Item No: 7.1	Classification: Open	Date: 27 November 2013	Meeting Name: Council Assembly
Report title:		Treasury Management – Mid-year update 2013/14	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Corporate Services	

RECOMMENDATION

1. That council assembly notes this 2013/14 mid-year treasury management update.

BACKGROUND INFORMATION

2. This item is one of an annual cycle of reports on the council's debt and investments. Other reports to council assembly on treasury include a strategy report at the start of each financial year and an out-turn report following the end of the year. The cabinet also receive quarterly updates and the audit and governance committee reviews treasury strategy annually.

3. Treasury activity is supported by a series of prudential indicators (estimates and limits on capital finance, debt and investments), which are agreed by council assembly each year and under financial delegation all executive, managerial and operational decisions are the responsibility of the strategic director of finance and corporate services. This area of finance falls under the Local Government Act 2003 and is supplemented by investment guidance issued by the government and codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

KEY ISSUES FOR CONSIDERATION

Investment Management Activity and Position

4. The council's cash is invested in accordance with its investment strategy, which is agreed annually by council assembly. The investment objectives are to preserve capital, ensure liquidity and secure a reasonable return.

5. Over the first half of 2013/14 the balance in investments averaged £242m and at 30 September 2013 stood at £231m (£176m at 31/3/2013). The change over the period reflects cash flow from day to day management of the council's financial affairs.

6. Investments were diversified across major high rated banks/building societies. Cash is also placed in the UK government or supranational bodies (such as the European Investment Bank and the International Bank for Reconstruction and Development, both backed by governments across the world).

7. Bank exposure is in the form of money market funds, call accounts, time deposits or certificates of deposits (CD), maturing within 12 months. The UK government exposure is in bonds or treasury bills, and the supranational is in bonds alone. The CD, treasury bill and bond portfolios are managed by two fund managers (AllianceBernstein and Aberdeen Investment Managers). Each

manager holds £50m and sums are placed in bonds longer than one year where prudent within a risk controlled framework, prioritising security and liquidity. The remainder of the funds are managed in-house, and the focus is on investing cash safely to meet day to day spending.

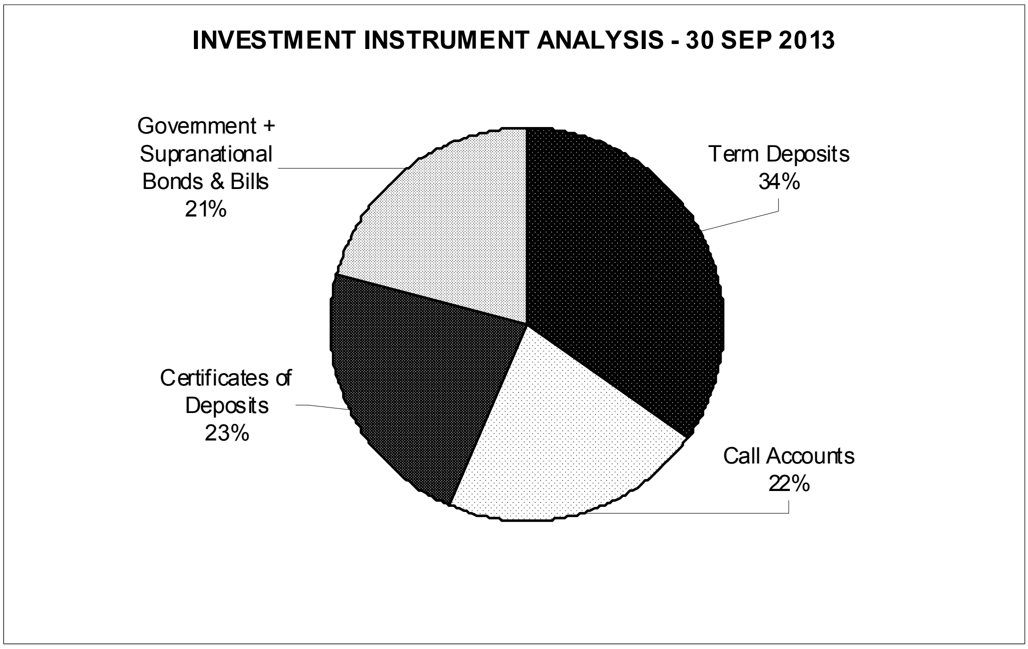
8. The half-year return to 30 September 2013 was 0.28%, reflecting the prolonged period of very low UK base rates (0.50%, equivalent to 0.25% over the half-year) and the stimulatory monetary policies which central banks here and abroad still have in place. Here the Bank of England has pledged, barring unforeseen circumstances, to keep base rates low until unemployment falls to 7% and no rate increase is expected until 2015.

9. The sum held across investment counterparties as at 30 September 2013, together with the rating and maturity profile is set out in the tables and chart below.

INVESTMENT COUNTERPARTY AND RATINGS - 30 SEP 2013									
Exposure £m	**FUND**				**Fitch Ratings**				
COUNTERPARTY	Aberdeen	Alliance Bernstein	In-House	**£m**	Long	Short	Sup-port	Sovereign	Sovereign Rating
NORDEA BANK FINLAND	5.7			5.7	AA-	F1+	1	FINLAND	AAA
CREDIT INDUST ET COMRCL	3.5			3.5	A+	F1	1	FRANCE	AA+
SOCGEN		1.0		1.0	A	F1	1	FRANCE	AA+
BANQUE NATIONAL DE PARIS		1.0	10.0	11.0	A+	F1	1	FRANCE	AA+
LANDESBANK BADEN WERTMBG		1.0		1.0	A+	F1+	1	GERMANY	AAA
DEUTSCHE BANK		2.0		2.0	A+	F1+	1	GERMANY	AAA
RABOBANK		1.0		1.0	AA	F1+	1	NETHERLANDS	AAA
ING BANK	3.4	1.0	15.0	19.4	A+	F1+	1	NETHERLANDS	AAA
ABN AMRO BANK	3.5	1.0		4.5	A+	F1+	1	NETHERLANDS	AAA
DNB BANK	3.5			3.5	A+	F1	1	NORWAY	AAA
EUROPEAN INV BANK	7.0	6.5		13.5	AAA	F1+		SUPRANATIONAL	AAA
INT BANK RECONST DEVT	3.5	6.8		10.3	AAA	F1+		SUPRANATIONAL	AAA
SVENSKA	3.3		15.0	18.3	AA-	F1+	1	SWEDEN	AAA
SKANDINAVISKA	3.5	1.0		4.5	A+	F1	1	SWEDEN	AAA
CREDIT SUISSE	3.5	1.1		4.6	A	F1	1	SWITZERLAND	AAA
UBS	1.6			1.6	A	F1	1	SWITZERLAND	AAA
NATIONWIDE BSOC	3.3	1.0	10.0	14.3	A	F1	1	UK	AA+
RBS/NATWEST			50.1	50.1	A	F1	1	UK	AA+
UK TREASURY		24.6		24.6	AA+	F1+		UK	AA+
BARCLAYS BANK	5.1	1.0	15.1	21.2	A	F1	1	UK	AA+
LLOYDS BANK			15.1	15.1	A	F1	1	UK	AA+
BNY MELLON	0.1	0.3		0.4	AA-	F1+	1	US	AAA
Total £m	50.5	50.3	130.3	231.1					

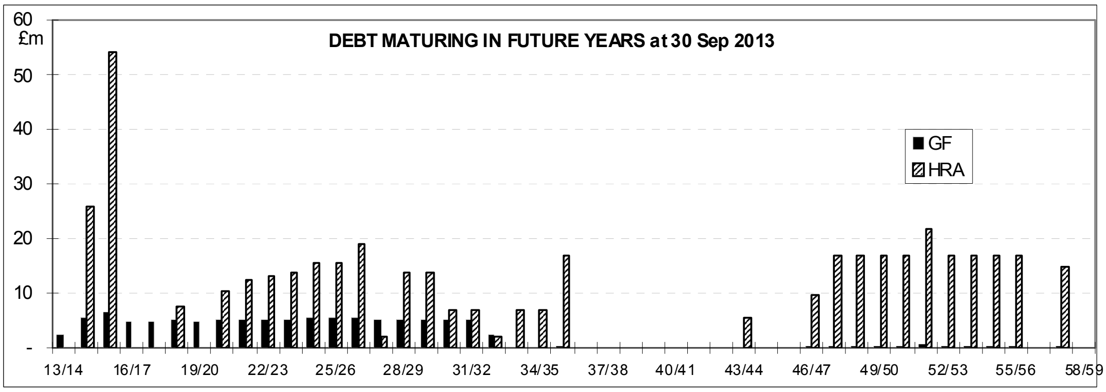
INVESTMENT MATURITY PROFILE AND LONG TERM RATING - 30 SEP 2013				
Yr Band	A+ to A	AA+ to AA-	AAA	Grand Total
Up to 1 Yr	162.3	37.2	2.9	202.4
1-2 Yrs			12.1	12.1
2-5 Yrs		7.8	8.8	16.6
Grand Total £m	162.3	45.0	23.8	231.1

Fitch Ratings	**Definition**
AAA	Highest credit quality
AA+,AA, AA-	Very high credit quality
A+, A	High credit quality
F1	Highest short term credit quality; strongest capacity for timely payment (+donates exceptionally strong credit feature)
1	Extremely high probability of support



Debt Management Activity and Position

10. The balance outstanding on loans taken to fund past capital expenditure was £560m at 31/3/2013. All loans are from the Public Works Loans Board (PWLB) and are divided between the HRA (£451m) and the general fund (£109m). No new loans were taken in the six months to September 2013, but £2.5m in general fund debt fell due for repayment and was paid off. The sums falling as maturities in the future are shown in the chart below.

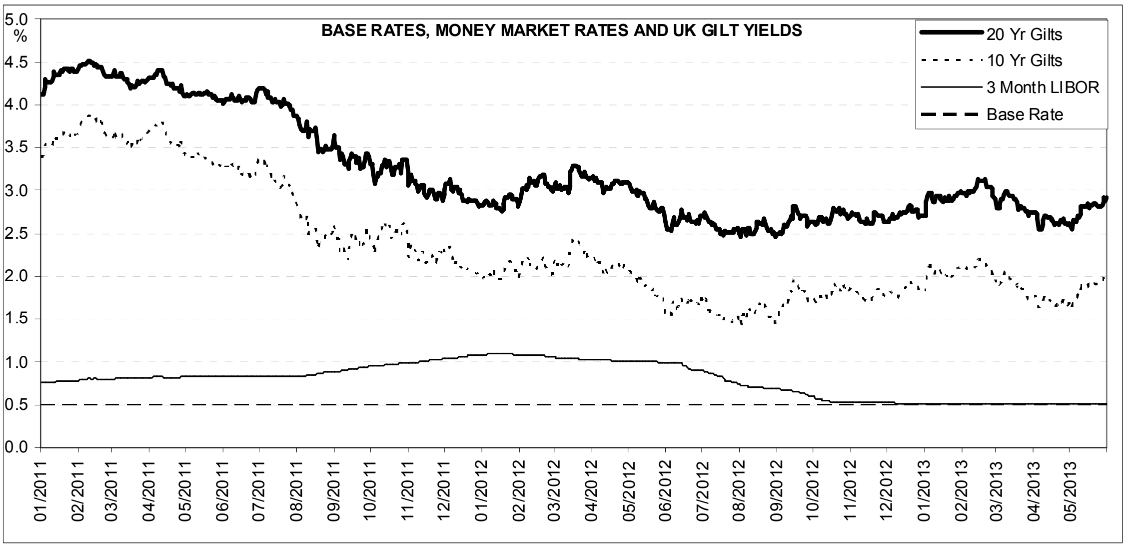


11. All loans are at fixed rates and the average rate of interest payable on HRA debt is 6.55% and for the general fund is 3.57%. The general fund rate reflects the low coupon loans taken in April 2012. The HRA has some £80m maturing between 2014/15 and 2015/16 at an average rate of 9.3%. Options are being considered for the future financing of this debt. The table below shows the movement in debt since 2005/6 and its impact on revenue in terms of interest payable.

Year	Closing debt	Annual interest payable	Average interest rate
	£m	£m	%
2006/07	693.7	60.9	8.8%
2007/08	738.3	54.6	7.6%
2008/09	770.7	52.0	7.0%
2009/10	761.7	52.8	6.9%
2010/11	761.7	52.8	6.9%
2011/12*	462.5	55.6	6.9%
2012/13	560.0	33.2	6.0%
2013/14	555.0	33.4	6.0%

* Under HRA self-financing reforms, the debt was reduced by £199.2 million in March 2012 and from 2012/13, councils became responsible for servicing the remaining debt out of rents and other HRA income.

12. Currently rates on new long term loans are low, although they have come under pressure since June 2013, when the outlook for growth in the United States began to improve and the central bank there indicated that monetary expansion would begin to slow if economic prospects continued to improve as expected. This led to higher sovereign bond yields not only in the US, but across all developed economies. Here in the UK, government bond yields (gilts) closed the half-year to September 2013 higher than they opened it at. Despite the increase, yields remain close to historical low; refer chart below. Since then however, yields have fallen a little as the US has delayed tapering monetary stimulus for the time being.



13. Gilt yields determine the rates at which the PWLB can lend to local authorities. A margin is added to gilts, but it remains a competitive source of long term funds.

14. The rates at which the council can replace its maturing debt will depend on rates prevailing at the time the loans are due for payment. In the case of the HRA the earliest the debt falls out is 2014/15 (when some £25m is due), with a further £55m due the year after. And although rates have already moved higher in anticipation of better economic prospects and tapering of monetary stimulus, the risk is that, despite a small fall recently, they go higher still, should prospects for growth continue to improve. Therefore, rather than wait for loans to mature before replacing them, they may be replaced sooner, subject to

refinancing costs, to protect the council from significant unexpected upward shift in long term rates.

15. The requirement for the general fund to replace maturing debt is negligible as revenue provisions are set-aside each year for debt repayment. At the moment, as no money is being set-aside for HRA debt repayment, maturing loans would have to be replaced. However, should the HRA set-aside sums in the future, it would, as with the general fund, reduce future refinancing requirements, exposure to interest rate risk and annual interest rate liability.

16. The general fund is also carrying some £190m as internal borrowing, mostly following the acquisition of its headquarters at 160 Tooley Street. This sum is also being pared down annually by the minimum revenue provision. Internal borrowing is currently cheaper than borrowing externally from the PWLB, however it may in the future become attractive to replace some of these internal funds with external ones.

17. Recently, the Local Government Association has made it one of its objectives to re-establish a municipal bond market. By doing so, they hope to offer competitive borrowing rates, and more flexibly structured loans with less restriction on early redemption. At best, the municipal bond agency would hope to be able to lend to councils similar to PWLB rates (between 0.70% and 0.80% above gilts). Against this background, the success of the agency remains uncertain, but officers are keeping this development under review

Prudential Indicators

18. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance and the Treasury Management in the Public Services Code of Practice and Guidance published by the Chartered institute of Public Finance and Accountancy and backed by the Local Government Act 2003. The codes introduced a series of prudential indicators, estimates and limits which authorities determine annually. Here the indicators were last determined by the council assembly in February 2013. The indicators have no impact on existing budgets. Borrowing and investment activities have remained within limits and the latest estimate and position against each indicator is set out below.

PRUDENTIAL INDICATORS – 2013/14 MID-YEAR UPDATE

(A) INDICATORS ON AFFORDABILITY AND PRUDENCE		
2012/13 Actual	2013/14 Estimate	***Ratio of Financing Cost to Net Revenue Stream*** - a measure of the cost of debt and PFI liability, net of interest income, as a percentage of revenue.
15%	15%	HRA
6%	7%	General Fund
2012/13 Actual	2013/14 Estimate	***Incremental Impact of Capital Spend*** - a measure of the effect of capital spend proposals on council tax and rents. Actual council tax and rents are however determined by the council assembly taking account of all the resources of the council.

nil	Nil	Weekly rents
nil	Nil	Council tax – band D
2012/13 Actual	2013/14 Estimate	***Capital Financing Requirements (CFR) and Gross Debt*** - the CFR is a measure of past capital expenditure financed through borrowing and long term liabilities (e.g. PFI). The level of debt should normally not exceed the CFR except over a short period. Actual debt remained below the CFR throughout the first half of 2013/14, on account of cash balances, internal borrowing and PFI transactions.
£848m	£840m	CFR
£562m	£560m	Maximum Debt, first half of 2013/14

(B) INDICATORS ON CAPITAL FINANCE		
2012/13 Actual	2013/14 Estimate	***Capital Expenditure Estimate*** - the estimated spend has been updated to reflect latest spend profile and includes PFI spend.
£86m	£133m	HRA
£262m	£80m	General Fund
£348m	**£213m**	**Total**
2012/13 Actual	2013/14 Estimate	***Estimated Capital Financing Requirement*** - past capital expenditure financed through borrowing and long term liabilities. The HRA includes the PFI facility to deliver heating to housing units in Southwark coming into operation this year. And the general fund includes provisions to reduce future CFR liabilities from revenue. No such provisions are made in respect of the HRA at the moment.
£451m	£456m	HRA
£397m	£384m	GF
£848m	**£840m**	**Total**
2012/13 Actual	2013/14 Estimate	***HRA Indebtedness Limit*** - a limit on capital finance met by debt and long term liabilities determined by the government.
£577m	£577m	Limit
£451m	£456m	HRA CFR

(C) INDICATORS ON TREASURY MANAGEMENT

2012/13 Actual Maximum	2013/14 Limit	2013/14 Max. to Sept. '13	***Operational Boundary on Debt and Authorised Limits for External Debt*** - limits the council determine to accommodate debt, internal borrowing and long term liabilities. The lower limit is the operational boundary and takes account of existing positions and ordinary activity and the higher limit is the authorised limit and enables additional debt to be taken for very short periods within a risk controlled framework, should it be prudent.
			Operational Boundary
£562m	£815m	£560m	Borrowing
£107m	£115m	£98m	Other Long Term Liabilities
£669m	**£930m**	**£658m**	**Total**

			Authorised Limit
£562m	£850m	£560m	Borrowing
£107m	£120m	£98m	Other Long Term Liabilities
£669m	**£970m**	**£658m**	**Total**
2012/13 Actual	2013/14 Limit	2013/14 Max. to Sept. '13	***Gross and Net Debt*** -an upper limit on net debt as a percentage of gross debt. The net has remained below gross on account of investments held to meet spend.
68%	100%	68%	Upper Limit
2012/13 Actual	2013/14 Limit	2013/14 Max. to Sept. '13	***Fixed and Variable Rate Upper Limits*** - limits recognising existing positions, with flexibility to vary exposure within a risk controlled framework should it be prudent.
£562m	£850m	£560m	Upper limit on fixed rate debt
£0m	£215m	£0m	Upper limit on variable rate debt
2013/14 Lower Limit	2013/14 Upper Limit	2013/14 Position at start of year	***Maturity Structure of Fixed Rate Debt*** - limits accommodating existing positions, with flexibility to vary exposure within a risk controlled framework should it be prudent.
0%	30%	1%	Under 1 year
0%	30%	6%	1 year and within 2 years
0%	60%	13%	2 years and within 5 years
0%	80%	12%	5 years and within 10 years
0%	100%	28%	10 years and within 20 years
0%	100%	6%	20 years and within 30 years
0%	100%	22%	30 years and within 40 years
0%	100%	12%	40 years and within 50 years

2013/14 Actual	2013/14 Limit	2013/14 Max. to Sept. '13	***Limit on Investments of one year or more*** - caps maximum exposure to longer investments, while recognising that it helps secure additional yield within a risk controlled framework. Exposure over the last six months has remained cautious in view of market volatility.
15%	50%	15%	Percentage in one year or longer
7 Mnths	3 Yrs	7 Mnths	Overall maximum average maturity
5 Yrs	10 Yrs	5 Yrs	Longest investment
Adoption of the CIPFA code of Practice on Treasury Management - the code and its principles were adopted by the council assembly in 2010.			

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Legal Services

19. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit and governance committee.

20. Financial standing orders require the strategic director of finance and corporate services to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a quarterly basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance and corporate services.

21. The Local Government Act 2003 and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

22. Section 15(1) of the 2003 Act requires a local authority "to have regard (a) to such guidance as the Secretary of State may issue". This guidance is found in the Department of Communities and Local Government Guidance on Local Authority Investments updated March 2010 and there is statutory guidance on the Minimum Revenue Provision (MRP) produced under amendments made to section 21(1A) of the 2003 Act by section 238(2) of the Local Government and the Public Involvement in Health Act 2007.

23. Section 12 of the 2003 Act grants local authorities the powers to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
None		

APPENDICES

No.	Title
None	

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Corporate Services	
Report Author	Jennifer Seeley, Deputy Finance Director	
Version	Final	
Version Date	13 November 2013	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments Sought**	**Comments Included**
Director of Legal Services	Yes	Yes
Strategic Director of Finance and Corporate Services	N/A	N/A
Cabinet Member	Yes	Yes
Final Report Sent to Constitutional Team		14 November 2013