

FOR DECISION  
WARD(S): GENERAL

AUDIT COMMITTEE

4 December 2014

TREASURY MANAGEMENT MID-YEAR REVIEW 2014-15

REPORT OF CHIEF FINANCE OFFICER

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RECENT REFERENCES:

CAB2554 – Treasury Management Strategy 2014/15, 12 February 2014

EXECUTIVE SUMMARY:

The Treasury Management Strategy for 2014/15 (CAB2554) has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

The Code also recommends that members are informed of treasury management activities at least twice a year. This report therefore ensures that the Council is embracing best practice in accordance with CIPFA's recommendations.

The report provides confirmation that, in the year to October 2014 there has been full compliance with the Treasury Management indicators set.

The management of investments was taken on by the Hampshire County Council Treasury Management Team in September and detail is provided in the report on some beneficial changes already made to the investment portfolio.

RECOMMENDATIONS:

- 1 That the Treasury Management Mid-Year Monitoring Report for 2014/15 be approved.

## AUDIT COMMITTEE

4 December 2014

## TREASURY MANAGEMENT MID-YEAR REVIEW 2014/15

### REPORT OF CHIEF FINANCE OFFICER

#### 1 Introduction

- 1.1 This report outlines the treasury management activities during the year to date.
- 1.2 Winchester City Council fully complies with the requirements of the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in the Public Services (2009). This report continues to ensure that the Council is following best practice in accordance with CIPFA's recommendations to report on treasury management activities.
- 1.3 Treasury management in the context of this report is defined as:  
"The management of the organisation'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" (CIPFA Code of Practice).

#### 2 Economic Background

- 2.1 The following paragraphs outline major macro economic themes in the domestic and global economy, which explain the background against which treasury management decisions have been made.
- 2.2 Growth - The recent strong performance of the UK economy has continued with output growing at a preliminary estimate of 0.7% in Quarter 3 of 2014, following on from figures of 0.7% and 0.9% in the first two quarters of the year. This made the economy 3.4% larger than the pre-crisis peak in the first quarter of 2008.
- 2.3 Unemployment - The labour market has continued to improve, with strong employment gains and the headline unemployment rate falling to 6.0% at the end of August 2014 (the lowest figure since late 2008). However, real earnings remain negative and employment growth trends have masked under employment, such as the large number of zero-hour contracts and people working part-time involuntarily.
- 2.4 Inflation - CPI inflation for September fell to 1.2% year-on-year from 1.5% in August. Expectations remain that inflation is likely to remain close to, but a little below, the Monetary Policy Committee's (MPC) 2% target for the next couple of years. In August the Bank of England's latest Inflation Report was published. CPI inflation projections were revised downwards over the two

year horizon and expectations for wage growth, the estimate of spare capacity and equilibrium unemployment also fell.

- 2.5 UK Monetary Policy - The MPC made no change to the Bank Base Rate of 0.5%. However, there was a marked shift in tone from the Bank of England's Governor and other MPC members. In his Mansion House speech in June 2014 Governor Mark Carney warned that interest rates might rise sooner than financial markets were expecting. Following some mixed messages from Governor Carney later in the summer, the minutes of the August and September MPC meetings revealed a split vote on the Bank Rate, with two of the nine votes to increase the Bank Rate by 0.25%.
- 2.6 The MPC emphasised that when the Bank Rate does begin to rise, it is expected to do so only gradually and to remain below average historical levels for some time to come. The Council's treasury management advisors, Arlingclose, estimate the first rise in interest rates will be in the third quarter of 2015, later than some economic commentators.

### 3 Investments

- 3.1 The Council has an investment portfolio consisting of reserves and short-term cash flows. The authority is currently investing according to a low risk, high quality lending list as outlined in its Treasury Management Strategy. In compliance with this Strategy, lending is restricted to the following instruments and counterparties:
- approved banks and building societies
  - highly rated bonds
  - AAA-rated money market funds and other suitable pooled investment vehicles
  - other Local Authorities
  - UK registered providers of social housing
  - the Government's Debt Management Office.
- 3.2 The Council's investment holding was £38.5m at 31 October 2014, which was placed with the following types of investments, a full list of investments with individual counterparties, is shown in Appendix A.

	£m
Bank call accounts	8.0
Bank & building society fixed deposits	16.0
Bank certificates of deposit	5.0
Floating rate note (bond)	1.0
Money market funds	4.5
Local authority fixed deposits	2.0
Pooled property fund	2.0
<u>Total</u>	<u>38.5</u>

- 3.3 The level of cash balances has increased from £32.5m at the beginning of the financial year, but is expected to reduce by the end of the financial year due to the profile of the Council's income.
- 3.4 The average interest rate earned on these investments at 31 October 2014 was 0.93%, which should be considered within the context of an unchanged UK Base Rate of 0.5% since March 2009 and similarly low short-term money market rates.
- 3.5 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy for 2014/15.
- 3.6 Counterparty credit quality is assessed and monitored with reference to a range of factors, including but not limited to, the ratings of the major ratings agencies. During the seven months to October 2014 investment counterparties and the duration of new investments have been monitored and amended where necessary based on this assessment.
- 3.7 From 15 September 2014 management of Winchester City Council's investments was taken on by the team delivering Treasury Management for Hampshire County Council and a number of other authorities. Since then some minor changes have taken place that will benefit the Council's cash investment portfolio:
- Through negotiation with two of the Council's Money Market Funds the share class that the Council invests in has changed, increasing the rate of interest earned.
  - Two longer term investments for up to three years with other local authorities have been made, due to start in November 2014. These investments were made jointly with others managed by Hampshire County Council, although the investments are separate and the Council has invested in its own right.

#### 4 Other Holdings

##### 4.1 Local Authorities Mutual Investment Trust (LAMIT)

- a) The Council holds 422,654 units in the LAMIT property fund which were purchased in 1989/90 at a cost price of £1 million, plus 447,507 units that were added to the Council's holding on the 30 April 2013 at a cost of £1m. The value of LAMIT has been subject to the following recent market fluctuations.

Valuation date	Value £	Gain / (Loss) on investment (unrealised) £
31 March 2012	963,000	(37,000)
31 March 2013	945,000	(55,000)

31 March 2014	2,115,000	115,000
31 October 2014	2,239,000	239,000

- b) The holding has increased in value by £124k since 1 April 2014.
- c) Dividends receivable on the investments to 31 October 2014 are £74k.

## 5 Heritable Bank in Administration

- 5.1 The Council had an investment of £1m with Heritable Bank Ltd which was placed into administration in October 2008. At 31 October 2014 the Council had received dividends of £943,419. The administrators have indicated that there will be no further dividends until ongoing legal proceedings are concluded.

## 6 Borrowing

- 6.1 The Council's underlying need to borrow is measured by the Capital Financing Requirement (CFR) which was £165.7m at 31 March 2014. Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy meaning that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.
- 6.2 For the Council the use of internal resources in lieu of borrowing has therefore continued to be the most cost effective means of funding capital expenditure. No new long-term borrowing has taken place in the seven months to October 2014, or is planned for the remainder of the financial year. This has lowered overall treasury risk by reducing both external debt and temporary investments.
- 6.3 As at 31 October 2014 the Council had £156.7m of outstanding long-term loans, from the Public Works Loan Board (PWLB), at an average interest rate of 3.3% and a weighted average outstanding term remaining of 23 years.
- 6.4 All of the Council's loans were taken out in 2012. The rates that the Council is paying on its debt portfolio are currently lower than the rates for the equivalent new loans from the PWLB, so it is very unlikely it would be of any financial benefit to restructure or repay any loans. However, consideration will continue to be given to any advantageous opportunity for the Council to reduce or restructure its debt portfolio in the future.

## 7 Compliance with treasury indicators

- 7.1 The Council measures and manages its exposure to treasury management risks using the following indicators that were set on 12 February 2014 (CAB2554) as part of the Council's Treasury Management Strategy Statement. The following section demonstrates the Council's compliance with the indicators that have been set.
- 7.2 In accordance with CIPFA's Prudential Code the Council's Treasury Management Strategy Statement also set a number of Prudential Indicators

to ensure and demonstrate that the Council's capital investment plans were affordable, prudent and sustainable. The reporting against the Prudential Indicators that have been set will take place after the financial year end, once outturn figures are available.

- 7.3 **Authorised limit for external debt** - CIPFA's Code of Practice requires authorities to set an authorised limit for external debt, defined as the sum of external borrowing and other long-term liabilities. The annual strategy report agreed by the Council on 12 February 2014 (CAB2554) set an authorised limit for external debt of £193m.
- 7.4 This limit is based on the estimated CFR in order to enable it to be financed entirely from external borrowing should the Council's internal reserves become depleted. The limit also includes an allowance for temporary borrowing to cover normal revenue cash flow requirements and unexpected outflows or delays in receiving cash.
- 7.5 During the period to 31 October 2014 borrowing remained within the authorised limit of £193m. Total external debt at the start of the financial year was £158.5m, which is below the limit that has been set and no new borrowing was undertaken in the year to date.
- 7.6 **Operational boundary for external debt** - The Council has set an operational boundary for external debt. This should reflect the most likely scenario and be consistent with the Council's capital plans and Treasury Management Strategy. Temporary breaches of the operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The Council approved an operational boundary for 2014/15 of £186m.
- 7.7 As outlined above the Council's maximum total external debt of £158m in the period to 31 October 2014, was within the operational boundary.
- 7.8 **Upper limit on fixed and variable interest rate exposure** - The Council has to set an upper limit on its fixed interest rate exposure for both total investments and total external debt. The Council approved an upper limit on fixed and variable interest rate exposure for external debt for 2014/15 of 100% and 66%.
- 7.9 In the period to 31 October 2014 the maximum value of the Council's borrowing at fixed rates was £158m, which is made up of PWLB loans and embedded leases relating to the Environmental Services Contract. The maximum exposure to variable rate debt was NIL in the same period. Both of these amounts are within the limit for fixed and variable interest rate exposure.
- 7.10 **Upper and lower percentage limits on the maturity structure of long-term fixed-rate borrowing outstanding in 2014/15** - The Code also requires the Council to set upper and lower percentage limits on the maturity structure of its long-term borrowing during 2014/15. The following table shows the limits approved by the Council. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

Maturity Structure of Fixed Rate Borrowing	Upper Limit	Actual Borrowing at 31/10/2014	Compliance with Set Limits?
	£m	£m	
under 12 months	20	0	Yes
12 months and within 24 months	20	0	Yes
24 months and within 5 years	20	0	Yes
5 years and within 10 years	20	10.0	Yes
10 years and within 30 years	120	90.0	Yes
30 years and within 40 years	50	20.0	Yes
40 years and within 50 years	50	36.7	Yes
50 years and above	50	0	Yes

- 7.11 **Upper limits on investments with maturities longer than one year -** Investments for periods in excess of a year are limited to £5m. At 31 October 2014 the Council had £3m of long-term investments with a remaining duration of greater than one year. In addition £2m has been committed to longer term investments with other local authorities, with the funds due to be placed in November.

#### OTHER CONSIDERATIONS:

#### 8 Community Strategy and Portfolio Plans (relevance to)

- 8.1 The Treasury Management Strategy supports all tenets of the Community Strategy including the core value of being efficient and ensuring value for money. The Finance and Organisational Development Portfolio Plan for 2014/15 includes the Development of the Council's Treasury Management Strategy to support the Council's increased capital spending requirements, with an acceptable level of risk, as a key action.

#### 9 Resource Implications

- 9.1 Interest payable:
- Housing Finance Reform, loans totalling £156.7m at a weighted average fixed rate of 3.30%. Annual interest cost is £5.20m. No capital repayments are due for 8.5 years. If the £5m loan due in 2023 was to be refinanced for a further 11 years an additional annual interest cost of £29,500 would be incurred, at current interest rates.
  - Embedded lease interest costs (in relation to the Environmental Services Contract) are at a fixed rate of 2.16% total £36k in 2014-15.
- 9.2 The Original Estimate for Interest Receivable in 2014/15 was £70k. The current forecast is £197k which is caused by both higher average balances



and higher interest rates achieved.

- 9.3 Interest sensitivity on a forecast average balance for the year of £41.6m is  
+/- 0.25% = £104,000.

## 10 Risk Management Issues

- 10.1 These are considered within the report.

### BACKGROUND DOCUMENTS

None

### APPENDICES

Appendix 1 – Investments at 31 October 2014

**Investments as at 31 October 2014**

	<b>2014/15</b>
	<b>31/10/2014</b>
	<b>£000s</b>
<b>Bank and Building Society Term Deposits (Cash and cash equivalent/Short term investments)</b>	
Barclays	3,000
Close Brothers	3,000
HSBC (call account)	2,000
Leeds Building Society	2,000
Lloyds (call account)	3,000
National Australia Bank	2,000
Nationwide	3,000
Rabobank	3,000
Svenska Handelsbanken	3,000
<b>Total banks and building societies</b>	<b>24,000</b>
<b>Term deposits UK Local Authorities (Short term investments)</b>	
Birmingham Council	1,000
Lancashire County Council	1,000
<b>Total UK Local Authority deposits</b>	<b>2,000</b>
<b>Bank Certificates of Deposit</b>	
Deutsche Bank	1,000
Nordea	2,000
Standard Chartered	2,000
<b>Total Bank Certificates of Deposit</b>	<b>5,000</b>
<b>AAA Money Market Funds (Cash and cash equivalents)</b>	
Federated Investors	1,000
Ignis Sterling Fund	1,500
<b>Total AAA Money Market Funds</b>	<b>2,500</b>
<b>Other money market collective investment funds</b>	
Federated Investors Cash Plus Fund	2,000
<b>Total other money market collective investment funds</b>	<b>2,000</b>
<b>Total cash and cash equivalents and short term investments</b>	<b>35,500</b>
<b>Long term Investments</b>	
Local Authorities Mutual Investment Trust	2,000
Yorkshire Building Society Floating Rate Note	1,000
<b>Total long term investments</b>	<b>3,000</b>
<b>Total cash and cash equivalents, short term investments and long term investments</b>	<b>38,500</b>
<b>Impaired investments</b>	
Heritable Bank Ltd in administration	56
<b>Total impaired investments</b>	<b>56</b>
<b>Total cash and cash equivalents, short term investments, long term investments and impaired investments</b>	<b>38,556</b>

