POLICY & RESOURCES COMMITTEE	Agenda Item 94 Brighton & Hove City Council

Subject:		**Treasury Management Policy Statement 2014/15 (including Annual Investment Strategy 2014/15) – Mid Year Review**	
Date of Meeting:		**4 December 2014**	
Report of:		**Executive Director of Finance & Resources**	
Contact Officer:	**Name:**	**James Hengeveld**	**Tel: 29-1242**
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Ward(s) affected:		**All**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2014/15 Treasury Management Policy Statement (TMPS), practices and schedules were approved by Policy & Resources on 20 March 2014. The TMPS sets out the role of Treasury Management, whilst the practices and schedules set out the annual targets and methods by which these targets will be met.

1.2 The TMPS includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash funds and was approved by Full Council on 27 March 2014.

1.3 It is recommended good and proper practice that Members receive half yearly reports and review and endorse treasury management actions during the year. The purpose of this report is to advise of the action taken in the first half of 2014/15.

2. RECOMMENDATIONS:

2.1 That Policy & Resources Committee endorses the key actions taken during the first half of 2014/15 to meet the treasury management policy statement and practices (including the investment strategy) as set out in this report.

2.2 That Policy & Resources Committee notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised limit and operational boundary have not been exceeded in the first half of the year.

3. CONTEXT/ BACKGROUND INFORMATION

Overview of Markets

3.1 The UK GDP has seen very strong growth in the last 3 quarters of 2013 (resulting in an annual growth of 2.7% in 2013), and the first two quarters of 2014, plus further strength suggested in quarter 3 estimates (which puts annual growth at 3.1% in quarter 3). It appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for both the construction and services sectors are encouraging, as is the recovery seen in business investment. The manufacturing sector has also been encouraging, though latest figures indicate a weakening in the future trend rate of growth. However, for the recovery to become more sustainable in the longer term, it needs to move away from dependence on consumer expenditure and the housing market.to exporting, and particularly of manufacturing goods, both of which need to substantially improve.

3.2 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.

3.3 Also encouraging has been the sharp decline in inflation, with CPI reaching 1.2% in September (The lowest rate since 2009). Forward indications suggest that it is likely to fall further in 2014. Thus, markets are expecting the MPC to be cautious in raising Bank Rate as it will want to protect heavily indebted consumers at a time where inflationary pressures are also weak. The Council's Treasury Advisors (and a number of other economists) have put back the expectation of a Bank Rate risk to Quarter 2 2015. They also expect rate rises to be at a much slower pace and to peak at lower levels than previous patterns.

3.4 The Eurozone (EZ) 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 0.30%. However, this is an average for all EZ countries and includes some countries currently running with a negative rate of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. Further action was taken in September, which resulted in setting a negative deposit rate of -0.2%, and started a programme of purchasing corporate debt. EZ sovereign difficulties subsided in 2013, but have not gone away, and major issues could return in respect of any countries that do no dynamically address fundamental issues of low growth, lack of international competitiveness, and the need for overdue reforms of the economy.

3.5 The expected delay in any increase in the Bank Rate is likely to supress the Council's Income from its investment portfolio. However, long term borrowing rates are also supressed in the current market, and therefore borrowing requirements for capital projects will be at a lower cost than earlier projections. Officers have carried out analysis on the current borrowing rates for future capital investment requirements and have assessed that the cost of carrying debts in advance of need is too great given the very low investment rates. Therefore it is not the right time for the council to borrow.

Treasury Management Strategy

3.6 A summary of the action taken in the six months to September 2014 is provided in Appendix 1 to this report and further information on borrowing and investment performance is shown in the September 2014 Bulletin at Appendix 2. The main points are:

- The council did not enter into any new borrowing arrangements during the period;
- The highest risk indicator during the period was 0.039% which is below the maximum set of 0.050%;
- The return on investments by the in-house treasury team and cash manager has exceeded the target rates.
- The two borrowing limits approved by full Council have not been exceeded.

3.7 Treasury management activity in the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1st Apr 2014 to 30 Sep 2014			
	Fixed deposits	Money market funds	Total	
Up to 1 week		£234.9m	£234.9m	77%
Between 1 week & 1 month	£7.0m		£7.0m	2%
Between 1 month & 3 months	£20.1m	£2.5m	£22.6m	8%
Over 3 months	£38.8m	-	£38.8m	13%
	£65.9m	**£237.4m**	**£303.30m**	**100%**

Summary of Treasury Activity April to September 2014

3.8 The following table summarises the treasury activity in the half year to September 2014 compared to the corresponding period in the pervious year.

April to September	2013/14	2014/15
Long-term borrowing repaid	-	-
Short-term borrowing repaid	-	-
Investments made	£350.0m	£303.3m
Investments maturing	(£311.0m)	(£296.6m)

3.9 The Financing Costs budget reported a breakeven position at Month 5. Within the budget, a saving generated by delaying long term borrowing, which is offsetting a pressure caused by lower cash balances for investment in the first half of the year. In addition there is expectation that short term borrowing will fund cash flows in the later part of the year.

3.10 Long term borrowing has been delayed in order to reduce the pressure caused by the difference between borrowing and investment rates. Officers are exploring the use of forward borrowing for capital investment in future years as this could provide certainty of future revenue costs, lock in to lower rates now, and avoid the cost of carry.

3.11 The following table summarises how the day-to-day cash flows in the first half-year have been funded compared to the same period in the previous year.

April to September	2013/14	2014/15
Cash flow surplus – general HRA Settlement Payment	£39.0m -	£11.3m -
Net cashflow surplus	**£39.0m**	**£11.3m**
Represented by: Increase in long-term borrowing Change in short-term borrowing Change in investments Change in bank balance	 - - (£39.0m) -	 - - (£6.7m) (£4.6m)

Security of Investments

3.12 A summary of investments made by the in-house treasury team and outstanding as at 30 September 2014 in the table below shows that investments continue to be held in good quality, short term instruments. The funds invested in BBB institutions included in the table below are invested in the part-nationalised banks which are backed by Government guarantee in line with the AIS.

'AAA' rated money market funds	£3.26m	6%
'AA' rated institutions	£2.00m	3%
'A' rated institutions	£45.53m	77%
'BBB' rated institutions	£8.50m	14%
Total	**£59.29m**	**100%**
Period – less than one week	£13.26m	23%
Period – between one week and one month	£18.51m	31%
Period – between one month and three months	£19.02m	32%
Period – between three months and 1 year	£8.50m	14%
Total	**£59.29m**	**100%**

Municipal Bonds Agency Investment

3.13 Policy & Resources delegated the authority to invest a maximum of £50,000, classified as capital expenditure, in an equity stake in the Municipal Bonds Agency. Following a meeting with the Local Government Agency and a review of the Agency's Business Case, there is a strong case for supporting the formation of the Agency in order to deliver potentially substantially lower future borrowing costs to the Local Government community.

3.14 The Executive Director of Finance & Resources has signed a Subscription Agreement which commits the authority to £25,000 in the initial subscription phase (£10,000 of which was drawn down by the Agency on 30th September 2014). The Subscription Agreement additionally sets out the Authority's intention to commit a further £25,000 in the second subscription.

Risk

3.15 As part of the investment strategy for 2014/15 the Council agreed a maximum risk benchmark of 0.050% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures the risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.009% and 0.039% between April 2014 and September 2014. It should be remembered however that the benchmark is an average risk of default measure, and does not constitute an expectation of loss against a particular investment.

3.16 In January 2014, Internal Audit and Business Risk undertook an audit of the treasury management function. The audit concluded that "substantial assurance" is provided on the effectiveness of the control framework operating and mitigating risks for treasury management.

Performance

3.17 The following table summarises the performance on investments compared with the budgeted position and the benchmark rate.

(*) Annualised rates	In-house investments		Cash manager investments	
	Average balance	Average rate (*)	Average balance	Average rate (*)
Budget 2014/15– full year*	£67.9m	0.63%	£25.3m	0.70%
Actual to end Sept 2014	£88.6m	0.65%	£25.3m	0.87%
Benchmark rate (i.e. 7 day LIBID Rate) to end Sept 2014	-	0.35%	-	0.35%

**please note this is an average for the full year –profile of balances are higher in the first half of the year and are expected to reduce over the financial year.*

3.18 The council is now part of a regional benchmark club which shares investment strategies and performance on a confidential basis. The benchmarking data demonstrates that the council's investment portfolio is performing in line with expectations.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report sets out action taken in the six months to September 2014. Treasury management actions have been carried out within the parameters of the AIS, TMPS and Prudential Indicators. Therefore no alternative options have been considered.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted over the content of this report. No other consultation was necessary.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as “best and proper practice” under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year’s performance. This report fulfils this requirement.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraph 3.6.

Finance Officer Consulted: James Hengeveld Date: 07/11/14

Legal Implications:

7.2 The TMPS and associated actions are exercised under powers given to the council by Part 1 of the Local Government Act 2003 which includes the power for a local authority to invest for the purposes of the prudent management of its financial affairs (section 12).

Lawyer Consulted: Oliver Dixon Date: 10/11/14

Equalities, Sustainability and other significant implications:

7.3 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. A summary of the action taken in the period April 2014 to September 2014

2. September 2014 Treasury Management Bulletin

Documents in Members' Rooms

None

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations

2. The Treasury Management Policy Statement and associated schedules 2014/15 approved by Policy & Resources on 20 March 2014

3. The Annual Investment Strategy 2014/15 approved by full Council on 27 March 2014

4. Treasury Management Policy Statement 2013/14 (including Annual Investment Strategy 2013/14) – End of year Review approved by Policy & Resources Committee on 11 July 2014

5. Papers held within Financial Services, Finance & Resources Directorate

6. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2011