Appendix D

2013/14 Treasury Management Progress Report to 30 June 2013

Report of Chief Officer (Resources)

1. Introduction

It is a requirement of the CIPFA Code of Practice on Treasury Management that regular monitoring reports are presented to Members on treasury activities. These reports will normally be presented after the end of June, September, December and March as part of the Council's performance management framework.

Council approved the 2013/14 Treasury Strategy, which incorporates the Investment Strategy, at its meeting on 27 February 2013. This report outlines activities undertaken in pursuance of those strategies during the financial year up to the end of Qtr 1.

Treasury management is a technical area. To assist with the understanding of this report, a glossary of terms commonly used in Treasury Management is attached at ***Annex A***. In addition, the Councillor's Guide to Local Government Finance also has a section on treasury and cash management and an updated Guide is now available through the Member Information section on the Intranet.

2. Economic update (provided by Sector)

During the quarter ended 30 June: -

- Indicators suggested that the economy accelerated.
- Stronger household spending occurred, both on and off the high street.
- Inflation remained stubbornly above the Monetary Policy Committee (MPC)'s 2% target.
- The MPC remained in a state of limbo ahead of its new Governor, Mark Carney, arriving.
- 10-year gilt yields rose above 2.5% and the FTSE 100 fell below 6,100.
- The Federal Reserve discussed tapering the pace of asset purchases under Quantitative Easing 3 (QE3).

3. Icelandic Investments Update

There were no further repayments expected or received during Qtr 1. Guidance from CIPFA, receiving during May, suggests that the expected recovery for investments with KSF should rise from 83.5% to 85.25%. The guidance reiterated that expected recovery of investments with Landsbanki remains at 100%, although this is subject to risks around exchange rate movements and timing particularly.

To 30 June, there is nothing further to report regarding Icelandic investments. The table below remains unchanged from 2012/13 outturn.

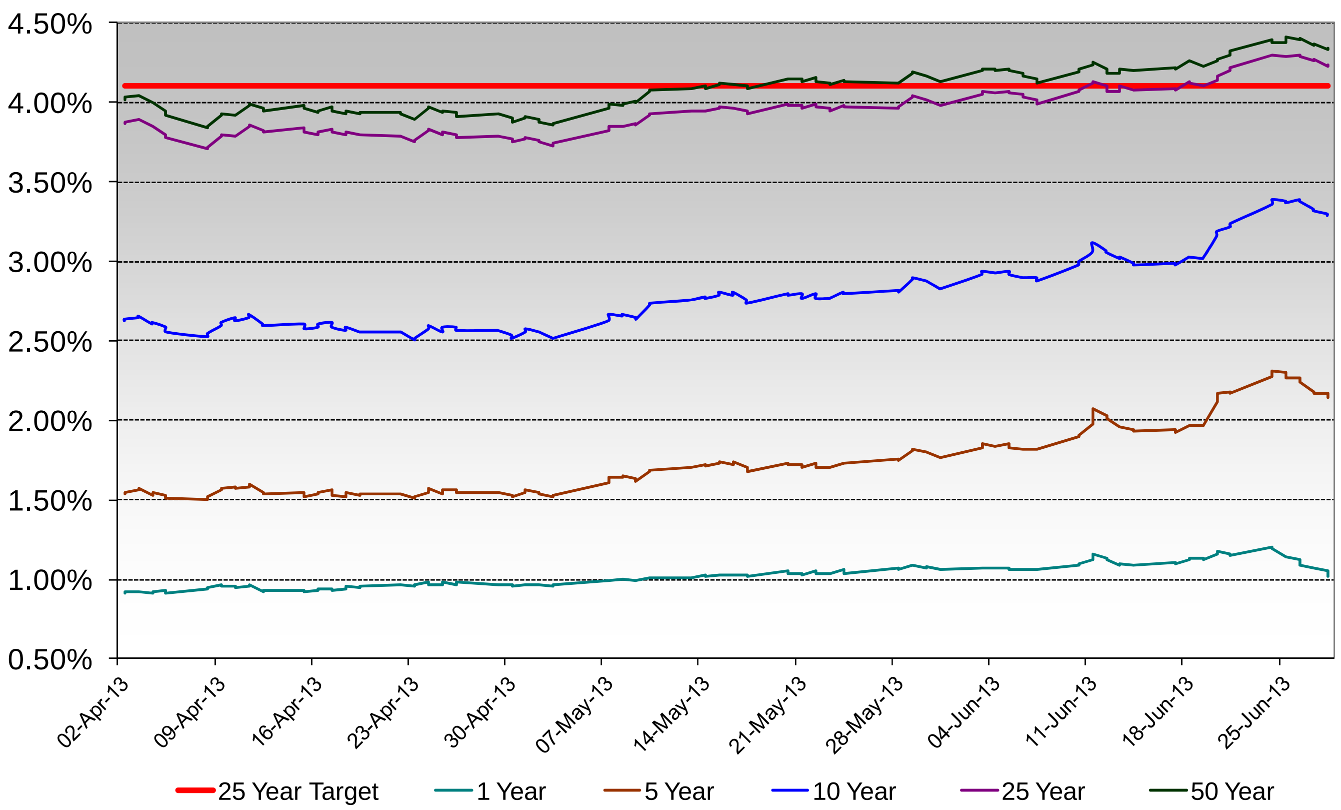
	KSF £000	Glitnir £000	Landsbanki £000	Total £000
Total Claim (including interest)	2,048	3,173	1,121	6,342
Payments received to date	1,556	2,508	529	4,593
Amounts held in ISK*		609	8	617
Total anticipated recovery (%)	83.50%	100%	100%	
Further payments due (%)	9.26%	0%	52%	
Further payments due (£000)	190	0	584	774
Total anticipated receipts	1,746	3,117	1,121	5,984

*These are earning interest but are also subject to currency fluctuations, these sums will be repatriated once Icelandic currency controls allow.

The total repayment in cash terms is still expected to be £5.98M, meaning that the majority of the £6M principal invested will be returned.

4. Current Borrowing Rates.

No new borrowing was undertaken during Qtr 1. Below is a graph of the PWLB certainty rates for the period ending 30 June 2013.



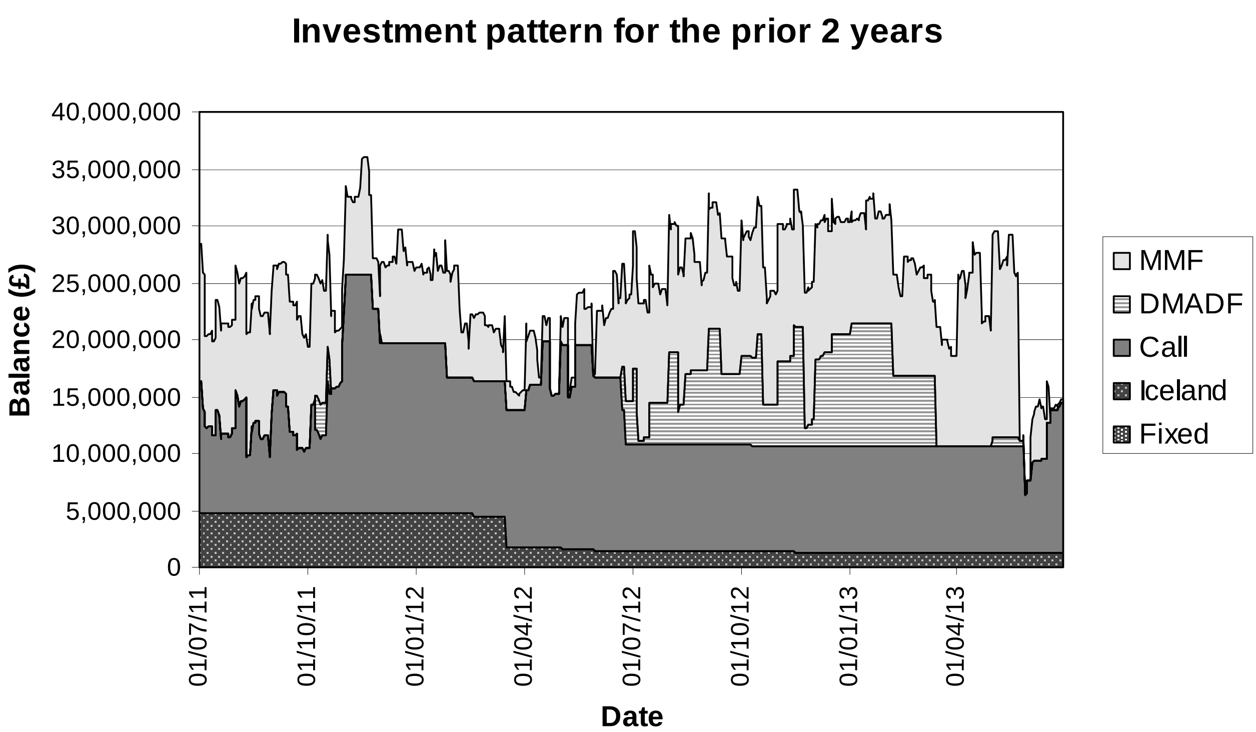
Officers continue to monitor potential saving opportunities associated with the early repayment of existing debt. This takes into account the premiums or discounts associated with early repayment and the projected cost of refinancing or loss in investment interest. At present, there are no opportunities that could generate long term savings.

5. Investing Activities

As laid down in the approved Investment Strategy, the aim is to prioritise security and liquidity of the Council's investments. This is to ensure that the Council has sufficient cash to support its business, but also to minimise any further chance of a counterparty failing and the Council not being able to remove any cash deposited.

All investment activity has been in line with the approved Treasury Strategy for 2013/14. No fixed term investments have been placed; surplus cash has been managed on a day to day basis using the call accounts and Money Market Funds (MMF). A full list of the investments at the end of Qtr 1 is shown below

Other Investments	Opening	Min	Max	Closing	Indicative rate	Cumulative Interest £
Call: RBS	£ -	£ -	£ 3,000,000	£ 3,000,000	0.80%	£ 1,908
Call: Barclays	£ -	£ -	£ -	£ -	0.55%	£ -
Call: Lancashire County Council	£ 9,300,000	£ 5,000,000	£ 10,060,000	£ 10,060,000	0.50%	£ 10,509
DMADF	£ -	£ -	£ 890,000	£ -	0.25%	£ 155
Government Liquidity MMF	£ -	£ -	£ 5,990,000	£ -	0.30%	£ 1,404
Liquidity First MMF.	£ 3,595,000	£ -	£ 6,000,000	£ -	0.41%	£ 3,459
Insight MMF	£ 4,370,000	£ -	£ 6,000,000	£ 370,000	0.33%	£ 6,918
Sub-total	£ 12,895,000			£ 13,060,000		£ 24,352



During the first quarter the Council has maximised its investment in the county call account, as far as possible. The account with RBS has been given preference over the MMF due to the higher interest rate available. This consideration of return is in view of the extent of RBS' Government backing and the impact on security; it remains part-nationalised but the position is closely monitored. If backing by the Bank of England is removed, the bank's associated credit ratings and other relevant information would take precedence.

6. Summary of Budget Position and Performance

In terms of performance against external benchmarks, the return on investments compared to the 7 day LIBID and bank rates over the year to date is as follows:

Base Rate	0.500%
7 day LIBID	0.485%
Lancaster City Council investments	0.504%

In terms of performance against budget, the details are as follows:

Budget to date:		
Icelandic credits	£9K	
Cash interest	£22K	
Total	£31K	
Actual to date:		
Icelandic credits to date	£16K	
Cash credits to date	£24K	
Total	£40K	
Variance	£9K	favourable

The favourable variance is mainly due to interest earned on Icelandic investments that was not budgeted for.

The return is just above base and is better than the 7 day LIBID benchmark which is positive given that the Council's investments are in the main on instant access. In absolute terms, as the Council has focused on secure and highly liquid deposits the rate of return is very modest but given the type of investment the Council is making, it is a reasonable rate.

Over the next quarter, the Council's cashflow should start to stabilise, which in turn should support a slightly longer term investment approach, subject to appropriate risk management regarding the security of investments and market rates.

7. Risk management

There has been no material change in the policy or operation of the treasury function over the quarter, in recognition of the considerable uncertainty that exists within the economy and financial sector. The view is, therefore, that residual counterparty risk exposure for investment remains low.

There is financial risk attached to the longer term debt portfolio, associated with interest rate exposure but all of the debt is on fixed interest and there has been no change to this over the quarter. Low investment returns mean that using cash invested to repay debt can appear more attractive, but the Council is not yet in position to be following such a strategy.

With regard to the Icelandic investments, there are still uncertainties over the timing and exact amounts of repayments, as well as how elements already repaid in ISK will be repatriated, but these are readily manageable and much smaller than in previous years. Measures are being considered to mitigate the remaining losses.

8. Conclusion

Investment security risk and associated returns remain low, which is likely to continue for the short to medium term. Cash balances remain on the low side, due to continuing delays in securing budgeted capital receipts. Loan repayment opportunities are being monitored and would be considered. They become more attractive if the recovery of interest rates is delayed, assuming such an approach fits with the Council's future investment plans and spending needs.

Treasury Management Glossary of Terms

- **Annuity** – method of repaying a loan where the payment amount remains uniform throughout the life of the loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.

- **Call account** – instant access deposit account.

- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.

- **Credit Rating** – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's, and Moody's. They analyse credit worthiness under four headings:

  Short Term Rating – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.

  Long Term Rating – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.

  Individual/Financial Strength Rating – a measure of an institution's soundness on a stand-alone basis based on its structure, past performance and credit profile.

  Legal Support Rating – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

  The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

- **DMADF and the DMO –** The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.

- **EIP –** Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal, therefore the interest due with each payment reduces as the principal is eroded, and so the total amount reduces with each instalment.

- **Gilts** – the name given to bonds issued by the U K Government. Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt.

Eg. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as 8%/1.45 = 5.5%.
See also PWLB.

- **LIBID** – The London Inter-Bank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time.

- **LIBOR** – The London Inter-Bank Offer Rate, the rate at which banks with surplus funds are offering to lend them to other banks, again published at 11am each day.

- **Liquidity** – Relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **Maturity** – Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.

- **Money Market Fund (MMF)** – Type of investment where the Council purchases a share of a cash fund that makes short term deposits with a broad range of high quality counterparties. These are highly regulated in terms of average length of deposit and counterparty quality, to ensure AAA rated status.

- **Policy and Strategy Documents** – documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.

- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.

- **Quantitative Easing (QE) –** is a monetary policy used to stimulate the national economy. In very simple terms, the policy involves the central bank buying "financial assets" - typically Government bonds - from commercial banks, amongst others. This then increases those banks' readily accessible money supply, which then puts them in a better position to increase lending to companies and individuals.

- **Sector** – Sector are the City Council's Treasury Management advisors. They provide advice on borrowing strategy, investment strategy, and vetting of investment counterparties, in addition to ad hoc guidance throughout the year.

- **Yield** – see Gilts

Members may also wish to make reference to The Councillor's Guide to Local Government Finance.