Agenda Item 5(ii)

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Subject	Treasury Management – Mid Year Monitoring Report – 2014/15

RECOMMENDATIONS

The Committee is asked to:

1) Receive and note the Treasury Management Mid Year Monitoring Report for the period ended 30th September 2014.

2) Commend the report to Council, making any relevant recommendations and observations as Members see fit.

SUMMARY

This report outlines the performance of the Treasury Management function of the Council for the six months ending 30th September 2014. It provides an update on the current economic conditions affecting Treasury Management decision making and looks ahead to future reporting requirements.

The key points to note are:

- All treasury related transactions were undertaken by authorised officers and within the limits approved by the Council.
- All investments were to counterparties on the approved lending list.
- The Council operated within the Prudential Indicators for Treasury Management.

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) has been adopted by the Council. The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management function.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by Council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a **Mid-year Review Report** and an Annual Report covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

This report meets that requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Management Strategy and PIs were previously reported to Audit Committee on 20th November 2013 and Council on 18th February 2014.

1. **Background**

1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation ensures that this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 As a consequence treasury management is defined as:
'The management of the local authority's cash flows, its 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'.

1.4 The report updates members on treasury management activities in the period to 30th September 2014 and covers:

- The general economic performance to date and outlook.
- Treasury Management Strategy Statement update
- Compliance with regulatory requirements (treasury and prudential limits), approved policies and practices for 2014/15.

2. **Economic Update**

2.1 **Economic performance to date and outlook**

2.2 Commentary from Capita Asset Services (Capita Asset Services is a trading name of Capita Treasury Solutions Limited and are the Council's treasury management advisors).

2.3 **United Kingdom**

2.4 After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in quarter 1, 0.9% in quarter 2 and a first estimate of 0.7% in quarter 3 2014 (annual rate 3.1% in quarter 3), it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, 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 through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back 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. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates 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.

2.5 Also encouraging has been the sharp fall in inflation (Consumer Price Index - CPI), reaching 1.2% in September, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in quarter 2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

2.6 The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018/19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

2.7 **United States**

2.8 In September, the Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2013. Asset purchases have now fallen from $85bn to $15bn and are expected to stop on 29th October 2014, providing the economic outlook remains strong. First quarter Gross Domestic Product (GDP) figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in quarter 2 to 4.6% (annualised).

2.9 The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions.

2.10 **Eurozone**

2.11 The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all Eurozone countries and includes some countries with negative rates of inflation. Accordingly, the European Central Bank (ECB) took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).

2.12 Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

2.13 **Japan and China**

2.14 Japan is causing considerable concern as the increase in sales tax in April has suppressed consumer expenditure and growth. In quarter 2 growth was -1.8% q/q and -7.1% over the previous year. The Government is hoping that this is a temporary blip. As for China, Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has raised fresh concerns. There are also major concerns as to the creditworthiness of much bank lending to corporates and local government during the post 2008 credit expansion period and whether the bursting of a bubble in housing prices is drawing nearer.

2.15 **Interest Rate Forecasts**

Capita Asset Services has provided the following forecast of interest rates:

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
5yr PWLB rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10yr PWLB rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%

(The Capita Assets Services forecasts above are for PWLB certainty rates).

2.16 Capita Asset Services undertook a review of its interest rate forecasts on 24th October. During September and October, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, plus fears around Ebola and an accumulation of dismal growth news in most of the ten largest economies of the world and also on the growing risk of deflation in the Eurozone, had sparked a flight from equities into safe havens like gilts and depressed Public Works Loans Board (PWLB) rates. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2015.

2.17 Their PWLB forecasts are based around a balance of risks. However, there are potential upside risks, especially for longer term PWLB rates, as follows:-

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds and into equities.
- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

2.18 Downside risks currently include:-

- The situation over Ukraine poses a major threat to Eurozone and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe.

- Fears generated by the potential impact of Ebola around the world
- UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.
- A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014.
- Weak growth or recession in the UK's main trading partner - the EU, inhibiting economic recovery in the UK.
- A return to weak economic growth in the UK, US and China causing major disappointment in investor and market expectations.
- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.
- Recapitalisation of European banks requiring more government financial support.
- Lack of support by populaces in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- Italy: the political situation has improved but it remains to be seen whether the new government is able to deliver the austerity programme required and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.
- France: after being elected on an anti austerity platform, President Hollande has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme. Major overdue reforms of employment practices and an increase in competiveness are also urgently required to lift the economy out of stagnation.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.
- There are also increasing concerns at the reluctance of western central banks to raise interest rates significantly for some years, plus the huge quantitative easing (QE) measures which remain in place (and may be added to by the ECB in the near future). This has created potentially unstable flows of liquidity searching for yield and, therefore, heightened the potential for an increase in risks in order to get higher returns. This is a return to a similar environment to the one which led to the 2008 financial crisis.

3. **Treasury Management Strategy Statement update**

3.1 The report is structured to highlight any key changes to the Council's capital activity (the prudential indicators (PIs)), the economic outlook and the actual and proposed treasury management activity (borrowing and investment).

3.2 The Treasury Management Strategy for 2014/15 was approved by the Council on 18th February 2014 there have been no changes to the Strategy in the half year to 30th September 2014.

4. **Compliance with Regulatory Requirements (Treasury and Prudential Limits), Approved Policies and Practices for 2014/15.**

Key Prudential Indicators

4.1 This part of the report is structured to update:

- The Council's capital expenditure plans
- How these plans are being financed
- The impact of the changes in the capital expenditure plans on the prudential indicators (PIs) and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity

4.2 Prudential Indicators for 2014/15 were set in accordance with the Prudential Code and the Treasury Management Code of Practice and were approved by Council on 18th February 2014. These Prudential Indicators and the actual performance against them are set out below:

Prudential Indicators for Capital Expenditure and the Financing of the Capital Programme

4.3 The table below draws together the main strategy elements of the capital expenditure plans and the expected financing arrangements of this capital expenditure.

Capital Expenditure	2014/15 Original £m	2014/15 Updated £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
Capital Expenditure	3.182	5.770	6.251	4.432	2.944
Financed by:					
Capital reserves	1.642	2.717	4.566	2.041	1.200
Government grants	0.270	0.270	0.270	0.270	0.270
Other grants and conts.	0.985	1.071	0.615	0.600	0.600
Revenue	0.285	1.712	0.800	1.521	0.874
Net financing need for the year	**0**	**0**	**0**	**0**	**0**

Prudential Indicator - Capital Financing Requirement (CFR)

4.4 The CFR reflects the underlying need to finance capital expenditure by borrowing or other long-term liability arrangements. Other long-term liabilities include credit arrangements associated with finance leases. The CFR will increase whenever capital expenditure is incurred. If this expenditure is resourced immediately then there is a zero net increase in the CFR. If this expenditure is not immediately resourced then the CFR of the Authority will increase. A positive CFR indicates a borrowing requirement which will incur a Minimum Revenue Provision (MRP) or statutory repayment of principal and interest from the general fund.

4.5 The latest CFR projections are:

	2014/15 Original £m	2014/15 Revised £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
Capital Financing Requirement (CFR)	2.791	2.785	2.485	2.185	1.885

Borrowing

4.6 There is no requirement to borrow to fund the capital programme in 2014/15 and as such any borrowing during the year would be on a short-term basis and for the purposes of cash flow management only. There has been no requirement for any short-term borrowing during the first half of the year. The Council's last external loan was repaid in February 1997 and Mole Valley became debt free on 1st April 1997.

Prudential Indicators for Borrowing:

Borrowing Limits

4.7 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowing less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and the next two financial years. This would allow some flexibility for limited early borrowing for future years.

	2014/15 Original Estimate	2014/15 Revised Estimate
External debt	**£m**	**£m**
Debt at 1st April	0	0
Expected change in debt	0	0
Other long-term liabilities (OLTL)	2.7	2.9
Expected change in OLTL	(0.3)	(0.3)
Actual gross debt at 31st March	**2.4**	**2.6**
Capital Financing Requirement	**2.8**	**2.8**
Under/(over) borrowing	**0.4**	**0.2**

4.8 The Strategic Director (Section 151 Officer) reports that no difficulties are envisaged for the current year in complying with this prudential indicator.

4.9 A further prudential indicator controls the overall level of borrowing. This is the **Authorised Limit** which represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. The Authorised Limit is the 'Affordable Borrowing Limit' required by Section 3 of the Local Government Act 2003 irrespective of its indebted status. The introduction of International Financial Reporting Standards (IFRS) required finance leases to be included under other long-term liabilities on the balance sheet. The Treasury Management Strategy agreed by Council on 18th February 2014 included for an Authorised Limit of £5,500,000. The cost of finance leases included within the Authorised Limit in 2013/14 amounted to £2,933,000.

4.10 The **Operational Boundary** is the expected borrowing position of the Council during the year and periods where the actual position is either below or over the Operational Boundary is acceptable subject to the Authorised Limit not being exceeded. The Treasury Management Strategy agreed by Council on 18th February 2014 included for an Operational Boundary of £4,000,000. The cost of finance leases included within the Operational Boundary in 2013/14 amounted to £2,933,000.

4.11 <u>Actual borrowing 1st April – 30th September 2014</u>

Maximum external borrowings at any one time	0
Total borrowings during period	0
Debt repaid during period	0

4.12 <u>Actual External Debt</u>

Actual borrowing as at 30th September 2014	0
Actual other long term liabilities at 30th September 2014	£2.9m
Actual external debt as at 30th September 2014	£2.9m

4.13 <u>NB</u> – borrowing limits set out how much the Council is able to borrow at any one time. The Authorised Limit is the maximum amount of borrowing allowed whereas the Operational Boundary is the most likely requirement. It is permissible for the Council to exceed the Operational Boundary on occasion but not to exceed the Authorised Limit without approval from Council.

4.14 <u>Interest Rate Exposure on Borrowing</u>

Upper limit for fixed interest rate exposure	0%
Upper limit for variable interest rate exposure	0%

4.15 <u>Actual Performance</u>

Proportion of interest paid at fixed rates	0%
Proportion of interest paid at variable rates	0%

4.16 <u>Maturity Structure of Borrowings</u>

Upper limit (under 12 months)	0%

Lower limit (under 12 months) 0%

4.17 Actual Performance
Upper limit (under 12 months) 0%
Lower limit (under 12 months) 0%

4.18 The table below shows the impact of debt and investments on the revenue budget.

	2013/14 Actual £m	2014/15 Estimate £m	2014/15 Estimate 30/09/14 £m	2015/16 Estimate £m	2016/17 Estimate £m
Interest on borrowing	0	0	0	0	0
Interest on investments	0.426	0.477	0.477	0.498	0.545

Investment Strategy

4.19 The objectives of the Council's investment strategy are safeguarding the repayment of the principal and interest of its investments on time, the liquidity of those sums, with the investment return being the final objective. As set out in paragraph 2 (Economic Background) it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. Indeed, the introduction of the Funding for Lending Scheme has reduced market investment rates even further.

4.20 The Council's in-house investment team manages an investment portfolio of between £22 million and £37 million. Fluctuations will occur during the year as for example council tax and non-domestic rate direct debits are collected in ten months out of twelve and this has a significant effect on the balances that are held at year end. The opening and closing balances on the Council's investment portfolio for the first half of 2014/15 are as follows:

	Investments at 01/04/2014 £m	Investments at 30/09/2014 £m
Temporary investments	18.905	23.987
Long-term investments	2.000	2.000
CCLA Property Fund investment	5.078	5.393
Total investments outstanding	25.983	31.380

4.21 The constituent parts of the investment position as at 30th September 2014 are:

Sector	Country	Up to 1 year £m	1 - 2 years £m	2 – 3 years £m	3 - 5 years £m
Banks	UK	8.987	2.000	0	0
Building Societies	UK	15.000	0	0	0
Property Fund investment	UK	5.393	0	0	0
Total		**29.380**	**2.000**	**0**	**0**

4.22 On 30th June 2013 the Council invested £5m in the Charities, Churches and Local Authorities (CCLA) Property Fund. This is a high quality, well diversified property fund. To realise the full potential of this investment it should be considered as a medium to long term placement. Income is received quarterly and in the current economic climate good yields were anticipated.

4.23 Excellent returns continue to be received on this Fund. At 31st March 2014 the valuation of the Fund, based on the units held x the bid (selling) price amounted to £5.078m. The valuation as at 30th September 2014 was £5.393m an increase in the Fund valuation of £315,000 (6.2%). CCLA interest earnings to 30th September amounted to £153,000. It is anticipated that the annual interest earnings from the CCLA Property Fund investment will amount to £313,000 out of a total projected interest forecast of £515,000 (budget £477,000).

4.24 Banks and building societies have availed themselves of cheaper funds through the Bank of England's Funding for Lending Scheme (FLS), first introduced in August 2012. Unfortunately this has had a detrimental effect on the Council's investment interest earnings.

<u>Prudential Indictors for Investments</u>

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

4.26 Maximum principal sum limits for investments for periods longer than 364 days maturing in:

2014/15 £12,000,000

2015/16	£12,000,000
2016/17	£12,000,000

4.27 Actual Performance (as at 30/09/14)

Matured or maturing within 2014/15	£0
Maturing in 12 to 24 months (2015/16)	£2,000,000
Maturing in 24 to 36 months (2016/17)	£0
Maturing in 36 to 48 months (2017/18)	£0

4.28 Interest Rate Exposure on Investments

Upper limit for fixed interest rate exposure	100%
Upper limit for variable interest rate exposure	35%

4.29 Actual Performance (as at 30/09/14)

Proportion of interest paid at fixed rates (April – September 2014)	100%
Proportion of interest paid at variable rates (April – September 2014)	24%

4.30 All of the Council's investments were placed with organisations approved in the Annual Treasury Management Strategy for 2014/15 and in accordance with the Prudential Indicators set out in that Strategy and with the Treasury Management Code of Practice.

4.31 Risk Benchmarking
A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are fairly new requirements to Member reporting, although the application of these is more subjective in nature. These were first set in the Treasury Strategy Report 26th January 2010 (Scrutiny and Audit Committee). The following reports the current position against the benchmarks originally approved.

4.32 Security
The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, was set as follows:

0.08% historic risk of default when compared to the whole portfolio.

The Strategic Director (Section 151 Officer) can report that the investment portfolio was maintained within this overall benchmark during this year to date.

Based on the Authority's minimum long-term credit rating of A/A3/A (Fitch/Moody's/Standard and Poor's) the security benchmarks for each individual year were set as:

Benchmarks	1 year	2 years	3 years	4 years	5 years
Maximum (01/04/14)	0.09%	0.25%	0.44%	0.62%	0.83%
Maximum (30/09/14)	0.08%	0.22%	0.38%	0.52%	0.71%

Since the benchmarks were first included in the Strategy our advisors have received more up to date default information, which reflects increased counterparty defaults during the banking crisis. The table shows how the Council is benchmarking risk.

The Strategic Director (Section 151 Officer) can report that these benchmarks were not breached during the year to date.

Note: The benchmarks are an average risk of default measure, and would not constitute an expectation of loss against a particular investment. Where a counterparty is not credit rated a proxy rating will be applied.

4.33 Liquidity

In respect of this area the Council set liquidity facilities/benchmarks to maintain:

- Bank overdraft - £100,000
- Liquid short term deposits of at least £2,000,000 available immediately.

The Strategic Director (Section 151 Officer) can report that liquidity arrangements were satisfactory during the year to date.

Yield - Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID (London Interbank BID) rate.

5. Corporate Implications

5.1 Legal Implications

The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the 2003 Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity.
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (no restrictions were made in the first six months of 2013/14).
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act.
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA *Prudential Code for Capital Finance in Local Authorities.*
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services.

- Under the Act the DCLG has issued *Guidance on Local Government Investments* to structure and regulate the Council's investment activities. Updated guidance became available on 1st April 2010.

The Council has complied with all of the above relevant statutory and regulatory requirements that limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

5.2 **Financial and Risk Implications**

Too high a reliance on investment income can place the Council at significant risk of budget variation as interest rates rise and fall which has a knock-on impact upon future Council Tax levels. The Council's Medium Term Financial Strategy (MTFS) addresses this risk and seeks to reduce this reliance over time.

Security of capital is cited in the Financial Services Risk Register (FIN 06) and this is mitigated by use of counterparty credit security ratings. The lowering of these ratings increases risk. It is felt that a credit rating of A is acceptable for the Council's risk profile (being 'top six' out of a possible 28 ratings) and represents upper quartile performance (Appendix A refers). Officers will also use supplementary credit information to monitor investment counterparties.

5.3 **Equalities Implications**

None within the report

5.4 **Employment Issues**

None within the report

5.5 **Sustainability Issues**

None within the report

5.6 **Consultation**

The Council is in regular contact with Capita Asset Services, the Council's appointed Treasury Management advisor. Conversations have been held during the first half-year involving Capita Asset Services and officers.

5.7 **Reputational Issues**

In undertaking Treasury Management activities, the Council is investing and potentially borrowing public money. In doing so, the Council must have regard to security, liquidity and yield of investments (in that order). The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code (CIPFA Prudential Code for Capital Finance in Local Authorities) and produce prudential indicators.

6. **Background papers**

Performance management information from Capita Asset Services.
CIPFA Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes (2011 edition).
CIPFA Treasury Management in the Public Services – Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (2011 edition).
CIPFA Prudential Code for Capital Finance in Local Authorities (2011 edition).
Treasury Management Annual Strategy Report 2014-15 and Prudential Indicators 2014-15 to 2016-17.

Appendix A – Hierarchy of Counterparty Security Ratings

Short Term		
Fitch	**Moody's**	**S&P**
F1+	P-1	A-1+
F1		A-1
F2	P-2	A-2
F3	P-3	A-3
B		B
C		C
D		D

Long Term			Description
Fitch	**Moody's**	**S&P**	(AAA = highest, D = lowest)
AAA	Aaa	AAA	Highest security
AA+	Aa1	AA+	
AA	Aa2	AA	
AA-	Aa3	AA-	
A+	A1	A+	
A	A2	A	
A-	A3	A-	
BBB+	Baa1	BBB+	
BBB	Baa2	BBB	
BBB-	Baa3	BBB-	
BB+	Ba1	BB+	
BB	Ba2	BB	
BB-	Ba3	BB-	
B+	B1	B+	
B	B2	B	
B-	B3	B-	
CCC+	Caa1	CCC+	
CCC	Caa2	CCC	
CCC-	Caa3	CCC-	
CC+	Ca	CC+	
CC	Ca	CC	
CC-	Ca	CC-	
C+	C	C+	
C	C	C	
C-	C	C-	
DDD	D	DDD	
DD	D	DD	
D	D	D	Lowest Security