

Audit Committee – 27 February 2014

5. Treasury Management Performance to December 2013

Chief Executive: Mark Williams
Assistant Director: Donna Parham – Finance and Corporate Services
Service Manager: Amanda Card - Finance
Lead Officer: Karen Gubbins - Principal Accountant - Exchequer
Contact Details: karen.gubbins@southsomerset.gov.uk or (01935) 462456

Purpose of Report

1. To review the treasury management activity and the performance against the Prudential Indicators for the nine months ended 31st December 2013. To carry out the mid-year review of the Treasury Management Strategy.

Recommendations

2. The Audit Committee are asked to:
 - Note the Treasury Management Activity for the nine-month period ended 31st December 2013;
 - Note the position of the individual prudential indicators for the nine-month period ended 31st December 2013.

The Investment Strategy for 2013/14

3. The Treasury Management Strategy for 2013/14 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.
4. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.
5. 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."*
6. With short term interest rates remaining lower for even longer than anticipated, our investment strategy will typically result in the lengthening of investment periods, where cash flow permits, in order to lock into higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.
7. In order to diversify the authority's investment portfolio which is largely invested in cash, investments will be placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved

8. Money Market Funds (MMFs) will be utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Authority will also seek to diversify any exposure by utilising more than one MMF. The Authority will also restrict its exposure to MMFs with lower levels of funds under management and it will not exceed 0.5% of the net asset value of the MMF. In the case of Government MMFs, the Council will ensure exposure to each Fund does not exceed 2% of the net asset value of the Fund.
9. The Authority has evaluated the use of pooled funds and determined the appropriateness of their use within the investment portfolio. Pooled funds enable the Authority to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns. Investments in pooled funds will be undertaken based on advice received from Arlingclose Ltd. We are currently investing in the Payden fund, and the CCLA Property Fund, both of which are classified as pooled funds.
10. In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills (The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure).

Interest Rates 2013/14

11. Base rate began the financial year and remains at 0.5%.
12. Our advisors are forecasting that rates will remain low for an extended period, as shown below:

| | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 | Jun-15 | Sep-15 | Dec-15 | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 |
|--------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 1.00 |
| Arlingclose Central Case | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Downside risk | | | | | | | | | | | | | |

Investment Portfolio

13. The table below shows the Council's overall investments as at 31st December 2013:

| | Value of Investments at 01.04.13 £ | Value of Investments at 31.12.13 £ |
|---|---|---|
| Investments advised by Arlingclose | | |
| World Bonds | 3,028,271 | 0 |
| Certificates of Deposit | 8,501,524 | 10,501,794 |
| Money Market Fund(Variable Net Asset Value) | 1,000,000 | 1,000,000 |
| Property Fund | | 2,005,000 |
| Corporate Bonds | | 7,088,637 |
| Floating Rate Notes (FRNs) | 5,985,000 | 7,991,256 |
| Total | 18,514,795 | 28,586,687 |

Internal Investments

| | | |
|---|-------------------|-------------------|
| Short Term Deposits (Banks) | 12,000,000 | 14,000,000 |
| Short Term Deposits (Other LA's) | 5,000,000 | 3,000,000 |
| Money Market Funds (Constant Net Asset Value) & Business Reserve Accounts | 3,810,000 | 3,710,000 |
| Total | 20,810,000 | 20,710,000 |

TOTAL INVESTMENTS

| | |
|-------------------|-------------------|
| 39,324,795 | 49,296,687 |
|-------------------|-------------------|

Note:

Variable Net Asset Value (VNAV) Money Market Funds - where there is greater than 12 month history of a consistent £1 Net Asset Value although there is a risk you may receive less than the £1 you originally invested. This is monitored closely by Arlingclose before they recommend the use of the fund.

Constant Net Asset Value (CNAV) Money Market Funds – where £1 is invested you receive £1 back on withdrawal.

Returns for 2013/14

14. The returns to 31st December 2013 are shown in the table below:

| | Actual Income £'000 | % Rate of Return |
|---|------------------------------------|---------------------------------|
| Investments advised by Arlingclose | | |
| World Bonds (Fixed) | 23 | |
| Certificate of Deposits (CDs) | 42 | |
| Pooled Funds (Payden VNAV, Property Fund) | 41 | |
| Corporate Bonds | 27 | |
| Floating Rate Notes (FRNs) | 39 | |
| Total | 172 | 0.94% |
| Internal Investments | | |
| Short Term Deposits | 88 | |
| Money Market Funds (CNAV) & Business Reserve Accounts | 49 | |
| Total | 137 | 0.68% |
| Other Interest | | |
| Miscellaneous Loans | 6 | |
| Total | 6 | |
| TOTAL INCOME TO 31ST DECEMBER 2013 | 315 | 0.81% |
| PROFILED BUDGETED INCOME | 235 | |
| FORECAST SURPLUS FOR YEAR END | | |
| BENCHMARK RATE OF RETURN | | 0.38% |

15. The table above shows investment income for the year to date compared to the profiled budget. The annual budget is set at £313,900. We currently estimate that the position at the end of the financial year will be an overall favourable variance in the order of £54,700.
16. The outturn position is affected by both the amount of cash we have available to invest and the interest base rate set by the Bank of England. Balances are affected by the timing of capital expenditure and the collection of council tax and business rates.

Investments

17. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14. New investments can be made with the following institutions:
 - a. Other Local Authorities;
 - b. AAA-rated Money Market Funds;
 - c. Certificates of Deposit (CDs) and Term Deposits with UK Banks and Building Societies systemically important to the UK banking system and deposits with select non-UK Banks (Australian, Canadian and American);
 - d. T-Bills and DMADF (Debt Management Office);
 - e. Bonds issued by Multilateral Development Banks, such as the European Investment Bank;
 - f. Commercial Paper;
 - g. Other Money Market Funds and Collective Investment Schemes meeting the criteria in SI 2004 No 534, SI 2007 No 573 and subsequent amendments.
18. The graph shown in Appendix A shows the performance of the in-house Treasury team in respect of all investments for the quarter ending 31st December 2013 in comparison to all other clients of Arlingclose.
19. The graph shows that SSDC is in a satisfactory position in terms of the risk taken against the return on investments.

Borrowing

20. An actual overall borrowing requirement (CFR) of £9.7 million was identified at the beginning of 2013/14. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 31st December 2013 the Council had no external borrowing.

Breakdown of investments as at 31ST December 2013

| Date Lent | Counterparty | Amount | Rate | Maturity Date |
|-----------|---|-------------------|-------------------------|---------------|
| 20-Mar-13 | Barclays Bank Plc | 1,000,000 | 0.88% | 20-Mar-14 |
| 12-Dec-13 | Barclays Bank Plc | 1,000,000 | 0.45% | 17-Feb-14 |
| 17-Jul-13 | Barclays Bank Plc | 1,000,000 | 0.85% | 17-Jul-14 |
| 7-Nov-13 | Bank of Scotland | 1,000,000 | 0.71% | 10-Mar-14 |
| 7-Nov-13 | Barclays Bank Plc | 1,000,000 | 0.86% | 7-Nov-14 |
| 12-Aug-13 | Nationwide Building Society | 1,000,000 | 0.72% | 12-Aug-14 |
| 30-Sep-13 | Birmingham City Council | 1,000,000 | 0.50% | 26-Sep-14 |
| 15-Oct-13 | Bank of Scotland | 1,000,000 | 0.75% | 28-Mar-14 |
| 3-Jun-13 | Nationwide Building Society | 1,000,000 | 0.70% | 3-Jun-14 |
| 2-Jul-13 | Bank of Scotland | 1,000,000 | 0.75% | 2-Jan-14 |
| 25-Oct-13 | Lancashire County Council | 1,000,000 | 0.55% | 24-Oct-14 |
| 14-Oct-13 | Credit Agricole Corporate & Investment Bank | 2,000,000 | 0.51% | 14-Jan-14 |
| 1-Nov-13 | Nationwide Building Society | 2,000,000 | 0.48% | 18-Mar-14 |
| 4-Nov-13 | IPA SCB TD Incoming (Santander) | 1,000,000 | 0.49% | 4-Mar-14 |
| 11-Dec-13 | Lancashire County Council | 1,000,000 | 0.60% | 5-Nov-14 |
| | | | | |
| | Handelsbanken Business Reserve Account | 3,710,000 | 0.60% | |
| | Payden Money Market Fund* | 1,000,000 | 0.90% | |
| | | | | |
| | Eurobond Floating Rate Note | 5,985,000 | SONIA+ 0.35% | 18-Mar-14 |
| | Rabobank Floating Rate Note | 1,003,300 | 3 month Libor +0.5% | 6-Jun-14 |
| | HSBC Floating Rate Note | 1,002,956 | 3 month Libor +0.28% | 16-May-16 |
| | Corporate Bond (SSE) | 3,153,600 | 1.12% | 5-Feb-14 |
| | Corporate Bond (Vodafone) | 1,038,750 | 1.02% | 8-Sep-14 |
| | Corporate Bond (E.on) | 1,015,736 | 0.92% | 27-Jan-14 |
| | Corporate Bond (General Electric) | 1,065,900 | 1.43% | 18-Jan-16 |
| | Corporate Bond (Lloyds TSB) | 814,651 | 0.62% | 15-Apr-14 |
| | Certificate of Deposit | 1,000,297 | 0.62% | 5-Jun-14 |
| | Certificate of Deposit | 1,000,297 | 0.60% | 4-Jun-14 |
| | Certificate of Deposit | 3,000,452 | 0.53% | 5-Feb-14 |
| | Certificate of Deposit | 1,000,297 | 0.62% | 13-Aug-14 |
| | Certificate of Deposit | 1,500,224 | 0.53% | 3-Apr-14 |
| | Certificate of Deposit | 1,000,076 | 0.47% | 7-Feb-14 |
| | Certificate of Deposit | 2,000,151 | 0.48% | 21-Feb-14 |
| | | | | |
| | CCLA Property Fund | 2,005,000 | 4.84% | |
| | | | | |
| | | 49,296,687 | | |

* Note: Money Market Funds are instant access accounts so the rate displayed is a daily rate

Prudential Indicators – Quarter 3 monitoring**Background:**

21. In March 2013, Full Council approved the indicators for 2013/14, as required by the Prudential Code for Capital Finance in Local Authorities. The Local Government Act 2003 allowed local authorities to determine their own borrowing limits provided they are affordable and that every local authority complies with the code.

Prudential Indicator 1 - Capital Expenditure:

22. The revised estimates of capital expenditure to be incurred for the current year compared to the original estimates are:

| | 2013/14 Original Estimate £'000 | Expected Outturn £'000 | 2013/14 Variance £'000 | Reason for Variance |
|--------------------------|--|---------------------------------------|---------------------------------------|--|
| Approved capital schemes | 2,140 | 2,845 | 705 | Slippage from previous years makes up the majority of the variance as well as new allocations in year and transfers into the main programme from the reserve schemes |
| Reserves | 1,062 | 2,725 | 1,663 | The variance is due to slippage from last financial year into this financial year and new allocation of monies |
| Total Expenditure | 3,202 | 5,570 | 2,368 | |

23. The above table shows that the overall estimate for capital expenditure has increased.

Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream:

24. A comparison needs to be made of financing capital costs compared to the revenue income stream to support these costs. This shows how much of the revenue budget is committed to the servicing of finance.

| Portfolio | 2013/14 Original Estimate £'000 | Expected Outturn £'000 | 2013/14 Variance £'000 | Reason for Variance |
|--------------------|--|---------------------------------------|---------------------------------------|---|
| Financing Costs* | (193) | (193) | 0 | |
| Net Revenue Stream | 17,955 | 18,319 | 364 | Carry forwards of £339k, £25k funding for Empty |

| | | | | |
|----|-------|-------|--|--|
| | | | | Homes Officer, £30k legal costs and £8k contribution to Welfare Benefits less £24k Save to Earn Transfer re Public Conveniences and £14k from VR in Democratic Services |
| %* | (1.1) | (1.1) | | |

*figures in brackets denote income through receipts and reserves

25. The financing costs include interest payable, notional amounts set aside to repay debt, less, interest on investment income. The figure in brackets is due to investment income outweighing financing costs significantly for SSDC but is nevertheless relevant since it shows the extent to which the Council is dependent on investment income.

Prudential Indicator 3 - Capital Financing Requirement:

26. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Estimates of the year-end capital financing requirement for the authority are:

| | 2013/14 Original Estimate | Expected Outturn | 2013/14 Variance | Reason for Variance |
|-----------------------------------|---------------------------------|---------------------|---------------------|---|
| | £'000 | £'000 | £'000 | |
| Opening CFR | 9,666 | 9,495 | 171 | |
| Capital Expenditure | 3,202 | 4,471 | 1,265 | See explanations for indicator 1 above |
| Capital Receipts* | (1,744) | (2,845) | (1,101) | Slippage of schemes approved in previous years |
| Grants/Contributions* | (1,458) | (1,626) | (168) | Re-profiling of income expected in future years |
| Minimum Revenue Position (MRP) | (121) | (121) | 0 | |
| Additional Finance Leases | 0 | 0 | 0 | |
| Closing CFR | 9,545 | 9,374 | 171 | |

*Figures in brackets denote income through receipts or reserves.

Prudential Indicator 4 – Net external Borrowing compared to the medium term Capital Financing Requirement:

27. The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the net external

borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period.

| | 2013/14 Original Estimate £'000 | 2013/14 Qtr 3 Actual £'000 | 2013/14 Variance £'000 | Reason for Variance |
|---------------|--|-------------------------------------|------------------------------|--|
| Net Borrowing | (38,910) | (57,341) | (18,431) | The estimate is a prediction of the year end balance whilst quarter 3 is always higher as we are 9 months into the 10 month council tax collection cycle |
| CFR | 9,545 | 9,374 | 0 | |

28. The figures above in brackets described as net borrowing actually represent net investments. Our net borrowing is forecast to remain as net investment for the foreseeable future and therefore will not at any time be in excess of the capital financing requirement.

Prudential Indicator 5 - Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

29. The Council must set three years of upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that its limit would allow it to have up to 100% invested in variable rate investments to cover against market fluctuations. For this purpose, term deposits of less than 365 days are deemed to be variable rate deposits. Fixed rate deposits are investments in Eurobonds, Corporate Bonds and term deposits exceeding 365 days.

| | 2013/14 % Limit | 2013/14 Qtr 3 Actual % | 2013/14 Variance % | Reason for Variance |
|----------|--------------------|------------------------------|--------------------------|---------------------|
| Fixed | 80 | 2.16 | 77.84 | Within limit |
| Variable | 100 | 97.84 | 2.16 | Within limit |

30. The Council must also set limits to reflect any borrowing we may undertake.

| | 2013/14 % Limit | 2013/14 Qtr 3 Actual % | 2013/14 Variance % | Reason for Variance |
|----------|--------------------|------------------------------|--------------------------|---------------------------------|
| Fixed | 100 | 0 | 100 | SSDC currently has no borrowing |
| Variable | 100 | 0 | 100 | SSDC currently has no borrowing |

31. The indicator has been set at 100% to maximise opportunities for future debt as they arise.

Prudential Indicator 6 - Upper Limit for total principal sums invested over 364 days:

32. SSSC must also set upper limits for any investments of longer than 364 days. The purpose of this indicator is to ensure that SSSC, at any time, has sufficient liquidity to meet all of its financial commitments.

| Upper Limit for total principal sums invested over 364 days | 2013/14 Maximum Limit £'000 | 2013/14 Qtr 3 Actual £'000 | 2013/14 Expected Outturn £'000 | Reason for Variance |
|--|------------------------------------|-----------------------------------|---------------------------------------|----------------------------|
| Between 1-2 years | 25,000 | 0 | 0 | Within limit |
| Between 2-3 years | 20,000 | 2,069 | 0 | Within limit |
| Between 3-4 years | 10,000 | 0 | 0 | Within limit |
| Between 4-5 years | 10,000 | 0 | 0 | Within limit |
| Over 5 years | 5,000 | 0 | 0 | Within limit |

33. The table above shows that the Council adopts a policy of safeguarding its investments by minimising investments that are redeemable more than five years ahead.

Prudential Indicator 7 – Credit Risk:

34. The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution and its sovereign
- Sovereign support mechanisms
- Credit default swaps (where quoted)
- Share prices (where available)
- Economic Fundamentals, such as a country's net debt as a percentage of its GDP
- Corporate developments, news articles, markets sentiment and momentum
- Subjective overlay

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

Prudential Indicator 8 - Actual External Debt:

35. This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities (this represents our finance leases). This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

| Actual External Debt as at 31/03/2013 | £'000 |
|--|--------------|
| Borrowing | 0 |
| Other Long-term Liabilities (Finance Leases) | 267 |
| Total | 267 |

Prudential Indicator 9 - Authorised Limit for External Debt:

36. The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy. Borrowing will arise as a consequence of all the financial transactions of the Council not just arising from capital spending.

37. This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this limit is exceeded the Council will have acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. A ceiling of £12 million was set to allow flexibility to support new capital projects over and above the identified borrowing requirement.

| | 2013/14 Estimate £'000 | 2013/14 Qtr 3 Actual £'000 | 2013/14 Variance £'000 | Reason for Variance |
|--|---------------------------------------|---|---------------------------------------|--|
| Borrowing | 11,000 | 0 | (11,000) | SSDC currently has no external borrowing |
| Other Long-term Liabilities (Finance Leases) | 1,000 | 261 | (739) | Within limit |
| Total | 12,000 | 261 | (11,739) | |

Prudential Indicator 10 – Operational Boundary for External Debt:

38. The operational boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million was set.

| | 2013/14 Estimate £'000 | 2013/14 Qtr 3 Actual £'000 | 2013/14 Variance £'000 | Reason for Variance |
|--|---------------------------------------|---|---------------------------------------|--|
| Borrowing | 9,200 | 0 | (9,200) | SSDC currently has no external borrowing |
| Other Long-term Liabilities (Finance Leases) | 800 | 261 | (539) | Within limit |
| Total | 10,000 | 261 | (9,739) | |

Prudential Indicator 11 - Maturity Structure of Fixed Rate borrowing:

39. This indicator is relevant to highlight the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest changes in any one period. When we borrow we can take a portfolio approach to borrowing in order to reduce interest rate risk. This indicator is shown as the Council has set limits in anticipation of future borrowing.

| Maturity structure of fixed rate borrowing | 2011/12 Actual | 2012/13 Actual | 2013/14 Qtr 3 Actual | Lower Limit | Upper Limit |
|---|-----------------------|-----------------------|-----------------------------|--------------------|--------------------|
| | % | % | % | % | % |
| Under 12 months | 0 | 0 | 0 | 0 | 100 |
| 12 months and within 24 months | 0 | 0 | 0 | 0 | 100 |
| 24 months and within 5 years | 0 | 0 | 0 | 0 | 100 |
| 5 years and within 10 years | 0 | 0 | 0 | 0 | 100 |
| 10 years and within 20 years | 0 | 0 | 0 | 0 | 100 |
| 20 years and within 30 years | 0 | 0 | 0 | 0 | 100 |
| 30 years and within 40 years | 0 | 0 | 0 | 0 | 100 |
| 40 years and within 50 years | 0 | 0 | 0 | 0 | 100 |
| 50 years and above | 0 | 0 | 0 | 0 | 100 |

As the council doesn't have any fixed rate external borrowing at present the above upper and lower limits have been set to allow flexibility.

Prudential Indicator 12 - Incremental Impact of Capital Investment Decisions:

40. SSDC must show the effect of its annual capital decisions for new capital schemes on the council taxpayer. Capital spend at SSDC is financed from additional receipts so the figure below actually shows the possible decreases in council tax if all capital receipts were invested rather than used for capital expenditure.

| Incremental Impact of Capital Investment Decisions | 2012/13 Actual | 2013/14 Actual | 2014/15 Estimate | 2015/16 Estimate |
|---|-----------------------|-----------------------|-------------------------|-------------------------|
| | £ | £ | £ | £ |
| Decrease in Band D Council Tax | 0.34 | 0.47 | 0.67 | 0.67 |

Prudential Indicator 13 - Adoption of the CIPFA Treasury Management Code:

41. This indicator demonstrates that the Council has adopted the principles of best practice.

| |
|--|
| Adoption of the CIPFA Code of Practice in Treasury Management |
| The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 18 th April 2002. |

Conclusion

42. The council is currently within all of the Prudential Indicators and is not forecast to exceed them.

Background Papers: *Prudential Indicators Working Paper, Treasury Management Strategy Statement*
