AGENDA ITEM 11	SOUTH HAMS DISTRICT COUNCIL	AGENDA ITEM 11

NAME OF COMMITTEE	**Executive**
DATE	**23 October 2014**
REPORT TITLE	**Treasury Management : Mid Year Review 2014-15**
Report of	**Head of Finance & Audit**
WARDS AFFECTED	**All**

Summary of report:
This report updates Members on the Treasury Management function for the first six months of the financial year.

Financial implications:
The Council is on course to meet its budget target of £110,000. To date, the Council has outperformed the industry benchmark by 0.21%.

RECOMMENDATION TO COUNCIL:

That the report is noted.

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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.

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 is currently debt-free.

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*."

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

- an annual treasury strategy in advance of the year (Executive 06/03/14
- a mid - year treasury update report (this report)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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.

2 ECONOMIC UPDATE

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

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.

2.2 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in August. 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.

2.3 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.

2.4 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%

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 STREATEGY UPDATE**

Overview

3.1 The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Council on 20th March 2014 (62/13 and E.75/13). 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 in periods up to 12 months, 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.

3.3 **Treasury Position at 30 September 2014**

	As at 30/09/2014		**As at 31/03/2014**	
	Principal £	**Interest %**	**Principal £**	**Interest %**
Call	5,000,000	0.30	-	-
Short Fixed	15,000,000	0.68	15,000,000	0.64
Long Fixed	-	-	-	
Money Market Funds	3,370,000	0.40	2,950,000	0.32
Heritable Bank	72,368	-	72,368	-
Total	**23,442,368***	**0.56**	**18,022,368***	**0.59**

- *Cash flows follow a cyclical pattern and are influenced by precept dates and Council Tax Collection schedules etc.*

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

	Fixed to	£	Interest rate
Barclays Bank	22.10.14	5,000,000	0.48%
Lloyds	03.09.14	5,000,000	0.95%
Nationwide BS	09.02.15	5,000,000	0.61%

3.5 At the 31 March 2014 the Council had £72,368 frozen in the Heritable Bank which is UK registered and regulated, but a subsidiary of Landsbanki, one of the Icelandic Banks that have been affected by the world economic crisis. Heritable Bank is registered in Scotland with a registered address in Edinburgh. Heritable Bank Plc is authorised and regulated by the Financial Services Authority and is on the FSA Register. The bank's shares are owned by Icelandic bank Landsbanki

3.6 The Council placed a deposit of £1,250,000 on 25th September 2008. At the time the deposit was placed the risk rating of Heritable was 'A' (long term deposits) and F1 (short term deposits) which were within the deposit policy approved by the Council. Both these ratings indicate low risk.

3.7 Administrators have kept the bank trading and are winding down the business over a period of years. The Administrators had paid fourteen dividends at the end of September 2013 amounting to 94% of the original deposit. However, they do not intend to make any further distributions until the conclusion of a legal dispute with Landsbanki.

3.8 **Performance Assessment**

The Council's budget for investment interest is £110,000 for 2014/15. Performance to date is on target to meet this budget.

3.9 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 0.21% lower than our weighted average return of 0.56%. The reason we are exceeding this benchmark is due to the use of fixed term deposits (see details in 3.3).

3.10 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 £5m per counterparty. This has resulted in only a small number of institutions in which we can invest (see Appendix A).

3.11 **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 2014/15 are detailed is shown in Appendix B.

4 FINANCIAL IMPLICATIONS

4.1 Income from Treasury Management is budgeted at £110,000 in 2014/15. Regular monitoring of performance and compliance with the TMSS forms an essential component of the Council's systems for public accountability. It also provides a platform for future investment planning.

5 LEGAL IMPLICATIONS

5.1 The report indicates that Treasury Management (TM) is being carried out with due regard to proper financial and TM standards and accordingly there are no legal implications in this report.

6 RISK MANAGEMENT

6.1 The Risk Management implications are shown at the end of this report in the Strategic Risks Template.

7. OTHER CONSIDERATIONS

Corporate priorities engaged:	Sound financial management underpins all of the Council's corporate priorities.
Statutory powers:	Local Government Act 1972, s148(5)
Considerations of equality and human rights:	N/a
Biodiversity considerations:	N/a
Sustainability considerations:	N/a
Crime and disorder implications:	N/a
Background papers:	Executive: 06/03/14
Appendices attached:	Appendix A - Counterparty List Appendix B - Prudential Indicators

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**			
1	Security	risk of failure of counterparty	5	3	15	⇔	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 the Executive. Audit Committee have a scrutiny role over the Treasury Management operation.	Head of Finance and Audit
2	Liquidity	liquidity constraints affecting interest rate performance	3	3	9	⇔	See above	Head of Finance and Audit
3	Yield	volatility of interest rates / inflation	4	4	16	⇔	See above	Head of Finance and Audit

Direction of travel symbols ⇩ ⇧ ⇔

APPENDIX A

SOUTH HAMS DISTRICT COUNCIL LENDING LIST AS AT 30 SEPTEMBER 2014.

Barclays Bank Plc
Co-operative Bank (the Council's Bank)*
HSBC Bank plc
Lloyds Banking Group Plc: • Bank of Scotland plc • Lloyds TSB 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

** The bank contract has been retendered following the Co-operative's decision to withdraw its banking service from the local authority market. The tender evaluation is currently in progress.*

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	2012/13 Actual £000	2013/14 Actual £000	2014/15 Estimate £000	2015/16 Estimate £000	2016/17 Estimate £000
Total	2,569	4,040	2,377	TBA	TBA

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).

The Council is currently debt-free and the approved Capital Programme for 2014/15 will be financed from capital receipts, capital grants and reserves. The Council is not currently undertaking any new borrowing to fund its Capital Programme from 2014/15 onwards. Therefore the Council currently has a nil borrowing requirement.

Capital Expenditure	2012/13 Actual £000	2013/14 Actual £000	2014/15 Estimate £000	2015/16 Estimate £000	2016/17 Estimate £000
Total	**2,569**	**4,040**	**2,377**	**TBA**	**TBA**
Financed by:					
Capital receipts	743	1,455	1,095		
Capital grants	554	1,549	282		
Reserves	1,272	1,036	1,000		
Net financing need for the year	**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 2013/14 onwards.

	2012/13 Actual £000	2013/14 Actual £000	2014/15 Estimate £000	2015/16 Estimate £000	2016/17 Estimate £000
Capital Financing Requirement (CFR)					
Total CFR	- 98	- 98	- 98	- 98	- 98
Movement in CFR	Nil	Nil	Nil	Nil	Nil
Net borrowing requirement (the Council is debt free)	Nil	Nil	Nil	Nil	Nil

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.

	2012/13 Actual	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Ratio of net investment income to net revenue stream. (surplus)	2.6%	1.8%	1.2%	1.2%	2.4%

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)

	2012/13 Actual £	2013/14 Actual £	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £
Future incremental impact of capital investment decisions on the band D council tax (Notional cost)	0.25	0.30	0.14	TBA	TBA

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	2013/14 £	2014/15 £	2015/16 £	2016/17 £
Borrowing	2,000,000	2,000,000	2,000,000	2,000,000
Other long term liabilities	-	-	-	-
Total	2,000,000	2,000,000	2,000,000	2,000,000

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	2013/14 £	2014/15 £	2015/16 £	2016/17 £
Borrowing	7,000,000	7,000,000	7,000,000	7,000,000
Other long term liabilities	-	-	-	-
Total	7,000,000	7,000,000	7,000,000	7,000,000