Appendix D

2014/15 Treasury Management Progress Report

For Consideration by Cabinet 17 February 2015

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 2014/15 Treasury Strategy, which incorporates the Investment Strategy, at its meeting on 26 February 2014. This report outlines activities undertaken in pursuance of those strategies during the financial year up to the end of Qtr 3.

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. Summary: Headline Messages

- **Icelandic Investments** – A further £20K was received in relation the claim with the Icelandic Bank KSF. This represents 1% of the claim with only 2.75% remaining to be collected.

- **Borrowing Activities** – no new borrowing has been undertaken during the first quarter of the year.

- **Investment Activities** – investment interest is £2K ahead of target for the third quarter.

3. Economic update *(provided by Capital Asset Services)*

After strong UK GDP growth in 2013 at an annual rate 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a *major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.*

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently predicted that the first increase in the Fed. rate will occur by the middle of 2015.

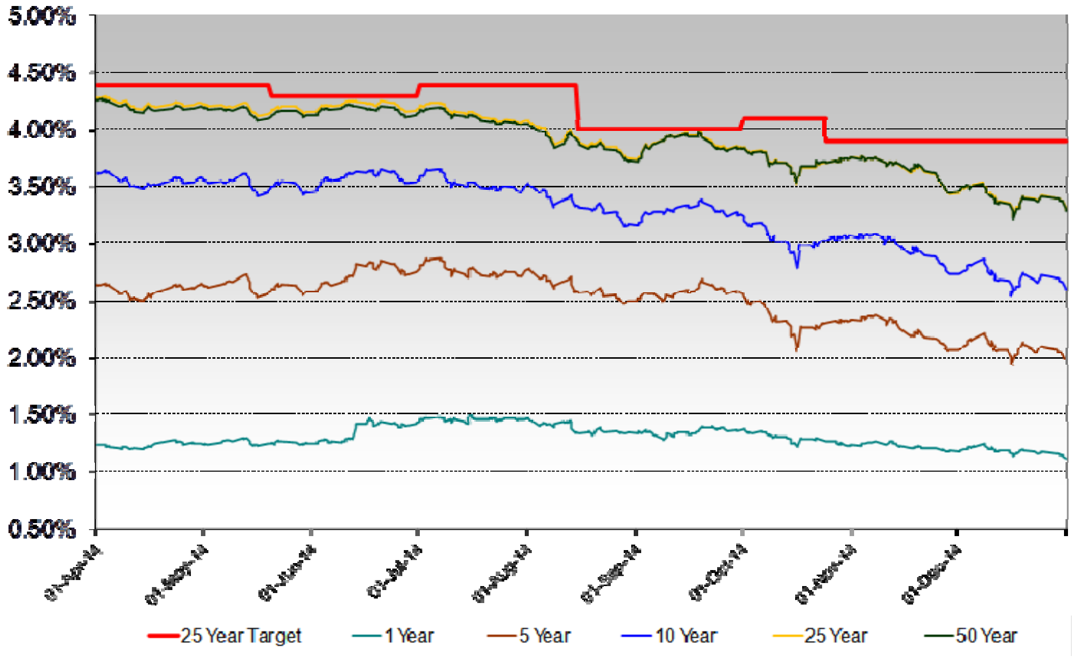
The Eurozone is facing an increasing threat from deflation. In November the inflation rate fell to 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth and is currently expected to embark on quantitative easing early in 2015 to counter this threat of deflation and to stimulate growth.

4. Icelandic Investments Update

There was a further distribution associated with the Council's only outstanding claim (with KSF), which equated to 1% of the claim (£20K). The outstanding money associated with Glitnir is slightly different in that the original claim has been repaid but is being held in an Icelandic bank escrow account, none of which can be repatriated as yet. These funds are held in Icelandic Kronur (ISK), however; it is likely that some further adjustment to their value in £ sterling will be needed, in closing the accounts.

5. Borrowing Activities

No new borrowing was undertaken during Qtr 3. The following graph shows the PWLB rates for the last three quarters ending 31 December 2014.



Early Repayment of Debt
Officers continue to monitor potential saving opportunities associated with the early repayment of existing debt, taking into account the premiums or discounts associated with early repayment and the projected cost of refinancing or loss in investment interest. No reasonable opportunities arose in Qtr 3.

6. 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.

The impact of business rates retention has had a marked positive impact on the Council's cash flow so far this year.

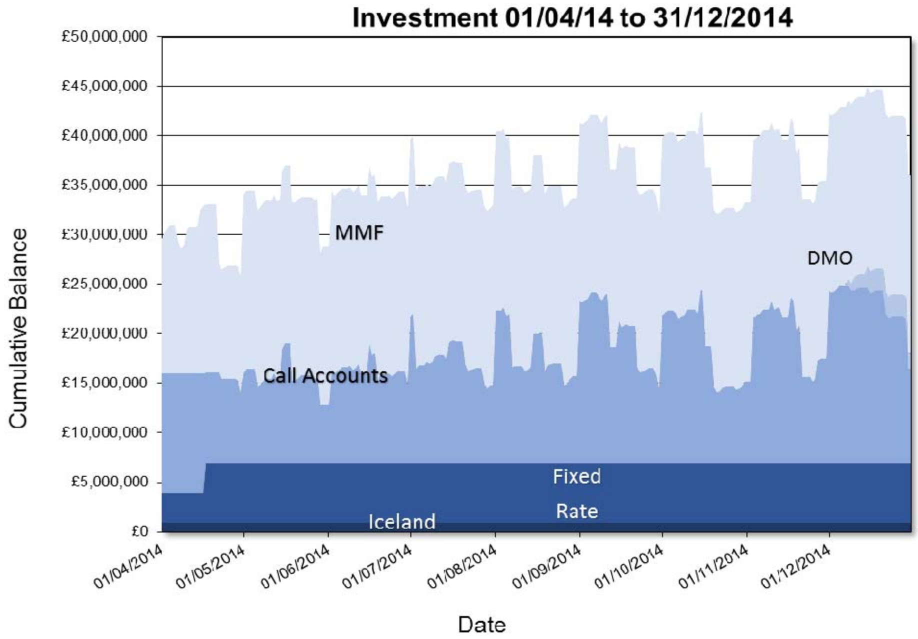
All investment activity has been in line with the approved Treasury Strategy for 2014/15. A full list of the investments at the end of Qtr 3 is shown below (Table 6.1):

Table 6.1 Counterparty balances

Other Investments	Opening £	Min £	Max £	Closing £	Indicative Rate	Cumulative Interest £
Call: RBS	0	0	0	0	0.25%	0
Call: Lancashire County Council	8,891,000	1,376,000	12,000,000	3,837,000	0.25%	12,082
Call: Svenska Handelsbanken	5,944,000	5,500,000	5,944,000	5,568,000	0.30%	15,109
DMADF	0	0	2,225,000	1,638,000	0.25%	306
Government Liquidity MMF	6,000,000	6,000,000	6,000,000	6,000,000	0.27%	11,825
Liquidity First MMF.	6,000,000	6,000,000	6,000,000	6,000,000	0.40%	17,981
Insight MMF	6,000,000	6,000,000	6,000,000	6,000,000	0.37%	16,549
Lloyds	6,000,000	6,000,000	6,000,000	6,000,000	0.60%	25,519
Sub-total	38,835,000			35,043,000		99,371

The following graph displays the different investment products used by the Council. The majority of the Council's balances are held within instant access MMF's or call accounts. This is partly because there are prudential controls that ensure a certain percentage is immediately available and also there is only a small pool of counterparties that meet the Council's credit criteria for fixed term deposits. Other UK banks, that meet the criteria such as HSBC, require much larger investment and market themselves at much larger institutional investors or corporations.

Graph 6.1 Investment balances



Two £3M fixed term investments have been placed with Lloyds Bank for a period of 3 months at a rate of 0.57%. The first matures on 09 January and the second on 19 January, and it is anticipated that these will be invested for 6 months upon maturity and attract 0.7% interest. Lloyds is still part nationalised and therefore continues to meet the criteria of 'Other Institutions' and the associated limits stated within the Treasury Management Strategy (reported to Council on 26th February 2014).

The recently opened account with Svenska Handelsbanken offers a dealing facility which is available until 3 pm, which is later than all other counterparties currently used. This enables the Council to sweep the cumulative balance held with The Cooperative Bank to ensure this balance is as close to zero by the end of the day.

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	0.354%
Lancaster City Council investments	0.375%

The return is below base rate and above the 7 day LIBID benchmark. Investment returns in percentage terms are lower than those used in the budget, but larger cash balances have negated this impact.

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

	Budget to Date £000's	Actuals to Date £000's	Variance £000's
Icelandic Credits	21	21	0
Cash Interest	97	99	(2)
Total	**118**	**120**	**(2)**

Investment returns, excluding balances held in the Icelandic account, exceed the budgeted level. This is due to cash balances being larger than expected as a result of delays within the capital programme and from business rates retention, mentioned earlier.

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.

The biggest impact on investment returns has been the shortage of suitable counterparties that fulfil the Council's approved credit criteria, especially with cash balances being higher than expected. The Strategy for 15/16 will address these restrictions by adopting a new methodology but retaining a low-risk appetite.

The funds being held in Iceland still expose the Council to exchange rate risks, but these are unavoidable. It is anticipated that some financial provision will be made for covering these risks, in preparing this year's accounts.

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 a clear enough position to be following such a strategy.

Cash balances held with The Cooperative Bank continue to be monitored on a daily basis following the bank's crisis in relation to its funding gap; this will be undertaken until such time as the transfer to the Council's new bank, Natwest, is complete.

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***.

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.
  E.g. 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.

- **Capita Asset Services** – 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.*

PRUDENTIAL INDICATORS - LANCASTER CITY COUNCIL

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			2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000
AFFORDABILITY							
PI 1:	Estimates of ratio of financing costs to net revenue stream	Non - HRA	64.4%	14.8%	17.0%	17.0%	17.8%
		HRA	23.3%	22.6%	22.0%	21.1%	20.3%
		Overall	42.7%	18.2%	19.3%	18.8%	18.9%
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		-£18.36	-£1.26	-£15.24	£7.22	£3.25
	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		-9.4%	-0.6%	-7.5%	3.5%	1.5%
PI 3A:	Illustrative Impact of Additional Borrowing £1 million			**Repayment Period**			
				5 Years	**10 Years**	**25 Years**	
	Increase in Council Tax (£)			£4.83	£2.57	£1.29	
	Increase in Council Tax (%)			2.47%	1.31%	0.85%	
PI 4:	Estimates of the incremental impact of Capital Investment on Housing Rents		Nil	Nil	Nil	Nil	Nil
CAPITAL EXPENDITURE							
PI 5:	Estimates of capital expenditure	Non - HRA	15,950	9,820	8,110	5,790	4,700
		HRA	4,285	4,967	5,123	4,882	4,882
		Total	20,235	14,787	13,233	10,672	9,582
PI 6:	Actual capital expenditure		Reported after each financial year end				
PI 7:	Estimates of Capital Financing Requirement	Non - HRA	33,976	35,902	38,834	39,398	38,353
		HRA	44,473	43,432	42,391	41,349	40,308
		Total	78,449	79,334	81,225	80,748	78,661
PI 8:	Actual Capital Financing Requirement		Reported after each financial year end				
EXTERNAL DEBT							
PI 9:	Authorised Limit						
	Authorised Limit for Borrowing		95,000	95,000	95,000	97,000	96,000
	Authorised Limit for Other Long Term Liabilities		1,000	1,000	1,000	1,000	1,000
	Authorised Limit for External Debt		96,000	96,000	96,000	98,000	97,000
PI 10:	External Debt: Operational Boundary		78,226	79,111	81,002	80,525	78,438
PI 11:	Actual external debt		Reported after each financial year end				
PI 12:	HRA limit on indebtedness						
PRUDENCE							
PI 13:	Treasury Management: adoption of CIPFA code of Practice		The Council has adopted the updated Treasury Management code of practice (2011).				
PI 14:	Net debt and the capital financing requirement						
	Anticipated indebtedness		68,800	67,571	66,417	65,249	64,208
	CFR		78,449	79,334	81,225	80,748	78,661
	Under/over borrowed (-/+)		9,649	11,762	14,808	15,498	14,453