

2015/16 Treasury Management Progress Report April to June 2015 (Quarter 1)

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 2015/16 Treasury Strategy, which incorporates the Investment Strategy, at its meeting on 4 March 2015. 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 Capital Asset Services)

After strong UK GDP growth in 2013 at an annual rate of 2.7% and 3.0% in 2014, quarter 1 of 2015 was disappointing at only 0.4%, though subsequent data indicates that this could well be revised up further down the line and also indicates a return to stronger growth in quarter 2. In its May quarterly Inflation Report, the Bank of England reduced its GDP forecast for 2015 from 2.9% to 2.5% and from 2.9% to 2.7% in 2016, while increasing its forecast for 2017 from 2.4% to 2.7%.

Uncertainty around the likely result of the UK general election in May has obviously now evaporated although this has been replaced by some uncertainty around the potential impact on the UK economy of the EU referendum promised by, or in, 2017. In addition, the firm commitment of the Conservative Government to eliminating the deficit within the term of this Parliament will have an impact on GDP growth rates. However, the MPC is fully alert to this and will take that into account, and also the potential spill over effects from the Greek crisis, in making its decisions on the timing of raising the Bank Rate.

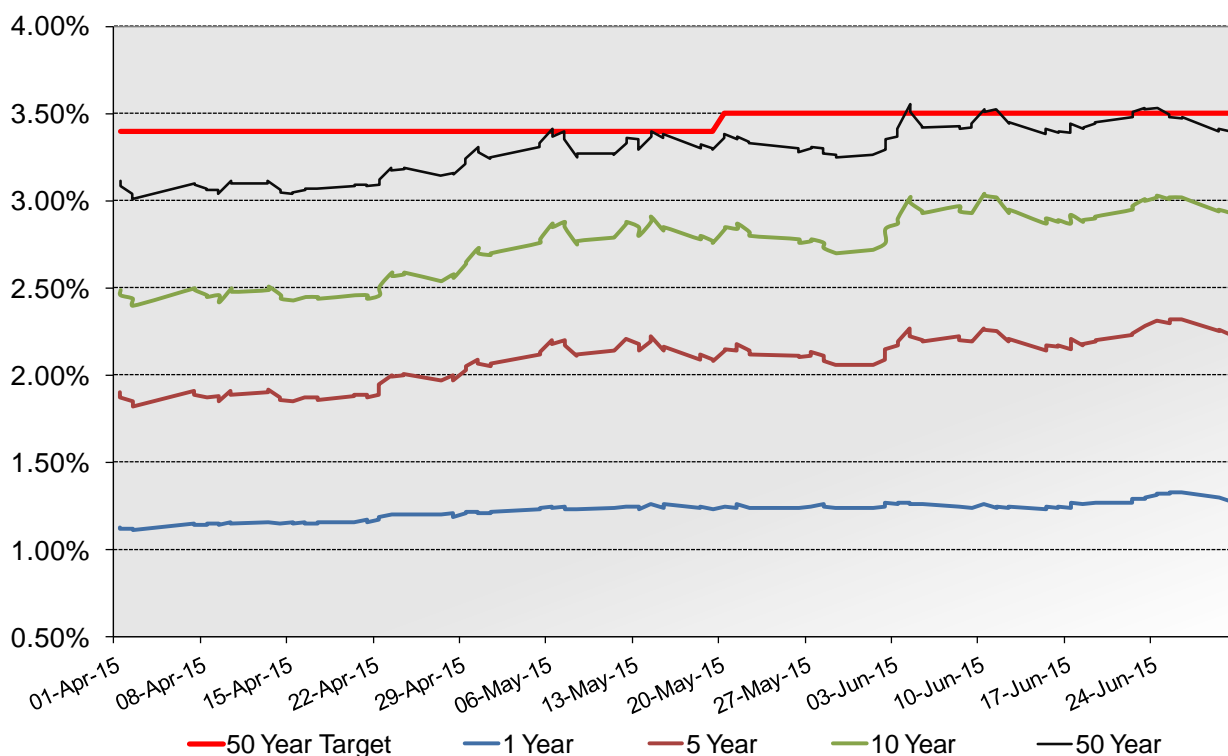
As for the American economy, confidence has improved markedly in this quarter that the US will start increasing the Fed funds rate by the end of 2015 due to a return to strong economic GDP growth after a disappointing start to the year in quarter 1, (a contraction of 0.2%), after achieving 2.4% growth in 2014.

In the Eurozone, the ECB unleashed a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in

economic growth, though it remains to be seen whether this will have an enduring effect as strong as the recovery in the US and UK.

3. Borrowing Activities

No new borrowing was undertaken during Qtr 1, therefore the level of debt outstanding with the Public Works Loans Board (PWLB) at the end of June was £67.332M, and the annual cost of borrowing is £3.071M. The following graph shows the PWLB rates for the first quarter of this year.



Early Repayment of Debt

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, it would not be financially prudent to repay any debt based on the current rates being offered.

4. 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 2015/16. A summary of the investments at the end of Qtr 1 is shown in the following table (Table 6.1):

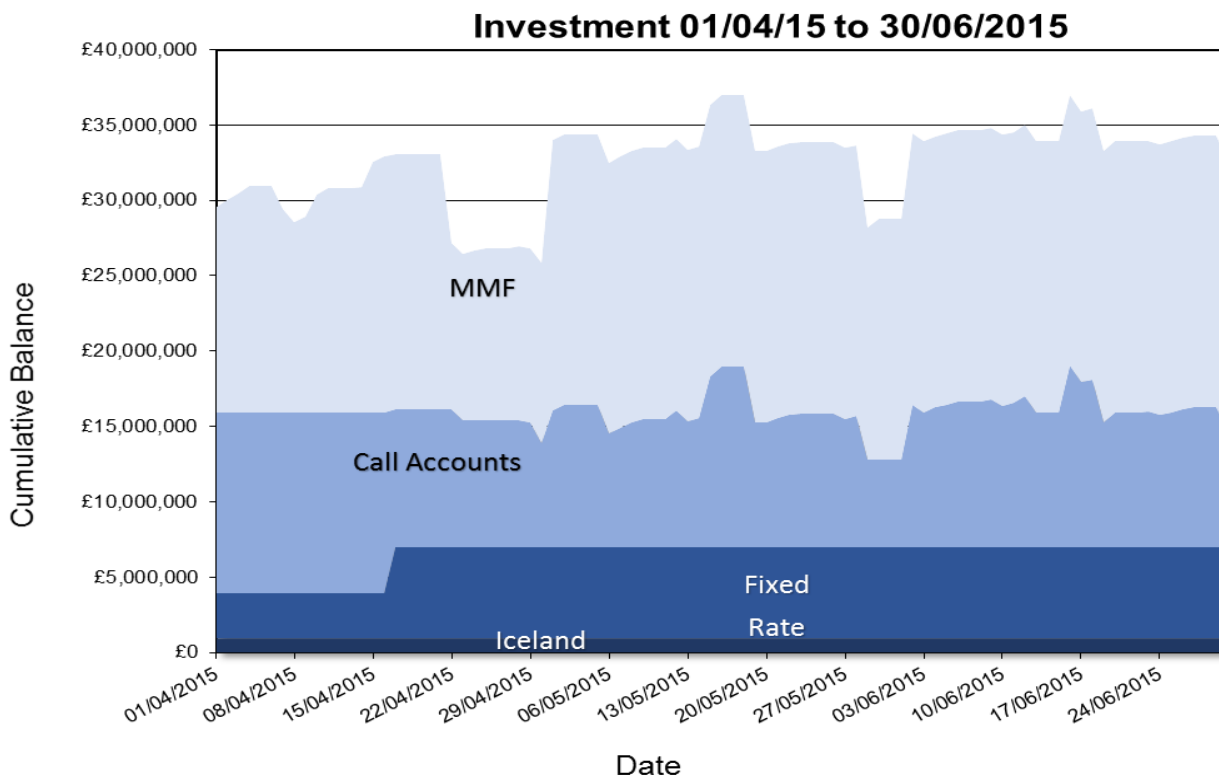
Table 6.1 Counterparty balances

Investments	Opening £	Min £	Max £	Closing £	Rate	Cumulative Interest £
Call Accounts:						Indicative Rate
RBS	0	0	9,923,904	24,306	0.25%	3,505
Lancashire County Council	49,000	0	7,000,000	7,000,000	0.25%	968
Svenska Handelsbanken	3,000,000	994,000	3,000,000	3,000,000	0.35%	2,502
Santander	0	0	2,000,000	2,000,000	0.40%	1,644
Lloyds	4,000,000	0	4,000,000	0	0.40%	2,060
DMADF	0	0	4,000,000	0	0.25%	219
Blackrock Government Liquidity MMF	6,000,000	6,000,000	6,000,000	6,000,000	0.34%	5,128
Blackrock Liquidity First MMF	6,000,000	6,000,000	6,000,000	6,000,000	0.43%	6,451
Insight MMF	6,000,000	6,000,000	6,000,000	6,000,000	0.39%	5,885
Ignis MMF	6,000,000	6,000,000	6,000,000	6,000,000	0.47%	7,006
Longer Term Fixed Rate Investments:						Fixed Rate
Lloyds	6,000,000	6,000,000	6,000,000	6,000,000	0.60%	9,551
Barclays	0	2,000,000	2,000,000	2,000,000	0.64%	2,700
Sub-total	37,049,000			42,024,306		44,920
				Budgeted income		32,435

The longer term credit rating of Government backed banks (RBS and Lloyds) has reduced slightly following the Government's decision to gradually sell off its stake in these banks. As a result for now, future investments placed with these banks will be kept short term. In addition, Officers are currently investigating investment returns offered by other Local authorities who are looking to borrow over longer periods (6-9 months).

The following graph shows 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 mainly because the Council is due to repay the Government £23M in respect of Transitional Protection monies, following settlement of one significant Business Rate appeal. However, the exact timing of this payment is still not certain therefore the majority of cash has been held in instant access accounts.

Graph 6.1 Investment balances



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	0.469%

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

	Budget to Date £000's	Actuals to Date £000's	Variance £000's
Cash Interest	32	45	13
Total	32	45	13

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, as touched on earlier.

5. Risk management

The new investment matrix, as approved by Council on 04 March, has increased the pool of counterparties that can be used and the term over which an investment can be placed, whilst still keeping risk appetite low. The grading of each counterparty is still based upon the credit rating assigned by the three main agencies.

There is financial risk attached to the longer term debt portfolio (associated with interest rate exposure) as all of the debt is on fixed interest but 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, however this is not a financially viable option at present due to the penalties associated with early repayment.

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*.