AGENDA ITEM 6	**WEST DEVON BOROUGH COUNCIL**	AGENDA ITEM 6

NAME OF COMMITTEE	**Audit Committee**
DATE	**11 February 2014**
REPORT TITLE	**Third Quarter Prudential Indicator and Treasury Management Monitoring Report 2013-2014**
Report of	**Head of Finance & Audit**
WARDS AFFECTED	**All**

Summary of report:
This report highlights the key changes to the Council's capital activity (the prudential indicators), the economic outlook and the actual and the proposed treasury management activity (borrowing and investment).

Financial implications:
The monitoring report shows that the Council outperformed the industry benchmark of 0.39% on its investment activity, by achieving a 0.42% return on its investments up to 31 December 2013.

RECOMMENDATIONS:
The Audit Committee is asked to recommend that Council notes the report, the treasury activity and recommends any changes to the prudential indicators

Officer contact:
For further information concerning this report, please contact: Alex Walker, Accountant (01822) 813621 or email awalker@westdevon.gov.uk

1. BACKGROUND

1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council.

1.3 Accordingly treasury management 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.'

2. ECONOMIC SITUATION

2.1 Economic forecasting remains difficult with many external influences weighing in on the United Kingdom.

The quarter ended 31 December 2013 saw:

- Signs that GDP growth may have accelerated;
- Evidence pointed to a moderation of household spending growth;
- Inflation fell to its lowest level since November 2009;
- Unemployment approached the MPC's 7% forward guidance threshold;
- The MPC maintained the stance of monetary policy;
- 10-year gilt yields rose to 3% and the FTSE 100 reach 6749;
- The Federal Reserve decided to reduce the size of its monthly asset purchases by $10bn (from $85bn to $75bn).

The Council's treasury advisor, Capita Asset Services, has provided the following forecast on the bank rate and borrowing rates from the Public Works Loan Board (PWLB):

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%
10yr PWLB rate	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%
25yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%
50yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%

Capita Asset Services undertook a review of its interest rate forecasts in late November, after the Bank of England's latest quarterly Inflation Report. The latest forecast now includes a first increase in Bank Rate in quarter 2 of 2016 (previously quarter 3) and reflects greater caution as to the speed with which the MPC will start increasing Bank Rate than the current expectations of financial markets.

The Government's target measure of inflation, Consumer Prices Index (CPI) fell from a 2013 peak of 2.9% in June to 2.1% in November.

The Retail Prices Index (RPI) annual inflation stood at 2.6% in November 2013.

3. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

3.1 The Treasury Management Strategy Statement (TMSS) for 2013/14, which includes the Annual Investment Strategy, was approved by Council on 08 October 2013. No policy changes to the TMSS are proposed in this report. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity
- Return (yield)

3.2 The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. During the period under review, the unsettled economic climate and heightened credit concerns made it appropriate to keep investments short term with a maximum duration of three months.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Treasury Position at 31 December 2013

3.3 Our investment position at the beginning of the year and at 31 December 2013 is as follows:

	As at 31/12/2013		**As at 31/03/2013**	
	Principal £	**Interest %**	**Principal £**	**Interest %**
SIBA	1,278,212	Daily Rate	1,646,325	Daily Rate
Short Fixed	6,000,000	0.41	1,000,000	0.46
Long Fixed	-	-	-	-
Money Market	1,000,000	0.32	-	-
Funds			-	-
Total	**8,278,212**		**2,646,325**	

There is a cashflow advantage during the year due to the timing of when the precepts are paid to precepting authorities.

The following is a list of our fixed term investments at 31 December 2013:

	Fixed to	£	Interest rate
*Lloyds TSB	03.01.14	2,000,000	0.50%
Nationwide BS	07.02.14	2,000,000	0.42%
Barclays	17.02.14	2,000,000	0.45%

*Rolled over from original maturity date of 21st October 2013

A list of our fixed term investments for the financial year is detailed in Appendix C.

Performance Assessment

3.4 The Council's budgeted investment return for 2013/14 is £45,321, and £15,768.23 has been received to date. The budget monitoring report to the Resources Committee shows an anticipated overspend of £20,000 against the budget.

3.5 Industry performance is judged and monitored by reference to a standard benchmark; this is the 7 day London Interbank Bid Rate (LIBID). The average weighted LIBID rate at the end of December was 0.39% which is 0.03% lower than our weighted average return of 0.42%. The reason we are exceeding this benchmark is due to the use of fixed term deposits. (see details in 3.3).

3.6 The Treasury Management Strategy is risk averse with a very high credit rating required together with a limit of £2 million per counterparty. This has resulted in only a small number of institutions in which we can invest (see Appendix A).

3.7 The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement (TMSS) is meeting the requirement of the treasury management function.

Compliance with Treasury Limits and Prudential Indicators

3.8 During the financial year the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Annual Treasury Strategy Statement. The Council's Prudential Indicators for 2013/14 are detailed in Appendix B.

4. LEGAL IMPLICATIONS

4.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2013/14);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the Department for Communities and Local Government (DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

4.2 The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

5. FINANCIAL IMPLICATIONS

5.1 The unprecedented financial crisis has resulted in significant interest cuts around the world and interest rates are currently at a record low level with the bank base rate at 0.5%. This, coupled with adopting a risk adverse investment strategy, has meant a significant drop in the level of investment income that supports the revenue budget.

5.2 To illustrate how falling interest rates are affecting the Council, in 2007/08 we had investment income of £720,000. For 2013/14 it is estimated to be £25,000, a reduction of £695,000 since 2007/08.

6. RISK MANAGEMENT

6.1 The Council is aware of the risks of management of the treasury portfolio and, with the support of Sector, the Council's advisers, has proactively managed its treasury position. The Council uses Sector's Creditworthiness approach when deciding who to invest with in order to mitigate any investment risk. The risk management implications are shown in the strategic risk template at the end of this report.

7. OTHER CONSIDERATIONS

Corporate priorities engaged:	Sound financial management underpins all of the Council's corporate priorities
Statutory powers:	See legal implications above
Considerations of equality and human rights:	N/A
Biodiversity considerations:	N/A

Sustainability considerations:	N/A
Crime and disorder implications:	N/A
Background papers:	Treasury Management Strategy and Annual Investment Strategy for 2013/14 to 2015/16
Appendices attached:	Appendix A – Counterparty List Appendix B – Treasury Indicators Appendix C – Benchmarking Internally Managed Funds

STRATEGIC RISKS TEMPLATE

No	Risk Title	Risk/Opportunity Description	Inherent risk status				Mitigating & Management actions	Ownership
			Impact of negative outcome	Chance of negative outcome	Risk score and direction of travel			
	Opportunity	For the Council to comply with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities.	1	1	1	⇔	The Council's adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.	Head of Finance and Audit
	Risk	The Council is aware of the risks of management of the treasury portfolio and, with the support of Sector, the Council's advisers, has proactively managed its treasury position. Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting	3	1	3	⇔	The Council has utilised low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.	Head of Finance and Audit

No	Risk Title	Risk/Opportunity Description	Inherent risk status				Mitigating & Management actions	Ownership
			Impact of negative outcome	Chance of negative outcome	Risk score and direction of travel			
		future returns can be difficult.						