

CABINET

18 November 2014

Title: Treasury Management Strategy Statement Mid-Year Review 2014/15	
Report of the Cabinet Member for Finance	
Open Report	For Decision
Wards Affected: None	Key Decision: Yes
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Accountable Director: Jonathan Bunt, Chief Finance Officer	
Summary: Regulation changes have placed greater onus on elected Members in respect of the review and scrutiny of treasury management policy and activities. This mid-year review report is important in that respect as it provides details of the mid-year position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly. The Assembly agreed the Treasury Management Strategy Statement for 2014/15 on 19 February 2014 which incorporated the Prudential Indicators. This report updates Members on treasury management activities in the current year.	
Recommendation(s) The Cabinet is asked to recommend the Assembly to: (i) Note the Treasury Management Strategy Statement Mid-Year Review 2014/15; (ii) Note that in the first half of the 2014/15 financial year the Council complied with all 2014/15 treasury management indicators; (iii) Note the borrowing of £89m through a loan facility from the European Investment Bank (EIB) to support an urban regeneration and economic growth programme agreed by the Assembly on 17 September 2014; and (iv) Delegate authority to the Chief Finance Officer, in consultation with the Cabinet Member for Finance, to proportionally amend the counterparty lending limits agreed within the Treasury Management Strategy Statement for the duration of the 2014/15 financial year, subject to a review of this authority in the February 2015 Treasury Management Strategy report to take into account of any potential additional borrowing from the EIB which has been agreed previously by Cabinet.	
Reason(s) This report is required to be presented in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services.	

1. Background and Introduction

- 1.1 The Council operates a balanced budget whereby cash raised during the year meets the Council's cash expenditure needs. Part of the treasury management operations is to ensure this cash flow is adequately planned, with surplus monies invested with counterparties of an appropriate level of risk, providing adequate liquidity before considering maximising investment return.
- 1.2 The second main function of treasury management is the funding of the Council's capital programme. These capital plans provide a guide to the Council's borrowing need, which is essentially the use of longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging loans, using cash flow surpluses or restructuring previously drawn debt to meet Council risk or cost objectives.
- 1.3 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) recommends the:
- I. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management.
 - II. Creation and maintenance of Treasury Management Practices which set out the how the Council will seek to achieve those policies and objectives.
 - III. Receipt by the full council of an annual Treasury Management Strategy Statement (TMSS), including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering the previous year's activities.
 - IV. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
 - V. Delegation by the Council to a specific named body, for this Council this is Cabinet, to scrutinise the treasury management strategy and policies.
- 1.4 This mid-year report has been prepared in compliance with CIPFA's Code of practice on Treasury Management, and covers the following:
1. Economic summary and outlook, including the Council's investment strategy;
 2. Treasury, Debt and Investment Position at 30 September 2014;
 3. The Council's Capital Position (Prudential Indicators), including:
 - Prudential Indicator for Capital Expenditure;
 - Changes to the Financing of the Capital Programme;
 - Prudential Indicator – Capital Financing Requirement; and
 - Limits to Borrowing Activity.

2. Economic Summary and Outlook

2.1 United Kingdom (UK)

- 2.1.1 The UK continued to grow steadily in Q2 2014 with a growth rate of 0.9% and an annual rate of 3.2%. Slower growth is forecast for the rest of the year and into 2015. Inflation (CPI) decreased to 1.2% in September 2014.
- 2.1.2 The improved economic conditions enabled unemployment levels to dip under the Monetary Policy Committee's (MPC) threshold rate of 7%, below which it would consider increasing its Bank Rate. The MPC subsequently broadened its forward guidance by adopting five qualitative principles and looking at a wider range of indicators to form a view on how much slack there is in the economy. The MPC has indicated that it is concerned that the squeeze on disposable incomes should be reversed by wage inflation rising back above the level of inflation to ensure the recovery is sustainable.
- 2.1.3 Most economic forecasters expect growth to peak in 2014 and then to ease off though but still remaining strong in 2015. Unemployment is expected to keep on its downward trend, which should feed through to an increase in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence are areas that will need to be kept under regular review.

2.2 United States

- 2.2.1 The Federal Reserve continued its monthly \$10bn reductions in asset purchases. Asset purchases have now fallen from \$85bn to \$15bn and are expected to stop in October 2014, providing strong economic growth continues. The US faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without significant damage to growth.

2.3 Eurozone (EZ)

- 2.3.1 The EZ is facing an increasing threat from weak or negative growth and from deflation. The ECB took limited action in June to loosen monetary policy in order to promote growth. In September, the inflation rate fell to a low of 0.3%. The EZ took further action to cut its benchmark rate to 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt.

2.4 China

- 2.4.1 The Chinese Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has raised fresh concerns. There are concerns as to the creditworthiness of much bank lending to corporates and local government during the post 2008 credit expansion period and whether the bursting of a bubble in housing prices is drawing nearer.

2.5 UK interest rate forecasts

- 2.5.1 A first increase in Bank Rate is expected by Q2 2015, followed by a slow pace of increases to lower levels than prevailed before 2008. Drivers that may push rates higher include UK inflation being higher than the EU and US, causing an increase in the inflation premium inherent to gilt yields and improved investor confidence leading to a flow of funds from bonds into equities.
- 2.5.2 Drivers that may push rates lower include geo-political pressures, a weak rebalancing of UK growth, weak growth or recession in the UK's main trading partners (the EU and US) or by monetary policy action failing to stimulate sustainable world growth.

2.6 Council investment strategy

- 2.6.1 The current economic conditions have resulted in an improvement in medium term (one to two years) rates of return. As a result the treasury section made a number of medium term investments in the first half of 2014/15. These investments pushed the rate of return as at 30 September 2014 to 1.03%, with an average duration of 0.7 years.
- 2.6.2 Members are asked to be aware that rates available to investments made by the Council are significantly lower than rates that may be available to individuals through the retail banking sector. Although rates of 3% to 5% are available within the retail banking sector, these are available on much smaller deposits. Given the duration, risk and size of the Council's cash holding a return of 1.03% in current market conditions is considered a good return for the level of risk taken.
- 2.6.3 Although market conditions are improving, counterparty risk remains significant and officers continue to monitor the financial institutions the Council is invested with. It is expected that, as the rate of returns improve during the remaining part of 2014/15, treasury will seek to increase the average duration to over one year, with the average forecast return improving to around 1.30% by 31 March 2015.
- 2.6.4 The current investment counterparty criteria selection approved in the TMSS and amended in the Annual Treasury Review report agreed by Assembly on 17 September 2014, is meeting the requirement of the treasury management function and there are no recommendations to change these.

3. Treasury Position at 30 September 2014

- 3.1 Table 1 below details the Council's mid year treasury position.

Table 1: Council's treasury position at 30 September 2014

	Principal Outstanding £000s	Rate of Return %	Average Life (yrs)
Fixed Rate Borrowing:			
PWLB	(265,912)	3.50	41.31
Local Authority (Temporary Loan)	(22,500)	0.38	0.20
Market	(40,000)	4.02	54.11
Total Debt	(328,412)	3.35	40.05
Investments			
Call Accounts / Money Market Funds	8,300	0.44	Nil
Bank Certificate Of Deposit	45,000	1.25	1.20
Banks Fixed Deposits	64,500	0.91	0.36
Local Authorities	25,000	1.04	1.04
UK GILTS	5,780	1.25	3.81
Total Investments	148,580	1.03	0.70

4. Debt Position at 30 September 2014

- 4.1 The Council's capital financing requirement (CFR) for 2014/15 is forecast to be £479.6m. The CFR denotes the Council's underlying need to borrow for capital purposes. This need to borrow can be met through the use of reserves, external and internal borrowing and careful management of the Council's cash flow.

The Council currently holds sufficient cash balances to allow a significant amount of its overall borrowing requirements to be funded internally. This approach has provided the Council with savings as the cost to borrow is significantly higher than the return achieved by investing the cash. Where any further borrowing is considered, officers will base any decisions on the Council's cash flow requirements at the most appropriate and cost effective interest rate available.

4.2 European Investment Bank (EIB) Funding

At the 17 September 2014 Assembly, Members agreed to borrow £89m from the EIB to support a comprehensive urban regeneration and economic growth programme in the borough including affordable housing, energy efficiency measures and other social infrastructure projects. The borrowing included:

1. £66m to finance the development and ownership of the Shared Ownership and Affordable Rent tenures in the Gascoigne Estate (East) Phase 1 re-development project; and
2. £23m to finance the development and ownership of the Affordable Rent tenures in the Abbey Road Phase 2 development project;

A further £4.5m worth of borrowing was agreed from the PWLB to fund 50% of 51 private for sale units to be developed and sold jointly by the Council and East Thames Group via a limited company;

The EIB loan agreement was signed with the EIB on 23 October 2014. The terms are sufficiently flexible to provide the Council with the option of fixing the interest

rate for some or all of the loan facility at completion of contracts; this will enable the Council to drawdown tranches on the most economically advantageous terms.

The EIB and the Council are discussing opportunities to fund further urban regeneration activities which could generate an income and help deliver the Council's wider social and economic growth agenda. As these opportunities are developed, further reports will be taken to Cabinet for approval of both the projects and to utilise the EIB as the source of funding.

At the September Assembly Members raised queries over the delegation of authority to the Chief Finance Officer in consultation with the Cabinet Member for Finance to proportionally amend the counterparty lending limits agreed within the TMSS to take into account the £89m borrowed from the EIB. The principal concern was that the delegated authority was open ended.

To address this, it is recommended that Members agree that the delegated authority is maintained, and amended to incorporate any subsequent decisions by Cabinet for additional borrowing from EIB, but that this is reviewed in each treasury management report to Assembly. The next opportunity for Members to review will be the annual TMSS report in February 2015.

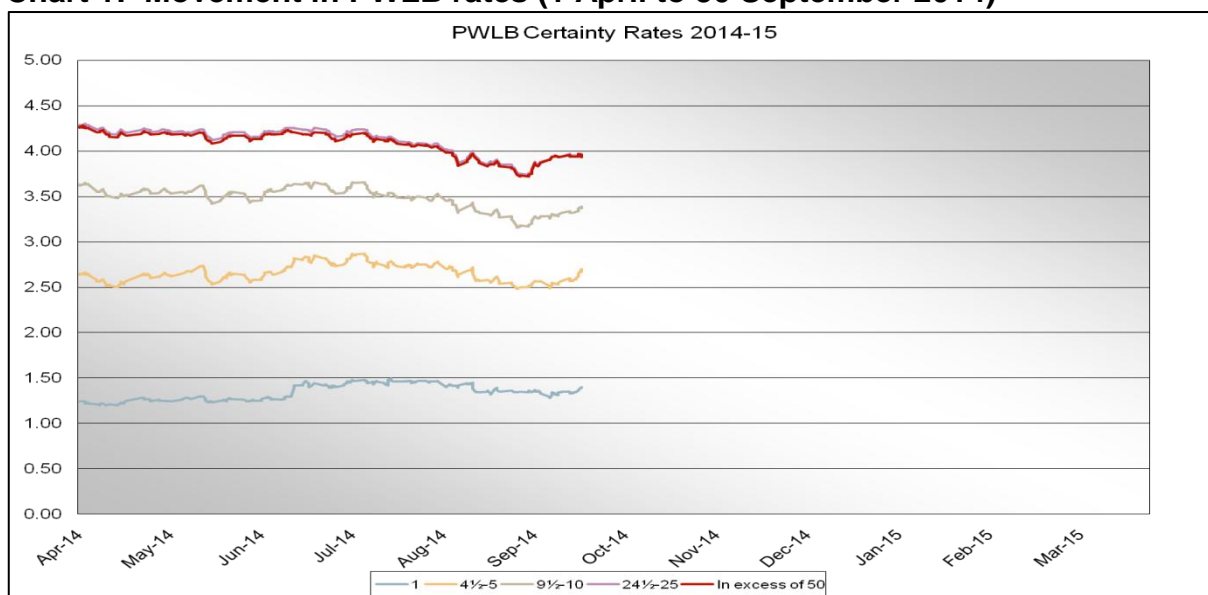
4.3 Debt Repayment and Rescheduling

On 28 April 2014 a £10m PWLB loan matured and, as there was sufficient cash held by the Council to meet the 2014/15 CFR, the £10m borrowing was not replaced. Repaying the £10m, with an interest rate of 4.25%, reduced the interest payments for 2013/14 by £394k. If the interest forgone is included, which would have been in the region of £88k, proper management of the Council's cash flow has made a net in year saving of £306k in 2014/15.

Debt rescheduling opportunities are limited in the current economic climate. During the first six months of the year, no debt rescheduling was undertaken.

- 4.4 Chart 1 below shows the movements in PWLB rates for the first six months of the financial year (to 30 September 2014). The chart shows that rates over 10 years have decreased with shorter terms borrowing costs of up to two years increasing.

Chart 1: Movement in PWLB rates (1 April to 30 September 2014)



4.5 Table 2 provides a breakdown of the Council's debt as at 30 September 2014.

Table 2: General Fund Debt held as at 30 September 2014

Borrowing/ Loan Held	Type	Interest Rate	Principal	2014/15 Interest
		%	£000s	£000s
PWLB	HRA	3.50	50,000	1,175
PWLB	HRA	3.48	65,912	2,294
PWLB	HRA	3.49	50,000	1,745
PWLB	HRA	3.52	50,000	1,760
PWLB	HRA	3.49	50,000	1,745
Barclays Bank	General Fund	3.98	10,000	398
Dexia Bank	General Fund	3.97	10,000	397
RBS Bank	General Fund	4.06	20,000	812
Short Term Loans	General Fund	0.38	22,500	21
Total		3.35	328,412	10,347

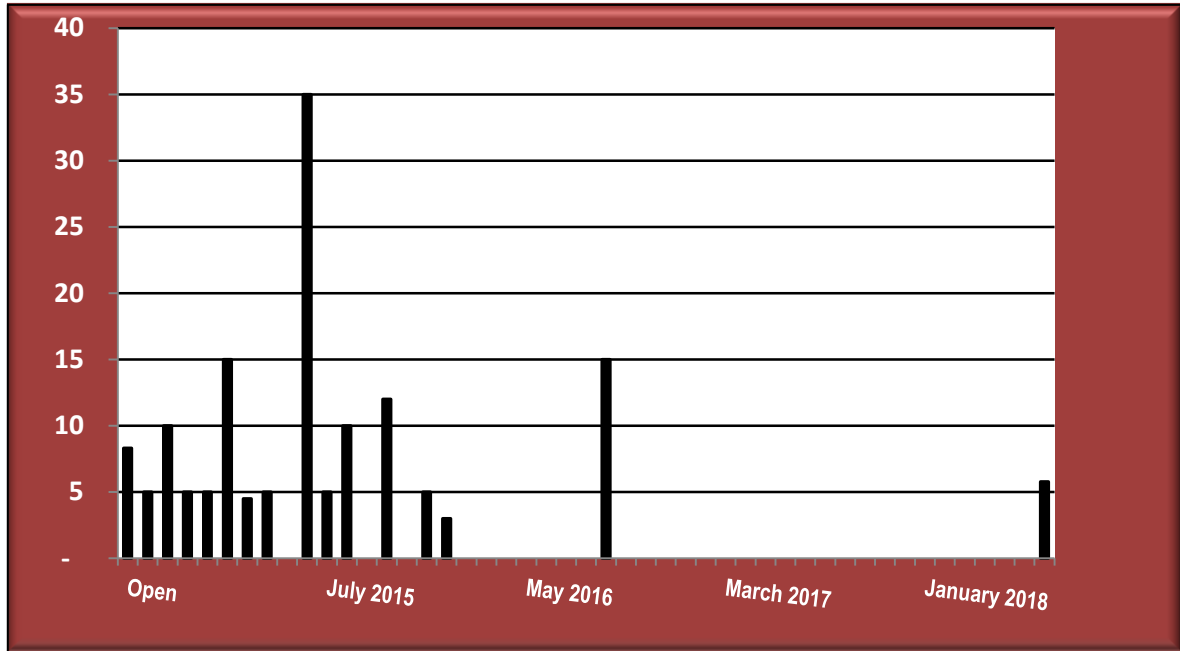
5. Investment Portfolio 2014/15

5.1 It is the Council's priority to ensure security of capital and liquidity before obtaining an appropriate level of return which is consistent with the Council's risk appetite. In the current economic climate the Council's risk appetite remains relatively low. There is an expectation that the base rate, currently at 0.5%, will increase in 2015 if economic indicators improve, which may increase the interest received.

5.2 Investment Profile

The Council's investment maturity profile in Chart 2 below shows that as at 30 September 2014, 15.7% of the Council's investments had a maturity of 60 days or less, with 72.6% having a maturity of one year or less. Spreading out the maturity of longer dated investments allows the Council to take advantage of improved rates of return while ensuring sufficient liquidity.

Chart 2: Investment Profile (Millions)



5.3 Holdings and Return

As at 30 September 2014 the Council held £148.6m of investments, all invested in-house by the Council’s treasury section. The Chief Finance Officer confirms that the approved investment limits within the Annual Investment Strategy were not breached during the first six months of 2014/15. A summary of the performance of the treasury management is provided below, with a full list of investments as at 30th September 2014 in appendix 1.

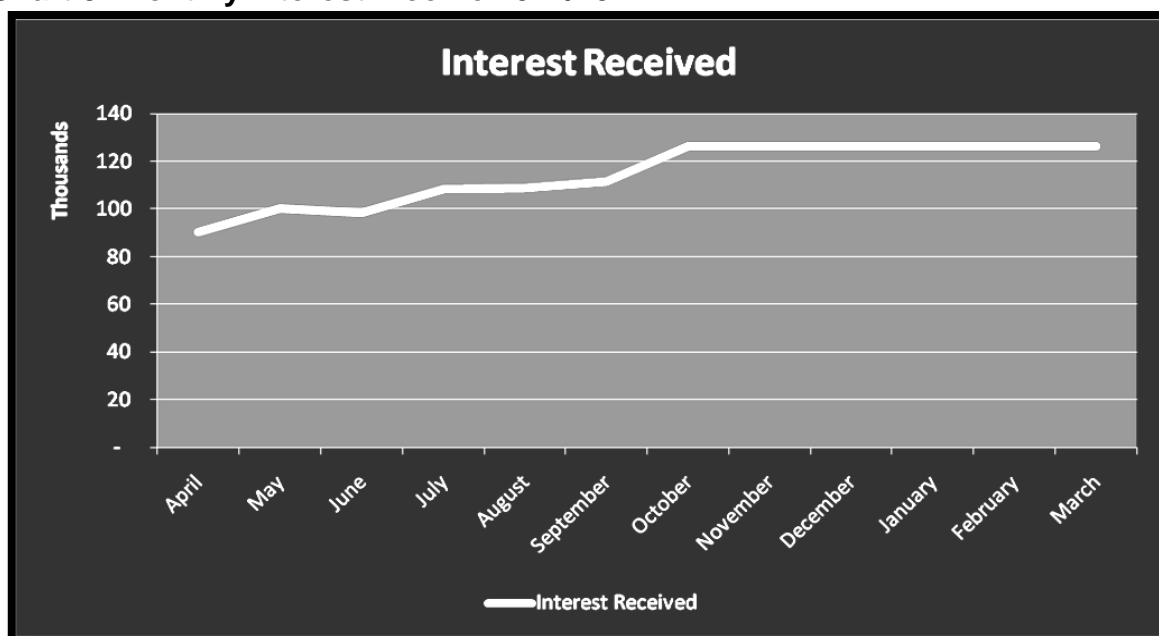
The interest received forecast is for an additional £350k to be received compared to the 2014/15 budget. The forecast is based on the first six month actual interest achieved and the expected interest to be received from the current investment held by the Council.

Table 3: Interest Received Budget against Actual for 2014/15

Description	2014/15 Budget £000s	2014/15 Forecast £000s	Variance £000s
Interest Received	(1,100)	(1,450)	(350)

Average returns increase over the first six month of the financial year with returns for the remainder of the year likely to average 1.15%. Chart 3 below provides a summary of the monthly interest income between April and September 2013 for the in-house treasury section and provides a forecast of the expected monthly interest income for the remaining six months of the year.

Chart 3: Monthly interest income 2014/15



6. The Council's Capital Position (Prudential Indicators)

6.1 Prudential Indicator for Capital Expenditure

Table 4 shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Table 4: Revised Estimate to Capital Programme as at 30 September 2014

Capital Expenditure by Service	2014/15 Original Budget £000s	2014/15 Revised Budget £000s
Adult & Community Services	10,056	10,451
Children's Services	30,098	26,882
Housing and Environment	5,104	5,492
Chief Executive	7,901	9,139
HRA	100,808	90,439
Total	153,967	142,403

6.2 Changes to the Financing of the Capital Programme

Table 5 draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Table 5: Revised Borrowing need as at 30 September 2014

Capital Expenditure	2014/15 Original Budget £000s	2014/15 Revised Budget £000s
General Fund CFR	153,967	142,403
Financed by:		
Capital grants & contributions (incl. S106)	34,851	31,696
Capital receipts	11,522	11,522
Contributions from Revenue / Reserves	3,109	4,703
MRA / HRA funding	100,808	90,439
Total financing	150,291	138,360
Borrowing need	3,676	4,043

6.3 Prudential Indicator (PI) – Capital Financing Requirement

The Council is on target to achieve the original forecast CFR as outlined in table 6 below:

Table 6: Revised CFR as at 30 September 2014

	2013/14 Outturn £000s	2014/15 Revised Estimate £000s
Capital Financing Requirement		
CFR – non housing	156,177	153,666
CFR – housing	267,722	267,722
Alternative Financing (PFI and leases)	60,844	58,191
Total CFR	484,743	479,579
Net movement in CFR	(6,835)	(5,163)
External Debt / the Operational Boundary		
Long Term Borrowing	305,912	305,912
Short Term Borrowing	10,000	0
Other long term liabilities	60,844	58,191
Total debt 31 March	376,756	364,103

6.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and next two financial years. This allows some flexibility for limited early borrowing for future years.

Table 7: Revised Borrowing Limits as at 30 September 2014

	2014/15 Original Estimate £000s	2014/15 Revised Estimate £000s
Gross borrowing	305,912	305,912
Plus other long term liabilities	60,844	58,191
Less investments	(140,000)	(140,000)
Net borrowing	226,756	224,103
CFR (year end position)	484,743	479,579

- 6.5 The Chief Finance Officer (CFO) reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.
- 6.6 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Table 8: Authorised External Debt Limit and Position at 30 September 2014

Authorised External Debt Limits	2014/15 Original Indicator £000s	Position at 30 September 2014 £000s
Borrowing	441,000	441,000
Other long term liabilities	59,000	59,000
Total	500,000	500,000

7. Consultation

- 7.1 The Chief Finance Officer has been informed of the approach, data and commentary in this report.

8. Financial Implications

Implications completed by: Jonathan Bunt, Chief Finance Officer

- 8.1 This report sets out the mid-year position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long term borrowing positions.

9. Legal Implications

Implications completed by: Eldred Taylor-Camara, Legal Group Manager

- 9.1 The Local Government Act 2003 (the "Act") requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy

which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

9.2 The Council also has to 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.

9.3 A report setting out the Council's strategies in accordance with the Act was presented to Cabinet in February 2014. This report is a midyear review of the strategy's application and there are no further legal implications to highlight.

10. Options Appraisal

10.1 There is no legal requirement to prepare a TMSS Mid-year Review; however, it is good governance to do so and meets 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).

11. Other Implications

11.1 **Risk Management** - The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income during the first 6 months of the year.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- **Appendix 1:** Investments as at 30 September 2014