

Treasury Management Performance to December 2014

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 2014.

Recommendations

2. The Audit Committee are asked to:
 - Note the Treasury Management Activity for the nine-month period ended 31st December 2014.
 - Note the position of the individual prudential indicators for the nine-month period ended 31st December 2014.

The Investment Strategy for 2014/15

3. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. The Council reports six monthly to Full Council against the strategy approved for the year. The scrutiny of treasury management policy, strategy and activity is delegated to the Audit Committee.
4. Treasury management in this context is defined as:

"The management of the local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".
5. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.
6. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.
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.
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 2014/15

11. Base rate began the financial year and remains at 0.5%.
12. Our advisors are forecasting that the outlook is for official interest rates to remain at 0.5% until September 2015, as shown below. They are also predicting the rise in the bank rate to be slow and gradual with the Bank Rate post-crisis to range between 2.5% and 3.5%.

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Average
Official Bank Rate				0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	
Upside risk				0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	
Arlingclose Central Case	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.75	1.17
Downside risk			0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	

Investment Portfolio

13. The table below shows the Council's overall investments as at 31st December 2014:

	Value of Investments at 01.04.14 £	Value of Investments at 31.12.14 £	Fixed/ Variable Rate
Externally Managed Investments			
Money Market Fund(Variable Net Asset Value)	997,565	997,565	Variable
Property Fund	3,052,479	3,052,479	Variable
Total	4,050,044	4,050,044	
Internal Investments			
Certificates of Deposit	6,519,416	7,501,806	Fixed
Corporate Bonds	8,127,004	9,903,906	Fixed
Floating Rate Notes (FRNs)	3,006,315	4,069,676	Variable
Term Deposits (Banks/Building Societies)	9,000,000	14,200,000	Variable
Term Deposits (Other LA's)	5,000,000	14,000,000	Variable
Money Market Funds (Constant Net	7,690,000	420,000	Variable

Asset Value) & Business Reserve Accounts		
Total	<u>39,342,735</u>	<u>50,095,388</u>
TOTAL INVESTMENTS	<u><u>43,392,779</u></u>	<u><u>54,145,432</u></u>

Returns for 2014/15

14. The returns to 31st December 2014 are shown in the table below:

	Actual Income £'000	Rate of Return
Externally Managed Investments/Pooled Funds		
Payden Money Market Fund (VNAV)	7	
Property Fund	124	
Total	<u>131</u>	4.18%
Internal Investments		
Certificates of Deposit	54	
Corporate Bonds	90	
Floating Rate Notes (FRNs)	18	
Term Deposits	117	
Money Market Funds (CNAV) & Business Reserve Accounts	23	
Total	<u>302</u>	0.76%
Other Interest		
Miscellaneous Loans	5	
Total	<u>5</u>	
TOTAL INCOME TO 31ST DECEMBER 2014	<u><u>438</u></u>	1.02%
PROFILED BUDGETED INCOME	<u><u>255</u></u>	

FORECAST SURPLUS FOR YEAR END

BENCHMARK RATE OF RETURN

15. The table above shows investment income for the year to date compared to the profiled budget. The annual budget is set at £340,340. We currently estimate that the position at the end of the financial year will be an overall favourable variance in the order of £215,300. This is due to extending the average length of investments to achieve higher returns and good performance from the property fund which we are assuming will continue however if there is a dip in the economy this could affect the forecasted return.

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 2014/15. New investments can be made with the following institutions:
- Other Local Authorities;
 - AAA-rated Money Market Funds;
 - 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);
 - T-Bills and DMADF (Debt Management Office);
 - Bonds issued by Multilateral Development Banks, such as the European Investment Bank;
 - Commercial Paper
 - 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 2014 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 2014/15. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 31st December 2014 the Council had no external borrowing.

Bail in update

21. As at 31st January 2015 SSDC has £3,801,000 made up of 5 investments that fall out of Arlingclose's current advice although they were within when they were taken out. The recent bail in update from Arlingclose states that with preference being given to large numbers of depositors other than local authorities, the risks of making unsecured deposits have risen relative to other investment options. Arlingclose is advising that a prudent response to this would be for clients to rein in maturity limits for new unsecured investments however they do not advise clients to exit any existing investments at this stage.

Breakdown of investments as at 31st December 2014

Date Lent	Counterparty	Principal Amount	Rate	Maturity Date
17-Feb-14	Barclays Bank Plc	1,000,000	0.85	17-Feb-15
29-Sep-14	Bank of Scotland	1,000,000	0.57	20-Jan-15
3-Jun-14	Nationwide Building Society	1,000,000	0.75	18-Mar-15
2-Jul-14	Bank of Scotland	1,000,000	0.76	20-Mar-15
4-Sep-14	Santander	1,000,000	0.63	9-Feb-15
5-Nov-14	Lancashire County Council	1,000,000	0.52	5-May-15
6-Jan-14	Greater London Authority	2,000,000	1.03	6-Oct-15
31-Mar-14	Bank of Scotland	1,000,000	0.95	27-Mar-15
14-Apr-14	Nationwide Building Society	1,000,000	0.77	19-Mar-15
23-May-14	Rabobank International	1,000,000	0.78	22-May-15
1-Jul-14	Rabobank International	1,000,000	0.70	18-Mar-15
15-Jul-14	Rabobank International	1,200,000	0.63	9-Mar-15
24-Jul-14	Barclays Bank Plc	1,000,000	0.70	27-Feb-15
4-Sep-14	Furness Building Society	1,000,000	0.65	4-Mar-15
16-Sep-14	Nationwide Building Society	1,000,000	0.56	19-Jan-15
18-Sep-14	National Counties Building Society	1,000,000	0.65	20-Feb-15
24-Nov-14	Herefordshire Council	1,000,000	0.50	10-Apr-15
3-Nov-14	Birmingham City Council	2,000,000	0.50	5-May-15
28-Nov-14	Lancashire County Council	1,000,000	0.60	28-Aug-15
19-Dec-14	Herefordshire Council	2,000,000	0.50	17-Apr-15
14-Nov-14	Salford City Council	2,000,000	0.45	17-Mar-15
1-Dec-14	Barnsley Metropolitan Borough Council	2,000,000	0.45	6-Mar-15
19-Dec-14	Blackpool Council	1,000,000	0.45	4-Mar-15
	Corporate Bonds			
10-Dec-13	GE Capital UK Funding	1,000,000	1.42	18-Jan-16
17-Jan-14	Places for People Capital Markets PLC	568,000	2.67	27-Dec-16
17-Jan-14	Places for People Capital Markets PLC	432,000	2.67	27-Dec-16
10-Feb-14	Thames Water Utilities Finance Ltd	450,000	1.02	30-Jun-15
10-Feb-14	Heathrow Funding Ltd	1,000,000	1.16	08-Jun-15
07-Apr-14	Commonwealth Bank of Australia	501,000	0.99	14-Dec-15
08-Apr-14	Nordea Bank AB	500,000	0.98	15-Dec-15
02-Jun-14	Volkswagen International Finance NV	500,000	0.98	20-Aug-15
21-Jul-14	GE Capital UK Funding	661,000	0.72	3-Mar-15
04-Aug-14	Leeds Building Society *Covered by Mortgage*	500,000	2.13	17-Dec-18
08-Sep-14	Rabobank Nederland NV	800,000	1.05	10-Sep-15
08-Sep-14	Volkswagen International Finance NV	500,000	0.98	20-Aug-15
30-Sep-14	European Investment Bank	500,000	0.64	8-Jul-15
22-Oct-14	Yorkshire Building Society *Covered*	1,500,000	1.56	12-Apr-18
	Certificates of Deposit (CDs)			
14-Feb-14	Deutsche Bank LDN 0.73 16/02/15	1,000,000	0.70	16-Feb-15
16-Apr-14	Deutsche Bank LDN 0.68% 16/1/15	1,000,000	0.65	16-Jan-15
05-Jun-14	Deutsche Bank 0.85% 4/6/15	1,000,000	0.82	04-Jun-15
09-Jul-14	Nordea Bank Finland 0.62% 9/1/15	1,000,000	0.59	09-Jan-15

15-Jul-14	Standard Chartered 0.65% 15/1/15	2,000,000	0.62	15-Jan-15
29-Oct-14	Standard Chartered 0.67% 29/4/15	1,000,000	0.64	29-Apr-15
4-Nov-14	Nordea Bank Finland 0.62% 4/5/15	500,000	0.59	5-May-15
	Floating Rate Notes (FRNs)			
25-Nov-13	HSBC Bank PLC	1,000,000	0.82	16-May-16
03-Apr-14	Yorkshire Building Society *Covered by Mortgage*	1,000,000	0.94	23-Mar-16
22-Oct-14	Abbey National Treasury Services *Covered*	1,000,000	0.71	5-Apr-17
21-Nov-14	Barclays Bank Plc *Covered*	1,000,000	0.68	15-Sep-17
	Business Reserve Accounts			
	Handelsbanken	420,000	0.50	
	Externally Managed Funds			
	CCLA Property Fund	3,000,000		
	Payden Fund VNAV	1,000,000		

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

Prudential Indicators – Quarter 3 monitoring

Background:

22. In March 2014, Full Council approved the indicators for 2014/15, 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:

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

	2014/15 Original Estimate £'000	Expected Outturn £'000	2014/15 Variance £'000	Reason for Variance
Approved capital schemes	4,561	2,898	(1,663)	The variance is made up from moving approved schemes from the main programme back into reserves relating to affordable housing and also slippage of current projects into the next financial year
Reserves	1,847	3,081	1,954	The variance is due to slippage from last financial year into this financial year and an increase in the affordable housing reserve from

				the main programme
Total Expenditure	6,408	5,979	291	

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

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

25. 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	2014/15 Original Estimate £'000	Expected Outturn £'000	2014/15 Variance £'000	Reason for Variance
Financing Costs*	(226)	(378)	(152)	Although MRP has increased due to taking out more leases in 13/14, investment income is higher due to higher returns and good performance from the property fund
Net Revenue Stream	17,541	17,859	318	Underspends from 13/14 being carried forward increasing the net revenue budget for 14/15
%*	(1.3)	(2.1)		

*figures in brackets denote income through receipts and reserves

26. 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 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:

27. 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:

	2014/15 Original Estimate £'000	Expected Outturn £'000	2014/15 Variance £'000	Reason for Variance
Opening CFR	9,374	9,622	248	
Capital Expenditure	5,410	3,995	(1,415)	See explanation for Prudential Indicator 1 above
Capital Receipts*	(4,461)	(2,968)	1,493	Slippage of schemes approved in previous years

Grants/Contributions*	(949)	(1,027)	(78)	
Minimum Revenue Position (MRP)	(114)	(178)	(64)	More leases taken out for vehicles at the end of 13/14. This is negative as it reduces the need for debt thus reducing the CFR
Closing CFR	9,260	9,444	184	

*Figures in brackets denote income through receipts or reserves.

Prudential Indicator 4 – Gross Debt and the Capital Financing Requirement:

28. 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 gross external borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period. This is a key indicator of prudence.

	2014/15 Original Estimate £'000	2014/15 Qtr 3 Actual £'000	2014/15 Variance £'000	Reason for Variance
Borrowing	0	0	0	
Finance Leases	147	348	201	More leases taken out for vehicles at the end of 13/14
Total Debt	147	348	201	

29. Total debt is expected to remain below the CFR.

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

30. 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.

	2014/15 % Limit	2014/15 Qtr 3 Actual %	2014/15 Variance %	Reason for Variance
Fixed	80	7	(73)	Within limit
Variable	100	93	(7)	Within limit

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

	2014/15 % Limit	2014/15 Qtr 3 Actual %	2014/15 Variance %	Reason for Variance
Fixed	100	0	100	SSDC currently has no borrowing
Variable	100	0	100	SSDC currently has no borrowing

32. 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:

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

Upper Limit for total principal sums invested over 364 days	2014/15 Maximum Limit £'000	2014/15 Qtr 3 Actual £'000	Reason for Variance
Between 1-2 years	25,000	4,143	Within limit
Between 2-3 years	20,000	2,040	Within limit
Between 3-4 years	10,000	2,203	Within limit
Between 4-5 years	10,000	0	Within limit
Over 5 years	5,000	0	Within limit

34. 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:

35. 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:

36. 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 31/03/2014	£'000
--	--------------

Borrowing	0
Other Long-term Liabilities (Finance Leases)	511
Total	511

Prudential Indicator 9 - Authorised Limit for External Debt:

37. 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.

38. 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.

	2014/15 Estimate £'000	2014/15 Qtr 3 Actual £'000	2014/15 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	349	(651)	Within limit
Total	12,000	349	(11,651)	

Prudential Indicator 10 – Operational Boundary for External Debt:

39. 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.

	2014/15 Estimate £'000	2014/15 Qtr 3 Actual £'000	2014/15 Variance £'000	Reason for Variance
Borrowing	9,200	0	(9,200)	SSDC currently has no external borrowing
Other Long-term Liabilities (Finance Leases)	800	349	(451)	Within limit
Total	10,000	349	(9,651)	

Prudential Indicator 11 - Maturity Structure of Fixed Rate borrowing:

40. This indicator is relevant to highlight the existence of any large concentrations of fixed rated 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:

41. 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	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
	£	£	£	£
Decrease in Band D Council Tax	0.29	0.04	0.15	0.17

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

42. 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

43. 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 2014/15, Quarter 3 2014/15 Capital Programme.

Average Rate vs Credit Risk (time-weighted)

