FINANCE AUDIT & PERFORMANCE COMMITTEE – 23RD FEBRUARY

TREASURY MANAGEMENT TO 31ST DECEMBER 2014

REPORT OF [DEPUTY CHIEF EXECUTIVE CORPORATE DIRECTION

WARDS AFFECTED: ALL WARDS

Hinckley & Bosworth Borough Council
A Borough to be proud of

---

1. PURPOSE OF REPORT

1.1 To inform the Select Committee of the Council's Treasury Management activity to 31st December 2014.

2. RECOMMENDATION

2.1 That the Select Committee note the investment performance for the first nine months.

3. BACKGROUND TO THE REPORT

3.1 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 nine months 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).

3.2 Economic Background

- After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then growth in 2014 of 0.6% in Q1, 0.8% Q2, 0.7% Q3 and 0.5% Q4 (annual rate for 2014 of 2.6%), there are good grounds for optimism that growth could pick back up again during 2015 after cooling towards the end of 2014, as the positive effects from the fall in the price of oil feeds through to consumers and other parts of the economy. 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, both of which need to substantially improve on their recent lackluster performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is not expected to take any action for at least the first half of 2015 as inflation could even turn negative in this period. However, even if oil was to remain at around the $50-60 per barrel price throughout all of 2015, the positive effect of the initial drop in price during Q4 2014 will fall out of the twelve month calculation of CPI towards the end of the year, leaving inflation vulnerable to a sharp jump upwards. The MPC will also be keeping alert as to how quickly slack in the economy is being used up, especially as unemployment continues to fall. It will also be monitoring how strong a stimulative effect the drop in oil prices has on the economy as falling inflation will be comfortably exceeded by wage increases meaning that the disposable incomes of consumers will recover strongly during 2015. One continuing area of weakness in the UK economy is the need for a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates after the positive effect of the fall in oil prices dissipates. Unemployment is expected to keep on its downward trend and this is likely to feed through into a return to significant increases in wage growth at some point during the next few years. However, just how much those increases in pay rates will counteract the dampening effect of stepped increases in the Bank Rate, albeit at a slow rate, on consumer confidence, consumer expenditure and the buoyancy of the housing market, is open to conjecture.

- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014 and then halving to 0.5% in December, the lowest rate since May 2000. Forward indications are that inflation could turn negative during the earlier part of 2015; however, the MPC is focused on where inflation will be over a 2 – 3 year time horizon so too much emphasis should not be placed on the short term outlook in terms of the risks around when Bank Rate is likely to start increasing. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed, being only a fraction lower than the previous year through to December 2014. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated. The flight to quality in January 2015 has seen gilt yields fall to incredibly low levels, reducing interest costs on new and replacement government

A full economic update for non UK countries is attached in Appendix A

3.3 Investment Activity

The Council's investment strategy primary objectives are safeguarding the re-payment 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.
  -

- **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 December 2014 the Council held the following investments totalling £21,098,000 details as given in the table below

Counterparty	Investment Date	Maturity Date	Amount	Interest Rate
Coventry BS	01/12/14	02/01/15	500,000	0.4000
Coventry BS	24/12/14	26/01/15	500,000	0.4000
Coventry BS	29/12/14	29/01/15	1,000,000	0.4100
Hinckley & Rugby	19/12/14	19/01/15	2,000,000	0.4000
Hsbc Call account	29/09/14	01/10/14	348,000	0.3500
Nationwide BS	01/12/14	02/01/15	1,000,000	0.4300
Nationwide BS	03/12/14	05/01/15	2,000,000	0.4300
Newcastle BS	03/12/14	05/01/15	1,000,000	0.4000
Nottingham BS	01/12/14	02/01/15	2,000,000	0.4500
Principality BS	03/12/14	05/01/15	1,650,000	0.4000

Santander	02/12/14	07/03/15	2,000,000	0.6000
Skipton BS	24/12/14	26/01/15	1,100,000	0.4000
Tin Hat Partnership	25/09/14	31/07/15	1,000,000	7.5000
Tin Hat Partnership	27/11/14	31/07/15	1,000,000	7.5000
Tin Hat Partnership	22/12/14	31/07/15	1,000,000	7.5000
Tin Hat Partnership	22/12/14	31/07/15	1,000,000	7.5000
West Brom BS	03/12/14	05/01/15	2,000,000	0.4100
Total			**21,098,000**	

Details of all investments held from April 2014 to December 2014 are included in Appendix B

Details of the weighted average investment to December 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 Dec 14	16,135,970	17.52	**1.7306**	0.3448	0.3498	0.3727

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 interbank rate (return of 1.7306% compared against 0.3727%).

3.4 Borrowing Activities

Long term borrowing to finance Capital Expenditure

Excluding the HRA self financing element the Council has a Capital Financing Requirement of around £19.162m for the current year is 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 1.37% 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 £195,000 pa. With 20 year rates at about 3.27% the additional cost would be £559,000pa. 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.

3.5 Short Term Borrowing

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

Total Amount borrowed to Dec 2014	£12,000,000
Less Total Amount repaid in year	£8,000,000
Amount outstanding at December 2014	£4,000,000

The average amount borrowed was	£3,356,164
Average period of loans	184 Days
Number of occasions	6
Average rate of interest paid	0.5062%

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

4. FINANCIAL IMPLICATIONS [IB]

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

5. LEGAL IMPLICATIONS [MR]

5.1 There are no legal implications arising directly from this report.

6. CORPORATE PLAN IMPLICATIONS

6.1 This report supports the following Corporate Aims

- Thriving Economy

7. CONSULTATION

7.1 None

8. RISK IMPLICATIONS

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

8.2 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.

8.3 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. KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS

9.1 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

10.1 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

Background papers: Interest Working Papers
Capita (Sector) Economic Update

Contact Officer: Ilyas Bham, Group Accountant, Ext 5924
Executive Member: Cllr Keith Lynch