FINANCE, AUDIT AND PERFORMANCE COMMITTEE – 12TH MAY 2014

REPORT OF DEPUTY CHIEF EXECUTIVE (CORPORATE DIRECTION)

Hinckley & Bosworth Borough Council
A Borough to be proud of

RE: TREASURY MANAGEMENT TO 31st MARCH 2014

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1. PURPOSE OF REPORT

To inform the Select Committee of the Council's Treasury Management activity in 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

During the first quarter of 2014:

- Indicators suggested that the economic recovery had retained its vigour;
- Household spending rose again;
- Inflation fell to its lowest level in over 4 years;
- Unemployment edged closer to the MPC's 7% forward guidance 'phase one' threshold;
- The Budget indicated that the fiscal shackles remained firmly in place;

- After another strong quarterly expansion in UK GDP of 0.7% in Q4,. However, January's industrial production figures suggested that the recovery in manufacturing output did not gather much pace. The 2.4%

monthly fall in the volume of exports in January highlights that the recovery is still struggling to broaden out to the external sector.

- Meanwhile, household spending may have made a decent contribution to GDP growth in Q1. Although it fell in January, the official measure of retail sales volumes increased by 1.7% in February. Growth in sales off the high street has also been strong. For example, annual growth in new car registrations averaged around 17% in January and February, up from 12% in Q4. This all suggests that overall household spending may have strengthened.
- Household spending growth has been supported by further improvement in the labour market. However, the jobs recovery has lost a little pace over recent months. The 105,000 increase in employment between the three months to October and the three months to January was the smallest rise since July. Although the headline (three-month average) unemployment rate fell from 7.4% in October to 7.2% in January, this remained above November's recent low of 7.1%. As a result, the unemployment rate is still just above the 7% threshold as set out in 'phase one' of the Monetary Policy Committee's forward guidance.
- However, the MPC decided to tweak its forward guidance at the time of the February Inflation Report. All members voted in favour of this new guidance. That being said, divisions within the MPC regarding the amount of slack in the economy have opened up, with several members revealing their own personal 'best estimate' of the output gap in recent speeches, to spurious degrees of accuracy. The Bank's own estimate of the output gap is a range of between 1% to 1.5%.
- CPI inflation fell to 1.7% in February, the lowest rate since October 2009. Further increases in the value of sterling over the first quarter will exert downward pressure on import prices, which, combined with past falls in commodity prices, should mean that inflation continues to trend downwards. This all emphasises the fact that interest rates will be on hold for a long while yet.
- Meanwhile, fiscal policy is not set to ease any time soon. The package of measures announced in the March Budget were broadly speaking, fiscally neutral. Admittedly, there were a few measures to help businesses and consumers, notably another increase in the annual investment allowance for businesses and in the personal income tax allowance, but these are relatively small in size compare to the overall fiscal tightening yet to come. The OBR's forecasts for borrowing were not materially revised from those in the Autumn Statement, indicating that the Chancellor is still expected to meet his primary fiscal mandate – to return the cyclically-adjusted current budget to balance over a rolling five-year period – a year early.

  Mr Osborne refrained from bowing to pressure to take the heat out of the housing market. In fact, he added further support to the flagship Help to Buy Scheme by extending the first phase, (the equity loan part), until 2020, though the more controversial mortgage-guarantee part of the scheme was left untouched. The latest housing market data will have done little to alleviate fears of a bubble. Prices rose at an annual rate of 10.2% and 9.2% in February according to the Halifax and Nationwide measures, respectively. Admittedly, the fall in the new buyer enquiries balance of February's RICS survey suggests that demand may be beginning to wane. But the new sales instructions balance fell further into negative territory. On the basis of past form, the difference between these two balances points to house prices continuing to rise strongly in the short term

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 31 March 2014 the Council held the following investments totalling £8,539,000

Counterparty	Investment Date	Maturity Date	Amount	Interest Rate
Coventry BS	27/03/2014	28/04/2014	500,000	0.4000
Hinckley & Rugby BS	17/03/2014	17/04/2014	2,000,000	0.4000
Hsbc Call Account	31/03/2014	01/04/2014	2,889,000	0.3500
Nationwide BS	05/03/2014	07/04/2014	1,000,000	0.4000
Newcastle BS	17/03/2014	17/04/2014	500,000	0.3800
Principality BS	27/03/2014	27/04/2014	1,650,000	0.4100

Details of all investments held from April 2013 to March 2014 are included in Appendix A

Details of the weighted average investment to March 2014 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 March 14	10,981,458	9	**0.3803**	0.3476	0.3542	0.3642

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 0.3803% compared against 0.3642%).

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 March 2014	£4,650,000
Less Total Amount repaid in year	£4,650,000
Amount outstanding at March 2014	Nil

The average amount borrowed was	£50,000
Average period of loans	5 Days
Number of occasions	5

Average rate of interest paid 0.4062%

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. Ensure that lending is for appropriate periods and amounts as per Counterparty list	I Bham I Bham

9. **KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS**

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

10. **CORPORATE IMPLICATIONS**

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

Background papers: Investment and borrowing records

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