TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

07 April 2015

Report of the Director of Finance and Transformation

Part 1- Public

Delegated

1 TREASURY MANAGEMENT UPDATE

This report provides an update on treasury management activity undertaken during the 2014/15 financial year within the context of the national economy and invites Members to endorse the action take by officers and note the treasury position at the end of February 2015.

1.1 Introduction

1.1.1 CIPFA issued a revised Code of Practice for Treasury Management in November 2009. The revised Code was adopted by the Council on 18 February 2010 and suggests that Members should be informed of Treasury Management activity at least twice a year, but preferably quarterly. This report ensures the Council is embracing Best Practice in accordance with CIPFA's revised Code of Practice and subsequent updates.

1.2 Economic Background

1.2.1 Economic growth in the UK slowed in the final quarter of 2014, with GDP rising by 0.5% compared to 0.7% in the previous quarter. Nevertheless, growth of 2.6% for the year as a whole made 2014 the best overall performance since 2007. Growth is expected to continue rising at similar levels in 2015 (2.5%) and 2016 (2.3%).

1.2.2 Inflation as measured by the Consumer Price Index (CPI) has continued to fall on the back of falling oil prices to a record low of 0.3% in January 2015. Inflation is expected to fall further and may turn negative late spring / early summer. Weak inflation, substantially below the 2% target, is perceived by the markets as sound reason for the Monetary Policy Committee (MPC) not to raise the Bank Rate in the near term.

1.2.3 The Chancellor's 2015 budget contained no major changes to the tone of fiscal policy. The programme of cuts in Government expenditure will continue in order to return the current budget deficit to a surplus in 2018/19.

1.2.4 On the international front the US Federal Reserve retained the current US base rate of 0.25% at its monthly meeting in March. The accompanying statement omitted the word ‘patient’ with regard to initiating normalisation of monetary policy, reinforcing market expectation of a rate rise this summer.

1.2.5 After several months of speculation the European Central Bank (ECB) announced a programme of quantitative easing (QE) to boost the ailing euro-zone economy. €60bn of public and private sector securities are expected to be purchased on a monthly basis from March 2015 until September 2016.

1.2.6 Following the formation of a coalition government headed by an anti-austerity party, negotiations on the restructuring Greek debt continue. The process has not been without its problems in recent weeks resulting in market volatility.

1.3 Interest rate forecast

1.3.1 The Bank Rate has remained at an emergency level of 0.5% for the last 6 years. Capita’s latest forecast, updated in February 2015, anticipates the Bank Rate will remain at this level for a further 9 months before rising in the first quarter of 2016.

Rate	**Now** %	**Jun-15** %	**Sep-15** %	**Dec-15** %	**Mar-16** %	**Jun-16** %	**Sep-16** %	**Dec-16** %	**Mar-17** %	**Jun-17** %	**Sep-17** %	**Dec-17** %
Bank Rate	**0.50**	**0.50**	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.25**	**1.25**	**1.50**	**1.50**	**1.75**
3 mth LIBID	**0.50**	**0.50**	**0.50**	**0.60**	**0.80**	**0.90**	**1.10**	**1.30**	**1.40**	**1.50**	**1.80**	**1.90**
6 mth LIBID	**0.65**	**0.70**	**0.70**	**0.80**	**1.00**	**1.10**	**1.30**	**1.50**	**1.60**	**1.70**	**2.00**	**2.10**
12 mthLIBID	**0.93**	**1.00**	**1.00**	**1.10**	**1.30**	**1.40**	**1.60**	**1.80**	**1.90**	**2.00**	**2.30**	**2.40**
25yr PWLB	**3.20**	**3.40**	**3.60**	**3.80**	**3.90**	**4.00**	**4.20**	**4.30**	**4.40**	**4.50**	**4.60**	**4.60**

1.4 Investment Performance

1.4.1 In accordance with the CIPFA Code the Council’s priorities in order of importance are: to ensure security of capital; liquidity; and having satisfied both, to obtain an appropriate level of return which is consistent with the Council’s risk appetite.

1.4.2 Cash flow funds are available on a temporary basis and their amount varies from month to month and during the course of each month depending on the timing of receipts (council tax, business rates, grants and other sources of income) and payments (precepts, NNDR pool contributions, benefits, staff and suppliers). In addition the Council has £13.4m of core cash balances available for investment. These funds which comprise our revenue and capital reserves are for the most part available to invest for more than one year.

1.4.3 As at the end of February 2015, funds invested and interest earned is set out in the table below.

	Funds invested at 28 Feb 2015 £m	Average duration to maturity Years	Weighted average rate of return %	Interest earned to 28 Feb 2015 £	Gross annualised return %	7 day LIBID benchmark %
In-house cash flow	9.1	0.03	0.68	65,050	0.64	0.35
Externally managed core funds to 31 July	-	0.78 [1]	0.61 [1]	27,900	0.62	0.35
In-house managed core funds from 1 August	13.4	0.15	0.72	58,050	0.74	0.35
Total	22.5	0.10	0.71	151,000	0.67	0.35

[1] Figures shown for comparative purposes represent the values applicable to the externally managed portfolio on 31 July, the day before transfer to in-house management.

1.4.4 The authority bettered the 7 day LIBID benchmark by 32 basis points and interest earned of £151,000 is £4,900 better than our 2014/15 revised estimate for the same period.

1.4.5 A full list of investments held on 27 February 2015 and our lending list of the same date are provided at **[Annex 1]** and **[Annex 2]**.

1.4.6 The Council participates in Capita's benchmarking service which enables the Council to gauge performance against Capita's other local authority clients. An extract from the latest benchmarking data is provided in the form of a scatter graph at **[Annex 3]**. The graph shows the return (vertical scale) against credit / duration risk (horizontal scale) associated with an authority's investments. At the end of December 2015 our return (purple diamond) outperformed that anticipated by the model based on our exposure to credit / duration risk. At 0.71% our return also bettered the non-metropolitan district average of 0.69% and the overall population average (includes county councils, unitary, police and fire authorities) of 0.68%.

1.4.7 **Cash Flow Funds**. Our daily cash flow balances for the year ahead are modelled at the start of the financial year. That cash flow model is then updated daily and reviewed on a regular basis. The majority of our cash flow surpluses are invested overnight in bank deposit accounts and money market funds to ensure sufficient short term liquidity to meet payment obligations. However, when cash surpluses permit, fixed term investments are also undertaken to take advantage of the higher yields available from this type of investment.

1.4.8 **Core Funds**. Historically these funds have been managed by an external fund manager and are used to support both revenue and capital expenditure. The core fund balance has been reducing in recent years and will continue to diminish over the next few years as the Council grapples with savings targets to achieve a balanced budget. The core fund balance has diminished to a level where in-house management is practical without the need for additional staff resources. As a consequence the 2014/15 Annual Investment Strategy made provision for these funds to be transferred in-house and contribute to future savings targets through reduced fund management fees. The transfer to in-house management took place on 1 August 2014.

1.4.9 On 1 August all tradable instruments (Gilts, Treasury Bills and Certificates of Deposit) which comprised the lion's share (£12.6m) of the core fund were transferred to the Council's custody account with King & Shaxon and the cash balance (£0.8m) transferred to the Council's bank account. With the exception of the Gilts (£2.2m, maturing 2018) the fund manager's preference for short duration instruments, typically three months in duration, explains their poor performance relative to in-house cash flow management identified in the table above (paragraph 1.4.3).

1.4.10 All the investments acquired by the external fund manager, including the Gilt, have now been reinvested by the Council's in-house team. On reinvestment, duration was extended and as a consequence returns have improved (0.74% in-house vs the external fund manager's 0.62%).

1.5 Borrowing

1.5.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits" by way of the Prudential Indicators (affordability limits) set out in the approved Treasury Management Strategy Statement. In this regard it is confirmed that no borrowing was undertaken in the period April 2014 to February 2015.

1.6 Compliance with the Annual Investment Strategy

1.6.1 Throughout the period April 2014 to February 2015 the requirements set out in the 2014/15 Annual Investment Strategy which aim to limit the Council's exposure to investment risks (minimum counterparty credit criteria; sovereign, counter-party and group exposure limits; type of investment instrument; and investment duration limits) have been complied with.

1.7 Legal Implications

1.7.1 Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority including securing effective arrangements for treasury management. In addition, Capita are employed to provide independent advice on legislative and professional changes that impact on the treasury management function.

1.8 Financial and Value for Money Considerations

1.8.1 The Bank Rate has remained at a historical low (0.5%) for a sixth successive year. The Funding for Lending initiative introduced by the Bank of England in summer 2012 had a significant downward impact on returns being offered by financial institutions at the time and that impact has continued. At the end of February 2015, investment income of £151,000 has been earned exceeding our revised estimate for the same period by £4,900.

1.8.2 Performance is monitored against a benchmark return (7 Day LIBID) and against other local authorities in Kent and the broader local authority pool via Capita's benchmarking service.

1.9 Risk Assessment

1.9.1 The application of best practice, including the regular reporting and scrutiny of treasury management activity, as identified by the CIPFA Code is considered to be an effective way of mitigating the risks associated with treasury management.

1.10 Equality Impact Assessment

1.10.1 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act.

1.11 Recommendations

1.11.1 Members are invited to **recommend** that Cabinet:

1) endorse the action taken by officers in respect of treasury management activity for the period April 2014 to February 2015, and

2) note the treasury position at the end of February 2015.

Background papers: contact: Mike Withey

Forecast and benchmarking data provided by Capita.

Sharon Shelton
Director of Finance and Transformation