**REPORT NO FAP**

**FINANCE, AUDIT AND PERFORMANCE SELECT COMMITTEE – NOVEMBER 11TH 2013**

**REPORT OF DEPUTY CHIEF EXECUTIVE (CORPORATE DIRECTION)**
**RE: TREASURY MANAGEMENT TO 30 SEPTEMBER 2013**

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## 1. PURPOSE OF REPORT

To inform the Select Committee of the Council's Treasury Management activity during the first six months of 2013/14.

## 2. RECOMMENDATION

That the Select Committee note the report.

## 3. BACKGROUND TO THE REPORT

At its meeting in February 2013 the Council approved the Council's Treasury Management Policy for the year 2013/14 and delegated the oversight of the execution of the Policy to the Select Committee.

This report sets out the Treasury Management activities for the first half of 2013/14 and shows that they are in line with the limits set out in the Policy.

Treasury Management covers two main areas:-

1. The management of day to day cash flows by way of short term investing and borrowing. Longer term investment opportunities may arise depending on cash flow requirements.

2. Management of the Council's Long term debt portfolio which is used to finance capital expenditure that cannot be immediately funded by internal resources (e.g. by Capital Receipts).

### 3.1 Economic Background

- The quarter ended 30 September saw:
  - Indicators suggested that the economic recovery accelerated;
  - Household spending growth remained robust;
  - Inflation fell back towards the 2% target;
- After strong growth of 0.7% between April and June, it appears that UK GDP is likely to have grown at an even faster pace between July and September. Business surveys for July and August point to quarterly growth

of potentially over 1.0% in the third quarter of 2013. Similarly, the official data have continued to improve even though industrial production did not increase.

- Consumer spending continued to rise .The retail surveys paint a positive picture for household spending growth, with retail sales indicators showing stronger growth between July and September.
- The run of good news on the labour market continued, with the unemployment rate falling to 7.7% in July from 7.8% in June. Employment rose by 80,000 in the three months to July, supported by an even bigger rise in full-time employment. This meant that the ratio of full-time to part-time workers continued to rise. Despite this, the headline (3 month average of the annual) rate of pay growth fell from 2.2% in June to just 1.1% in July. This still remained well below the rate of CPI inflation at 2.7% in August, meaning real wages continued to fall.
- The cost of new credit has continued to fall, perhaps in response to the extension of the Bank of England’s Funding for Lending Scheme (FLS) earlier this year.
- Demand in the housing market continued to grow at a fast pace, supported by the FLS and the Government’s Help to Buy scheme, which provide equity loans to credit-constrained borrowers. The RICS housing market survey reported that new buyer enquiries hit their highest level on record in August. Mortgage approvals for new house purchase rose to their highest level since February 2008 in August. Consequently, house prices continued to rise, with the Halifax and Nationwide measures recording 6.2% and 3.5% y/y rises in August, respectively. ONS data, though, shows that in real terms only London experienced year-on-year price rises in July. All other regions saw modest falls.
- Although the government registered a surprise deficit in July (a month that normally delivers a surplus), in August net borrowing was ‘just’ £13.2bn, compared to £14.4bn in August 2012.
- The new Governor of the Bank of England, Mark Carney, took office in July. Alongside the August Quarterly Inflation Report, the Bank introduced its new policy of forward guidance in which the Monetary Policy Committee (MPC) pledged not to raise official interest rates, or reduce the size of the asset purchase facility, until the unemployment rate falls to 7%. At this point, the MPC would discuss whether or not to alter official policy. This guidance was subject to three ‘knockouts’ which, if breached, would invalidate the guidance. These are that the MPC forecasts inflation at or above 2.5% in 18-24 months’ time, inflation expectations are no longer sufficiently well anchored or financial stability is threatened by the stance of monetary policy. On the MPC’s current forecasts, the unemployment rate is most likely to reach 7% in late 2016.
- Financial markets however, continued to price in increases in Bank Rate by mid-2015.

- CPI inflation fell from a 2013 peak of 2.9% in June to 2.7% in August. The fall was primarily the result of a drop in the contribution from petrol prices and a reduction in core inflation from 2.3% in June to 2% in August. CPI inflation looks likely to have edged down again in September, perhaps to about 2.5%, reflecting a further fading of both energy prices and core inflation.
- The Federal Reserve (FED) unexpectedly decided not to taper its asset purchases in September. Its monthly purchases at $85bn will continue until "*more evidence that [the economic recovery] will be sustained before adjusting the pace of its purchases.*" This came despite previous hints of tapering from the Fed and the fall in the unemployment rate in both July and August. It currently stands at 7.3%.
- Meanwhile, Eurozone business surveys suggested that the economy continued to expand in Q3, albeit at a moderate pace. There was also a general election in Germany in which the incumbent Chancellor, Angela Merkel, performed better than expected by winning 41.5% of the vote. She is now likely to form a coalition, but it remains to be seen what form this will take.

3.2 Investment Activity

The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time, then ensuring adequate liquidity, with the investment return being the final objective. Following the economic background above, officers are implementing an operational strategy which tightens the controls already in place in the approved investment strategy.

The Council's investment criteria, approved by Council in February 2013 are:-

- **Banks 1 - Good Credit Quality –** the Council will only use banks which:

  i) Are UK banks; and/or
  ii) Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AAA.

  And have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

  i) **Short Term –** F1
  ii) **Long Term –** A
  iii) **Individual / Financial Strength –** C (Fitch / Moody's only)
  iv) **Support –** 3 (Fitch only)

- **Banks 2 – Guaranteed Banks with suitable Sovereign Support –** In addition, the Council will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:

- (a) wholesale deposits in the bank are covered by a government guarantee;
- (b) the government providing the guarantee is rated “AAA” by all three major rating agencies (Fitch, Moody’s and Standard & Poors); and
- (c) the Council’s investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.

- **Banks 3 - Eligible Institutions** - the organisation was considered an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above. These institutions were subject to suitability checks before inclusion.

- **Banks 4** - The Council’s own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

- **Bank Subsidiary and Treasury Operations –** the Council will use these where the parent bank has the necessary ratings outlined above.

- **Building Societies –** the Council will use all Societies which:

  i) meet the ratings for banks outlined above
  Or are both:
  ii) Eligible Institutions; and
  iii) Have assets in excess of £500m.

- **Money Market Funds** - AAA
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils etc**
- **Supranational institutions**

Funds for investment come from the following Sources
a) Revenue Account Balances held by the Council
b) Earmarked Reserves and Provisions
c) Unapplied Capital Receipts
d) Cash flow balances - income received before expenditure needs to be incurred

As at 30 September 2013 the Council held the following investments totalling £6,810,100

| Counterparty | Investment Date | Maturity Date | Amount | Interest Rate |
|---|---|---|---|---|
| Hinckley & Rugby BS | 19/09/2013 | 18/10/2013 | 2,000,000 | 0.4000 |
| Hsbc Call Account | 30/09/2013 | 02/10/2013 | 660,100 | 0.3500 |
| Nationwide BS | 02/09/2013 | 02/10/2013 | 1,000,000 | 0.3800 |
| Newcastle BS | 12/09/2013 | 14/10/2013 | 500,000 | 0.3800 |
| Principality BS | 23/09/2013 | 23/10/2013 | 1,650,000 | 0.4000 |
| West Bromwich BS | 16/09/2013 | 16/10/2013 | 1,000,000 | 0.4000 |

Details of all investments held from April 2013 to September 2013 are included in Appendix A

Details of the weighted average investment to September 2013 are shown in the table below together with the average overnight, 7 day and 1 month London Inter Bank Bid (LIBID) as a bench mark to the rates received by the Council.

| **Period** | **Weighted Average invested** | **Average period (days)** | **HBBC Average Return** | **Overnight LIBID** | **7 Day LIBID** | **1 Month LIBID** |
|---|---|---|---|---|---|---|
| April 13 to Sept 13 | 5,576,344 | 9 | **0.3743** | 0.3547 | 0.3615 | 0.3672 |

The figures above show that the Council received a rate of return that is compatible with the returns available in the market.

It also shows that the weighted average period is within the maximum set of 0.5 years.

Due to current economic conditions officers have decided to limit investment to a one month excluding weekends, and not to invest with banks other than with the Council's Bank. This together with mergers of Building Societies has meant the Counter Party invest list of organisations has shrank. Average investments returns are however still higher then the comparable inter bank rate (return of 0.3743% compared against 0.3672%).

3.3 Borrowing Activities

*Long term borrowing to finance Capital Expenditure*

Excluding the HRA self financing element the Council has a Capital Financing Requirement of around for the current year is £19m which arises from previous decisions to incur Capital Expenditure that was not financed immediately by internal resources e.g. Capital Receipts or Grants giving rise to the need to borrow to finance the expenditure. This borrowing requirement can either be met by long or short term external borrowing or by internal borrowing i.e. using the cash behind the authority's balances and reserves and foregoing investment income. At the present time the interest payable on long term borrowing is significantly greater than the returns the Council could expect on its investments and therefore the Council has adopted a policy of being "underborrowed" with only £3.3m of long term loans on its books. One year loans from the PWLB currently cost 1.59% so if the Council was fully funded with short term money and was receiving investment income of 0.4% there would be a cost of £202,000 pa. With 20 year rates at about 4.27% the additional cost would be £670,000pa. In these circumstances the Council has not undertaken any long term borrowing in the current year and has relied on short term borrowing to meet cash flow needs.

Additionally, as part of the Self Financing HRA Settlement £67.652m has been borrowed from PWLB. Repayment options have been discussed with members and were presented to the Executive on 13th March 2012. Repayments for principal amounts for these loans will commence in 7 years time. The loan will be repaid in equal instalments of £2.9414m over 23 yrs.

3.4 Short Term Borrowing (to cover cash flow shortfalls).

Some short term borrowing took place to cover temporary cash flow shortfalls. The movements are as follows:-

| | |
|---|---|
| Amount outstanding at 1 April 2013 | £000 |
| Plus Total Amount borrowed to September 2013 | £1,650,000 |
| Less Total Amount repaid in year | £1,650,000 |
| Amount outstanding at 30 September | Nil |

| | |
|---|---|
| The average amount borrowed was | £25,342.47 |
| Average period of loans | 6 Days |
| Number of occasions | 3 |
| Average rate of interest paid | 0.4284% |

All borrowing was conducted with the Operational Limit set by the Council.

## 5. FINANCIAL IMPLICATIONS (IB)

Any variations to budgets resulting from borrowing investing activities are reported within the Outturn position.

## 5. LEGAL IMPLICATIONS (AB)

There are no legal implications arising directly from this report.

## 6. CORPORATE PLAN IMPLICATIONS

This report supports the following Corporate Aims

- Thriving Economy

## 7. CONSULTATION

None

## 8. RISK IMPLICATIONS

It is the Council's policy to proactively identify and manage significant risks which may prevent delivery of business objectives.

It is not possible to eliminate or manage all risks all of the time and risks will remain which have not been identified. However, it is the officer's opinion based on the information available, that the significant risks associated with this decision / project have been identified, assessed and that controls are in place to manage them effectively.

The following significant risks associated with this report / decisions were identified from this assessment:

| **Management of significant (Net Red) Risks** | | |
|---|---|---|
| Risk Description | Mitigating actions | Owner |
| Loss of investments due to failure of Counterparty | Ensure Counterparty is financially secure prior to lending by confining activity to institutions on a list of approved institutions based on credit ratings. | I Bham |
| | Ensure that lending is for appropriate periods and amounts as per Counterparty list | I Bham |

9. **<u>KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS</u>**

Treasury management activities support all activities of the Borough Council and therefore impact on all areas of and communities within the Borough

10. **<u>CORPORATE IMPLICATIONS</u>**

By submitting this report, the report author has taken the following into account:

- Community Safety implications
- Environmental implications
- ICT implications
- Asset Management implications
- Human Resources implications
- Planning Implications
- Voluntary Sector implications

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Background papers: Investment and borrowing records

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