Appendix D

2013/14 Treasury Management Progress Report to 30 September 2013

Report of Chief Officer (Resources)

1. Introduction

The CIPFA Code of Practice on Treasury Management requires that regular monitoring reports be 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 2.

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 September: -

- Indicators suggested that the economic recovery accelerated;
- Household spending growth remained robust;
- Inflation fell back towards the 2% target;
- The Bank of England introduced state-contingent forward guidance;
- 10-year gilt yields rose to 3% at their peak and the FTSE 100 fell slightly to 6460;
- The Federal Reserve decided to maintain the monthly rate of its asset purchases.

3. Icelandic Investments Update

There was a fourth distribution from Landsbanki regarding the Council's investment, representing 5.23% of the original claim, of which 53.9% has now been recovered.

The initial claim of £1.1m was converted into Icelandic Krona using the exchange rate on 22 April 2009 (191.08ISK:1GBP). Distributions to date have been based on this historic rate. There has, however, been a dispute over which exchange rate should be used with the Supreme Court now ruling that the exchange rate on the date of distribution should be used. This exposes the Council to some further exchange rate uncertainties; the Icelandic Krona has weakened against the other major currencies (GBP, USD, EUR) since April 2009, although this could change in future.

The table below remains displays the outstanding balances.

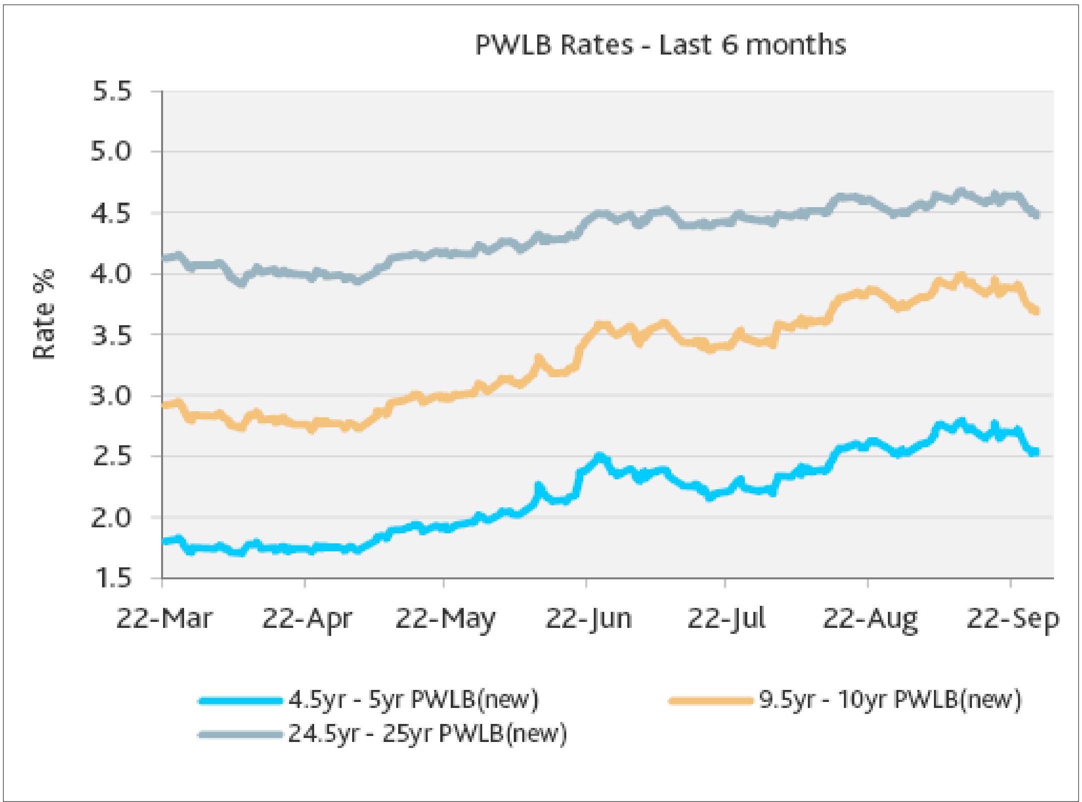
	KSF £000	Glitnir £000	Landsbanki £000	Total £000
Deposit	2,000	3,000	1,000	6,000
Claim	2,048	3,173	1,121	6,342
GBP Payments received	1,618	2,508	585	4,711
Amounts still held in ISK		609	8	617
Total anticipated recovery (%)	85.25%	100%	100%	
Further payments due (%)	6.25%	0%	46%	
Further payments due (£000)	128	0	516	644
Total anticipated receipts	1,746	3,117	1,109	5,972

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

There are no major changes to report. The Council still expects to recover around £6M, equivalent to the value of the original investments. Furthermore, there is no substantive progress to report as yet regarding the exempt matter first reported to Cabinet Members back in July.

4. Current Borrowing Rates.

No new borrowing was undertaken during Qtr 2. Below is a graph of the PWLB rates for the last six month ending 30 September 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.

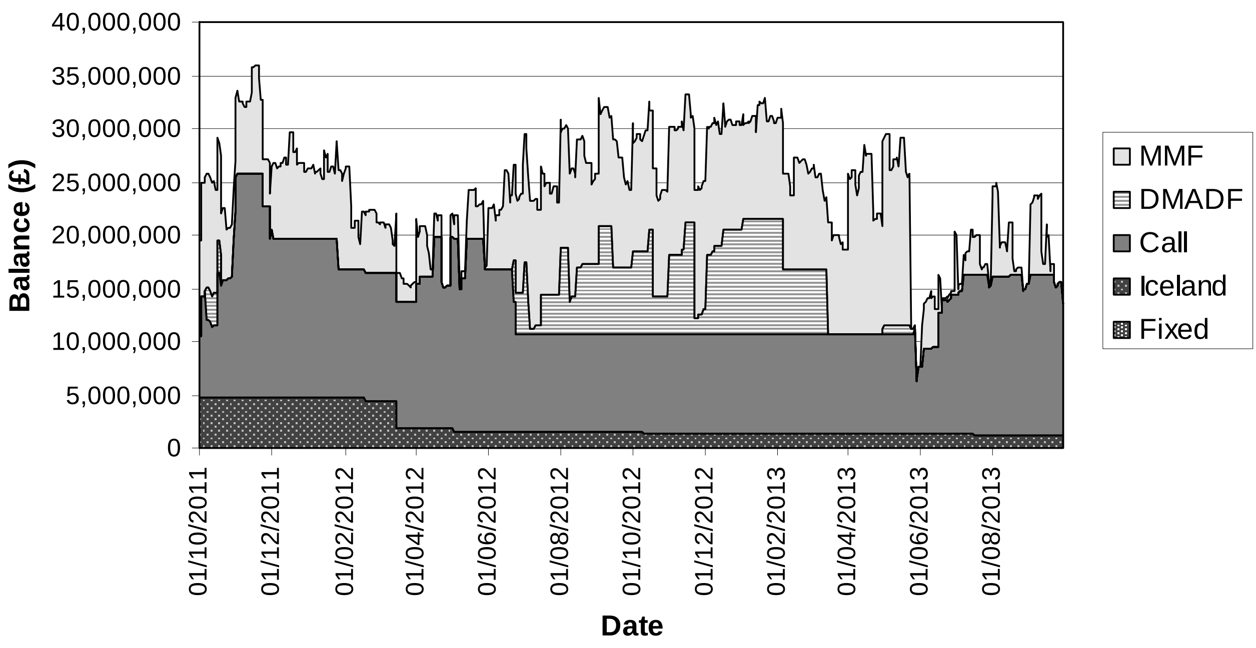
5. Investing Activities

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 2 is shown below

Other Investments	Opening	Min	Max	Closing	Indicative rate	Cumulative Interest £
Call: RBS	£ 3,000,000	£ 932,000	£ 3,000,000	£ 932,000	0.70%	£ 7,609
Call: Barclays	£ -	£ -	£ -	£ -	0.55%	£ 185
Call: Lancashire County Council	£ 10,060,000	£ 10,060,000	£ 12,000,000	£ 11,410,000	0.50%	£ 25,411
DMADF	£ -	£ -	£ -	£ -	0.25%	£ 155
Government Liquidity MMF	£ -	£ -	£ -	£ -	0.30%	£ 1,404
Liquidity First MMF.	£ 5,570,000	£ -	£ 6,000,000	£ -	0.39%	£ 5,918
Insight MMF	£ 370,000	£ -	£ 2,712,000	£ -	0.33%	£ 3,834
Sub-total	£ 18,630,000			£ 12,342,000		£ 44,516

Investment pattern for the prior 2 years



During the second quarter the Council has maximised its investment in the county call account, as far as possible. Furthermore the account with RBS has been given preference, particularly over MMFs, 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	0.362%
Lancaster City Council investments	0.556%

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

Budget to date:		
Icelandic credits	£18K	
Cash interest	£50K	
Total	£68K	
Actual to date:		
Icelandic credits to date	£17K	
Cash credits to date	£45K	
Total	£62K	
Variance	£6K	adverse

The adverse variance is mainly due to delays in the receipt of a large capital receipt, which has meant cash balances are lower than expected at this point in the year.

The return is just above base rate 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, the rate of return is very modest but given that the Council has continued to focus on secure and highly liquid deposits, it is considered reasonable.

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.

Although further Icelandic investment recoveries are expected, there is still uncertainty over extent and timing but these risks are now readily manageable.

More specifically, some risks exist in relation to banking services. The Co-operative Bank, used by the Council and many other local authorities as a general account for collecting funds and making payments, has reported losses over the summer months. At the time of producing this report, it had just been reported that the Co-Op Group's proposal for resolving its financial predicament had been rejected by a small number of major bondholders. Instead, the bondholders' alternative proposal is for their bonds to be converted into shares, which would result in them having a controlling stake in the bank (and therefore the Co-op Group would lose control). It is understood that if no rescue can be agreed voluntarily, control of the bank would be seized temporarily by the Bank of England (BoE), under a process called resolution. This could involve the BoE forcing losses on Co-op Group and obliging the bank's bondholders to convert their loans to the bank into loss-absorbing shares on terms regarded by the Bank of England as fair. In future, these sorts of powers and arrangements are expected to be provided for under Banking Reform legislation, currently working its way through Parliament. The overall aim is to keep an affected bank operating as a going concern, but force its owners/investors to take the associated losses. Developments are being closely monitored by Officers; overnight balances are being minimised as much as possible, as a precaution. There are no investments placed with the Co-op – and so the risks are different to the Icelandic position, as an example – but there are uncertainties and it is unsettling, nonetheless. The Council's banking services contract is due to run until March 2016.

8. Prudential Indicators

These indicators are prescribed by the Prudential Code, to help demonstrate that the Council can finance its debt and have funds available when needed. The prudential indicators are listed in ***Annex B*;** they have been updated to reflect the current capital position and they will be referred onto Council in due course, allowing for further updates as need be to reflect other budget changes.

9. Conclusion

Treasury activity during Quarter 2 followed in the same vein as Quarter 1. Monitoring developments linked to transactional services (and the Co-op Bank) are high on the agenda, however, given announcements after the period end. Although in principle there should be little financial or operational risk to the Council, relevant legislative/regulatory provisions linked to Banking Reform are in their infancy and are as yet untested.

Annex A

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.

Annex B

PRUDENTIAL INDICATORS - LANCASTER CITY COUNCIL

AFFORDABILITY

			2012/13 £'000	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000
PI 1:	Estimates of ratio of financing costs to net revenue stream	Non - HRA	16.2%	12.4%	11.1%	11.2%	11.2%
		HRA	24.0%	23.3%	22.4%	21.7%	21.7%
		Overall	19.3%	16.7%	15.7%	15.5%	15.5%
PI 2:	Actual ratio of financing cost to net revenue stream				Reported after each financial year end		
PI 3:	Estimates of the incremental impact of new Capital Investment decisions on the Council Tax		£2.81	-£8.97	-£11.64	-£0.49	-£0.79
	This includes the impact of all elements of funding, including any increase in the need to borrow, required to finance new schemes added to the Capital Programme		1.5%	-4.7%	-5.9%	-0.2%	-0.4%
PI 3A:	Illustrative Impact of Additional Borrowing £1 million				**Repayment Period**		
					5 Years	**10 Years**	**25 Years**
	Increase in Council Tax (£)				£4.86	£2.65	£1.47
	Increase in Council Tax (%)				2.48%	1.35%	0.99%
PI 4:	Estimates of the incremental impact of Capital Investment on Housing Rents			Nil	Nil	Nil	Nil

CAPITAL EXPENDITURE

			2012/13	2013/14	2014/15	2015/16	2016/17
PI 5:	Estimates of capital expenditure	Non - HRA	5,323	5,983	6,173	3,938	3,980
		HRA	3,591	4,827	4,621	4,707	5,079
		Total	8,914	10,810	10,794	8,645	9,059
PI 6:	Actual capital expenditure					Reported after each financial year end	
PI 7:	Estimates of Capital Financing Requirement	Non - HRA	37,567	39,045	39,997	41,267	39,856
		HRA	45,514	44,473	43,432	42,391	41,350
		Total	83,081	83,518	83,429	83,658	81,206
PI 8:	Actual Capital Financing Requirement					Reported after each financial year end	

EXTERNAL DEBT

		2012/13	2013/14	2014/15	2015/16	2016/17
PI 9:	Authorised Limit					
	Authorised Limit for Borrowing		100	100	99	99
	Authorised Limit for Other Long Term Liabilities		1	1	1	1
	Authorised Limit for External Debt		101	101	100	100
PI 10:	External Debt: Operational Boundary		83	83	83	83
PI 11:	Actual external debt			Reported after each financial year end		
PI 12:	HRA limit on indebtedness		60,194	60,194	60,194	60,194

PRUDENCE

PI 13:	Treasury Management: adoption of CIPFA code of Practice	The Council has adopted the updated Treasury Management code of practice (2011).

		2012/13	2013/14	2014/15	2015/16	2016/17
PI 14:	Net debt and the capital financing requirement					
	Anticipated indebtedness (operational boundary)		83,295	83,435	83,435	83,435
	Anticipated investment		10,301	18,210	18,900	19,960
	CFR		83,518	83,429	83,658	81,206
	Under/over borrowed (-/+)		-10,078	-18,216	-18,677	-22,189