# EXECUTIVE BOARD - 18 NOVEMBER 2014

| | | | |
|---|---|---|---|
| **Subject:** | Treasury Management 2014/15 Half Yearly Update | | |
| **Corporate Director(s)/ Director(s):** | Glen O'Connell, Acting Corporate Director for Resources | | |
| **Portfolio Holder(s):** | Councillor Graham Chapman, Deputy Leader/Portfolio Holder for Resources and Neighbourhood Regeneration | | |
| **Report author and contact details:** | Geoff Walker, Acting Director of Strategic Finance<br>0115 8764157<br>geoff.walker@nottinghamcity.gov.uk | | |
| **Key Decision** | ☐ Yes ☒ No | **Subject to call-in** | ☒ Yes ☐ No |
| **Reasons:** ☐ Expenditure ☐ Income ☐ Savings of £1,000,000 or more taking account of the overall impact of the decision | | | ☐ Revenue ☐ Capital |
| Significant impact on communities living or working in two or more wards in the City | | | ☐ Yes ☐ No |
| **Total value of the decision:** Nil | | | |
| **Wards affected:** All | | **Date of consultation with Portfolio Holder(s):** Throughout the financial year to date | |

| **Relevant Council Plan Strategic Priority:** | |
|---|---|
| Cutting unemployment by a quarter | ☒ |
| Cut crime and anti-social behaviour | ☒ |
| Ensure more school leavers get a job, training or further education than any other City | ☒ |
| Your neighbourhood as clean as the City Centre | ☒ |
| Help keep your energy bills down | ☒ |
| Good access to public transport | ☒ |
| Nottingham has a good mix of housing | ☒ |
| Nottingham is a good place to do business, invest and create jobs | ☒ |
| Nottingham offers a wide range of leisure activities, parks and sporting events | ☒ |
| Support early intervention activities | ☒ |
| Deliver effective, value for money services to our citizens | ☒ |


**Summary of issues (including benefits to citizens/service users):**

This report sets out details of treasury management actions and performance from 1 April 2014 to 30 September 2014:

- no new long-term borrowing or debt rescheduling had been undertaken to 30 September 2014;
- the average return on investments to 30 September 2014 was 0.640%;
- there has been compliance with Prudential Indicators for 1 April to 30 September 2014;
- the HRA fixed £19.161m of internal borrowing for 30 years at 4.31%.


**Exempt information:**

None

**Recommendation(s):**

**1** To note the treasury management actions taken in 2014/15 to date.

## 1 REASONS FOR RECOMMENDATIONS

1.1 To ensure that Councillors are kept informed of the actions taken by the Chief Finance Officer (CFO) under delegated authority. The currently adopted Treasury Management Code of Practice requires the CFO to submit at least three reports on treasury management each year; a policy and strategy statement for the ensuing financial year, a 6-monthly progress report and an outturn report after the end of the financial year. The Code also requires that the reports be considered by relevant scrutiny or executive committees, and that the City Council approves any treasury management strategy decisions.

## 2 BACKGROUND (INCLUDING OUTCOMES OF CONSULTATION)

2.1 Treasury management is defined as the management of an organisation's cash flows, borrowings and investments, together with the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks. Since 1 April 2004, local authorities have been required to have regard to the Prudential Code. This Code requires treasury management to be carried out in accordance with good professional practice. The Council retains external advisors to support this activity.

2.2 In respect of external investments, the Council is also required to ensure that the Department for Communities and Local Government (CLG) guidance is followed, with the priorities being, in order:

- security of the invested capital;
- liquidity of the invested capital; and
- commensurate with security and liquidity, an optimum return on those investments.

2.3 The successful identification, monitoring and control of risk are the prime criteria by which the effectiveness of our treasury management activities is measured. Treasury management risks are identified in the Treasury Management Practices document. The main risks to the Council's treasury activities are:

- liquidity risk (inadequate cash resources);
- market or interest rate risk (fluctuations in interest rate levels and, thereby, in the revenue impacts of loans and investments);
- inflation risks (exposure to inflation);
- credit and counterparty risk (security of investments);
- refinancing risks (impact of debt maturing in future years);
- legal and regulatory risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

## 3 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

No other options were considered as the report is required by the Treasury Management Code of Practice.

## 4 TREASURY MANAGEMENT ACTIVITY TO 30 SEPTEMBER 2014

4.1 2014/15 Strategy

The overall Treasury Management Strategy for 2014/15 was approved by the City Council on 3 March 2014. **Table 1** summarises the actions taken to 30 September 2014 against each of the main three elements of that strategy:

| TABLE 1: TREASURY MANAGEMENT ACTIONS | |
|---|---|
| **Strategy 2014/15** | **Actions to 30 September 2014** |
| **New borrowing** – to raise up to £24.6m to finance new capital expenditure in the year and replace maturing long-term debt. | To 30 September, no new long-term borrowing had taken place (see 4.3). |
| **Debt rescheduling** – to consider any debt rescheduling or repayment opportunities which enable revenue savings to be generated in the year. | To 30 September, no debt rescheduling had taken place (see 4.4). |
| **Investments** – to ensure the security of funds invested through the application of a restricted counterparty list and the imposition of limits on the period and levels of individual investments. Within those confines, to maximise the return on investments. | The average return on investments from 1 April to 30 September 2014 was 0.64%. The benchmark average 7-day London Inter-Bank Bid (LIBID) rate for the same period was 0.347%. The 2014/15 budget assumed an average return of 0.68% for the period (see 4.6). |

4.2 Interest rates during 2014/15

The Bank of England Base Interest Rate of 0.50% has been so far unchanged in 2014. Although the UK has shown some positive signs of economic recovery during the year, this recovery is developing slowly and it is currently expected that the base rate will remain at its present level for at least the first half of 2015.

Short-term interest rates have continued to be kept low by a combination of the Government's Quantitative Easing and Funding for Lending programmes, designed to increase the liquidity in financial markets. The Bank of England's 'forward' guidance from the Monetary Policy Committee (MPC) has reinforced the view that increases to base interest rates will only begin when the economic recovery is deemed to be sustainable. Key indicators include the degree of spare capacity in the economy, growth in exports and earnings growth. The MPC emphasised that when Bank Rate did begin to rise, it was expected to do so gradually and would likely remain below average historical levels for some time to come.

This expectation has seen a small increase to short-term interest rates over the last few months however, weakness in the Eurozone economy is becoming an growing risk to the UK recovery and could damage confidence and disrupt financial markets.

Longer-term interest rates increased during 2013/14 across all periods, however, in the first 6 months of 2014/15 rates have fallen back as guilt yields react to the escalation of geo-political risks in the Middle East and the Ukraine alongside the slide towards deflation within the Eurozone.

**Table 2** shows actual interest rates for the half-year from 1 April:

| TABLE 2: INTEREST RATES 2014/15 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Date** | **Base Rate** | **1 month** | **3 month** | **6 month** | **1 year** | **5 year** | **20 year** | **40 year** |
| | **%** | **%** | | | | | | |
| 1 Apr | 0.50 | 0.42 | 0.46 | 0.56 | 0.84 | 2.03 | 3.24 | 3.26 |
| 30 Apr | 0.50 | 0.42 | 0.47 | 0.57 | 0.85 | 2.02 | 3.19 | 3.23 |
| 31 May | 0.50 | 0.43 | 0.48 | 0.67 | 0.87 | 1.98 | 3.14 | 3.19 |
| 30 Jun | 0.50 | 0.43 | 0.50 | 0.71 | 0.94 | 2.17 | 3.22 | 3.25 |
| 31 Jul | 0.50 | 0.43 | 0.50 | 0.72 | 0.97 | 2.17 | 3.07 | 3.07 |
| 31 Aug | 0.50 | 0.43 | 0.50 | 0.77 | 0.98 | 1.93 | 2.77 | 2.78 |
| 30 Sep | 0.50 | 0.43 | 0.51 | 0.66 | 1.00 | 1.99 | 2.83 | 2.86 |

4.3 Borrowing

The continuing low return on short-term investments, coupled with the ready availability of cheap short-term borrowing, has led to the deferral in the raising of long-term borrowing in the last 3 financial years, with a combination of internal cash balances and short-term debt being used as a preferred source of finance. Although long-term borrowing costs are projected on an upward path through the medium-term, the margins between short and long-term interest rates remains an important influence on the Council's borrowing strategy and no new long-term borrowing was raised to 30 September. Existing cash surpluses have been used to fund maturing debt in the year. **Table 3** summarises the Council's outstanding external debt at 30 September 2014 showing the value of debt and the average interest rate payable on the debt:

| TABLE 3: DEBT PORTFOLIO | | |
|---|---|---|
| | **30 SEP 2014** | |
| **DEBT** | **£m** | **%** |
| PWLB borrowing | 641.9 | 3.830 |
| Market loans | 49.0 | 4.348 |
| Local bonds & stock | 0.9 | 3.263 |
| Temporary borrowing | 6.0 | 0.450 |
| **TOTAL DEBT** | **697.8** | **3.837** |

4.4 Debt rescheduling

The penalties (premia) for the early repayment of Public Works Loan Board (PWLB) debt, which constitutes over 90% of the Council's existing long-term borrowing, have remained prohibitively high. Therefore, no opportunities for debt rescheduling arose in the first half of 2014/15.

4.5 HRA Treasury Management Strategy

From 1 April 2002, the Council's HRA was allocated a separate debt portfolio based on the appropriate proportion of the Councils existing debt at that time. As a result of existing debt maturing and not being replaced the HRA accumulates a variable rate internal borrowing position. On the 1st April £19.161m of internal borrowing was fixed on a maturity loan basis for 30 years with reference to the 4.31% PWLB interest rate quoted on the day.

4.6 Investments

The 2014/15 approved strategy allows for investments with the following counterparties; the UK Government's Debt Management Office, UK Government Gilts and Treasury Bills, other local authorities, UK and overseas banks meeting the required investment criteria, Money Market Funds (pooled, short maturity, high quality investment vehicles offering instant access), other pooled funds (variable net asset value, high quality investment vehicles offering 1-5 day access), Housing Associations and Supranational Bonds. The adoption of specific counterparties is based on a wide range of criteria, including credit ratings, credit default swap rates, government support mechanisms and parent bank support. Maximum sums and periods of investment are set for individual counterparties.

During the year, monitoring of the financial position of all counterparties was undertaken by treasury management colleagues and retained advisors. The credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating is A- across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

This then informs any decisions to revise the investment strategy. Where considered necessary, individual counterparties may be suspended from the approved list, or the maximum amount or period of investment reduced.

The Council's cash investments represent reserves and provisions held within the balance sheet, plus surplus working capital. During 2014 to date, all investments have been managed in-house. The original 2014/15 budget assumed an average cash surplus of £243.3m during the year. The actual average cash balance to 30 September was £246.0m, largely as a result of the receipt of a number of grant payments in advance of required expenditure.

The average rate of interest earned on all investments to 30 September was 0.640%. The original budget assumed a return of 0.680% for the same period. The return on investments is expected to be as budgeted by the end of 2014/15. In comparison, the benchmark 7-day LIBID interest rate for the same period was 0.347%.

**Appendix A** provides details of the Council's external investments at 30 September 2014, analysed between investment type and individual counterparties showing the current Fitch long-term credit rating.

4.7 Icelandic Bank deposits – update

The City Council had £41.6m invested over three Icelandic banks, when the Icelandic banking system collapsed in October 2008, forcing all three banks into administration. Since then, these banks have continued to pass through an administration process to determine the level of payments to be made to the banks' creditors. No further payments have been received up to 30 September 2014.

The latest repayment position and the final expected recovery levels, based on the latest reports from the various bank administrators are shown in Table 4:

| TABLE 4: ICELANDIC BANK DEPOSITS | | | |
|---|---|---|---|
| **Bank** | **Deposit** | **Recovery To 30/9/14** | **Final Est. Recovery** |
| | **£m** | **%** | **%** |
| Glitnir | 11.0 | 79 | 97 |
| Landsbanki | 15.0 | 91 | 91 |
| Heritable | 15.6 | 94 | 94 |
| **TOTAL** | **41.6** | **89** | **94** |

a) Glitnir Bank (£11m) – the administrators have made repayment to all priority creditors, including the City Council, in full settlement of the accepted claims. However, approximately 21% of this sum has been paid in ISK. Because of ongoing currency restrictions in Iceland, this sum is currently retained in an interest-bearing account with the Central Bank of Iceland, pending resolution of the currency release issues.

4.8 Daily Cash Management

To avoid bank overdraft charges and maximise interest earned, the Council seeks to have a near zero overnight cash balance held in its group of accounts at the Co-op bank.

Due to the difficulties experienced by the Co-op Bank, which increased the risk associated with balances held at the Co-op, including uncleared banking items management action was taken that ensured the cash balance plus uncleared items were kept as close to zero as possible over the weekends.

The Council has appointed Lloyds Bank as its new banking provider. However, mitigating action will need to continue until banking services are fully transferred.

4.9 Compliance with Prudential Indicators

The Authority confirms compliance with its Prudential Indicators for 2014/15, which were set in 3 March 2014 as part of the Authority's Treasury Management Strategy Statement.

The Authority measures and manages its exposures to treasury management risks using the following indicators.

**Interest Rate Exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The limits on fixed and variable rate interest rate exposures on its debt are:

| | 2014/15 % | 2015/16 % | 2016/17 % |
|---|---|---|---|
| Upper limit on fixed interest rate-debt | 50-100 | 50-100 | 50-100 |
| Actual | 92 | | |
| Upper limit on variable interest rate exposure | 0-50 | 0-50 | 0-50 |
| Actual | 8 | | |

**Maturity Structure of Borrowing**: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

| | Lower | Upper | Actual |
|---|---|---|---|
| Under 12 months | 0% | 25% | 4% |
| 12 months and within 24 months | 0% | 25% | 2% |
| 24 months and within 5 years | 0% | 25% | 8% |
| 5 years and within 10 years | 0% | 50% | 20% |
| 10 years and within 25 years | 0% | 50% | 35% |
| 25 years and within 40 years | 0% | 25% | 21% |
| 40 years and above | 0% | 75% | 10% |

**Principal Sums Invested for Periods Longer than 364 days**: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

| | 2014/15 £m | 2015/16 £m | 2016/17 £m |
|---|---|---|---|
| Limit on principal invested beyond year end | 50 | 40 | 40 |
| Actual | 25 | | |

**Operational Boundary and Authorised Limit for External Debt**: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

| | 2013/14 (max in year £m) | 2014/15 (max to date £m) |
|---|---|---|
| Total Debt including PFI | 842.7 | 805.7 |
| Operational Boundary | 914.9 | 1,041.6 |
| Authorised Limit | 954.9 | 1,091.6 |

## 5 FINANCIAL IMPLICATIONS (INCLUDING VALUE FOR MONEY/VAT)

5.1 Treasury management payments comprise interest charges and receipts and provision for repayment of debt. A proportion of the City Council's debt relates to capital expenditure on council housing and this is charged to the Housing Revenue Account (HRA). The remaining costs are included within the treasury management section of the General Fund budget. The General Fund Treasury Management budget is £50.610m for 2014/15.

5.2 An estimated outturn for 2014/15 is included in the quarter 2 revenue monitoring report on the 16 December 2014 Executive Board agenda. The budget for 2015/16 will be submitted with the 2015/16 treasury management strategy, in February 2015.

## 6 RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS AND CRIME AND DISORDER ACT IMPLICATIONS)

6.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is prepared for the treasury function.

6.2 The key Strategic Risk relating to treasury management is SR17 'Failure to protect the Council's investments'. The rating for this risk at 30 September 2014 was Likelihood = unlikely, Impact = moderate which represents the same risk assessment as at 31 March 2014. The Treasury Management working group continue to manage this risk and take appropriate actions as required.

## 7 SOCIAL VALUE CONSIDERATIONS

7.1 Not applicable.

## 8 REGARD TO THE NHS CONSTITUTION

8.1 Not applicable.

## 9 EQUALITY IMPACT ASSESSMENT (EIA)

Has the equality impact been assessed?

| | | |
|---|---|---|
| (a) | not needed (report does not contain proposals for new or changing policies, services or functions, financial decisions or decisions about implementation of policies development outside the Council) | ☒ |
| (b) | No | ☐ |
| (c) | Yes – Equality Impact Assessment attached | ☐ |

## 10 LIST OF BACKGROUND PAPERS RELIED UPON IN WRITING THIS REPORT (NOT INCLUDING PUBLISHED DOCUMENTS OR CONFIDENTIAL OR EXEMPT INFORMATION)

10.1 None

## 11 PUBLISHED DOCUMENTS REFERRED TO IN THIS REPORT

11.1 Treasury Management in the Public Services Code of Practice 2011–CIPFA

## 12 OTHER COLLEAGUES WHO HAVE PROVIDED INPUT

Glyn Daykin, Finance Analyst - Treasury Management
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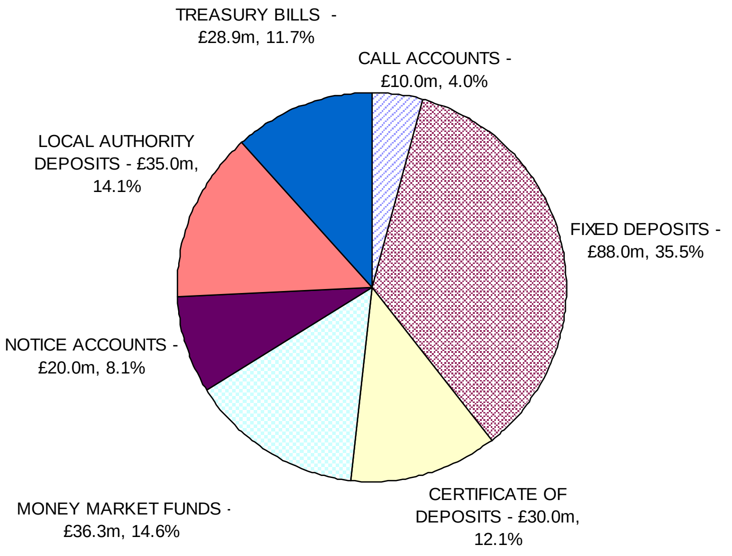
# APPENDIX A

## Type of Investment as at 30 September 2014




## Investments by counterparty including the Fitch long-term credit rating as at 30 September 2014