TRAFFORD COUNCIL

Report to: **Accounts & Audit Committee – 20 November 2013**
Executive – 3 December 2013

Report for: **Decision**

Report of: **The Executive Member for Finance and Director of Finance**

Report Title

Treasury Management 2013-14 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 2013/14.

- **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 £100.4m.

- **Investment Activity:-**

The priorities when undertaking any investment continue to be security first, liquidity and then rate of return. During the first half of 2013/14 the annualised investment rate of return from proactive cash flow management was 0.71% with income generated from investment interest currently on target to meet the 2013/14 budgeted provision of £(0.5)m. The level of return is 0.35% or £(145)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 £64.m.

- **Prudential Indicators:-**

During the first half of 2013/14 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. Note the Treasury Management activities undertaken in the first half of 2013/14.

Contact person for background papers:
Graham Perkins – Technical Accountant Extension: 4017

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.
Legal Implications:	No legal implications arising from this report
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Staffing/E-Government/Asset Management Implications	Not applicable
Risk Management Implications	The monitoring and control of risk underpins all treasury management activities. The main risks are of adverse or unforeseen fluctuations in interest rates and security of capital sums.
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).

For information, Full Council receives the annual strategy and activity report for approval.

1.2 The Council operates a balanced budget from which the treasury management operations ensures that day to day cash flow events are adequately planned, with surplus monies being invested in low risk counterparties ensuring that cash flow requirements are met whilst optimising the investment return.

1.3 Another function of the treasury management service is the management of longer term cash by either arranging long or short term loans or using longer term cash flow surpluses and restructuring existing debt to meet Council risk or cost objectives.

1.4 Treasury management in this context is defined as:
"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.5 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)
- Risk Benchmarking (section 6)
- Prudential and Performance Indicators (section 7)
- Other Activity Update (section 8)
- Recommendations (section 9)

2. ECONOMIC UPDATE

2.1 During the first half of 2013/14, the main economic headlines were as follows:

UK

- a triple dip recession was avoided and predictions of continued gloom and doom have evaporated with a number of prominent organisations, among them the Bank of England and OECD, raising their growth projections for this year and beyond,
- economy showed signs of recovering as demonstrated by growth of 0.3% and 0.7% in quarters 1 and 2 of 2013 respectively;
- industrial output is recovering;
- household spending rose during the summer from increases in retail sales, mortgages, house prices and new motor registrations in spite of squeezed incomes;
- the 3 month unemployment average to July fell from 7.8% to 7.7% when compared to the previous quarter;
- Government deficit is starting to reduce;
- Consumer Price Inflation (Government target is 2%) grew slightly from 2.4% in April to 2.7% in September;
- The Monetary Policy Committee (MPC) maintained both the Bank Rate at 0.5% and the level of quantitative easing at £375bn;

- under the guidance of the new Bank of England's Governor Mark Carney, the MPC in August provided forward guidance that the Bank Rate will only be reviewed when unemployment falls to 7% which is not expected to occur until mid-2016;
- The Bank of England extended its Funding for Lending scheme into 2015, thereby encouraging banks to increase its lending to small and medium size businesses;
- the housing market was given a boost with the launch of the Government's Help to Buy scheme which is aimed at first time buyers by providing equity loans to borrowers;
- whilst talk of a house price bubble is already being discussed, the Bank of England has been instructed to take evasive action if it believes lending levels become problematic.

Eurozone

- a return to growth was reported in quarter 2, the first time in 6 quarters although the economy still remains in a fragile situation;
- currency pressures and sovereign debt uncertainties continue and could re-emerge after the German election.

US & Rest of the World

- the US Federal bank has suggested that it may reduce its asset purchase (quantitative easing) scheme earlier than anticipated however no date has been announced for this;
- US Congress passed a bill to raise the federal debt limit on 16 October, just hours before the nation risked default;
- US unemployment rate has fallen from a high of 8.1% to 7.3%;
- the US housing market is starting to show signs of recovering;
- Growth in the US is struggling to establish above 3%, a level considered critical in ensuring recovery becomes self-sustaining;
- China might have recovered from its growth deceleration it is still too early to be certain;
- India is submerged in a currency crisis;
- Brazil's recovery appears to have faltered.

2.2 Economic forecasting continues to remain difficult to undertake as a result of so many external factors influencing the UK economy (volatility in bond yields, continual movement in investor confidence and fears between favouring more risky assets, equities, or safer bonds). The economic outlook for the next 6 months currently forecasts the following major events;

UK

- positive growth encountered in the first 2 quarters of the year is set to continue;
- Bank Rate is unlikely to rise until mid-2016;
- CPI is forecast to fall to 2.0% in 2015;
- economy is still vulnerable to overseas markets.

Eurozone

- growth will remain weak although most Eurozone countries are now starting to see a return to growth;
- European Central Bank is to maintain its central policy rate at 0.5%;
- Greece will probably need another, but smaller bailout in the near future;
- concerns over the Spanish economy remain;
- the consequences from the bail out in March 2013 has done huge damage to the Cypriot economy and many commentators now consider it is only a matter of time before either another bailout is needed or the country leaves the Euro.

US & Rest of the World

- the passing of a US Federal budget for the new financial year starting on 1 October and raising of the debt ceiling in mid-October proved to be problematic with numerous government departments temporarily closing until the issue was settled;
- it is unlikely that US interest rates will increase until at least mid-2015;
- concerns remain around an unbalanced economy in China;

2.3 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 2013:

	2013-14 Original Forecast%	2013-14 Revised Forecast%	2014-15 % Revised Forecast%	2015-16 % Revised Forecast%
UK Bank Rate	0.50	0.50	0.50	0.50
Investment Rates				
3 month	0.50	0.40	0.40	0.40
1 Year	1.00	0.80	0.80	1.00
PWLB Loan Rates				
5 Year	1.65	2.20	2.30	2.70
25 Year	3.80	4.25	4.45	4.85

2.4 As a result of the economic position 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 2013			30 September 2013		
	Principal (£m)	Total (£m)	Interest Rate (%)	Principal (£m)	Total (£m)	Interest Rate (%)
DEBT						
Fixed rate:						
- PWLB	44.5			44.4		
- Market	25.0	69.5	5.55	25.0	69.4	5.55
Variable rate:						
- PWLB	0.0			0.0		
- Market	31.0	31.0	4.58	31.0	31.0	4.58
Total debt		**100.5**	**5.25**		**100.4**	**5.25**
INVESTMENTS						
- Fixed rate	32.4			52.5		
- Variable rate	19.8			11.5		
Total Investments		**52.2**	**0.88**		**64.0**	**0.84**
NET ACTUAL DEBT		**48.3**			**36.4**	

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 2013, was under borrowed by £47m, as its total capital financing requirement (CFR), underlying need to borrow for capital purposes, is higher than its actual level of external debt, £147.6m compared to £100.5m 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 approach, which has been widely adopted by other councils, is due to the high "cost of carry" i.e. the difference between long-term debt interest rates (4.5%) and the average return available from short term investments (0.84%).

4.3 For 2013/14 the Council's (CFR) position, will fall by £(1.3)m reflecting the difference between the level of new capital expenditure financed by borrowing compared to the statutory minimum revenue provision, which reduces indebtedness.

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 £(1.3)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.

4.6 For reference the maturity structure of the debt portfolio has not changed significantly from that previously reported in the 2012/13 Outturn report.

5. INVESTMENT ACTIVITY

5.1 The investment strategy, in accordance with the Code of Conduct, stipulates that the Council's priority when undertaking any investment is to ensure that the security of funds is the first consideration with liquidity and appropriate level of return consistent with this approach is achieved.

5.2 In order to ensure the security of funds is maintained, a "voluntary" internal action was taken prior to 2013/14, not to directly place investments with any Euro zone institution whilst the current economic uncertainty continued. This is despite certain Euro zone banks meeting the minimum credit criteria stipulated by the Council. This course of action will remain in place until it is considered that conditions have improved from their current state.

5.3 As highlighted at Section 2, the investment market continues to be very difficult. Earning the level of interest rates seen in previous decades is impossible as investment rates are low and in line with the 0.5% Bank rate. Indeed the introduction of the Funding for Lending scheme has reduced market investment rates even further and it is widely acknowledged investment returns are likely to remain low for some time.

5.3 The Council's temporary investments at 30/09/2013 were £64.0m and were invested in the following categories;

Sector	Country	Value (£m)
Banks	UK	41.7
Money Market Funds	UK	0.8
Local Authority	UK	5.0
Banks	Rest of World	16.5
Total		**64.0**

The maturity structure of the investment portfolio was as follows:

	31 March 2013 (£m)	30 September 2013 (£m)
Instant Access	19.8	11.5
Under 1 year	32.4	47.5
Under 3 years	0.0	5.0
Total	52.2	64.0

5.4 During the first half of the year, a total of 171 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 2013/14, is in line with the budget of £0.5m.

Average temporary Investment (£m)	Average interest rate earned %	Average 7 day LIBID rate %	Additional interest earned (£k)
82.2	0.71	0.36	145

5.5 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.

5.6 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.

5.7 A breakdown of the Council's investments, as at 30 September 2013 is provided at Appendix A for reference.

6. RISK BENCHMARKING

6.1 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.

6.2 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.

6.3 During the first half of 2013/14 the Director of Finance can confirm that no benchmarks, which were set in the Strategy report in February 2013, 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 30.09.13	**0.01%**	**0.00%**	**0.13%**

- **Liquidity –** In respect of this the Council set liquidity facilities/benchmarks of:

  Bank overdraft - £0.5m
  Liquid short term deposits of at least £20m 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 2013/14 the above liquidity arrangements were complied with and at 30 September 2013 the WAL of its investments was 4.8 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 2013/14 the investment interest return averaged 0.71%, against a 7 day LIBID rate of 0.36%.

- **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 2013/14 the maximum level during this period was 29%.

7. PRUDENTIAL AND PERFORMANCE INDICATORS

7.1 In accordance with CLG Guidance, the CIPFA prudential Code and the CIPFA Code of Practice on Treasury Management, the Council has in place a total of 11 prudential indicators ensuring that the Council's capital expenditure plans and borrowing remain robust, prudent and sustainable.

7.2 These indicators were originally set in February 2013 for the forthcoming year and have been updated to reflect new major capital schemes i.e. Local Authority Mortgage Scheme added to the Council's capital programme since this date.

7.3 All indicators are monitored on a monthly basis and during the first half of 2013/14 it can be reported that no breaches occurred.

7.4 The Council's Audit & Assurance Service, as part of their 2012/13 audit plan, undertook a review of the treasury management function. The objective of the review was to provide assurance on the operation of the key controls within the treasury management system. For the 8th year in succession a report was issued stating that the treasury management service offered a High Level of Assurance and for the 5th successive year there were no recommendations required to be implemented as a result of their audit.

8 OTHER ACTIVITY UPDATE

8.1 In the Treasury Management 2012/13 Outturn report, Members were provided with an update on the position of the Council's banking services provider, The Co-operative bank, following its credit rating downgrade to sub investment levels by all 3 Credit rating agencies in May 2013.

8.2 Since this date, the bank have announced a number of measures it intended to put in place aimed at resolving its long term funding capital gap of £1.5bn which included the Co-operative group putting in capital of £1bn with the balance of £500m coming from its bond and preference shares holders. The bank would then have been floated with the Co-operative Group holding a 70% share.

8.3 The bank's creditors led by 2 US hedge funds rejected this plan and a revised deal was finally agreed on 21 October 2013 which enabled the Co-operative Group to remain the single largest stakeholder with 30% control of the bank.

8.4 The bank's short and medium term funding levels continue to remain strong and liquid.

8.5 The current banking services contract is due to expire on 31 March 2014 and in accordance with the terms and conditions of this agreement, it has been extended by a further 12 months to 31 March 2015.

8.6 By adopting this course of action it will enable the Council to undertake a bank tender exercise with at least 2 other Greater Manchester Councils in 2014/15 thereby potentially achieving a more cost effective outcome than if this exercise was to be completed alone.

8.7 The Council's Treasury Management advisors are Sector which were part of the Capita group. As a result of a comprehensive review by Capita Plc of all of its brands, it was decided that all businesses within the group should be branded Capita going forward. So, accordingly, Sector's brand changed on Monday 9 September to Capita Asset Services – Treasury Solutions.

9 RECOMMENDATIONS

9.1 **That the Accounts & Audit Committee & Executive be requested to;**

- **note the Treasury Management activities undertaken in the first half of 2013/14.**

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 2013/14.

Consultation

Information for the period 1 April 2013 to 30 September 2013 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 …ID……

Legal Officer Clearance ......MJ......

Director's Signature **[Appended in hard copy.]**

APPENDIX A

Breakdown of Investments as at 30 September 2013

Counterparty	**Amount £k**	**Amount £k**
UK Institution		
Local Authority		
Greater Manchester Waste Disposal Authority	5,000	5,000
Banks		
Barclays	5,000	
Lloyds	20,000	
Royal Bank of Scotland	14,700	
- Ulster Bank (Belfast)	2,000	41,700
Money Market Funds		
Federated	370	
Goldman Sachs	50	
Ignis	210	
Morgan Stanley	120	750
	Total UK Institutions	**47,450**
Non UK Institutions		
National Australia bank	5,000	
National Bank of Abu Dhabi	5,000	
Development Bank of Singapore	2,500	
United Overseas Bank	4,000	16,500
	Total Non UK Institutions	**16,500**
	Grand Total	**63,950**