

Report to:



Listening Learning Leading

Cabinet

Council

Audit and Corporate Governance Committee

Report of Head of Finance

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To: Audit and Corporate Governance Committee on: 20 January 2015

To: Cabinet on: 12 February 2015

To: Council on: 19 February 2015

Treasury management mid year monitoring report 2014/15

Recommendations

That Audit and Corporate Governance committee:

1. notes the treasury management mid year monitoring report 2014/15, 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 2014/15 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 Code of Practice for Treasury Management requires a monitoring report to be provided mid year to council. The report covers the treasury activity for the period 1 April 2014 to 30 September 2014.
4. The 2014/15 treasury management strategy was approved by council on 20 February 2014. This report provides details on the treasury activity and performance for the first six months of 2014/15 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 and amendments to the Treasury Management Strategy.

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 £2,144,488 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 twelfth dividend on 10 December 2014. The estimated total amount to be recovered is forecast to be in the range of 85p to 86.5p in the pound. This equates to between £2,236,209 and £2,275,671.

Investments

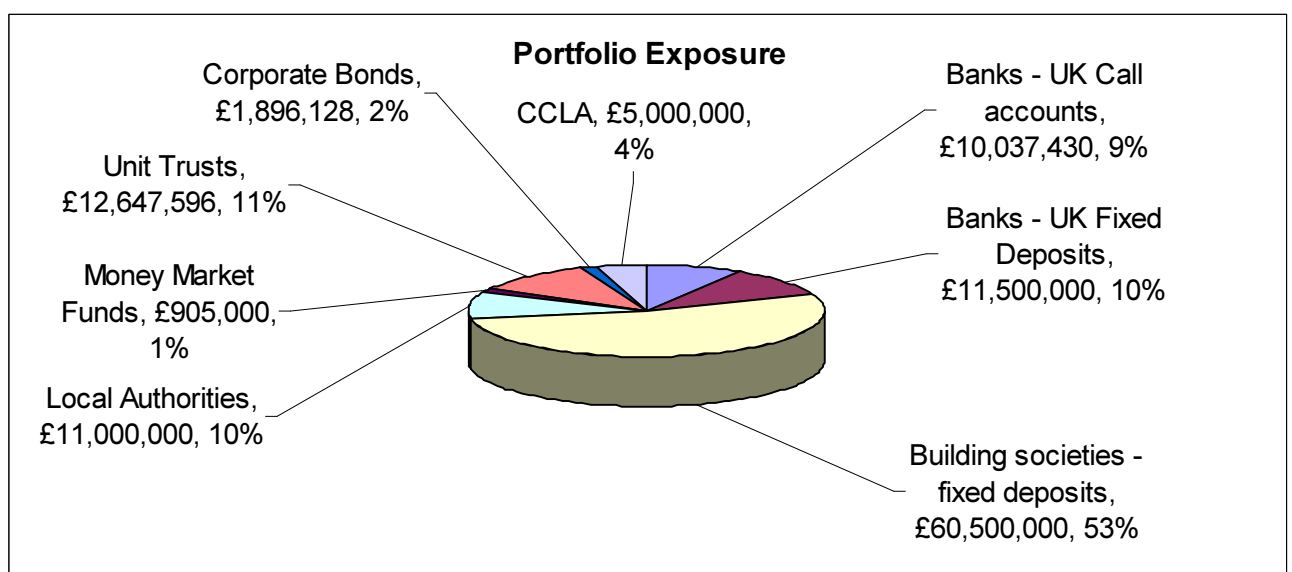
8. In accordance with the Code the council's investment position as at 30 September 2014 is shown in table 1 below.

Table 1: maturity structure of investments				
	Classification of investment at deal date £'000	% holding	Classification as at 30/09/14 £'000	% holding
Call	10,037	9%	10,037	9%
Money market funds	905	1%	905	1%
Less than 6 months	0	0%	36,000	32%
6 months to 1 year	66,000	58%	35,000	31%
1 - 2 years	2,000	2%	3,000	3%
2 - 3 years	3,000	3%	2,000	2%
3 - 7 years	12,000	11%	7,000	6%
Corporate bonds	1,896	2%	1,896	2%
CCLA - property fund	5,000	4%	5,000	4%
Equities	12,648	11%	12,648	11%
	113,486	100%	113,486	100%

Note: £113 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.

The figure for total investments shown above excludes the £15 million 20-year loan to SOHA made in 2013/14 and the balance outstanding with KSF.

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. 9 per cent of the entire investment portfolio is held on call or in notice accounts, with 83 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 £2.4 million in 2014/15 against a budget of £2.1 million. Table 2 shows the interest earned for the first six months.

Table 2: Investment interest earned by investment type				
Interest Earned April - September 2014				
Investment type	Annual Budget	Actual To date	Profiled Budget	Variation
	£000's	£000's	£000's	£000's
Call accounts	250	28	125	(97)
Cash deposits < 1 yr	560	277	280	(3)
Cash deposits > 1 yr	526	197	263	(66)
MMF	34	6	17	(11)
Corporate bonds	120	88	60	28
CCLA	300	150	150	-
Equities*	300	183	150	33
SOHA loan	0	312	0	312
	2,090	1,241	1,045	196

Treasury activity

12. The Funding for Lending Scheme (FLS) lowered funding costs for banks and building societies. This access to cheaper borrowing is a key factor in the fall in market rates currently available. Longer term investment rates with high quality counterparties remain low, restricting the ability to place investments of greater than 12 months duration.
13. As at the end of September 2014, the weighted average maturity period of investments was 272 days. This is higher than the equivalent period last year, reflecting lower balances held in call accounts and the placing of long term investments with two local authorities (Blaenau Gwent County Borough Council and Kingston Upon Hull City Council) subsequent to the issue of the last mid year monitoring report.
14. 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 for a longer duration with a view to increasing the weighted average maturity of the portfolio.

Performance measurement

15. A list of investments as at 30 September is shown in appendix B. All investments were with approved counterparties. 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	0.42%	1.13%	0.71%	3 Month LIBID
Equities	-1.41%	1.48%	2.89%	FTSE all shares index
Property related investments	4.15%	6.55%	2.40%	IPD balanced property trust index
Corporate bonds	0.50%	9.91%	9.41%	BoE base rate

Note:

- (i) Benchmark return for equities reflects the movement in capital value. All other benchmarks reflect earnings of investment income.
- (ii) Return on corporate bond represents return against par value of bonds and ignores amortisation of purchase premium. If bonds are held to redemption the return will be in the region of 5.89% (5.39% above benchmark).

Treasury management limits on activity

- 16. 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 2014/15

- 17. During the first six months of 2014/15 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.

Financial implications

- 18. Recent economic data has shown continued growth in UK GDP, improving sentiment in the services and construction sectors and falling levels of unemployment. Despite this, the Bank of England's Monetary Policy Committee continues to take a cautious view on rates and the projection from the council's treasury advisors (Capita Asset Services) is that falling rates of inflation have reduced the likelihood of a rise in official rates before the second quarter of 2015. It is estimated that when rates do rise, they will do so slowly due to concerns over the sustainability of the recovery and the continuing levels of high personal indebtedness.
- 19. The latest estimate is that income receivable on cash investments will come in below budget, owing to the continued challenging interest rate environment and a limited number of high quality counterparties with which to invest. However, as a result of interest receivable on the £15 million loan to SOHA which was advanced in 2013/14 it is projected that overall interest receivable will be in the region of £324,000 above budget.

Legal implications

20. 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 and the CLG Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

Conclusion

21. This report provides details of the treasury management activities for the period 1 April 2014 to 30 September 2014 and the mid year prudential indicators to council.
22. 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 (revised 2011)
- CIPFA Prudential Code for Capital Finance in Local Authorities (2011 edition)
- Various committee reports, principally:-
 - I. Treasury Management Investment Strategy 2014/15(cabinet 13 February 2014, council 20 February 2014)

Appendices

- A – Economic update and interest rates
- B – List of investments as at 30.09.14
- C – Prudential Indicators

Economic Update and interest rates

1. There was strong growth in UK Gross Domestic Product in quarters 2-4 of the 2013 calendar year. Quarter 1 and 2 of 2014 continued this trend and surveys in the services and construction sector have revealed encouraging business sentiment.
2. The overall strong growth has seen unemployment fall below the threshold of 7% originally earmarked by the Bank of England Monetary Policy Committee (MPC) as the level below which unemployment had to fall before it would consider an increase in the bank base rate.
3. The MPC subsequently broadened its forward guidance by looking at a much broader range of indicators in order to form a view on when rates should rise. The MPC is particularly concerned that wage inflation needs to rise above the level of general inflation (a real terms rise in wages) for the economic recovery to be sustainable.
4. Growth is expected to peak in 2014 and tail off slightly into 2015 and 2016. Unemployment is expected to continue on a downward trend and this is expected to significant increases in pay rates at some point in the next three years.
5. In the global economy, the United States demonstrated disappointing quarter 1 GDP figures, but quarter 2 figures rebounded strongly. On the other hand, the Eurozone area is facing an increasing threat from deflation. Greece continues to struggle with implementing fiscal controls and the second and third largest European economies – France and Italy – are struggling to enforce their own austerity programmes.
6. In the UK, inflation has also fallen (Consumer Price Inflation fell to 1.2% in September 2014 from 1.5% in August), reflecting cheaper transport costs, lower energy and food prices. In reaction to this data and uncertainty in the Middle East, UK government bond prices rose to their highest level in over a year as investors sought a safe haven. Bond yields have fallen accordingly, with 10-year gilts falling from 2.13% to under 2% - the lowest since June 2013.
7. The fall in UK inflation and the weakening in the Eurozone area has increased market speculation that any move to increase Bank of England base rates will now be delayed until later in 2015.
8. Concerns over investment counterparty risk remain because of the wider economic conditions. However the council's current treasury management policy aims to manage this risk down to a low level.

Interest rates

9. The bank rate remained unchanged at 0.5 per cent throughout the first half of 2014/15. The council's treasury advisor, Capita Asset Services, has undertaken a review of interest rate forecasts. The current period of strong economic growth in the UK remains vulnerable to a downturn in the Eurozone area and there are concerns that UK growth is currently over dependent on consumer spending and the strength of the housing market. Consequently, whilst the expectation remains that bank rates will rise in the next financial year, the latest projection from Capita Asset Services is that the first increase in bank rate will not happen until the second quarter of 2015.
10. The Governor of the Bank of England has signalled that any increase in base rates will be slow and gradual as the MPC is concerned about the impact that increases will

have on heavily indebted consumers, especially given that wage inflation is running significantly below the rate of CPI inflation.

11. Capita Asset Service’s forecast of the expected movement in medium term interest rates is shown in the table below:

	NOW	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
BANK RATE	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	2.00	2.25	2.50
3 month LIBID	0.50	0.50	0.60	0.80	0.90	1.10	1.30	1.40	1.60	1.90	2.10	2.10	2.30	2.40	2.60
6 month LIBID	0.65	0.70	0.80	1.00	1.10	1.20	1.40	1.50	1.80	2.00	2.20	2.30	2.50	2.70	2.80
12 month LIBID	0.93	0.90	1.00	1.20	1.30	1.40	1.70	1.80	2.10	2.20	2.30	2.40	2.60	2.80	3.00
5 yr PWLB	2.40	2.50	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.50	3.50	3.50
10 yr PWLB	3.00	3.20	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.10	4.10	4.20	4.20	4.30	4.30
25 yr PWLB	3.70	3.90	4.00	4.10	4.30	4.40	4.50	4.60	4.70	4.70	4.80	4.80	4.90	4.90	5.00
50 yr PWLB	3.70	3.90	4.00	4.10	4.30	4.40	4.50	4.60	4.70	4.70	4.80	4.80	4.90	4.90	5.00

Agenda Item 6 Appendix B

Investments as at 30 September 2014					
Counterparty	Deposit type	Maturity date	Investment duration in days	Principal	Rate
Newcastle Building Society	Fixed	02/10/2014	304	2,000,000	0.85%
Furness Building Society	Fixed	02/10/2014	304	2,000,000	0.88%
Progressive Building Society	Fixed	03/10/2014	302	1,000,000	0.85%
Manchester Building Society	Fixed	13/10/2014	273	2,000,000	0.90%
West Bromwich Building Society	Fixed	15/10/2014	364	2,000,000	1.00%
Manchester Building Society	Fixed	27/10/2014	273	2,000,000	0.90%
National Counties Building Society	Fixed	03/11/2014	305	2,500,000	1.00%
Close Brothers	Fixed	27/11/2014	364	2,500,000	1.15%
Close Brothers	Fixed	15/12/2014	364	3,000,000	1.00%
Skipton Building Society	Fixed	17/12/2014	364	2,000,000	0.88%
Newcastle Building Society	Fixed	05/01/2015	308	2,000,000	0.90%
Newcastle Building Society	Fixed	19/01/2015	308	2,000,000	0.90%
Skipton Building Society	Fixed	05/02/2015	247	2,000,000	0.73%
Principality Building Society	Fixed	05/02/2015	234	2,000,000	0.70%
Nottingham Building Society	Fixed	12/03/2015	254	3,000,000	0.75%
Skipton Building Society	Fixed	13/03/2015	270	2,000,000	0.80%
National Counties Building Society	Fixed	16/04/2015	304	1,500,000	0.80%
National Counties Building Society	Fixed	20/04/2015	304	2,000,000	0.85%
Manchester Building Society	Fixed	23/04/2015	274	1,000,000	0.90%
Newcastle Building Society	Fixed	27/04/2015	304	2,000,000	0.93%
West Bromwich Building Society	Fixed	05/05/2015	364	2,000,000	0.95%
Skipton Building Society	Fixed	08/05/2015	364	2,000,000	0.91%
Newcastle Building Society	Fixed	08/05/2015	304	2,000,000	0.95%
National Counties Building Society	Fixed	21/05/2015	304	2,000,000	0.90%
Furness Building Society	Fixed	02/06/2015	273	2,000,000	0.85%
West Bromwich Building Society	Fixed	15/06/2015	364	3,000,000	0.90%
National Counties Building Society	Fixed	26/06/2015	304	2,000,000	0.84%
Progressive Building Society	Fixed	26/06/2015	304	1,000,000	0.83%
Progressive Building Society	Fixed	26/06/2015	304	1,000,000	0.83%
West Bromwich Building Society	Fixed	02/07/2015	364	4,000,000	1.15%
Skipton Building Society	Fixed	02/07/2015	364	1,500,000	0.93%
West Bromwich Building Society	Fixed	22/07/2015	364	1,000,000	1.10%
Skipton Building Society	Fixed	01/09/2015	364	2,000,000	1.00%
Santander	Call *			9,940,000	0.40%
Royal Bank of Scotland	Call *			2,329	0.25%
Royal Bank of Scotland	Call *			95,101	0.25%
Goldman Sachs	MMF *			320,000	0.41%
Deutsche Bank	MMF *			265,000	0.40%
Blackrock	MMF *			320,000	0.40%
Total short term cash investments (<1 yr duration)				76,942,430	
Barclays Bank	Fixed	02/12/2014	1096	2,000,000	3.75%
Kingston upon Hull City Council	Fixed	15/06/2015	1309	1,000,000	1.90%
Close Brothers	Fixed	14/09/2015	367	2,000,000	1.30%
Blaenau Gwent County Borough Council	Fixed	08/04/2016	913	3,000,000	1.38%
HSBC	Fixed	27/02/2017	1827	2,000,000	1.90%
Kingston upon Hull City Council	Fixed	19/08/2020	2557	3,500,000	2.70%
Kingston upon Hull City Council	Fixed	19/08/2020	2557	1,500,000	2.70%
Kingston upon Hull City Council	Fixed	15/01/2021	2557	2,000,000	2.50%
Total long-term cash investments (>1 yr duration)				17,000,000	
Royal Bank of Scotland	Corporate Bond	22/06/2015		1,578,000	9.63%
Santander	Corporate Bond	04/01/2017		318,128	11.50%
Total corporate bond investments				1,896,128	
CCLA	Property			5,000,000	Variable
Legal & General Equities	Unit Trust			12,647,596	Variable
Total Investments				113,486,154	

* Rates are variable. Returns shown represent prevailing rates at end Q2 2014.

Above figures exclude balance outstanding from Kaupthing Singer and Friedlander and SOHA loan

Prudential indicators as at 30th September 2014

	2014/15 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	83
Limits on variable interest rates	30	11
Principal sums invested > 364 days		
Upper limit for principal sums invested >364 days	70	17
Limit to be placed on investments to maturity:		
1 - 2 years	70	2
2-5 years	50	5
5 years+	50	9
Investment portfolio spread		
Supranational bonds	15	0
Gilts	15	0
Equities*	10	13
Corporate bonds	10	2
Money market funds	20	1
Pooled bond fund	5	0
Property - direct investments	30	0
Property related pooled funds	20	5
Cash and certificates of deposit	85%	83%
Debt management account deposit facility	100%	0%

*Limit at time of purchase - Actuals shown for equities include accumulated dividends

Above table excludes £15m SOHA loan