FAREHAM
BOROUGH COUNCIL

Report to the Executive for Decision
03 November 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 September 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 September 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	5.0	14.0	58.5	77.5
Repaid	5.0	9.0	57.2	71.2
At 30 Sept 2014	**10.0**	**23.0**	**14.1**	**47.1**

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

Performance for the second 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.

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

Cost of proposals: Not applicable.

Appendices:

A: Externally & Internally Managed Investments (Confidential Appendix)
B: Q2 Treasury and Prudential Indicators
C: Treasury and Prudential Indicators Explained

Background papers:

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Executive Briefing Paper

Date: 03 November 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 September 2014 was £47.1 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
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3. The increase in funds of £6.3 million during the second 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 September 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	1.0	12.1	14.1
For periods of 1 to 3 months	2.0	5.0	2.0	9.0
For periods of 3 to 6 months	0	5.0	0	5.0
For periods of 6 to 12 months	4.0	11.0	0	15.0
For periods of 1 to 2 years	3.0	1.0	0	4.0
Total Investments at 30 Sept 2014				
Investments for periods < 365 days	7.0	22.0	14.1	43.1
Investments for periods 365+ days	3.0	1.0	0	4.0

8. To increase the liquidity of the Council's investments, call accounts with Nat West, Santander, HSBC and 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 September 2014 is set out in the following table:-

Call Accounts	**£m**
NatWest	3.1
Santander – 95 Day Notice	2.0
Svenska Handelsbanken	3.0
HSBC	6.0
Total	**14.1**

ECONOMIC BACKGROUND AND OUTLOOK

10. After strong UK GDP quarterly growth since early 2013, it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors are very encouraging and business investment is also strongly recovering.

11. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of

which need to substantially improve on their recent lacklustre performance.

12. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates.

13. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases 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, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

14. Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far this year.

15. In September, the U.S. Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $15bn and are expected to stop in October 2014, providing strong economic growth continues. First quarter GDP figures were depressed by exceptionally bad winter weather, but quarter 2 rebounded strongly to 4.6%.

16. The Eurozone is facing an increasing threat from deflation. In September, the inflation rate fell further, to reach 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth.

INTEREST RATES

17. The base rate has remained at 0.5% since March 2009. The forecast for the timing of the first increase in Bank Rate is currently under review by Capita Asset Services.

18. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual as the MPC is concerned about the impact of increases on many heavily indebted consumers, especially when disposable income is currently being squeezed by wage inflation running significantly under the rate of CPI inflation.

19. 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

20. 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.

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 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

23. 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

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 2 years with highly credit rated financial institutions.

25. 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), HSBC, (£6m limit), Skipton BS, West Brom BS, Leeds BS and Principality (£2m limit).

COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

26. 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.

27. Performance for the second 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

28. 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