

**REPORT OF DEPUTY CHIEF EXECUTIVE (CORPORATE  
DIRECTION)**

**RE: TREASURY MANAGEMENT TO 30 SEPTEMBER 2014**

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1. **PURPOSE OF REPORT**

To inform the Select Committee of the Council's Treasury Management activity to the second quarter of 2014/15.

2. **RECOMMENDATION**

- a, That the Select Committee note the investment performance for the first six months;
- b, Note the proposed ratings changes highlighted in Appendix B.

3. **BACKGROUND TO THE REPORT**

At its meeting in February 2014 the Council approved the Council's Treasury Management Policy for the year 2014/15 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 quarter of 2014/15 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**

- After strong UK GDP in 2013, (2013 annual rate 2.7%), and 0.7% in Q1 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), it appears likely that growth will continue through 2014 and into 2015 although at a slower rate. Forward surveys for the services, construction sectors and manufacturing, are encouraging. Overall strong growth 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. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment

is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years.

- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far this year.
- In September, the U.S. Federal Reserve continued with its monthly \$10bn reductions quantitative easing. First quarter GDP figures were depressed by exceptionally bad winter weather, but quarter 2 rebounded strongly to 4.6%.
- The Eurozone (EZ) is facing an increasing threat from deflation. In September, the inflation rate fell further, to reach 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth

### 3.2 Investment Activity

The Council's investment strategy primary objectives are safeguarding the repayment of the principal and interest of its investments on time, 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 2014 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.
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- **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 2014 the Council held the following investments totalling £16,498,000 details as given in the table below

Counterparty	Investment Date	Maturity Date	Amount	Interest Rate
Coventry BS	09/09/14	09/10/14	500,000	0.4100
Coventry BS	29/09/14	29/10/14	1,000,000	0.4100
Hinckley & Rugby	18/09/14	20/10/14	2,000,000	0.4000
Hsbc Call account	29/09/14	01/10/14	348,000	0.3500
Nationwide BS	04/09/14	06/10/14	1,000,000	0.4300
Nationwide BS	11/09/14	13/10/14	1,000,000	0.4300
Nationwide BS	15/09/14	15/10/14	1,000,000	0.4300
Newcastle BS	18/09/14	20/10/14	500,000	0.3700

Newcastle BS	22/09/14	22/10/14	500,000	0.3700
Nottingham BS	01/09/14	01/10/14	500,000	0.4000
Principality BS	01/09/14	01/10/14	1,650,000	0.4100
Skipton BS	15/09/14	15/10/14	1,500,000	0.4000
Tin Hat Partnership	25/09/14	31/07/15	1,000,000	7.5000
West Bromwich BS	01/09/14	01/10/14	2,000,000	0.4400
Yorkshire BS	01/09/14	01/10/14	2,000,000	0.3000

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

Details of the weighted average investment to September 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 14 to Sep 14	9,407,203	12	<b>0.8876</b>	0.3444	0.3471	0.3694

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 shrunk. Average investments returns are however still higher than the comparable inter bank rate (return of 0.6220% compared against 0.3629%).

### 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 £19.162m 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 1.62% so if the Council was fully funded with short term money and was receiving investment income of 0.35% there would be a cost of £201,000 pa. With 20 year rates at about 4.27% the

additional cost would be £628,000pa. 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 13<sup>th</sup> 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:-

Total Amount borrowed to Sep 2014	£8,000,000
Less Total Amount repaid in year	£7,000,000
Amount outstanding at September 2014	£1,000,000
The average amount borrowed was	£915,068
Average period of loans	107 Days
Number of occasions	2
Average rate of interest paid	0.3987%

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

#### 4. Rating Agency Changes

- 4.1 After the banking crisis in the 2008 the government decided to look at the regulations that underpin investment banking. As a result the government has decided to stop underpinning support for the “investment/casino” element of the investment market. These changes are designed to give more stability and lower the risk for taxpayers. From 2016 this will result in the ratings agencies changing the way institutions are rated. The attached briefing note (Appendix B) summaries these changes.

#### 5. **FINANCIAL IMPLICATIONS (IB)**

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

#### 5. **LEGAL IMPLICATIONS (MR)**

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:

<b>Management of significant (Net Red) Risks</b>		
<b>Risk Description</b>	<b>Mitigating actions</b>	<b>Owner</b>
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. **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

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Background papers: Investment and borrowing records

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