Southend-on-Sea Borough Council

Agenda Item No.

Report of Corporate Director of Corporate Services
to
Cabinet
on
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Mid-Year 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 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 2014.

2. Recommendations

That the following is approved:

2.1 The Mid-Year Treasury Management Report for 2014/15.

2.2 The Revised Annual Investment Strategy 2014/15, as set out in Section 9.

That the following is noted:

2.3 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 2014.

2.4 The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.

2.5 An average of £75.7m of investments were managed in-house. These earned £0.19m of interest during this six month period at an average rate of 0.49%. This is 0.14% over the average 7 day LIBID (London Interbank Bid Rate) and 0.01% under bank base rate.

2.6 An average of £24.7m of investments was managed by our external fund manager. These earned £0.11m of interest during this six month period at an average rate of 0.87%. This is 0.52% over the average 7 day LIBID and 0.37% over bank base rate.

2.7 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 the same level of £250.8m (Housing Revenue Account (HRA): £84.5m, General Fund: £166.3m) during the period from April to September 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 second quarter report for the financial year 2014/15.

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

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

4 National Context

4.1 The Office for National Statistics (ONS) incorporated new data and introduced significant changes to the methodology for calculating GDP. As a result the ONS has now stated that GDP was 2.7%, rather than just 0.2% above its pre-crisis peak. It appears likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. However, 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.

4.2 Much of UK GDP is dependent on overseas trade, with the EU and US being its greatest trading counterparts, therefore the UK economy is susceptible to how these two economies perform. The Eurozone is facing an increasing threat from weak or negative growth. However, the US has been experiencing economic growth. Cuts in US government expenditure together with tax rises have allowed the annual government deficit to be halved from its peak without damaging growth.

4.3 The overall strong growth in the UK has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. (The unemployment rate for the three months to July was 6.2%.) The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much capacity there is in the economy and how quickly that capacity is being used up.

4.4 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. Some forecasts suggest that the Bank of England may raise the bank rate in the first quarter of 2015 whilst other forecasts suggest a later increase. There is still much uncertainty about the timing, with many factors at play.

4.5 The CPI inflation figure for August was 1.5% which was lower than the July figure of 1.6%. Forward indications are that inflation is likely to fall further in 2014. The Eurozone is facing an increasing threat from deflation. In September the Eurozone inflation rate fell further to reach 0.3%. This is an average for all Eurozone countries and includes some countries with negative rates of inflation.

4.6 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.

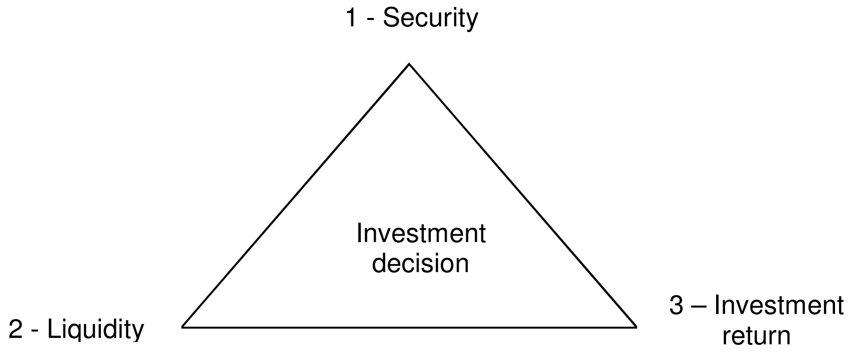
4.7 However, with a restricted list of counterparties and the increased focus on counterparty risk following the Icelandic Banks collapse, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.

4.8 Low interest rates prevailed throughout the period from April to September 2014 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 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 principal of monies is minimised through the Annual Investment Strategy.

5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter two; 40% of our in-house investments were placed with financial institutions with a long term rating of AAA, 12% with a long term rating of AA- and 48% with a long term rating of A.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 60% being placed directly with banks and 40% 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 one, except for £10m which has been placed in a 100 day notice account and £12m which has been placed in a 95 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 Aberdeen Asset Management (formerly Scottish Widows Investment Partnership) to manage monies on our behalf. An average of £24.7m was invested in this fund throughout the quarter earning an average rate of 0.99%.

5.9 The Council had an average of £75.3m 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 £22.0m was held in notice accounts that earned an average interest rate of 0.63%.

- use was also made of call accounts during the year, because they provide instant access to funds. An average of £25.0m was held in these accounts and earned an average return of 0.45% over the quarter.

- an average of £28.3m was held in money market funds earning an average of 0.40% 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, investment performance was higher than the average 7 day LIBID and was slightly lower than the average base rate for the quarter. The bank base rate remained at 0.50% throughout the period from July to September 2014, and the 7 day LIBID rate fluctuated between 0.35% and 0.36%. Performance is shown in Graph 1 of Appendix 2.

5.11 The in-house managed funds could have achieved higher than the bank base rate by making much more use of the notice accounts. However, this could not be achieved due to the need to keep sufficient funds liquid to ensure adequate cash resources to allow the council to operate. Our fund manager (Aberdeen Asset Management) was able to achieve a higher investment return, as those funds are invested for the longer term so liquidity is less of a consideration for them and as a large investment manager in the market with global reach they have access to many more types of investment than the in-house team.

6 Investments – quarter two cumulative position

6.1 During the period from April to September 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 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 2014:

Table 1: Investment position

	At 31 March 2014	At 30 September 2014	April to September 2014	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Notice accounts	10,000	22,000	21,533	0.62
Call accounts	25,171	14,234	26,528	0.49
Money market funds	18,500	24,000	27,647	0.39
Total investments managed in-house	**53,671**	**60,234**	**75,708**	**0.49**
Investments managed by external fund managers	24,642	24,749	24,702	0.87
Total investments	**78,313**	**84,983**	**100,410**	**0.58**

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 30 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)	17	71
BlackRock	Money Market Fund (Various Counterparties)	13	68.5

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. 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 2014 an average of £26.5m 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 £250.8m 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 £250.8m 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 3.20% and 3.71%; 25 year PWLB rates between 3.75% and 4.24% and 50 year PWLB rates between 3.72% and 4.20%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

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 2014/15 are shown in the table below:

	2014/15 (£m)
Authorised Limit	310
Operational Boundary	300

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 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.

8.2 The Council's outstanding borrowing as at 30th September 2014 was:

- Southend-on-Sea Borough Council £250.8m
- ECC transferred debt £14.5m

Repayments in the first 6 months of 2014/2015 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 2014 were £5.659m, compared to the original budget of £5.764m 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 two quarters of 2014/15.

8.5 The table below summarises the PWLB borrowing activities over the period from April to September 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
Of which:					
General Fund	166.3	0	0	(0)	166.3
HRA	84.5	0	0	(0)	84.5

All PWLB debt held is repayable on maturity.

9 Revised Annual Investment Strategy

9.1 A Revised Annual Investment Strategy was approved at the Cabinet meeting of 23rd September and this included changes to the credit rating matrices used as one of the measures to assess the credit worthiness of financial institutions considered for investment. This change did not reflect deterioration in the credit environment, rather a change of method in response to forthcoming regulatory changes. These regulatory changes are still subject to change and therefore the Annual Investment Strategy may be subject to further change in response to this.

9.2 Since that Cabinet meeting and following further advice from our Treasury Management advisers, the Annual Investment Strategy has also been amended for the following:

- the credit rating matrix for lending up to 100 days has been amended slightly to anticipate the likely result of the forthcoming regulatory changes;
- Paragraph 5.2 has been added to clarify how the investment limits apply to supranationals;
- Paragraph 5.11 has been amended to set out the maximum duration for investments with the UK Government, to be consistent with other deposits.

9.3 A Revised Annual Investment Strategy is attached as Appendix 3.

10 Compliance with Treasury Management Strategy – quarter two

10.1 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 and the Revised Annual Investment Strategy approved by the Cabinet on 23rd September 2014. 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 3 of Appendix 2.

11. Other Options

11.1 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.

12. Reasons for Recommendations

12.1 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.

13. Corporate Implications

13.1 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.

13.2 Financial Implications

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

13.3 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.

13.4 People Implications

None.

13.5 Property Implications

None.

13.6 Consultation

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

13.7 Equalities and Diversity Implications

None.

13.8 Risk Assessment

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

13.9 Value for Money

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

13.10 Community Safety Implications

None.

13.11 Environmental Impact

None.

14. Background Papers

None.

15. Appendices

Appendix 1 – Treasury Management Position as at 30th September 2014

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

Appendix 3 – Revised Annual Investment Strategy 2014/15