TRAFFORD COUNCIL

Report to:	**Accounts & Audit Committee** **Executive**
Date:	**19 November 2014** **1 December 2014**
Report for:	**Discussion**
Report of:	**The Executive Member for Finance and Director of Finance**

Report Title

Treasury Management 2014-15 Mid-Year Performance Report

Summary

In accordance with the CIPFA Code of Practice adopted by the Council, this report provides an update on the progress of the treasury management activities undertaken for the first half of 2014/15.

- **Debt Activity:-**

No new borrowings to finance the capital programme were taken and due to unfavourable market conditions no debt restructuring exercises were undertaken. At 30 September the Council's external debt was £95.3m.

- **Investment Activity:-**

The priorities when undertaking any investment continue to be security first, liquidity and then rate of return. During the first half of 2014/15 the annualised investment rate of return from proactive cash flow management was 0.71% with income generated from investment interest currently on target to exceed the 2014/15 budgeted provision of £(0.4)m by £(0.1)m. The level of return is 0.36% or £(150)k above the comparable performance indicator of the average 7-day **L**ondon **I**nterbank **BID** interest rate. At 30 September the Council's level of investments was £69.9m.

- **Prudential Indicators:-**

During the first half of 2014/15 the Council complied with its legislative and regulatory requirements, including compliance with all treasury management prudential indicators.

Recommendations

That the Accounts & Audit Committee & Executive be requested to:

1. To note the Treasury Management activities undertaken in the first half of 2014/15.

Contact person for background papers and further information:

Name: Graham Perkins
Extension: 4017

Background papers: None

Relationship to Policy Framework/Corporate Priorities	Value for Money
Financial	The Council did not encounter any cash flow liquidity difficulties and all investment income was received on time. The projected level of investment income from investments for 2014/15 is £0.5m and exceeds budget by £0.1m. Debt interest payable remains in-line with budget at £5.8m.
Legal Implications:	This is a finance report for noting.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Resource Implications e.g. Staffing / ICT / Assets	Not applicable
Risk Management Implications	The monitoring and control of risk underpins all treasury management activities and these factors have been incorporated into the treasury management systems and procedures which are independently tested on a regular basis. The Council's in-house treasury management team continually monitor to ensure that the main risks associated with this function of adverse or unforeseen fluctuations in interest rates are avoided and security of capital sums are maintained at all times.
Health & Wellbeing Implications	Not applicable
Health and Safety Implications	Not applicable

1. BACKGROUND

1.1 Each year in order to comply with the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code), the Accounts & Audit Committee together with the Executive will receive the following reports:

- annual treasury strategy for the year ahead (February)
- mid-year update report (November i.e. this report)
- annual report describing the activity undertaken compared to the strategy (June).

1.2 The Treasury Management Strategy for 2014/15 was approved by Council at its meeting on 19 February 2014 and the policies to be adopted for the year remain unchanged.

1.3 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- Economic Update (section 2)
- Treasury Position (section 3)
- Debt Activity (section 4)
- Investment Activity (section 5)
- Investment Counterparty Criteria (section 6)
- Risk Benchmarking (section 7)
- Prudential and Performance Indicators (section 8)
- Other Activity Update (section 9)
- Recommendations (section 10)

2. ECONOMIC UPDATE

2.1 The main economic headlines during the first half of 2014/15 were as follows:

UK

- GDP in 2013 grew at an annual rate of 2.7% and this trend is set to continue in 2014 with forecasters currently predicting an annual growth rate of 3.1%;
- the 3 month unemployment average continues its downward trend falling to 6.2% for the quarter ending July 2014 compared to 6.6% for the previous quarter;
- rate of inflation (CPI), fell from 1.8% in April 2014 to 1.2% in September, the lowest rate since 2009, with forward indications predicting that this is likely to fall further in 2014 to possibly near to 1%, (Government target rate is 2.0%);
- Monetary Policy Committee (MPC) maintained both the Bank Rate at 0.5% and the level of quantitative easing at £375bn. Markets had been expecting Bank Rate to rise in the first quarter of 2015 however this has now been pushed back until early Summer 2015 at the earliest in response to the MPC October minutes, which revealed that concerns were increasing over UK growth prospects and growing apprehensions of the Eurozone crises returning. This delay in the Bank Rate increasing was also highlighted by the Deputy Governor of Bank of England who stated that rates are likely to stay low for some time yet.

U.S.

- the Federal Reserve announced in October that it was to cease its quantative easing stimulus programme introduced in 2008, as it was now confident its economic recovery would continue.
- first quarter GDP figures were depressed by exceptionally bad winter weather, but growth rebounded strongly in quarter 2 to 4.6% (annualised);
- the U.S. faces similar debt problems to those of the UK, however as a result of reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has fallen from a peak of $1tr in 2009 to $486bn as at 30 September 2014, its lowest level for 6 years.

Eurozone

- the Eurozone continues to face the threat from weak or negative growth as a result from deflation;

- inflation fell further, to reach a low of 0.3% in September 2014 however, this is an average for all EZ countries and includes some countries with negative inflation;
- ECB loosened monetary policy in June 2014 to promote growth and in September it took further action when it cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and commenced a programme of purchases of corporate debt;
- whilst concern in the financial markets for the Eurozone subsided considerably during 2013, there still remain concerns that sovereign debt difficulties exist;
- in October, the European Banking Authority (EBA) & European Central Bank (ECB) both announced the results of their health checks, carried out on all Eurozone banks to determine whether the banks could withstand another financial crisis. Using the banks' financial position as at 31 December 2013, 24 failed the EBA checks and 25 failed ECB checks. These banks now have 9 months to correct their finances or risk being shut down.

2.2 Interest rate forecasts are provided by the Council's treasury management advisors Capita and the table below outlines the latest situation as at mid-September 2014 taking into consideration the above economic conditions:

	2014-15 Original Forecast%	2014-15 Revised Forecast%	2015-16 Revised Forecast%	2016-17 Revised Forecast%
Bank Rate	0.50	0.50	0.88	1.38
Investment Rates				
3 month	0.50	0.53	1.03	1.75
1 Year	0.80	0.90	1.40	2.10
PWLB Loan Rates				
5 Year	2.90	2.53	2.85	3.25
25 Year	4.75	3.87	4.33	4.70

2.3 As a consequence of the current and forecasted economic position as outlined above, the Council will continue to take a cautious approach to its treasury management strategy.

3. TREASURY POSITION

3.1 The Council's debt and investment position at the beginning and midway through the current financial year is as follows:

	31 March 2014			30 September 2014		
	Principal (£m)	**Total (£m)**	**Interest Rate (%)**	**Principal (£m)**	**Total (£m)**	**Interest Rate (%)**
DEBT						
Fixed rate:						
- PWLB	41.4			39.3		
- Market	5.0	46.4	6.83	5.0	44.3	6.70
Variable rate:						
- PWLB	0.0			0.0		
- Market	51.0	51.0	5.14	51.0	51.0	5.14
Total debt		**97.4**	**5.95**		**95.3**	**5.87**
INVESTMENTS						
- Fixed rate	26.9			47.6		
- Variable rate	24.0			22.3		
Total Investments		**50.9**	**0.79**		**69.9**	**0.71**
NET ACTUAL DEBT		**46.5**			**25.4**	

Net actual debt = Total debt less Total Investments

3.2 When reviewing the table above, it is important to note that the investment figures fluctuate daily, reflecting funds that were available on a temporary basis due to timing issues such as precept payments, receipt of grants and progress on the capital programme.

4. DEBT ACTIVITY

4.1 The Council, at 31 March 2014, was under borrowed by £45.9m, as its total Capital Financing Requirement (CFR), the underlying need to borrow for capital purposes, is higher than its actual level of external debt, £143.3m compared to £97.4m respectively and this situation is set to continue for the foreseeable future.

4.2 The Council's under borrowed position reflects historical decisions taken to fund its borrowing requirement from its own funds (cash supporting its reserves & balances) rather than taking on any new debt. This prudent and cost effective approach continues to be widely adopted by other councils and reflects the high "cost of carry" i.e. the difference between long-term debt interest rates (3.7% 25yr PWLB rate) and the current average return available from short term investments (0.5% 3mth rate).

4.3 For 2014/15 the Council's (CFR) position, is forecasted to fall by £(3.7)m reflecting the difference between the level of new capital expenditure financed by borrowing compared to the statutory minimum revenue provision (the amount set aside from revenue for the repayment of debt).

4.4 However given that the Council's CFR is higher than the actual level of external debt, there is no need for the Council to prematurely reduce its levels of debt, by the value of £(3.7)m. This course of action would incur additional costs from early breakage payments.

4.5 In the current economic climate, debt rescheduling opportunities have been limited due to the high breakage penalty (premium) costs which would need to be incurred. Therefore during the first half of the year no debt restructuring has been undertaken.

5. INVESTMENT ACTIVITY

5.1 In accordance with the Code of Conduct, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As highlighted in Section 2, it remains a difficult investment market as a result of interest rates continuing to be in line with the 0.5% Bank Rate. Indeed, the Funding for Lending scheme has reduced some market investment rates even further and investment returns are likely to remain low.

5.2 The Council's temporary investments at 30/09/2014 totalled £69.9m and were invested in the following categories;

Sector	Country	Value (£m)
Banks	UK	25.0
Building Societies	UK	5.0
Money Market Funds	UK	6.8
Local Authority	UK	5.0
Banks	Rest of World	28.1
Total		**69.9**

The maturity structure of the investment portfolio was as follows:

Period	31 March 2014 (£m)	30 September 2014 (£m)
Instant Access	24.0	21.9
Under 1 year	21.9	43.0
Under 3 years	5.0	5.0
Total	**50.9**	**69.9**

5.3 During the first half of the year, a total of 184 temporary investments were undertaken by the Council's in house treasury management team in an environment of historically low interest rates. The table below details the results of these activities, which clearly illustrates the Council outperforming the 7day LIBID benchmark, a recognised market performance indicator, by 36 basis points whilst ensuring that all risk was kept to a minimum. Currently the performance for investment interest to be earned for 2014/15 is £0.5m which is £0.1m higher than budget as a result of monies being received ahead of spending requirement.

Average temporary Investment (£m)	Average interest rate earned %	Average 7 day LIBID rate %	Additional interest earned (£k)
83.2	0.71	0.35	150

5.4 None of the institutions in which investments were placed had any difficulty in repaying and the list of institutions in which the Council invests is kept under continuous review.

5.5 During the first half of the year the Council had no liquidity difficulties due to proactive cash flow management and no temporary borrowing was undertaken.

5.6 A breakdown of the Council's investments, as at 30 September 2014 is provided at Appendix A for reference.

6. INVESTMENT COUNTERPARTY CRITERIA

6.1 As highlighted in paragraph 5.1 the primary principle governing the Council's investment criteria is the security of its investments and in order to comply with this, the Council uses a credit methodology based on credit ratings issued by the three main agencies Fitch, Moody's and Standard and Poor's.

6.2 These rating agencies recently announced that during the recent financial crisis, some institutions were provided with a ratings "uplift" due to implied levels of sovereign support. In response to a recent review of this situation by the agencies, these "uplifts" in ratings are to be removed as a result of sovereign governments moving away from a bail out role. It is important to stress that the rating agency amendments do not reflect changes in the underlying status of the institution, merely the removal of that element which has previously been built into the rating for implied Government support.

6.3 Whilst the actual timing of these changes is still subject to discussion, it is not envisaged that it will occur shortly and therefore this issue will be covered in more detail when the 2015/16 Treasury Management Strategy report is presented to Members in February 2015.

6.4 In the meantime should the credit rating agencies amend their ratings accordingly, then investments which mature and are not required for cash flow purposes will, in order to comply with the Council's current Investment criteria, be placed into Money Market Funds which are excluded from this review, until the 2015/16 strategy becomes effective.

7. RISK BENCHMARKING

7.1 In accordance with the Code of Practice and Department for Communities and Local Government Investment Guidance, appropriate security and liquidity benchmarks are used by Officers to monitor the current and future potential risk conditions and undertake any corrective action to the operational strategy if required.

7.2 These benchmarks are simple guides to maximum risk (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria.

7.3 During the first half of 2014/15 the Director of Finance can confirm that no benchmarks, which were set in the Strategy report in February 2014, were breached as shown from the information below;

- **Security** – This table shows the benchmark for the Council's investment portfolio for each individual year and reflects the level of potential default when compared to the historic default rates.

	1 year	2 years	3 years
Original maximum default rate	**0.09%**	**0.04%**	**0.14%**
Position at 30.09.14	**0.01%**	**0.04%**	**0.00%**

- **Liquidity** – In respect of this the Council set liquidity facilities/benchmarks of:
  Bank overdraft - £0.5m
  Liquid short term deposits of at least £15m available with a week's notice.
  Weighted Average Life (WAL) benchmark expected to be 6 months, with a maximum of 3 years.

  For the first half of 2014/15 the above liquidity arrangements were complied with and at 30 September 2014 the WAL of its investments was 4 months.

- **Yield** - The local measure of the yield benchmark is to achieve a return above the 7 day LIBID rate.

  For the first half year of 2014/15 the investment interest return averaged 0.71%, against a 7 day LIBID rate of 0.35%.

- **Origin** – This stipulated that no more than 40% of the Council's total investments to be directly placed with non-UK counterparties at any time.

  For the first half of 2014/15 the maximum level during this period was 40%.

8. PRUDENTIAL AND PERFORMANCE INDICATORS

8.1 In accordance with CLG Guidance, the CIPFA prudential Code and the CIPFA Code of Practice on Treasury Management, the Council has in place a number of prudential indicators ensuring that the Council's capital expenditure plans and borrowing remain robust, prudent and sustainable.

8.2 These indicators were originally set in February 2014 for the forthcoming year and are monitored on a monthly basis. During the first half of 2014/15 it can be reported that no breaches occurred.

9 OTHER ACTIVITY UPDATE

9.1 In the Treasury Management 2013/14 Outturn report, Members were informed of the decision by The Co-operative bank to withdraw from the Local Authority market and as a consequence of this, an AGMA Procurement exercise to find a replacement bank for 14 Local Authorities, including 2 from West Yorkshire, has been undertaken.

9.2 A total of 3 banks returned tenders for this service which were analysed by the group and following interviews and presentations, Barclays Bank was successfully appointed to provide the banking services effective from 2015.

9.3 Within the terms and conditions of the AGMA Framework Agreement, Barclays Bank is to provide the Council's banking service requirements during the next 5 years with an option to extend this for a further 2 years. It is anticipated that during the life of the original 5 year contract period, a revenue saving in bank charges of approximately £118k could be encountered, however the level of actual saving will be subject to banking activities undertaken.

10 RECOMMENDATIONS

10.1 That the Accounts & Audit Committee & Executive be requested to;

- Note the Treasury Management activities undertaken in the first half of 2014/15.

Other Options

This report has been produced in order to comply with Financial Regulations and relevant legislation and provides an overview of transactions undertaken during the first half of 2014/15.

Consultation

Information for the period 1 April 2014 to 30 September 2014 was obtained from Capita, the Council's external consultants.

Reasons for Recommendation

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

Finance Officer Clearance *GB ……*

Legal Officer Clearance ....HK.......

Director's Signature …………….

APPENDIX A

Breakdown of Investments as at 30 September 2014

Counterparty	Amount £k	Total £k
UK Institution		
Local Authority		
Greater Manchester Waste Disposal Authority	5,000	5,000
Banks		
Barclays	5,000	
Lloyds	20,000	25,000
Building Societies		
Nationwide	5,000	5,000
Money Market Funds		
Federated	3,000	
Ignis	2,760	
Invesco Aim	380	
Legal & General	630	6,770
Total UK Institutions		**41,770**
Non UK Institutions		
National Bank of Abu Dhabi	5,000	
Overseas Chinese Banking Corporation	4,000	
Development Bank of Singapore	5,600	
Sumitomo Mitsui Banking Corp. Europe Ltd	3,000	
Svenska Handelsbanken	10,500	28,100
Total Non UK Institutions		**28,100**
Grand Total		**69,870**