AGENDA ITEM 5

WEST DEVON BOROUGH COUNCIL

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NAME OF COMMITTEE	**Audit Committee**
DATE	**25 November 2014**
REPORT TITLE	**Mid Year Prudential Indicator and Treasury Management Monitoring Report 2014-2015**
Report of	**Finance Community of Practice Lead**
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 treasury management activity (borrowing and investment) for the first six months of the financial year.

Financial implications:
The monitoring report shows that the Council outperformed the industry benchmark of 0.36% on its investment activity, by achieving a 0.45% return on its investments up to 30 September 2014.

RECOMMENDATIONS:
The Audit Committee is asked to recommend the following to Council:

1. Note the report, the treasury activity and recommend any changes to the prudential indicators

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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."*

1.4 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 (i.e. Treasury Management Strategy Statement (TMSS), Annual Report and Midyear Report). This report therefore ensures this Council is implementing best practice in accordance with the Code.

2. ECONOMIC UPDATE

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

2.2 It appears likely that strong growth in UK Gross Domestic Product 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. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. 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. 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.

2.3 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May and July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q1 or Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

2.4 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 2013 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 in 2014/15.

2.5 The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%
10yr PWLB rate	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%
25yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%
50yr PWLB rate	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%

2.6 Capita Asset Services undertook a review of its interest rate forecasts in mid August, after the Bank of England's Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts and depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2015.

3. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

Overview

3.1 The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Council on 11 February 2014. 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:

1. Security of Capital
2. Liquidity
3. 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. 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, with highly credit rated financial institutions, using Capita's suggested creditworthiness approach. This includes reference to the sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Capita.

Treasury Position at 30 September 2014

3.3 Our investment position at the beginning and mid-point of the financial year is as follows:

	As at 30/09/2014		As at 31/03/2014	
	Principal £	**Interest %**	**Principal £**	**Interest %**
SIBA	1,045,898	Daily Rate	1,630,072	Daily Rate
Short Fixed	4,000,000	0.45	2,000,000	0.46
Long Fixed	-	-	-	-
Money Market Funds	700,000	0.32	- -	- -
Total	**5,745,898**		**3,630,072**	

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

3.5 The following is a list of our fixed term investments at 30 September 2014:

	Fixed to	£	Interest rate
*Barclays Bank	25.11.14	2,000,000	0.47%
**Lloyds TSB	13.01.15	2,000,000	0.57%
Nationwide BS	21.10.14	2,000,000	0.46%

*Rolled over from original maturity date of 16th October 2014

**Rolled over from original maturity date of 13th October 2014

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

Performance Assessment

3.7 The Council's budgeted investment return for 2014/15 is £40,321, and £10,555.93 has been received to date.

3.8 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 September was 0.36% which is 0.09% lower than our weighted average return of 0.45%. The reason we are exceeding this benchmark is due to the use of fixed term deposits. (see details in 3.3).

3.9 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).

3.10 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

3.11 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 2014/15 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 2014/15);
- 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. To illustrate how falling interest rates are affecting the Council, in 2007/08 we had investment income of £720,000. In 2013/14 the Council achieved £27,930 in investment income, a reduction of £692,070 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 2014/15 to 2016/17
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 & 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 future returns can be difficult.	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