Report to:	**Audit**
Date:	**19 January 2016**
Title:	**Treasury Management Mid-Year Review**
Portfolio Area:	**Support Services**
Wards Affected:	**ALL**

Relevant Scrutiny Committee: Overview and Scrutiny Committee (Internal)

Urgent Decision:	**N**	Approval and clearance obtained:	**Y**

Date next steps can be taken:
(e.g. referral on of recommendation or implementation of substantive decision)

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Recommendations:

It is recommended that the report be noted

It is recommended to Council that:

1. **The counterparty limit for counterparties set out in Appendix A (with the exception of Lloyds Bank plc) is increased from £2 million to £3 million.**
2. **The counterparty limit for Lloyds Bank plc (the Council's Bank) is increased from £3 million to £4 million. This allows flexibility to maintain a working balance of up to £1 million in the account, with the option to invest up to £3 million additional funds at any one time.**

1. Executive summary

The Council is on course to meet its budget target of £40,321. To date, the Council has outperformed the industry benchmark by 0.17%. The Council has achieved a rate of return of 0.52%, against the 7 day LIBID bid rate (LIBID) of 0.35%.

Raising the limit on the amount we could invest with agreed counter parties from £2 million to £3 million could increase the return by a few thousand pounds annually, whilst still maintaining a good spread of risk between British owned banks and money market funds.

2. Background

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.

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, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. The Council currently has a £2.1 million loan with the Public Works Loan Board.

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."

The Council's Finance Procedure Rules require that a report be taken to the Audit Committee three times a year on Treasury Management. The specific reporting requirements are:

- An annual treasury strategy in advance of the year (Audit Committee 24/02/2015 – AC39)
- A mid-year (minimum) treasury update report (This report)
- An annual review following the end of the year describing the activity compared to the strategy (Audit Committee 29/09/2015)

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 and midyear reports).

This report therefore ensures this Council is implementing best practice in accordance with the Code.

Economic Background

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, possibly being equal to that of the US.

The Bank of England is forecasting growth to remain around 2.4 – 2.8% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth.

The August Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon.

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

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

Capita Asset Services undertook a review of its interest rate forecasts on 11 August after the August Bank of England Inflation Report. This latest forecast includes no change in the timing of the first increase in Bank Rate as being quarter 2 of 2016.

The significant appreciation of Sterling against the Euro in 2015 has also acted as a dampening to UK growth while sharp volatility in financial markets since the Inflation Report has depressed equity prices, raised bond prices and lowered bond yields (and PWLB rates).

The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual.

Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by the Council on 31/03/15 - CM94 (Audit Committee 24/02/2015 – AC39). It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

The Council will also aim to achieve the optimum return (yield) on its 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 periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

Treasury Position at 30 September 2015

Investment Type	As at 31/03/2015		As at 30/09/2015	
	Principal £	**Interest %**	**Principal £**	**Interest %**
SIBA Call Account	1,456,341	0.30	39,936	0.40
Short Fixed	2,000,000	0.46	6,000,000	0.57
Money Market Funds	4,000,000	0	5,450,000	0.45
Total	**7,456,341**	**0.40**	**11,489,936**	**0.52**

The following is a list of our fixed investments at 30 September 2015:

Counterparty	Fixed to	£	Interest Rate
Barclays Bank plc	11/02/2016	2,000,000	0.63%
Nationwide BS	26/11/2015	2,000,000	0.57%
Lloyds Bank Plc	22/10/2015	2,000,000	0.51%

Performance Assessment

The Council's budget for investment interest is £40,321 for 2015/16. Performance to date is on target to meet this budget.

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 0.35% which is 0.17% lower than our weighted average return of 0.52%. The reason we are exceeding this benchmark is due to the use of fixed term deposits.

The Treasury Management Strategy is risk averse with no investments allowed for a period of more than a year and very high credit rating are 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).

Compliance with Treasury Limits and Prudential Indicators

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 2015/16 are detailed is shown in Appendix B.

3. Outcomes/outputs

In the last 18 months the interest achieved has been above the industry benchmark due to better use of fixed term investments

4. Options available and consideration of risk

Many of the large income streams such as grants and council tax are received in advance of the authority needing them. This has led, on a few occasions to finance having to use poor returning investment counterparty's on the lending list such as Government UK Debt Management Facility (0.25%) and from November, the Natwest SIBA Call account will also be 0.25% as we have now closed the current account and switched to Lloyds.

Natwest have dropped the previously used interest rate on the call account from 0.40% to 0.25%. These are used as a final resort when we have reached the £2 million limit to invest with any one counter party. It is recommended to increase the Counter party limit from £2 million to £3 million per Counter party (with an increased limit of £4 million for Lloyds Bank plc, which is the Council's bank).

5. Proposed Way Forward

Raising the limit on the amount we could invest with agreed counter parties from £2 million to £3 million could increase the return by a few thousand pounds annually, whilst still maintaining a good spread of risk between British owned banks and money market funds.

6. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	Statutory powers are provided by the Local Government Act 1972 Section 151 and the Local Government Act 2003
Financial	Y	2015-16 Budget for investment income is £40,321 and we are on target to meet or slightly exceed this. Consideration of the Annual Treasury Report forms an essential component of the Council's systems for public accountability. It also provides a platform for future investment planning.
Risk	Y	The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation. The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines. The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and the Hub Committee.
Comprehensive Impact Assessment Implications		
Equality and Diversity	N	N/A
Safeguarding	N	N/A
Community Safety, Crime and Disorder	N	N/A
Health, Safety and Wellbeing	N	N/A
Other implications	N	None

Supporting Information

Appendices:

Appendix A – Lending list as at 31 March 2015
Appendix B – Prudential and Treasury Indicators 2015/16

Background Papers:

Annual treasury strategy in advance of the year Annual Investment Strategy, was approved by the Council on 31/03/15 - CM94 (Audit Committee 24/02/2015 – AC39).
Annual review following the end of the year describing the activity compared to the strategy (Audit Committee 29/09/2015)

Approval and clearance of report

Process checklist	Completed
Portfolio Holder briefed	**Yes**
SLT Rep briefed	**Yes**
Relevant Exec Director sign off (draft)	**Yes**
Data protection issues considered	**Yes**
If exempt information, public (part 1) report also drafted. (Cabinet/Scrutiny)	**N/A**

APPENDIX A

West Devon Borough Council lending list

Barclays Bank Plc
HSBC Bank plc
Lloyds Banking Group Plc: • Bank of Scotland plc • Lloyds Bank plc
Nationwide Building Society
Royal Bank of Scotland Group Plc: • The Royal Bank of Scotland plc • National Westminster Bank plc
Government UK Debt Management Facility
Local Authorities (as defined under Section 23 of the Local Government Act 2003)
AAA rated Money Market Funds

APPENDIX B

PRUDENTIAL INDICATORS

THE CAPITAL PRUDENTIAL INDICATORS

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Capital Expenditure.

This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual £000	Actual £000	Estimate £000	Estimate £000	Estimate £000
Total	**490**	**473**	**451**	**651**	**651**

The table below summarises the above capital expenditure plans and how these plans are being financed. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual £000	Actual £000	Estimate £000	Estimate £000	Estimate £000
Total	**490**	**473**	**451**	**651**	**651**
Financed by:					
Capital receipts	312	259	0	0	0
Capital grants	178	186	239	239	239
Reserves	0	28	0	0	0
New homes Bonus	0	0	212	412	412
Net financing need for the year	**Nil**	**Nil**	**Nil**	**Nil**	**Nil**

The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). It is essentially a measure of the Council's underlying need to borrow if the figure is greater than zero. The negative figure reflects the fact that the Council is debt-free and has a nil borrowing requirement. The Council is not currently undertaking any borrowing to fund its Capital Programme from 2015/16 onwards.

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual £000	**Actual £000**	**Estimate £000**	**Estimate £000**	**Estimate £000**
Capital Financing Requirement (CFR)					
Total CFR	1,842	1,799	1,757	1,715	1,673
Movement in CFR	-43	-42	-42	-42	-42
Movement in CFR represented by:					
Net Financing need for the year	0	0	0	0	0
MRP (Minimum Revenue Provision) and other financing movements	-43	-42	-42	-42	-42
Net borrowing requirement	0	0	0	0	0

Minimum Revenue Provision (MRP)

The Minimum Revenue Provision is calculated at £42,000 per year. This is the Council's borrowing of £2.1 million divided by the life of the asset of 50 years.

Debt Rescheduling

The Council has one PWLB loan of £2.1 million which matures in 2053; this is at a rate of 4.55%.
The Council has not undertaken any debt rescheduling during the first six months of 2015/16 and there are no current opportunities for debt rescheduling.

AFFORDABILITY PRUDENTIAL INDICATORS

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans.
These provide an indication of the impact of the capital investment plans on the Council's overall finances.

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the receipt of net investment income against the net revenue stream. It is calculated by dividing investment income and interest received by the Council's Net Budget.

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	**Actual**	**Estimate**	**Estimate**	**Estimate**
Ratio of net investment income to net revenue stream. (Surplus)	1.6%	1.2%	1.2%	1.6%	1.3%

Estimates of the incremental impact of capital investment decisions on council tax

This indicator calculates the notional cost of the impact of lost investment income on the Council Tax, from spending capital resources.

The Council is not undertaking any borrowing to fund its Capital Programme at present.

Incremental impact of capital investment decisions on the band D council tax (Notional cost as explained above)

	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Actual	Estimate	Estimate	Estimate
	£	£	£	£	£
Future incremental impact of capital investment decisions on the band D Council tax (Notional cost)	0.13	0.03	0.07	0.13	0.18

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

The Operational Boundary – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	2014/15	2015/16	2016/17	2017/18
	£	£	£	£
Borrowing	3,000,000	3,000,000	3,000,000	3,000,000
Other long term liabilities	-	-	-	-
Total	3,000,000	3,000,000	3,000,000	3,000,000

Operational Boundary	2014/15	2015/16	2015/16	2015/16
	Actual	Estimate	Current Position	Revised Position
	£	£	£	£
Prudential Indicator – Capital Financing Requirement				
CFR	1,799,000	1,757,000		1,757,000
Prudential Indicator – External Debt/ The Operational Boundary				
Total Debt 31 March 2015	2,100,000	2,100,000	2,100,000	2,100,000

The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

Authorised limit	2014/15	2015/16	2016/17	2017/18
	£	£	£	£
Borrowing	6,000,000	6,000,000	6,000,000	6,000,000
Other long term liabilities	-	-	-	-
Total	6,000,000	6,000,000	6,000,000	6,000,000

West Devon Borough Council's current level of external borrowing is £2.1 million.