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AUDIT COMMITTEE 26 SEPTEMBER 2014

# TREASURY MANAGEMENT MID YEAR MONITORING REPORT 2013/14

## 1 PURPOSE

1.1 The Treasury Management Strategy for 2014/15 is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

1.2 The Code also recommends that members are informed of Treasury Management activities at least twice a year (a mid year and a year end report). This report therefore ensures that New Forest District Council (NFDC) are embracing best practice in accordance with CIPFA's recommendations.

1.3 Treasury management is defined as: "The management of investments and cash flows, banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

## 2 ECONOMIC BACKGROUND

2.1 The following Section outlines the key economic themes currently in the UK against which investment and borrowing decisions have been made in the year to date.

2.2 Growth - The recent strong performance of the UK economy has continued with output growing at a preliminary estimate of 0.8% in Q2 2014, following on from the same figure in Q1. This made the economy 0.2% larger than the pre-crisis peak of Q1 2008.

2.3 Unemployment - The labour market has continued to improve, with strong employment gains and the headline unemployment rate falling to 6.4%. However, earnings growth weakened further and turned negative with total pay for the three months to June falling by 0.2% when compared to the previous year. Employment growth was masked by a large number of zero-hour contracts and working part-time involuntarily.

2.4 Inflation: CPI inflation for July fell to 1.6% year-on-year from 1.9% which was lower than market expectations. Expectations remain that inflation is likely to remain close to, but a little below, the MPC's 2% target for the next couple of years. In August the Bank of England's latest Inflation Report was published. CPI inflation projections were revised downwards over the two year horizon and expectations for wage growth, the estimate of spare capacity and equilibrium unemployment also fell.

2.5 UK Monetary Policy: The MPC made no change to the Bank Rate of 0.5%. However, there was a marked shift in tone from the Bank of England's Governor and other MPC members. In his Mansion House speech in June 2014 Governor Mark Carney warned that interest rates might rise sooner than financial markets were expecting. Following some mixed messages from Governor Carney later in the summer, the minutes of the August MPC meeting revealed a split vote with regards to the Bank Rate, with two of the nine votes to increase the Bank Rate by 0.25%.

2.6 The MPC emphasised that when the Bank Rate did begin to rise, it was expected to do so only gradually and to remain below average historical levels for some time to come. NFDC's treasury management advisors, Arlingclose, now estimate the first rise in interest rates will be in the third quarter for 2015. Their forecast of the timing of the rise has been brought forward but is still later than many economic commentators.

## 3 INVESTMENTS

3.1 NFDC has an investment portfolio consisting of reserves and short-term cash flows. The Council is currently investing according to a low risk, high quality lending list as outlined in its Treasury Management Strategy.

3.2 NFDC's investment holding was £55.4m at 31 August 2014, which is over £12.9m (30%) higher than the same time last year, which was placed with the following counterparties:

| Counterparty | £m | £m |
|---|---|---|
| Barclays | 5.0 | |
| Close Brothers | 2.0 | |
| Deutsche | 5.0 | |
| HSBC | 5.0 | |
| Lloyds TSB | 5.0 | |
| Nationwide | 4.0 | |
| NatWest | 4.0 | |
| Nordea | 2.0 | |
| Standard Chartered | 3.5 | |
| Svenska Handlesbanken | 5.0 | |
| Banks and Building Societies sub-total (less than 1 year) | | 40.5 |
| Ignis | 5.4 | |
| Federated | 2.3 | |
| Deutsche | 4.2 | |
| Money Market Funds | | 11.9 |
| UK Local authorities (from 1 to 3 years) | | 1.0 |
| CCLA LAMIT Property Fund (at cost) | | 2.0 |
| Total | | 55.4 |

3.3 The level of cash balances is expected to reduce slightly between now and the end of the financial year due to the profile of the Council's income, which falls away in the final months of the financial year.

3.4 The average interest rate earned on these investments at 31 August 2014 was 0.68%, which should be considered within the context of an unchanged UK Base Rate of 0.5% since March 2009 and very low short-term money market rates.

3.5 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. This has been maintained by following the counterparty policy as set out in its Treasury Management Strategy for 2014/15.

3.6 Counterparty credit quality is assessed and monitored with reference to a range of factors, including but not limited to, the ratings of the major ratings agencies. During the five months to the end of August 2014 investment counterparties and the duration of new investments have been monitored and amended where necessary based on this assessment.

## 4 BORROWING

4.1 NFDC's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31 March 2014 was £147.7m in total, including HRA and non-HRA. Affordability and the "cost of carry" remained important influences on the borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

4.2 For the Council the use of internal resources in lieu of borrowing has, therefore, continued to be the most cost effective means of funding capital expenditure. No new long-term borrowing has taken place in the five months to August 2014, or is planned for the remainder of the financial year. This has lowered overall treasury risk by reducing both external debt and temporary investments.

4.3 As at 31 August 2014 NFDC had a total of £144.7m of long term loans, made up of a number of Public Works Loan Board (PWLB) loans at a weighted average fixed interest rate of 3.12%, and average outstanding term remaining of 20.3 years. This average rate is below the rate currently being offered for a similar timescale and therefore when viewed against historic interest rates the debt portfolio represents good mitigation against the long-term risk of exposure to interest rate fluctuations, which could increase the cost of borrowing.

4.4 The premia that applies to the premature repayment of PWLB loans is still relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling. As a consequence no rescheduling activity has taken place. However, consideration will continue to be given to any advantageous opportunity for NFDC to reduce or restructure its debt portfolio.

## 5 COMPLIANCE WITH PRUDENTIAL INDICATORS

5.1 During the first five months of 2014/15, NFDC operated within the treasury management indicators set out in the Treasury Management Strategy.

**Authorised limit for external debt**

5.2 CIPFA's Code of Practice requires authorities to set an authorised limit for external debt, defined as the sum of external borrowing and other long-term liabilities. The annual strategy report agreed by NFDC on 10 January 2014 set an authorised limit for external debt of £179m.

5.3 This limit is based on the estimated CFR in order to enable it to be financed entirely from external borrowing should NFDC's internal reserves become depleted. The limit also includes an allowance for temporary borrowing to cover normal revenue cash flow requirements and unexpected outflows or delays in receiving cash.

5.4 During the five month period to 31 August 2014 borrowing remained well within the authorised limit of £179m and no new long term borrowing has been taken out. There has been no temporary borrowing, so the total external debt has remained at the total long-term borrowing amount of £144.7m.

**Operational boundary for external debt**

5.5 The Council has set an operational boundary for external debt. This should reflect the most likely scenario and be consistent with NFDC's capital plans and Treasury Management Strategy. Temporary breaches of the 2014/15 operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The approved operational boundary for 2014/15 is £146m.

5.6 As outlined above the Council's maximum total external debt of £144.7 in the period from April to August 2014 is within the operational boundary.

**Upper limit on fixed and variable interest rate exposure**

5.7 NFDC has to set an upper limit on its fixed interest rate exposure for both total investments and total external debt. The approved upper limit on fixed interest rate exposure for external debt for 2014/15 is 100% and all of the Council's long-term debt portfolio is made up of fixed interest loans.

5.8 The Council also has to set an upper limit on its interest rate exposure for fixed and variable rate investments, which is 100% for both to allow maximum policy flexibility. In the period from April to August 2014 the Council had a maximum of £1m (1.5% of total cash balances) of investments at fixed rates (term deposits with a duration of more than a year) and £67.6m (100% of total cash balances) at variable rates, both within the approved limits above.

**Upper and lower percentage limits on the maturity structure of long-term fixed-rate borrowing outstanding in 2014/15**

5.9 The Code also requires NFDC to set upper and lower percentage limits on the maturity structure of its long-term fixed rate borrowing during 2014/15. The following table shows the limits approved by NFDC. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

| | Upper limit (%) | Lower limit (%) | Actual (%) |
|---|---|---|---|
| Under 12 months | 25 | 0 | 0.1 |
| 12 to 24 months | 25 | 0 | 0.1 |
| 24 months to 5 years | 25 | 0 | 6.1 |
| 5 years to 10 years | 25 | 0 | 14.9 |
| 10 years and above | 100 | 0 | 78.8 |

**Upper limits on investments with maturities longer than one year**

5.10 For 2014/15 NFDC restricted investments for periods of over a year to a maximum of £10m. At 31 August 2014 NFDC had £3m of long-term investments, which was made up of £1m invested with another local authority and a £2m investment in a pooled property fund. A further £1m commitment has been made to another investment with a local authority, which will be made in September 2014.

## 6 RECOMMENDATIONS

Members are recommended to:

6.1 Consider the performance of the treasury function detailed in this report.

| Further Information | Background Papers |
|---|---|
| Please contact Andrew Boutflower (HCC), or Bob Jackson (Executive Director) | The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance |
| | Local Government Act 2003 |
| e-mail:<br>andrew.boutflower@hants.gov.uk<br>bob.jackson@nfdc.gov.uk | SI 2003/3146 - Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 |
| | Council 24 February 2014 – Audit Committee – Treasury Management Strategy Report 2014/15 |
| | Published Papers |