Report to Scrutiny Commission

Overview Select Committee

Date of Commission meeting: 28th November 2013

Review of Treasury Management Activities 2013/14

Report of the Director of Finance

Useful Information:

- Ward(s) affected: All
- Report author: David Janes, Treasury Manager
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- Date of Exec meeting Not applicable

1. Summary

1.1 This report reviews how the Council conducted its borrowing and investments during the first six months of 2013/14.

1.2 The most significant features of 2013/14 have been signs of economic recovery in the UK and elsewhere. Within the Eurozone, economic and financial tensions have eased, but many underlying issues remain to be resolved. The dispute between the President and Congress over the raising of the US debt ceiling does not yet have a long term resolution.

1.3 Treasury Management is the process that ensures that the Council always has enough cash to make the payments that are necessary for its operations, and this involves both borrowing and investment. The Council's borrowing totals some £240 million; and during 2013/14 its investments varied from below £116 million to over £227 million depending on circumstances.

1.4 The Council has a prudent approach to treasury management. It does not borrow more than it needs; generally preferring to use cash balances as an alternative to borrowing. It only lends to very strong banks and this discipline is enforced by maintaining a regularly updated list of who we will lend to. A particularly cautious approach is being adopted during the current economic difficulties.

1.5 The report commences with an overview of treasury management, including loans and investments at key dates. It then reviews the credit worthiness of investments and implementation of our strategy, provides outcomes on key performance measures and concludes by reviewing compliance against limits set by the Council. It also refers to the financial troubles of the Co-op bank (which is the Council's banker)

2. Recommendation(s) to scrutiny

2.1 Members are recommended to receive and consider the report and comment as appropriate.

3. Supporting Information

Main elements of Treasury Management

3.1 There are two main elements to treasury management. The first is managing our borrowings which have been taken out to finance capital expenditure. Most capital schemes are now financed by grant, and only a limited number are financed by borrowing. This is due to a change in Government policy: the Government used to expect us to borrow but allow for the cost of borrowing in our grant settlement; now we simply get one-off grant. However, we still have a lot of debt which was taken to meet past capital expenditure.

3.2 Historic debt can sometimes be restructured to save money, i.e. repaying one loan and replacing it with another and this is currently being given active consideration.

3.3 The revenue budget approved by the Council for each financial year includes provision for the interest payable on this borrowing. It also includes a provision for repaying the borrowing over a number of years (broadly speaking over the economic life of the assets acquired).

3.4 The second element is cash management which involves managing the Council's investments to ensure the optimum amount of money is in the bank account on a day-to-day basis – so that there is enough money on the account to cover the payments made on the day but no more (cash held on the bank account earns virtually no interest).

3.5 The Council has substantial investments but this is not "spare cash". Some comes from grants received in advance of expenditure and from reserves held for designated purposes. The balance of the cash represents cash that we hold in order to meet known liabilities (for example trade creditors) less the money that other people owe us.

3.6 There is a provision for interest earned on investments in the Council's revenue budget.

Treasury Management Policy and Monitoring

3.7 These activities were governed by the Treasury Strategy for 2013/14 which was approved by the Council on 25th January 2013. This establishes an outline plan for borrowing and investment. The strategy is drawn up in the light of the Council's expected borrowing requirements, its expected cash balances, the outlook for interest rates and the credit worthiness of the banks with whom the Council might invest its cash balances.

3.8 A twice-yearly report is submitted to your Committee reviewing the treasury activity undertaken in the year. This report is the mid-year report for 2013/14.

3.9 Additionally a brief monthly report is submitted to the City Mayor which reports the current investment portfolio, the current list of organisations with which the Council will place deposits and also has a brief commentary. Where appropriate, it also will consider other topical issues that impact on treasury management.

Loans and Investments at Key Dates

3.10 Table 1 below shows the loans (money borrowed by the Council) and investments (money invested by the Council) at 31/03/2013 and 18/10/2013. The rates shown are the averages paid and received for 2012/13 and for 2013/14 up to 18th October 2013.

3.11 It can be seen that the level of gross debt (total loans borrowed) is unchanged at a level of £239m. No new loans have been borrowed and no debt restructuring has taken place.

3.12 Investments have increased by £90m from £117m to £207m which is typical at the mid-year. Net borrowing has decreased by the same amount (net borrowing is simply gross loans less investments).

Table 1- Loans & Investments

	Position at 31/03/2013 Principal £M	**Average Rate**	**Position at 18/10/2013 Principal £M**	**Average Rate**
Long Term Fixed Rate Loans Public Works Loan Board (PWLB) Market & Stock	134 9	4.2% 7.0%	134 9	4.2% 7.0%
Variable Rate Loans Bank Loans	96	4.4%	96	4.4%
Gross Debt	239	4.4%	239	4.4%
Investments Banks and Build Soc Other Local Authorities Government Debt	28 88 0 1		31 156 18 2	

Management Office Government Treasury Bills				
Total Investments	117	0.4%	207	0.4%
NET BORROWING	**122**		**32**	

Credit Worthiness of Investments

3.13 The economic signals within the UK and within the world economy are mixed, with signs of economic recovery but against a background of continuing risks within the euro zone.

3.14 The dispute over the raising of the debt ceiling of the USA has only been temporarily resolved and further disputes between the President and Congress have the scope to lead to economic disruption. However, most commentators do not expect this to happen.

3.15 The governments of the largest world economies have been seeking to implement measures to make banks less likely to fail and to reduce the impact on the financial system and on tax payers if they do fail. The measures for dealing with a failing bank would see investors, other than small depositors, taking significant losses (being "bailed in") before any loss falls on the taxpayer. The investors taking losses will mainly be shareholders and bondholders (a "bond" is the form in which many large commercial investors lend money to banks and other corporate bodies). It is possible that in some circumstances losses might also be imposed on large deposits placed with a bank.

3.16 This approach can be seen in the UK Government's stance with regard to the Co-op bank which faces financial difficulties on a number of fronts, including losses on non-performing loans from its takeover of the Britannia Building Society in 2009. No tax payer support has been offered and there have been difficult negotiations regarding the allocation of losses between bond holders and shareholders, but progress has been made. It appears that these negotiations have taken place against a background in which it has been made clear that if agreement is not be reached, emergency legislation would be passed.

3.17 Such an approach gives comfort to bank depositors and the way in which the Council invests money in banks is in the form of deposits. This reassurance is not total, however, as there is some speculation that this "bailing in" could be imposed on large depositors also.

3.18 These developments have been reflected in the Council's approach to managing credit risk. It has adopted a cautious stance over the whole period covered by this report and has only lent to strong UK banks, other local authorities and the UK Government (either indirectly though the Debt Management Office or directly through the purchase of short-dated loans known as treasury bills). The banks to whom it will lend are:

- Bank of Scotland
- Barclays Bank
- HSBC
- Lloyds Bank
- Nationwide Building Society
- Santander
- Standard Chartered Bank

3.19 The Council does not use the Co-op bank as an investment party as for a long time its credit ratings have been below the Council's minimum credit rating. As the Co-op is the Council's banker, it does expose us to some risk, which we seek to manage by ensuring balances in the account are kept as low as possible.

3.20 The Council's current banking contract expires in 2015. It will be appropriate to consider these issues as work is done in preparation for retendering.

Implementation of Borrowing & Investment Strategy

3.21 The strategy approved by Council for 2013/14 envisaged using cash balances instead of borrowing, and this strategy has been adhered to.

3.22 The strategy left open the possibility of borrowing at long-term fixed interest rates if they were low enough. However, no new long-term fixed rate loans were borrowed despite interest rates being low. The constraint was the expectation that the money raised would not have been spent for at least two years – the money raised by borrowing would have been invested and the interest payments on the loans would have been far greater than the investment income resulting in a net cost to the Council.

3.23 Given that the Council continues to have a high level of investments active consideration is being given to the possible early redemption of a limited amount of debt. This, however, is not straightforward as debt repayment usually involves the payment of a premium.

Other Sources of Capital Finance

3.24 Major assets are funded primarily by grant or capital receipts. The acquisition of smaller assets such as vehicles and computer equipment can be financed by borrowing or leasing and a comparison is made in order to choose the option that is most cost effective. During the period under review, leasing has not been used, and assets have been bought outright.

Key Performance Measures

3.25 The most important performance measures are the rate of interest on the Council's borrowings, the timing of borrowing decisions, the timing of decisions to prematurely repay debt and the return on investments. The second and the third of these do not apply because no new loans have been borrowed and no existing loans have been prematurely repaid.

3.27 The Council is a member of a benchmarking club: the latest data is for 2012/13.

The average rate of interest on investments for members of that club is 1.1%. The Council's own rate is lower: 0.4%.

3.28 This difference in the interest rate on investments reflects the cautious approach adopted by the Council and reflected in the approved treasury strategy. This has impacted in two ways:

- The best rates of interest have been those offered by banks, but the limited number of high credit rated institutions has resulted in a lot of money being invested with safe counterparties that paid low rates of interest (i.e. other local authorities and the Government's debt management office).
- Such investments as we have made with banks have been for shorter periods than the investments of some other councils.This reduces the risk of being locked into an investment with a bank whose credit worthiness has deteriorated, but results in a lower interest rate.

3.29 The current low interest rate environment is forecast to continue for a number of years and this consideration will feed into the review as to whether cash balances should be used repay existing long-term, fixed rate, debts.

3.30 The trade-off between risk and reward was considered when investment strategies were set for 2013/14 and in the current economic climate continues to be a most important consideration. The "return of the principal" is considered more important than the "return on the principal", that is our primary concern is to ensure that the funds invested will be repaid on time and in full. However, it is now some time since the economic crisis of 2008. Whilst circumstances remain far from normal, it is believed that we can relax criteria slightly in respect of the major UK banking institutions and a revised approach will be prepared as part of the 2014/15 treasury strategy.

Use of Treasury Advisors

3.31 The Council are advised by Arlingclose Ltd. They advise on all aspects of treasury management but their main focus is on providing advice on the following matters:

- the creditworthiness of banks
- the most cost effective ways of borrowing
- appropriate responses to Government initiatives
- technical and accounting matters.

3.32 The contract is subject to retendering in 2013/14.

Compliance with the Council's Treasury Strategy

3.33 As required by the statutory borrowing framework, the Council is required to set a number of prudential limits and indicators, and is encouraged to supplement these with local indicators when appropriate. These limits are set annually and can be found within the budget and the Treasury Strategy and cover both capital spending and treasury management.

3.34 For the operational implementation of the Council's Treasury Management Strategy the most important limits and indicators that need to be monitored throughout the year are:

- The authorised limit – the maximum amount of borrowing that the Council permits itself to have outstanding at any one time
- The operational limit – a lower limit to trigger management action if borrowing is higher than expected.
- The maximum proportion of debt that is fixed rate.
- The maximum proportion of debt that is variable rate.
- Limits on the proportion of debt maturing in a number of specified time bands
- Limits on sums to be invested for more than 364 days

3.35 These limits are monitored, and have been complied with.

4. Financial, legal and other implications

4.1 Financial implications

4.1.1 This report is solely concerned with financial issues.

4.2 Legal implications

4.2.1 Sarah Khawaja, Legal Services has been consulted as Legal Advisor and there are no legal implications.

4.3. Climate Change implications

4.3.1 This report does not contain any significant climate change implications and therefore should not have a detrimental effect on the Council's climate change targets – Chloe Hardisty, Senior Environmental Consultant.

4.4 Equality Impact Assessment

None

4.5 Other Implications

None

5. Background information and other papers:

The Council’s Treasury Management Strategy - “Treasury Strategy 2013/14” – Council 24th January 2013. The Council’s Treasury Policy Document – “Framework for Treasury Decisions” – Council 29 March 2012.

6. Summary of appendices: None

7. Is this a private report ? No.