Meeting:	**Council**
Date:	**27th November 2014**
Subject:	**Monitoring Treasury Management Outturn**
Report of:	**Cllr Maurice Jones, Deputy Leader and Executive Member for Corporate Resources**
Summary:	This report provides a review of the performance of the Treasury Management strategy and Prudential Indicators for the six month period ending 30th September 2014.

Advising Officer:	Charles Warboys, Chief Finance Officer and Section 151 Officer
Contact Officer:	Charles Warboys, Chief Finance Officer and Section 151 Officer
Public/Exempt:	Public
Wards Affected:	All
Function of:	Council
Key Decision	Yes
Reason for urgency/ exemption from call-in (if appropriate)	Not applicable

CORPORATE IMPLICATIONS

Council Priorities:

The actions support the Council priorities by:

- the effective management of the Council's financial resources and the associated risks.

Financial:

1. The Council's Treasury Management strategy and prudential indicators underpin the Medium Term Financial Plan (MTFP). Performance against the strategy and the prudential indicators is explained within the body of this report.

Legal:

2. The Council's treasury management activities are regulated by statute, professional codes and official guidance. The Local Government Act 2003 (the Act) provides the powers to borrow and invest as well as providing controls and limits. Under the Act, Communities and Local Government has issued Guidance on Local Government Investments (revised March 2010) to structure and regulate the Council's investment activities. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 – Statutory Instrument (SI) 3146 (plus subsequent amendments), develops the controls and powers within the Act. The SI requires the Council to undertake any borrowing activity with regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities. The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services (the Code of Practice).

3. CIPFA revised the Code of Practice in November 2011 following developments in financial markets and the introduction of the Localism Act for English local authorities. The revised Code was adopted by Council on 29th November 2012.

Risk Management:

4. The approved strategy aims to manage the risks to the Council's finances from instability in financial markets.

Staffing (including Trades Unions):

5. Not applicable.

Equalities/Human Rights:

6. Not applicable.

Public Health:

7. Not applicable.

Community Safety:

8. Not applicable.

Sustainability:

9. Not applicable.

Procurement:

10. Not applicable.

Overview and Scrutiny:

11. The CIPFA Code of Practice for Treasury Management in the Public Services requires that Council receives two treasury and prudential indicator performance reports in respect of each financial year, addressing the first six months and the outturn position. This mid year report explains performance for the six months to September 2014. Annually the Corporate Resources Overview & Scrutiny Committee considers the proposed treasury management strategy and receives quarterly treasury management performance information as part of the ongoing budget monitoring process. This report recommends changes to the current Treasury Management strategy to maintain access to a diversified range of investment counterparties in the event of credit rating downgrades. The urgency of the changes precluded a report to the Corporate Resources Overview and Scrutiny Committee but the Chair has been kept fully informed of the proposals.

RECOMMENDATION(S):

Council is asked to:

1. **Acknowledge the satisfactory performance on Treasury Management and Prudential Indicators for the 6-month period ending 30th September 2014 and the single breach of investment counterparty limits (as detailed in paragraph 37 below).**

2. **Approve a revision to the minimum investment credit rating criteria for acceptable investment counterparties to BBB+ (or Moody's equivalent of Baa1), from A- (or Moody's equivalent of A3), in order to allow the Council flexibility to continue to invest with the major UK banks and building societies in the event of further downgrades in credit ratings (see paragraphs 30-33 below).**

3. **Approve an increase in the non-specified cash limit for total investments rated below a credit rating of A- (or equivalent) from £15m to £30m (see paragraph 34 below).**

4. **Approve a reduction in the investment counterparty limit for any single organisation (or group of organisations under the same ownership) from £15m to £7m (see paragraph 34 below).**

5. **Approve the revisions to the Treasury Management Strategy set out at Appendix C to this report.**

6. **Confirm the Prudential Indicators for 2014/15 as set out at Appendix D to this report.**

Reason for Recommendation(s):	*The CIPFA Code of Practice for Treasury Management requires that all Members are informed of treasury management activities at least twice a year. The proposed amendments to the current Treasury Management Strategy respond to the likely impact of the UK implementing the final bail-in provisions of the EU Bank Recovery and Resolution Directive to commence in January 2015.*

Executive Summary

12. The Council's treasury advisers, Arlingclose Ltd, do not expect the Bank of England to raise its Base Rate until Quarter 3 of 2015 and the short term return on cash investments will continue to remain at very low levels. Arlingclose Ltd have also advised that the introduction of new bank bail in provisions in the UK from January 2015 could, in the immediate future, lead to downgrades in the credit ratings of leading UK Banks and Building societies.. This report recommends changes in the current treasury strategy to allow the Council to access a diversified range of investment counterparties. Due to the limited time available to consider the strategy changes the proposals have not been considered by Corporate Resources Overview and Scrutiny Committee but the Chair of that Committee has been kept fully informed of the proposals.

13. The Council continues to prioritise the security and liquidity of its investments and has continued to internally borrow from its balances to fund capital expenditure in lieu of additional external borrowing.

14. Rates of borrowing from the Public Works Loan Board (PWLB) have remained broadly unchanged from 1st April – 30th September 2014.

15. The Chief Finance Officer can confirm that the Council has complied with its Prudential Indicators for the 6-month period ending 30th September 2014.

Background

16. Treasury management is defined by the CIPFA Code of Practice for Treasury Management in the Public Services as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

17. The Council's Treasury Management Strategy has been underpinned by the adoption of the CIPFA Code of Practice on Treasury Management (2011 Edition), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

18. The Code also recommends that all Members are informed of Treasury Management activities at least twice a year. This report therefore ensures this Authority has adopted best practice in accordance with CIPFA's recommendations. Local arrangements require the Corporate Resources Overview & Scrutiny Committee to receive, on a quarterly basis, treasury management performance reports and every year to scrutinise the proposed revised strategy.

19. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

20. This report provides members with a summary of the treasury management activity during the six months ending 30th September 2014. The Council has complied with its Prudential Indicators and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Treasury Activities for the period 1st April 2014 to 30th September 2014

Borrowing

21. The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) was £418.2m. At 30th September 2014 £308.0m had been externally borrowed, with the remainder borrowed internally from the Council's own cash balances. The Council will continue to utilise cash balances to fund capital expenditure in lieu of borrowing externally, but it is currently anticipated that some external borrowing will be required by the end of December 2014. The amount of borrowing required will be dependent on the actual cash flows experienced but has been currently estimated at a level up to £10m.

22. The Council has £165m of borrowing relating to the Housing Revenue Account (HRA) which was arranged as part of HRA Self Financing, introduced by Central Government in the 2011/12 financial year.

23. Most of the Council's borrowing (96%) is from the Public Works Loan Board (PWLB), a borrowing facility provided to Local Authorities by Central Government. The rate at which local authorities can borrow from this facility is determined by the market rate of interest on UK Gilts. An economic summary for the period 1st April – 30th September 2014 is included in Appendix A.

24. Over the next two quarters the Council plans to maintain minimum cash levels for operational purposes and source its borrowing needs from other local authorities on a short term rolling basis in order to achieve significant revenue cost savings over the more traditional route of borrowing long term from the PWLB. This borrowing strategy assumes that interest rates will continue to remain low for longer than previously envisaged, in line with advice from the Council's treasury advisers, Arlingclose Ltd. However, the Council will continue to monitor long term rates with a view to fixing a portion of its borrowing if rates are favourable.

25. No new external borrowing has been undertaken to finance capital expenditure in the current financial year. Debt management activities for the period are outlined in Appendix B.

Investments

26. The Council only places funds with counterparties of high creditworthiness and restricts time periods for investments. Priority is given to security and liquidity over yield.

27. At 30th September 2014, the Council held £27.1m in investments. Forecast investment income is £0.4m for the current financial year, with short term money market rates very low and forecast to remain low over the medium term.

28. Criteria to determine suitable investment counterparties for the Council are approved annually by Council as part of the Treasury Management Strategy. Investment activities for the period are detailed in Appendix C.

29. The UK is implementing the final bail-in provisions of the EU Bank Recovery and Resolution Directive to commence in January 2015, a year ahead of most other countries. Following the 2008 financial crisis, governments injected hundreds of billions to bail-out the banks. Bail-outs of failing banks in Greece, Portugal and Iceland were primarily financed by taxpayers. As time has passed and the cost of government bail-outs has risen, the appeal of asking private-sector investors to suffer a greater proportion of losses has increased. A bail-in forces the bank's bondholders and depositors to bear some of the burden by having part of the debt they are owed written off.

30. As outlined above, there is a risk that following the introduction of the above Directive the credit ratings of a number of UK banks and building societies may be reduced to reflect the reduction in likely central government support. The Council has two broad options to respond to this risk:

- amend the Treasury Management Strategy (TMS) to allow investment in lower rated banks and building societies, or
- prepare to invest without using any of the major UK banks and building societies.

31. Adopting the option to amend the TMS would allow the Council to broadly maintain its existing investment approach of investing with the major UK banks and building societies.

32. The Council's cash investments are too small to attract interest from overseas banks. By maintaining a minimum investment credit rating criteria of A- (or equivalent), the Council's investment options could be limited to the Bank of England's UK Debt Management Office (DMO) which pays a minimal interest rate of 0.25% on cash deposits and AAA-rated Money Market Funds.

33. To ensure the Council has recourse to a reasonable number of investment counterparties and as advised by the Council's advisers, Arlingclose Ltd, a reduction in the minimum investment credit rating criteria from A- to BBB+ (or Moody's equivalent of A3 and Baa1 respectively) is recommended. A 'BBB' rating denotes investment grade of a good credit quality, where there is a low risk of default and the capacity for payment of financial commitments is considered adequate.

34. Reflecting the reduction in minimum criteria it is also recommended that the maximum investment with any one bank or building society (or any group of organisations under the same ownership) is reduced from £15m to £7m. To allow flexibility to access a number of BBB+ rated institutions, it is recommended that the overall non-specified cash limit for total investments rated below a credit rating of A- (or equivalent) be increased from £15m to £30m. The proposed amendments to investment limits are detailed in Appendix C.

Prudential Indicators

35. The CIPFA Prudential Code for Capital Finance in Local Authorities requires performance against specified key indicators to be measured and reported. The purposes of these indicators are to demonstrate prudence, affordability and sustainability.

36. The Council has complied with its Prudential Indicators for the period 1st April 2013 to 30th September 2014. Explanations of the Prudential Indicators and performance against these is included in Appendix D. Key points include:

- The Council has remained within its authorised and operational borrowing limits.
- Borrowing is less than the Capital Financing Requirement (CFR), demonstrating that all long term borrowing has been undertaken for capital purposes in line with the Prudential Code.
- The Council is within its limits regarding the maturity profile of its fixed rate borrowing, ensuring that debt maturities are spread over many years in order to control the Council's exposure to refinancing risk.
- The Council is within its limits regarding its exposure to variable interest rates and thus its exposure to interest rate fluctuations.

37. In the six months to 30th September there was a breach of investment counterparty limits on 7th and 8th May 2014, where actual deposits placed with the Lloyds Banking Group exceeded the limit of £15m by £0.5m and between 9th and 11th May 2014 by £2.5m. The reasons for the breach are detailed in Appendix D to this report and internal procedures have been reviewed and revised to minimise the risk of any similar breach.

Appendices:

Appendix A – Economic Background 1st April – 30th September 2014

Appendix B – Debt Management Activities 1st April – 30th September 2014

Appendix C – Investment Activities 1st April – 30th September 2014

Appendix D – Prudential Indicators 1st April – 30th September 2014

Background Papers: (open to public inspection)

CIPFA – The Prudential Code for Capital Finance in Local Authorities (2013 Edition)

CIPFA – Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2011 Edition)
CIPFA – Treasury Management in the Public Services: Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (2011 Edition)