FAREHAM
BOROUGH COUNCIL

Report to
Audit and Governance Committee

Date **25 November 2013**

Report of: **Director of Finance and Resources**

Subject: **IMPLEMENTATION OF TREASURY MANAGEMENT POLICY AND STRATEGY**

SUMMARY

In accordance with the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice, the Audit and Governance Committee is the responsible body to examine and assess the effectiveness of the Council's treasury management policy and strategy.

In accordance with this role, this report sets out the mid-year review of treasury management activity up to 30 September 2013.

RECOMMENDATION

The Audit and Governance Committee is asked to note the report.

INTRODUCTION

1. The purpose of this report is to satisfy the requirement contained within the revised CIPFA Treasury Management Code of Practice to have a nominated responsible body, being the Audit and Governance Committee, examine and assess the effectiveness of the Council's treasury management strategy and policies.

2. The current Treasury Management Strategy, in Appendix A, was submitted to the Executive on 11 February 2013 and was formally adopted by Full Council on 22 February 2013.

MID YEAR REVIEW

3. This mid-year review has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

   - An economic update for the first six months of 2013/14;
   - A review of the Council’s investment portfolio;
   - A review of the Council's borrowing requirement;
   - A review of the Treasury Management Strategy 2013/14; and
   - A review of compliance with Treasury and Prudential Limits for 2013/14.

ECONOMIC UPDATE

4. During 2013/14 economic indicators suggest that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% expansion the economy grew 0.7% in Q2. There have been signs of renewed vigour in household spending in the summer, with a further pick up in retail sales, mortgages, house prices and new car registrations.

5. The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace and strong enough to reduce the level of unemployment further. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April’s cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.0%, well below the rate of inflation at 2.7% in August, causing continuing pressure on household’s disposable income.

6. The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Together with the Government’s Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years pre 2008.

7. Summary outlook for the UK:

   - Growth has been on an upward trend – 0.3% in Q1; 0.7% in Q2 and likely to be much stronger in Q3. The so called double dip recession at the beginning of 2012 was erased by the latest revision of statistics.

- Business surveys, consumer confidence, consumer borrowing and house prices are all on the up and may help to create a wide spread feel good factor. However, this is still a long way away from the UK getting back to sustainable strong growth.
- A fair proportion of UK GDP is dependent on overseas trade; the high correlation of UK growth to US and EU GDP growth means that the UK economy is still vulnerable to what happens in overseas markets.
- Consumer expenditure is likely to remain suppressed by inflation being higher than increases in average earnings i.e. disposable income will continue to be eroded.

8. Economic forecasting remains difficult with so many external influences weighing on the UK. Volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds.

9. The base rate has remained at 0.5% since March 2009. Capita Asset Services (previously known as Sector) undertook a review of its interest rate forecasts in late September as a result of an increase in confidence in economic recovery. The latest forecast now includes a first increase in Bank Rate in quarter 3 of 2016 (previously quarter 4).

INVESTMENT PORTFOLIO 2013/14

10. In accordance with the Code, 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.

11. In the current economic conditions, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very 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. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

12. The total of fixed term investments and call accounts, as at 30 September 2013 was £45.5 million, as summarised below. The activity during the year for fixed investments is detailed in Appendix B.

Investments	**Externally Managed £m**	**Internally Managed £m**	**Call Accounts £m**	**Total £m**
At 1 April 2013	**10.0**	**12.0**	**10.8**	**32.8**
New	7.0	9.0	62.9	78.9
Repaid	7.0	7.0	52.2	66.2
At 30 Sept 2013	**10.0**	**14.0**	**21.5**	**45.5**

13. The increase in funds of £12.7 million during the first half of the year was mainly due to the timing of precept payments, receipts of grants and progress on the capital programme.

Investment Structure

14. The structure of investments at 30 September is shown in the table below. Over the past couple of years, most investments have been held on short periods to mitigate the risks that have been seen during the recession. At the same time, officers have actively sought to spread investments across a wider range of counterparties rather than operating at the upper limit for investments to limit the exposure to financial loss.

Investment Structure	**External £m**	**Internal £m**	**Call £m**	**Total £m**
For periods of less than 1 month	1.0	0	17.5	18.5
For periods of 1 to 3 months	2.0	0	0	2.0
For periods of 3 to 6 months	0	5.0	4.0	9.0
For periods of 6 to 12 months	5.0	9.0	0	14.0
For periods of 1 to 2 years	2.0	0	0	2.0
Total Investments at 30 Sept 2013				
Investments for periods < 365 days	8.0	14.0	21.5	43.5
Investments for periods 365+ days	2.0	0	0	2.0

15. Throughout this period of uncertainty, officers have been taking advice from the Council's treasury advisor, Capita Asset Services, to ensure that decisions are taken in light of the latest facts at the time. This has given rise to lower interest rates being secured but this is the lowest priority consideration compared to the security of investments and the liquidity of cash flow.

16. The Council's fixed term investments are partly managed externally by Tradition UK Ltd. The role of the broker is to determine the most appropriate investment option within criteria set by the Council. All cash transfers are made by Council officers and Executive approval has been given for the allocation of up to £13 million to the externally managed portfolio. This retains sufficient funds within the direct management of officers, while still ensuring that maximum yield is achieved from the longer term investments.

17. The investment structure is sufficient to meet the capital programme and other large cash outflows.

18. To increase the liquidity of the Council's investments, call accounts with Nat West (including a 95 day notice account), Santander and HSBC are being used. These accounts offer quick access to funds however they do attract a lower rate of interest than some of the fixed term investments shown in the table above.

19. The balance within each call/notice account as at 30 September 2013 is set out in the following table:

Call Accounts	£m
NatWest	5.5
NatWest - 95 day notice	4.0
Santander UK	6.0
HSBC	6.0
Total	**21.5**

BORROWING

20. The Council's external long term debt amounted to £40.6 million as at 1 April 2013. This is as a result of the HRA reforms (£40m) and the Hampshire County Council interest free loan for Portchester Community Centre (£0.6m). Further borrowing is anticipated in 2013/14 in relation to the Solent Growing Places Fund for Daedalus.

21. The Council has taken out ten £4 million loans from the PWLB with duration of between 40 and 50 years at an average interest rate of 3.50% as detailed in the table below:-

Repayment Date	Loan Amount	Interest Rate
30/09/2052	£4m	3.52%
30/09/2053	£4m	3.51%
30/09/2054	£4m	3.51%
30/09/2055	£4m	3.51%
30/09/2056	£4m	3.50%
30/09/2057	£4m	3.50%
30/09/2058	£4m	3.50%
30/09/2059	£4m	3.49%
30/09/2060	£4m	3.49%
30/09/2061	£4m	3.48%
Total	**£40m**	**3.50% average**

22. Interest payable for 2013/14 is budgeted at £1,870,900 and will be met by the HRA. £1,400,400 relates to the PWLB loans and £470,500 for interest on internal borrowing between the General Fund and the HRA.

STRATEGY COMPLIANCE

23. The Council's Treasury Management Strategy Statement for 2013/14 in Appendix A, which includes the Annual Investment Strategy 2013/14, was approved by the Council on 22 February 2013. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

24. The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs but also to seek out value available in higher rates in periods up to 12 months with highly credit rated financial institutions.

25. Paragraph 60 of the Treasury Management Strategy states that:

    "In the event that the UK looses its AAA status which impacts on the ratings of UK banks, clearing banks that have a systematic and reputational value will continue to be used."

26. Earlier in the year the UK lost its AAA rating from Fitch and Moody's. However, this has caused little market reaction and has not impacted on the credit ratings of UK banks.

27. The compliance with the various elements of the strategy are set out in the following table:-

Compliance on Individual Elements	**Yes/No**	**Notes**
Borrowing only up to "supported" level	Yes	No borrowing this quarter
All investments with approved institutions	Yes	Treasury management advisors provide updated list of approved institutions each month
All individual investments within prescribed financial limits	Yes	There are currently 5 institutions where the total investment is at the maximum level. They are Lloyds Bank (£8m limit), Barclays Bank, HSBC, Santander (£6m limit), and Skipton BS (£2m limit)

28. No changes to the Council's Treasury Management Strategy Statement and Annual Investment Strategy 2013/14 are considered necessary at this time as the rules currently being applied to investments are much tighter than those approved within the Treasury Management Strategy.

COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

29. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordable limits) were approved by the Executive at its meeting on 11 February 2013.

30. Performance for the first half of the year is shown in Appendix C and the purpose of each indicator is explained in more detail in Appendix D. During the financial year to date the Council has operated within the treasury limits and the Prudential Indicators.

RISK ASSESSMENT

31. In the current economic climate and the heightened credit concerns, there are risks that financial institutions holding Council investments could default and be unable to fulfil their commitments to repay the sums invested with them.

32. To help mitigate this risk, the Council maintains a list of approved institutions based on a grading system operated by the Council's treasury management advisers. Maximum limits are also set for investments with individual institutions

Background Papers: None

Reference Papers: 11 February 2013 Executive Report - Treasury Management Policy and Strategy 2013/14

Appendices:

Appendix A - Treasury Management Strategy 2013/14
Annex A - Summary of Prudential and Treasury Indicators

Appendix B - Total investment activity to 30 September 2013 with each approved institution

Appendix C - 2013/14 Prudential Indicators - Half-Yearly Performance

Appendix D - Details of Prudential Indicators

Enquiries:

For further information on this report please contact Caroline Hancock. (Ext 4589)