

Agenda Item 8

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| Date | 28th November 2013 |

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| Subject | Treasury Management – Mid Year Monitoring Report – 2013/14. |
| <p>RECOMMENDATIONS</p> <p>The Committee is asked to:</p> <ol style="list-style-type: none"> 1) Receive and note the Treasury Management Mid Year Monitoring Report for the period ended 30th September 2013. 2) Commend the report to Council, making any relevant recommendations and observations as Members see fit. | |

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| <p>SUMMARY</p> <p>This report outlines the performance of the Treasury Management function of the Council for the six months ending 30th September 2013. It provides an update on the current economic conditions affecting Treasury Management decision making and looks ahead to future reporting requirements.</p> <p>The key points to note are:</p> <ul style="list-style-type: none"> • 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. <p>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:</p> <ul style="list-style-type: none"> • 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 |
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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 29th November 2012 and Council on 19th February 2013.

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 2013 and covers:
 - The general economic background for the 2013/14 financial year to 30th September 2013.
 - Capita Asset Services outlook for the next six months of 2013/14.
 - Update on amendments to the Treasury Management Strategy
 - Compliance with regulatory requirements (treasury and prudential limits), approved policies and practices for 2013/14.

2. **Economic Background**

- 2.1 During 2013/14 economic indicators suggested that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion the economy grew 0.7% in quarter 2. There have been signs of renewed vigour in household spending in the summer, with a further pick-up in retail sales, mortgages, house prices and new car registrations.
- 2.2 The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace and strong enough to reduce the level of unemployment further. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.0% year-on-year, well below the rate of inflation at 2.7% in September, causing continuing pressure on households' disposable income.
- 2.3 The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Together with the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years' pre 2008.
- 2.4 Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in quarter 2 started to come down, but only slowly, as Government expenditure cuts took effect and economic growth started to show through in a small increase in tax receipts. The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan, and monetary policy was unchanged in advance of the new Bank of England Governor, Mark Carney, arriving. The Bank Rate remained at 0.5% and quantitative easing also stayed at £375bn. In August, the Monetary Policy Committee (MPC) provided forward guidance that the Bank Rate is unlikely to change until unemployment first falls to 7%, which was not expected until mid 2016. However, 7% is only a point at which the MPC will review the Bank Rate, not necessarily take action to change it. The unemployment rate, at the end of September, of the economically active population was 7.6%.
- 2.5 Consumer Price Index (CPI) inflation (MPC target of 2.0%), fell marginally from a peak of 2.9% in June to 2.7% in September. The Bank of England expects inflation to fall back to 2.0% in 2015.
- 2.6 Financial markets sold off sharply following comments from Ben Bernanke (the Federal Reserve chairman) in June that suggested the Federal Reserve may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK. Equity prices fell initially too, as the Federal Reserve's

purchasing of bonds has served to underpin investor moves into equities out of low yielding bonds. However, as the market moves to realign its expectations, bond yields and equities are likely to rise further in expectation of a continuing economic recovery. Increases in payroll figures have shown further improvement, helping to pull the unemployment rate down from a high of 8.1% to 7.7%, and continuing house price rises have helped more households to escape from negative equity. In September, the Federal Reserve surprised financial markets by not starting 'tapering' as it felt the run of economic data in recent months had been too weak to warrant taking early action. Bond yields fell sharply as a result, though it still only remains a matter of time until 'tapering' does start.

- 2.7 Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth in quarter 2, so ending six quarters of Eurozone recession.

Capita Asset Services outlook for the next six months of 2013/14

- 2.8 Capita Asset Services is a trading name of Sector Treasury Services Limited and are the Council's treasury management advisors.
- 2.9 Economic forecasting remains difficult with so many external influences weighing on the UK. Volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities and safer bonds. Downside risks to UK gilt yields and Public Works Loans Board (PWLB) rates include:
- A return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations.
 - The potential for a significant increase in negative reactions of populaces in Eurozone countries against 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.
 - The Italian political situation is frail and unstable. The coalition government fell on 29th September.
 - Problems in other Eurozone, heavily indebted, countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts.
 - Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
 - Weak growth or recession in the UK's main trading partners, the EU and US, depressing economic recovery in the UK.
 - Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds.
- 2.10 Upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -
- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

- Increased investor confidence that sustainable robust world economic growth is firmly expected, together with a reduction or end of quantitative easing (QE) operations in the US, causing a further flow of funds out of bonds into equities.
- A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.
- In the longer term - a reversal of QE in the UK, this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.
- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and sustained recovery of economic growth, causing the ratio of total Government debt to Gross Domestic Product (GDP) to rise to levels that provoke major concern.

2.11 The overall balance of risks to economic recovery in the UK is now weighted to the upside after six months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last, and it remains exposed to vulnerabilities in a number of key areas. The longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Near-term, there is some residual risk of further QE if there is a dip in strong growth or if the MPC were to decide to take action to combat the market's expectations of an early first increase in the Bank Rate. If the MPC does takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years, such action could cause gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The tension in the US over passing a Federal budget for the new financial year starting on 1st October and raising the debt ceiling in mid October could also see bond yields temporarily dip until agreement is reached between the opposing Republican and Democrat sides. Conversely, the eventual start of 'tapering' by the Federal Reserve will cause bond yields to rise.

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

| | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 | Jun-15 | Sep-15 | Dec-15 | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 |
|----------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Bank rate | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.75% | 1.00% | 1.25% |
| 5yr PWLB rate | 2.50% | 2.50% | 2.50% | 2.60% | 2.70% | 2.70% | 2.80% | 2.80% | 2.90% | 3.00% | 3.20% | 3.30% | 3.50% | 3.60% | 3.70% |
| 10yr PWLB rate | 3.70% | 3.70% | 3.70% | 3.70% | 3.80% | 3.80% | 3.90% | 4.00% | 4.10% | 4.20% | 4.30% | 4.40% | 4.50% | 4.60% | 4.60% |
| 25yr PWLB rate | 4.40% | 4.40% | 4.40% | 4.40% | 4.50% | 4.50% | 4.60% | 4.70% | 4.80% | 4.90% | 5.00% | 5.10% | 5.10% | 5.10% | 5.20% |
| 50yr PWLB rate | 4.50% | 4.40% | 4.40% | 4.40% | 4.50% | 4.60% | 4.70% | 4.80% | 4.90% | 5.00% | 5.10% | 5.20% | 5.20% | 5.20% | 5.30% |

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

2.13 Expectations for the first change in the Bank Rate in the UK are now dependent on how to forecast when unemployment is likely to fall to 7%. Financial markets have taken a very contrary view to the MPC and have aggressively raised short term interest rates and gilt yields due to their view that the strength of economic recovery is now so rapid that unemployment will fall much faster than the Bank of England forecasts. They therefore expect the first increase in Bank Rate to be in quarter 4 of 2014. There is much latitude to disagree with this view as the economic downturn since 2008 was remarkable for the way in which unemployment did not rise to anywhere near the extent likely, unlike in previous recessions. This meant that labour was retained, productivity fell and now, as the MPC expects, there is major potential for unemployment to fall only slowly as existing labour levels are worked more intensively and productivity rises back up again. The size of the work force is also expected to increase relatively rapidly and there are many currently self employed or part time employed workers who are seeking full time employment. Capita Asset Services take the view that the unemployment rate is not likely to come down as quickly as the financial markets are currently expecting and that the MPC view is more realistic. The prospects for any increase in Bank Rate before 2016 are therefore seen as being limited. However, some forecasters are forecasting that even the Bank of England forecast is too optimistic as to when the 7% level will be reached and so do not expect the first increase in Bank Rate until spring 2017.

3. **Amendments to the Treasury Management Strategy**

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 2013/14 was approved by the Council on 19th February 2013 there have been no changes to the Strategy in the half year to 30th September 2013.

4. **Compliance with Regulatory Requirements (Treasury and Prudential Limits), Approved Policies and Practices for 2013/14.**

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 2013/14 were set in accordance with the Prudential Code and the Treasury Management Code of Practice and were approved by Council on 19th February 2013. 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 | 2013/14 Original £m | 2013/14 Updated £m | 2014/15 Estimate £m | 2015/16 Estimate £m | 2016/17 Estimate £m |
|--|--------------------------------|-------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Capital Expenditure | 3.136 | 7.384 | 2.674 | 2.624 | 2.624 |
| Financed by: | | | | | |
| Capital receipts | 2.264 | 5.567 | 2.054 | 2.004 | 1.206 |
| Government grants | 0.272 | 0.272 | 0.270 | 0.270 | 0.270 |
| Other grants and conts. | 0.600 | 1.545 | 0.350 | 0.350 | 0.350 |
| Revenue | 0 | 0 | 0 | 0 | 0.798 |
| 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:

| | 2013/14 Original £m | 2013/14 Revised £m | 2014/15 Estimate £m | 2015/16 Estimate £m | 2016/17 Estimate £m |
|-------------------------------------|--------------------------------|-------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Capital Financing Requirement (CFR) | 3.212 | 3.091 | 2.791 | 2.491 | 2.191 |

Borrowing

- 4.6 There is no requirement to borrow to fund the capital programme in 2013/14 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 2013/14 and the next two financial years. This would allow some flexibility for limited early borrowing for future years.

| | 2013/14 Original Estimate £m | 2013/14 Revised Estimate £m |
|---|---|--|
| External debt | | |
| Debt at 1 st April | 0 | 0 |
| Expected change in debt | 0 | 0 |
| Other long-term liabilities (OLTL) | 3.5 | 3.1 |
| Expected change in OLTL | (0.3) | (0.3) |
| Actual gross debt at 31st March | 3.2 | 2.8 |
| Capital Financing Requirement | 3.2 | 3.1 |
| Under/(over) borrowing | 0.0 | 0.3 |

- 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 19th February 2013 included for an Authorised Limit of £5,500,000. The cost of finance leases included within the Authorised Limit in 2012/13 amounted to £3,124,000.
- 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 19th February 2013 included for an Operational Boundary of £4,000,000. The cost of finance leases included within the Operational Boundary in 2012/13 amounted to £3,124,000.

- 4.11 Actual borrowing 1st April – 30th September 2013
 Maximum external borrowings at any one time 0
 Total borrowings during period 0
 Debt repaid during period 0
- 4.12 Actual External Debt
 Actual borrowing as at 30th September 2013 0
 Actual other long term liabilities at 30th September 2013 £3.1m
 Actual external debt as at 30th September 2013 £3.1m
- 4.13 NB – 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 Interest Rate Exposure on Borrowing
 Upper limit for fixed interest rate exposure 0%
 Upper limit for variable interest rate exposure 0%
- 4.15 Actual Performance
 Proportion of interest paid at fixed rates 0%
 Proportion of interest paid at variable rates 0%
- 4.16 Maturity Structure of Borrowings
 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.

| | 2012/13 Actual £m | 2013/14 Estimate £m | 2013/14 Estimate 30/09/13 £m | 2014/15 Estimate £m | 2015/16 Estimate £m |
|-------------------------|-------------------------|---------------------------|---------------------------------------|---------------------------|---------------------------|
| Interest on borrowing | 0 | 0 | 0 | 0 | 0 |
| Interest on investments | 0.342 | 0.320 | 0.383 | 0.477 | 0.498 |

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 £36 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 2013/14 are as follows:

| | Investments at 01/04/2013 £m | Investments at 30/09/2013 £m |
|-------------------------------|------------------------------------|------------------------------------|
| Temporary investments | 20.452 | 22.393 |
| Long-term investments | 4.000 | 2.000 |
| Total investments outstanding | 24.452 | 24.393 |

4.21 The constituent parts of the investment position as at 30th September 2013 are:

| Sector | Country | Up to 1 year £m | 1 - 2 years £m | 2 – 3 years £m | 3 - 5 years £m |
|---------------------------|---------|--------------------|-------------------|-------------------|-------------------|
| Banks | UK | 16.893 | 2.000 | 0 | 0 |
| Building Societies | UK | 5.500 | 0 | 0 | 0 |
| Total | | 22.393 | 2.000 | 0 | 0 |

4.22 Members will recall that as part of the Treasury Management Strategy Report 2013/14 to 2015/16 agreement was given to increased licence in terms of the scope and range of its investments. The change was required as initial preparatory work on the Medium Term Financial Strategy had demonstrated an imbalance between reducing funding sources and increased costs.

- 4.23 The focus of the new strategy remained primarily on safeguarding sufficient of the Council's balances in secure and liquid investments to ensure overall stability. However, it was recommended that between £8m and £12m could be diverted in the interests of securing a higher return and providing a more substantial income stream for the Council's revenue account. This was dependent on the options that became available. These options would include extending the investment portfolio (eg through longer term investments or property funds) and/or diverting part of the investment portfolio into property purchases.
- 4.24 On 27th June 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 are anticipated.
- 4.25 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.

Prudential Indicators for Investments

- 4.26 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.
- 4.27 Maximum principal sum limits for investments for periods longer than 364 days maturing in:
- | | |
|---------|-------------|
| 2013/14 | £12,000,000 |
| 2014/15 | £12,000,000 |
| 2015/16 | £12,000,000 |
- 4.28 Actual Performance (as at 30/09/13)
- | | |
|---------------------------------------|------------|
| Matured or maturing within 2013/14 | £2,000,000 |
| Maturing in 12 to 24 months (2014/15) | £0 |
| Maturing in 24 to 36 months (2015/16) | £2,000,000 |
| Maturing in 36 to 48 months (2016/17) | £0 |
- 4.29 Interest Rate Exposure on Investments
- | | |
|---|------|
| Upper limit for fixed interest rate exposure | 100% |
| Upper limit for variable interest rate exposure | 60% |
- 4.30 Actual Performance
- | | |
|--|------|
| Proportion of interest paid at fixed rates (April – September 2013) | 100% |
| Proportion of interest paid at variable rates (April – September 2013) | 8% |

4.31 All of the Council's investments were placed with organisations approved in the Annual Treasury Management Strategy for 2013/14 and in accordance with the Prudential Indicators set out in that Strategy and with the Treasury Management Code of Practice.

4.32 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.

4.33 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/A2/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 (01/04/13) | 0.08% | 0.22% | 0.37% | 0.52% | 0.70% |
| Maximum (30/09/13) | 0.08% | 0.24% | 0.41% | 0.57% | 0.76% |

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.

4.34 Liquidity

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

- Bank overdraft - £500,000
- 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. Meetings have been convened during the first half-year involving Capita Asset Services, Officers and Members.

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 2013-14 and Prudential Indicators 2013-14 to 2015-16.

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 |

