FAREHAM
BOROUGH COUNCIL

Report to the Executive for Decision
01 September 2014

Portfolio:	Policy and Resources
Subject:	**Treasury Management Monitoring Report 2014/15**
Report of:	Director of Finance and Resources
Strategy/Policy:	Finance and Treasury Management Strategies
Corporate Objective:	A dynamic, prudent and progressive council

Purpose:
This report summarises the Council's investment activity up to 30 June 2014 and provides details of the Council's money market transactions.

Under the Code of Conduct that governs the operation of the money markets, it is not possible to make public details of specific transactions. For this reason, Appendix A is included in the confidential part of the agenda.

Executive summary:
This report gives the Executive the opportunity to review the treasury management activity up to 30 June 2014 along with the Treasury and Prudential Indicators.

The overall position is set out in the following table:

Investments	Externally Managed £m	Internally Managed £m	Call Accounts £m	Total £m
At 1 April 2014	**10.0**	**18.0**	**12.8**	**40.8**
New	4.0	9.0	30.1	43.1
Repaid	4.0	4.0	26.4	34.4
At 30 June 2014	**10.0**	**23.0**	**16.5**	**49.5**

The actual fixed term investments are set out in Appendix A with more detailed information set out in the briefing paper.

The minimum credit rating criteria for counterparties has been reviewed due to anticipated regulatory changes in the banking sector. It is recommended that the Treasury Management Strategy for 2014/15 is updated to take into account the changes.

Performance for the first quarter of the year for the Treasury and Prudential Indicators are shown in detail in Appendix B. During the financial year to date the Council has operated within the treasury limits and Prudential Indicators.

Recommendation:
That the treasury management monitoring report be noted and that the minimum credit ratings for counterparties in the Treasury Management Strategy 2014/15 are updated in light of anticipated regulatory changes in the bank sector.

Reason:
To inform the Executive of the Council's investment, borrowing and repayment activity up to 30 June 2014.

Cost of proposals:
Not applicable.

Appendices:

A: Externally & Internally Managed Investments (Confidential Appendix)
B: Q1 Treasury and Prudential Indicators
C: Treasury and Prudential Indicators Explained

Background papers:

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Executive Briefing Paper

Date: 01 September 2014

Subject: Treasury Management Monitoring Report 2014/15

Briefing by: Director of Finance and Resources

Portfolio: Policy and Resources

INTRODUCTION

1. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly. This report therefore ensures this Council is implementing best practice in accordance with the Code.

2. The total amount of fixed term investments and call accounts as at 30 June 2014 was £49.5 million, as summarised below. The movements during the year for fixed term investments are detailed in Appendix A.

Investments	Externally Managed £m	Internally Managed £m	Call Accounts £m	Total £m
At 1 April 2014	**10.0**	**18.0**	**12.8**	**40.8**
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3. The increase in funds of £8.7 million during the first quarter was mainly due to the timing of precept payments, receipts of grants and progress on the Capital Programme.

INVESTMENT STRUCTURE

4. The structure of the investments at 30 June is shown in the table below. Over the past few 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.

5. Throughout this period of uncertainty, officers have been taking advice from the Council's retained treasury advisers, 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.

6. 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.

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

Investment Structure	**External £m**	**Internal £m**	**Call £m**	**Total £m**
For periods of less than 1 month	1.0	0	14.5	15.5
For periods of 1 to 3 months	0	5.0	0	5.0
For periods of 3 to 6 months	3.0	6.0	2.0	11.0
For periods of 6 to 12 months	2.0	12.0	0	14.0
For periods of 1 to 2 years	4.0	0	0	4.0
Total Investments at 30 June 2014				
Investments for periods < 365 days	6.0	23.0	16.5	45.5
Investments for periods 365+ days	4.0	0	0	4.0

8. To increase the liquidity of the Council's investments, call accounts with Nat West, Santander, HSBC and a new account with Svenska Handelsbanken 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.

9. The balance within each call account as at 30 June 2014 is set out in the following table:-

Call Accounts	**£m**
NatWest	1.5
Santander – 95 Day Notice	2.0
Santander	3.0
Svenska Handelsbanken	4.0
HSBC	6.0
Total	**16.5**

ECONOMIC BACKGROUND AND OUTLOOK

10. Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded during 2013 and the first quarter of 2014 to surpass all expectations, propelled by recovery in consumer spending and the housing market.

11. Forward surveys are currently very positive in indicating that growth prospects are also strong for the rest of 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very

encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established.

12. One drag on the economy has been that wage inflation has been significantly below CPI inflation, so disposable income and living standards were being eroded, (although income tax cuts had improved this to some extent). However, recent falls in inflation have created the potential for the narrowing of this gap and it could narrow further during this year, especially if there is also a recovery in growth in labour productivity (leading to increases in pay rates).

13. With regard to the US, the main world economy, it 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 appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

14. As for the Eurozone, concerns subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international un-competitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

INTEREST RATES

15. The base rate has remained at 0.5% since March 2009. Capita Asset Services undertook a review of its interest rate forecasts in May, after the Bank of England's Inflation Report. However, more recent developments to the Bank of England's forward guidance have necessitated a second updating in this quarter carried out on 30 June. This latest forecast now includes a first increase in Bank Rate in quarter 1 of 2015 (previously quarter 4 of 2015).

16. Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the ultra-low Bank Rate and other extraordinary measures such as the Funding for Lending Scheme. Actual investment income for 2013/14 was £770,881 with the budget for 2014/15 set at £676,900 for the General Fund and HRA.

BORROWING

17. The Council's external long term borrowing amounted to £40.4 million as at 1 April 2014. This is as a result of the HRA reforms (£40m) and the Hampshire County Council interest free loan for Portchester Community Centre (£0.4m). It is anticipated that borrowing will be required later in the year for the Daedalus capital scheme.

18. 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**

19. Interest payable for 2014/15 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

20. The Council's Treasury Management Strategy Statement for 2014/15, which includes the Annual Investment Strategy 2014/15, was approved by the Council on 21 February 2014. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

21. 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 2 years with highly credit rated financial institutions.

22. 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 weekly
All individual investments within prescribed financial limits	Yes	There are currently 6 institutions where the total investment is at the maximum level. They are Lloyds Bank (£8m limit), Barclays Bank and HSBC, (£6m limit), Skipton BS, West Brom BS and Principality (£2m limit).

CHANGES TO THE TREASURY MANAGEMENT STRATEGY

23. In order to minimise the risk to investments, the Council applies minimum acceptable credit ratings of counterparties for inclusion on the lending list.

24. There are continuing regulatory changes in the banking sector designed to see greater stability and lower risk and will result, in the future, in the Government not needing to provide financial support should an institution fail.

25. As a result of this, Capita Asset Services anticipate that there will be a withdrawal of sovereign support which will affect the credit ratings applied to institutions. This will mean that the key ratings used to monitor counterparties from the main rating agencies (Fitch, Moody’s and Standard & Poor’s) will be short term and long term ratings only. Viability, financial strength and support ratings previously applied will effectively become redundant.

26. The Treasury Management Strategy Statement for 2014/15 currently states:

    The Council will use banks which are UK banks and/or are non-UK and domiciled in a country which has a minimum sovereign rating of AA and have as a minimum, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):

	Fitch	**Moody's**	**Standard and Poor's**
Short Term	F1	P-1	A-1
Long Term	A	A2	A
Viability/Financial Strength	bb-	C-	-
Support	3	-	-

27. As a result of the anticipated changes, it is recommended that the Viability/Financial Strength and Support ratings are removed and only the Short Term and Long Term ratings are used. All other criteria remains as previously approved.

COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

28. 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 10 February 2014.

29. Performance for the first quarter of the year is shown in Appendix B and the purpose of each indicator is explained in more detailed in Appendix C. During the financial year to date the Council has operated within the treasury and prudential indicators.

RISK ASSESSMENT

30. There are no significant risk considerations in relation to this report.

Reference Papers:
10 February 2014 Executive Report - Treasury Management Strategy and Prudential Indicators 2014/15