earned an average interest rate of 0.65%.

- use was also made of call accounts during the quarter, because they provide instant access to funds. An average of £23.6m was held in these accounts and earned an average return of 0.49% over the quarter.

- an average of £28.6m was held in money market funds earning an average of 0.55% 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 2014, and the 7 day LIBID rate fluctuated between 0.35% 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 2014 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 2014:

Table 1: Investment position

	At 31 March 2014	At 31 December 2014	April to December 2014	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Notice accounts	10,000	10,000	18,549	0.63
Call accounts	25,171	11,328	25,557	0.49
Money market funds	18,500	27,000	27,974	0.54
Total investments managed in-house	**53,671**	**48,328**	**72,080**	**0.55**
Investments managed by external fund managers	24,642	24,809	24,732	0.90
Total investments	**78,313**	**73,137**	**96,812**	**0.61**

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 45 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)	23	114
Goldman Sachs	Money Market Fund (Various Counterparties)	22	92

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 2014 an average of £25.6m was held in such accounts.

6.6 During quarter three, there was no fixed investment activity. See Table 1 of Appendix 2.

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).

7.2 The Council began quarter two in the second of the above scenarios, with actual borrowing below CFR.

7.3 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.

7.4 During quarter three, no new loans were taken out. £10m of loans were repaid on maturity during the quarter.

7.5 The level of PWLB borrowing (excluding debt relating to services transferred from Essex County Council on 1st April 1998) decreased from £250.8m to £240.8m during quarter three. The average rate of borrowing at the end of the quarter was 4.54%. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

7.6 The level of PWLB borrowing at £240.8m 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.

7.7 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 2.59% and 3.29%; 25 year PWLB rates between 3.25% and 3.86% and 50 year PWLB rates between 3.22% and 3.84%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

7.8 During quarter three, there was no short term borrowing activity undertaken for cash flow purposes. See Table 2 of Appendix 2.

8. Borrowing – quarter three cumulative position

8.1 The Council's borrowing limits for 2014/15 are shown in the table below:

	2014/15 Original (£m)	2014/15 Revised (£m)
Operational Boundary	300	265
Authorised Limit	310	275

The Operational Boundary is the expected total borrowing position of the Council during the year and reflects decisions on the amount of debt needed for the Capital Programme. Periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached.

The Authorised Limit is the "Affordable Borrowing Limit" required by the Local Government Act 2003. This is the outer boundary of the Council's borrowing based on a realistic assessment of the risks and allows sufficient headroom to take account of unusual cash movements.

8.2 The Council's outstanding borrowing as at 31st December 2014 was:

- Southend-on-Sea Borough Council £240.8m
- ECC transferred debt £13.8m

Repayments in the first 9 months of 2014/2015 were:

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

8.3 Outstanding debt relating to services transferred from Essex County Council (ECC) on 1st April 1998, remains under the management of ECC. Southend Borough Council reimburses the debt costs incurred by the County. The debt is recognised as a deferred liability on our balance sheet.

8.4 The interest payments for PWLB and excluding transferred debt, during the period from April to December 2014 were £7.606m, compared to the original budget of £7.905m for the same period. These interest payments are lower than budgeted as, when the budget was set, it was anticipated that £20m of new loans would be taken out during the remainder of 2013/14 and that £30m of new loans would be taken out during 2014/15, but due to the reasons set out in paragraph 7.3, £14m of new loans were taken out in 2013/14 and no new loans were taken during the first three quarters of 2014/15.

8.5 The table below summarises the PWLB borrowing activities over the period from April to December 2014:

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 2014	250.8	0	0	(0)	250.8
July to September 2014	250.8	0	0	(0)	250.8
October to December 2014	250.8	0	0	(10)	240.8
Of which:					
General Fund	166.3	0	0	(7.2)	159.1
HRA	84.5	0	0	(2.8)	81.7

All PWLB debt held is repayable on maturity.

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 27th February 2014. The investment activity during the quarter conformed to the approved strategy, and the cash flow was successfully managed to maintain liquidity. See Table 3 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 2014/15 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 - 2014/15

Appendix 2 – Treasury Management Performance for Quarter Three – 2014/15