Report to:

Cabinet

Council

Audit and Corporate Governance Committee

Report of Head of Finance

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To: Audit and Corporate Governance Committee on: 28 January 2014
To: Cabinet on: 13 February 2014
To: Council on: 20 February 2014

Treasury management mid year monitoring report 2013/14

Recommendations

That Audit and Corporate Governance committee:

1. notes the treasury management mid year monitoring report 2013/14, and
2. is satisfied that the treasury activities are carried out in accordance with the treasury management strategy and policy.

That Cabinet:

3. considers any comments from Audit and Corporate Governance committee and recommends council to approve the report.

Purpose of report

1. The report fulfils the legislative requirements to ensure the adequate monitoring of the treasury management activities and that the council's prudential

indicators are reported to council mid year. The report provides details of the treasury activities for the first six months of 2013/14 and an update on the current economic conditions with a view to the remainder of the year.

Strategic objectives

2. An effective treasury management strategy is required in order to meet our strategic objective of managing our business effectively. Managing the finances of the authority in accordance with the treasury management strategy will help to ensure that resources are available to deliver its services and meet the council's other strategic objectives.

Background

3. The council's treasury activities are strictly regulated by legislation. The CIPFA Prudential Code and CIPFA Treasury Management Code of Practice requires a monitoring report to be provided mid year to council. The report covers the treasury activity for the period 1 April to 30 September.

4. The 2013/14 treasury management strategy was approved by council on 22 February 2013. This report provides details on the treasury activity and performance for the first six months of 2013/14 against prudential indicators and benchmarks set for the year. It is also an opportunity to review and revise the limits if required. Full council is required to approve this report.

The economy and interest rates

5. An update on the economic conditions and interest rate forecasts is in appendix A.

Icelandic banks – Kaupthing Singer & Friedlander

6. The council has now received £2,078,706 in respect of the claim for £2.6 million (£2.5 million investment plus interest) from the investment made with the failed Icelandic bank Kaupthing Singer & Friedlander (KSF).

7. The administrators intend to make further payments at regular intervals. The latest information states that it is the administrators' current intention to pay the eleventh dividend by the end of December 2013. The estimated total amount to be recovered is forecast to be in the range of 84p to 86.5p in the pound. This equates to between £2,209,901 and £2,275,671.

Investments

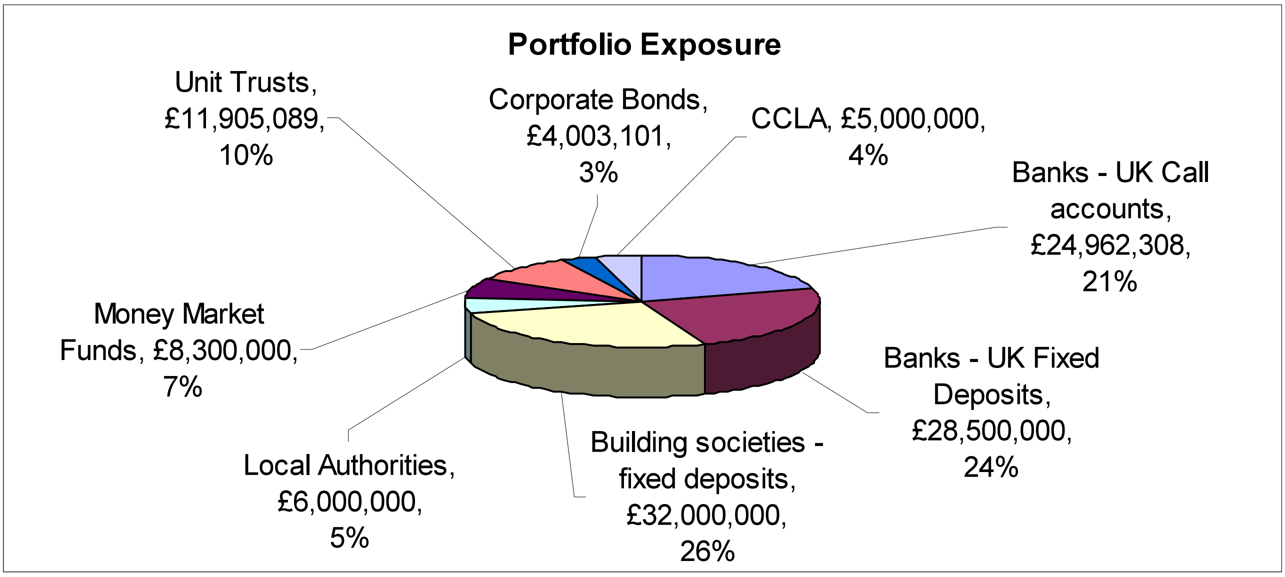
8. In accordance with the Code the council's investment position as at 30 September 2013 is shown in table 1 below.

Table 1: maturity structure of investments at 30 September 2013:	Total £000's	% holding
Cash deposits:		
Call accounts	24,962	21%
Up to 1 month	4,000	3%
2 Month	8,000	7%
3 Month	9,000	7%
4 Month	6,500	5%
5-6 Month	5,500	5%
7-12 Month	23,500	19%
1 -2 Year	3,000	2%
3-4 Year	2,000	2%
7 year	5,000	4%
Kaupthing Singer & Friedlander	222	1%
Total cash deposits	**91,685**	**77%**
CCLA Property Fund	5,000	4%
Equities	11,905	10%
Corporate bonds	4,003	2%
Money market funds	8,300	7%
Total investments	**120,893**	**100%**

Note: £121 million does not represent uncommitted resource the council has at its disposal. This amount includes council tax receipts held prior to forwarding to Oxfordshire County Council and the Police and Crime Commissioner for the Thames Valley, business rate receipts prior to payment to the government and committed capital and revenue balances. Details of the council's uncommitted balances are provided in the annual budget and council tax setting report.

9. The council currently holds a significant proportion of its investments in the form of cash deposits, the majority of which have been placed for fixed terms with a fixed investment return. 21 per cent of the entire investment portfolio is held on call or in notice accounts, with 77 per cent of the total investment portfolio held in cash deposits.

10. The chart below shows in percentage terms how the portfolio is spread across the types of investments.



11. Total investment income is forecast to be around £2.1 million in 2013/14 against a budget of £1.9 million. Table 2 shows the interest earned for the first six months.

Table 2: Investment interest earned by investment type Interest Earned April - September 2013				
Investment type	Annual Budget £000's	Actual To date £000's	Profiled Budget £000's	Variation £000's
Call accounts	223	119	112	7
Cash deposits < 1 yr	770	193	385	(192)
Cash deposits > 1 yr	80	456	40	416
MMF	15	14	8	6
Corporate bonds	259	198	130	68
CCLA	300	150	150	-
Equities*	300	205	150	55
	1,947	**1,335**	**975**	**360**

* Interest on equities not included in annual budget as non-distributable

Treasury activity

12. Market rates are significantly lower than they were a year ago. The government's Funding for Lending Scheme (FLS) has lowered the rates at which banks can access funding and has now been extended to building societies. This access to cheaper borrowing is a key factor in the fall in market rates now available to the council.

13. Re-investment opportunities are not nearly as attractive as a year ago, one year rates have dropped by nearly two per cent. There is currently little incentive to reinvest longer term periods. However, in order to widen the

investment portfolio and spread the balance of risk, officers have been seeking longer dated investments with other local authorities.

14. The weighted average maturity period has increased to 264 days from 231 days in 2012/13. As a result of the many banking downgrades there are now fewer financial institutions meeting the council's investment criteria. When it is possible investments will be placed with highly rated institutions with a view to increase the weighted average maturity of the portfolio.

15. The value of the unit trusts has moved from £13.4 million at the start of April down to £11.9 million at the end of September. This movement is due to a sale of £2 million made in May 2013, when the value of the unit trusts reached £14 million. This is the trigger point value at which it was agreed to sell some of the council's holdings and officers continue to monitor the valuations for further possible disposals.

Performance measurement

16. A list of investments as at 30 September is shown in appendix B. All investments were with approved counterparties. The average level of investments held was £110 million and the average return on these investments is shown below in table 3. This shows in summary the performance of the council's investments against the benchmarks set out in the Treasury Management Strategy. These benchmarks are used to assess and monitor the council's investment performance for each type of investment.

Table 3: investment returns achieved against benchmark

	Benchmark return %	Actual return %	Growth (below)/above benchmark %	Benchmarks
Bank & building society deposits - non-managed	0.38%	1.50%	1.12%	3 Month LIBID
Equities	1.89%	1.70%	-0.19%	FTSE all shares index
Corporate bonds	0.50%	5.68%	5.18%	BoE base rate

Note: the benchmark return for equities reflects the movement in capital value. All other benchmarks reflect earnings of investment income.

Treasury management limits on activity

17. The council is required by the Prudential Code to report on the limits set each year in the Treasury Management Strategy. The purpose of these limits is to ensure that the activity of the treasury function remains within certain parameters, thereby mitigating risk and reducing the impact of an adverse

movement in interest rates. However, if these limits are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The limits are shown in appendix C.

Debt activity during 2013/14

18. During the first six months of 2013/14 there has been no need for the council to borrow. The council will continue to take a prudent approach to its debt strategy. The prudential indicators and limits set out in appendix C provide the scope and flexibility for the council to borrow in the short-term up to the maximum limits, if such a need arose within the cash flow management activities of the authority, for the achievement of its service objectives.

Recommended changes to the treasury management strategy

19. Council approved the 2013/14 treasury management strategy on 21 February 2013. There are no proposed changes to the strategy for 2013/14 at this time.

Investments made outside the treasury management strategy

20. During the first six months of 2013/14, officers made a seven-year deal with another local authority. This increases the spread of the portfolio and balances the risk. The treasury management strategy allows lending to local authorities for a maximum five year period. The decision to lend outside the treasury management strategy was taken in consultation with the section 151 officer/Head of Finance as per the council's constitution.

Financial implications

21. This time last year forecasts were that inflationary pressures would mean that interest rates would probably have to start rising towards the end of 2013. This hasn't happened and the current outlook for growth for the UK economy means interest rates are very low and likely to remain so. Investments made early in 2013 should ensure that the interest earned on investments for 2013-14 is around £2.1 million. However from 2014, income may reduce for a year or so until market rates rise. This will be reflected in the council's medium term financial plan.

22. As a result of the agreed expenditure priorities of the council, investments, including working capital, are projected to fall to approximately £90 million by 2015/16. Should investment rates recover to three percent then annual returns will be around £3 million.

Legal implications

23. There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services, the ODPM Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

Conclusion

24. This report provides details of the treasury management activities for the period 1 April 2013 to 30 September 2013 and the mid year prudential indicators to council.

25. These details confirm that treasury activities have operated within the agreed parameters set out in the approved treasury management strategy, and provides the monitoring information for audit and corporate governance committee to fulfil the role of scrutinising treasury management activity.

Background papers

- CIPFA Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes
- CIPFA Prudential Code for Capital Finance in Local Authorities
- Various committee reports, principally:-

  I. Treasury Management Policy Statement, Treasury Management Practices (cabinet 7 March 2002)
  II. Recommendation of amendment to delegated authority (council 28 October 2004)
  III. Treasury Management Investment Strategy 2013/14(cabinet 14 February 2013, council 21 February 2013)

Appendices

A – Economic update and interest rates
B – List of investments as at 30 September 2013
C – Prudential Indicators

Appendix A

Economic Update and interest rates

A1. UK is in a period of sustained growth in 2013 as the economic recovery since 2008 had been the worst and slowest in recent history. All three main sectors, construction, services and manufacturing contributed to this upturn.

A2. Growth is expected to be strong in the immediate future. One downside is that wage increases continue to remain significantly below CPI inflation so disposable income and living standards are under pressure.

A3. The Euro region returned to growth in 2013, ending seven quarters of recession. However, growth is still weak but the ECB has declared it would do whatever it takes to stabilise the Eurozone including buying unlimited amounts of bonds of countries asking for a bailout.

A4. The government's 'Funding for Lending Scheme' (FLS) has been introduced to improve access to mortgages at lower rates. The FLS certainly seems to be having a positive effect in terms of encouraging house purchases. While there have been concerns that these schemes are creating a bubble in the housing market, the house price increases outside of London and the south-east have been minimal. However bank lending to small and medium enterprises still remains weak as banks continue to repair their balance sheets and anticipating tightening of regulatory requirements.

A5. Investor demand in UK gilts as a 'safe haven' continues to keep yield increases down. Long term rates will eventually rise, mainly due to the fact that high volumes of gilts have been issued already in the UK and also in other major western countries. Increasing investor confidence is also likely to compound the effect.

A6. The Bank of England issued forward guidance in August which said that the Bank will not start to consider raising interest rates until the jobless rate has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years in August, but revised to possibly quarter 4 2014 in November.

A7. Concerns over investment counterparty risk remain because of the volatile economic conditions. However the council's current treasury management policy manages this risk down to a low level.

Interest rates

A8. The Bank of England changed its forecast in the August Inflation report and upgraded growth from 1.2% to 1.6% in 2013 and from 1.7% to 2.8% in 2014.

A9. Bank rate remained unchanged at 0.5% throughout the first half of 2013/14. The earlier forecast of a rate rise in Q4 of 2014 has been postponed until Q2 in 2016

A10. Deposits rates have fluctuated in a very narrow range during the first six months of the financial year. Investment rates have remained flat with a range between 0.5 per cent to around 1.0 per cent for up to a year's maturity. This has dropped significantly as banks and building societies were offered further cheap cash supply via the FLS. The short term rates from one month to six months offer very little differential with six month rates ranging between 0.37 per cent and 0.55 per cent.

Appendix A

A11. Sector's forecast of the expected movement in medium term interest rates:

	NOW	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3 month LIBID	0.39	0.40	0.50	0.50	0.50	0.50	0.50	0.50
6 month LIBID	0.47	0.50	0.60	0.60	0.60	0.60	0.60	0.60
12 month LIBID	0.74	0.80	0.80	0.80	0.80	0.80	0.80	0.80
5 yr PWLB	2.20	2.20	2.50	2.50	2.60	2.70	2.70	2.80
10 yr PWLB	3.40	3.30	3.60	3.60	3.70	3.80	3.80	3.90
25 yr PWLB	4.30	4.20	4.40	4.40	4.50	4.50	4.60	4.60
50 yr PWLB	4.30	4.30	4.40	4.40	4.50	4.50	4.60	4.70
	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
BANK RATE	0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.25
3 month LIBID	0.50	0.50	0.50	0.50	0.60	0.70	0.90	1.30
6 month LIBID	0.60	0.60	0.60	0.70	0.80	1.00	1.20	1.40
12 month LIBID	0.80	1.00	1.20	1.40	1.60	1.80	2.00	2.30
5 yr PWLB	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.40
10 yr PWLB	3.90	4.00	4.10	4.20	4.30	4.30	4.40	4.50
25 yr PWLB	4.70	4.80	4.90	5.00	5.10	5.10	5.10	5.10
50 yr PWLB	4.80	4.90	5.00	5.10	5.20	5.20	5.20	5.20

Appendix B

Investments as at 30 September 2013 Counterparty	Deposit Type	Principal	Rate
Kaupthing Singer and Friedlander TUK		222,229	6.41%
Barclays Bank plc	Fixed	2,000,000	2.60%
West Bromwich Building Society	Fixed	2,000,000	0.95%
Bank of Scotland	Fixed	3,000,000	2.80%
Barclays Bank plc	Fixed	3,000,000	2.75%
Royal Bank of Scotland	Fixed	2,000,000	1.55%
Royal Bank of Scotland	Fixed	5,000,000	2.82%
Royal Bank of Scotland	Fixed	1,500,000	3.25%
Royal Bank of Scotland	Fixed	1,500,000	3.10%
Marsden Building Society	Fixed	1,000,000	0.60%
National Counties Building Society	Fixed	2,500,000	0.65%
Manchester Building Society	Fixed	2,000,000	0.86%
Manchester Building Society	Fixed	2,000,000	0.90%
Newcastle Building Society	Fixed	2,000,000	0.88%
Newcastle Building Society	Fixed	2,000,000	0.88%
Barclays Bank plc	Fixed	1,500,000	2.60%
Nottingham Building Society	Fixed	2,000,000	0.85%
West Bromwich Building Society	Fixed	2,000,000	1.05%
Skipton Building Society	Fixed	2,000,000	0.86%
West Bromwich Building Society	Fixed	3,000,000	0.95%
National Counties Building Society	Fixed	1,500,000	1.00%
National Counties Building Society	Fixed	2,000,000	1.00%
Bank of Scotland	Fixed	5,000,000	1.01%
National Counties Building Society	Fixed	2,000,000	1.00%
West Bromwich Building Society	Fixed	1,000,000	0.93%
West Bromwich Building Society	Fixed	3,000,000	1.05%
Barclays Bank plc	Fixed	2,000,000	3.75%
Kingston upon Hull City Council	Fixed	1,000,000	1.90%
HSBC	Fixed	2,000,000	1.90%
Kingston upon Hull City Council	Fixed	3,500,000	2.70%
Kingston upon Hull City Council	Fixed	1,500,000	2.70%
Santander	Call	14,960,000	0.90%
Royal Bank of Scotland	Call	10,000,000	1.05%
Royal Bank of Scotland	Call	2,308	0.85%
Goldman Sachs	MMF	3,910,000	Variable
Deutsche Bank	MMF	1,030,000	Variable
Blackrock	MMF	3,360,000	Variable
L&G Equities	Unit Trust	11,905,089	Variable
CCLA	Property Fund	5,000,000	Variable
Royal Bank of Scotland	Corporate Bond	1,642,500.00	9.63%
Halifax	Corporate Bond	2,048,400.00	11.50%
Santander	Corporate Bond	312,201.00	11.50%
GRAND TOTAL		**120,892,727**	

Appendix C

Prudential indicators as at 30th September 2013

	2013/14 Original Estimate £m	Actual as at 30-Sep £m
Debt		
Authorised limit for external debt		
Borrowing	5	0
Other long term liabilities	5	0
	10	**0**
Operational boundary for external debt		
Borrowing	2	0
Other long term liabilities	3	0
	5	**0**
Interest rate exposures		
Maximum fixed rate borrowing	100%	**0**
Maximum variable rate borrowing	100%	**0**
Investments		
Interest rate exposures		
Limits on fixed interest rates	100	100
Limits on variable interest rates	30	21
Principal sums invested > 364 days		
Upper limit for principal sums invested >364 days	70	10
Limit to be placed on investments to maturity:		
1 - 2 years	70	3
2-5 years	50	2
5 years+	50	5
Investment portfolio spread		
Supranational bonds	15	0
Gilts	15	0
Equities*	10	12
Corporate bonds	10	4
Money market funds	20	8
Pooled bond fund	5	0
Property - direct investments	30	16
Property related pooled funds	10	5
External fund manager	20	0
Cash and certificates of deposit	85%	77%
Debt management account deposit facility	100%	0%

*Limit at time of purchase - Equities include accumulated dividends

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