Southend-on-Sea Borough Council

Agenda Item No.

Report of Corporate Director of Corporate Services
to
Cabinet
on
5 November 2013

Report prepared by:
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Mid-Year Treasury Management Report – 2013/14
Policy and Resources Scrutiny Committee
Executive Councillor: Councillor AJ Moring
A Part 1 Public Agenda Item

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1. Purpose of Report

1.1 The Mid-Year Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for both quarter two and the period from April to September 2013.

2. Recommendations

2.1 That the Mid-Year 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 September 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 £59m of investments were managed in-house. These earned £0.14m of interest during this six month period at an average rate of 0.48%. This is 0.12% over the average 7 day LIBID (London Interbank Bid Rate) and 0.02% under bank base rate.

2.5 An average of £24.5m of investments was managed by our external fund manager. These earned £0.083m of interest during this six month period at an average rate of 0.68%. This is 0.32% over the average 7 day LIBID and 0.18% 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) has remained at the same level of £246.8m (Housing Revenue Account (HRA): £87.3m, General Fund: £159.5m) during the period from April to September 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 second quarter report for the financial year 2013/14.

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

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

4 National Context

4.1 Following a series of positive economic data and upbeat predictions of growth from independent forecasters, the Chancellor has said that, following the longest and deepest economic downturn in modern history the UK economy is 'turning a corner'.

4.2 GDP growth in the three months to June was 0.7%, equal to the growth during the 2012 London summer Olympics and the fastest pace since early 2010. GDP growth in the three months to September is due to be announced shortly. Business and household confidence is improving with retail sales rising at their fastest pace in two years in spite of the fact that real incomes have remained under significant pressure. The number of businesses experiencing signs of distress has declined, falling to 35% in September from a high of 53% in June 2012.

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 quantative 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 from 7.8% in the quarter to April to 7.7% in the quarter to July. On the Monetary Policy Committee's current forecasts, the unemployment rate is most likely to reach 7% in late 2016.

4.4 CPI inflation fell from a 2013 peak of 2.9% in June to 2.7% in August and stayed at 2.7% in September. The Organisation for Economic Co-operation and Development upgraded its 2013 outlook for the economy to 1.5%, from 0.8% four months ago. However, the UK economic recovery is still fragile and in its early stages. The world economy remains volatile. Trade figures showed UK exports fell by 9.1% in July and official industrial production data, including manufacturing, was weaker than expected in July.

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.

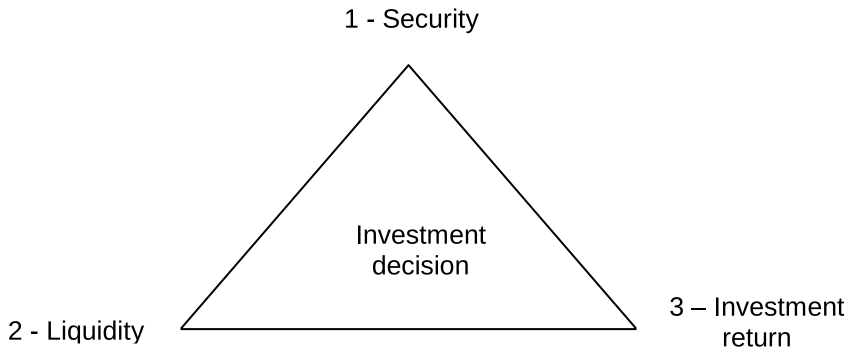
4.6 However, with a restricted list of counterparties and the increased focus on counterparty risk following the Icelandic Banks collapse, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.

4.7 Low interest rates prevailed throughout the period from April to September 2013 and this led to low investment income earnings from all our investments.

5 Investments – quarter two (July to September)

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. During the period from July to September 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 principal of all monies is minimised through the Annual Investment Strategy.

5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter one 27% of our in-house investments were placed with financial institutions with a long term rating of AAA and 73% with a rating of A.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 73% being placed directly with banks and 27% 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 two, except for £10m which has 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 fund manager Scottish Widows Investment Partnership Limited to manage monies on our behalf. An average of £24.5m was invested in this fund throughout the quarter earning an average rate of 0.81%.

5.9 The Council had an average of £60.8m of investments managed in-house over the period from July to September, and these earned an average interest rate of 0.48%. 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 0.61%.

- use was also made of call accounts during the year, because they provide instant access to funds while paying base rate or better. An average of £23.7m was held in these accounts and earned an average return of 0.55% over the quarter.

- an average of £27.1m was held in money market funds earning an average of 0.37% 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. Overall, investment performance was higher than the average 7 day LIBID. The average 7 day LIBID rate for the quarter was 0.36%. Performance is shown in Graph 1 of Appendix 2.

6 Investments – quarter two cumulative position

6.1 During the period from April to September 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 six 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 September 2013:

Table 1: Investment position

	April to September 2013	
	Average Balance (£000s)	Average Rate (%)
Variable rate investments managed in-house	58,993	0.48
Investments managed by external fund managers	24,489	0.68
Total investments	**83,482**	**0.54**

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 six month period monies were placed 22 times for periods of one year or less. The table below 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)
Goldman Sachs	Money Market Fund (Various Counterparties)	12	60
BlackRock	Money Market Fund (Various Counterparties)	10	53

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 unexpected cash flow events to avoid having to pay higher rates to borrow from the market. During the period from April to September 2013 an average of £20.6m was held in such accounts.

7. Borrowing – quarter two

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 new PWLB loans were taken out during the quarter and none were repaid on maturity.

7.4 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) remained at £246.8m during the quarter. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

7.5 The level of PWLB borrowing at £246.8m 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, with the 50 year PWLB rates ranging between 4.47% and 4.71%.

7.7 During quarter two, there was no short term borrowing activity undertaken for cash flow purposes.

8. Borrowing – quarter two cumulative position

8.1 The Council's borrowing limits for 2013/14 are shown in the table below:

	2013/14 (£m)
Authorised Limit	330
Operational Boundary	320

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.

The Operational Boundary is the expected 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.

8.2 The Council's outstanding borrowing as at 30th September 2013 was:

- Southend-on-Sea Borough Council £246.816m
- ECC transferred debt £15.079m

Repayments in the first 6 months of 2013/2014 were:

- Southend-on-Sea Borough Council £0m
- ECC transferred debt £0m

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 September 2013 were £5.435m, compared to the original budget of £5.899m for the same period. These interest payments are lower than budgeted as, when the budget was set, it was anticipated that £16m of new loans would be taken out during the remainder of 2012/13 and that £20m of new loans would be taken out during 2013/14 (£10m of this was to re-finance loans that mature in October), but due to the reasons set out in paragraph 7.3, no new loans were taken during the period.

8.5 The table below summarises the PWLB borrowing activities over the period from April to September 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
Of which:					
General Fund	159.5	0	0	(0)	159.5
HRA	87.3	0	0	(0)	87.3

All PWLB debt held is repayable on maturity.

9 Compliance with Treasury Management Strategy – quarter two

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 28th February 2013. The investment activity during the quarter conformed to the approved strategy and the cash flow was successfully managed to maintain liquidity. This is shown in Table 1 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 and Diversity Implications

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 Two - 2013/14

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