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To: County Council – 27 March 2014

Subject: **Treasury Management 6 Month Review 2013/14**

Classification: Unrestricted

Summary: To present the Treasury Management 6 Month Review

For Decision

Introduction

1. This is a 6 month update on treasury management issues.

Background

2. The Treasury Management Strategy for 2013/14 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

3. The Code also recommends that members are informed of Treasury Management activities at least twice a year-in fact we report to each meeting of this committee. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

4. Treasury management is defined as: "The management of the local authority's investments and 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."

5. Although formally this report is to 30 September it covers developments in the period since up to the date of this report.

6. The report was agreed by Governance and Audit Committee on 18 December 2013.

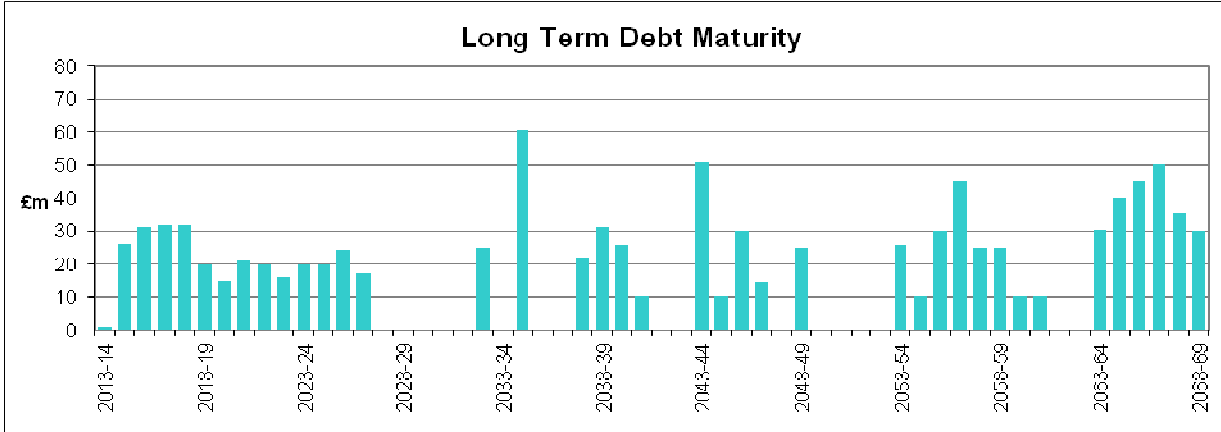
Debt Management

7. The PWLB remained an attractive source of borrowing for the Authority as it offers flexibility and control. As concerns mounted over the timing of the removal or 'tapering' of QE by the US Federal Reserve, gilts sold off and yields rose in May and June. The sharp rise in gilt yields led to a corresponding rise in PWLB rates while the most pronounced increase was for 10 year loans where rates as at 30 September were 0.83% higher than 1 April. Affordability and the "cost of carry" remained

important influences on the Authority’s borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

8. For the Authority the use of internal resources in lieu of borrowing has, therefore, continued to be the most cost effective means of funding capital expenditure. This has lowered overall treasury risk by reducing both external debt and temporary investments. Borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Authority’s treasury advisor.

9. As at 30 September the Council had long term borrowings of £1,012million with a maturity profile as follows:



10. Total external debt managed by KCC includes £42.6million pre-LGR debt relating to Medway Council and £2.5million for other bodies.

11. The forecast financing items under spend is £1.178million comprising a £1.582million shortfall in interest on cash balances due to lower than anticipated interest rates on deposits, offset by savings of £2.760million on debt charges as no new borrowing is planned.

Investment Activity

12. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council’s aim is to achieve a yield commensurate with these principles. This has been maintained by following the Council’s counterparty policy as set out in its Treasury Management Strategy Statement (TMSS) for 2013/14.

13. During the 6 months to 30 September the Council’s maximum maturities for new investments have been:

- Royal Bank of Scotland, NatWest and Santander UK - overnight
- Barclays and Nationwide BS for a maximum period of 100 days
- Lloyds TSB and Bank of Scotland for a maximum period of 6 months

- HSBC Bank and Standard Chartered for a maximum period of 12 months
- DMO – 6 months

The maximum investment with a single financial institution is £50 million.

Counterparty Update

14. Counterparty credit quality is assessed and monitored with reference to Credit Ratings (the Authority's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms / potential support from a well-resourced parent institution; share price.

15. On 17 September the Government sold a 6% stake in the Lloyds Banking Group to institutional investors at a price of 75p and in a positive move Fitch upgraded Lloyds' viability rating to bbb+. Lloyds TSB Bank Plc subsequently changed its name to Lloyds Bank Plc with effect from 23 Sept 2013 and 632 Lloyds' branches were transferred to TSB Bank, a new bank which will be sold through a listing on the stock market in 2014. Following advice from Arlingclose the maximum duration of term deposits was increased to 6 months with Lloyds

16. Following a meeting of The Treasury Management Advisory Group (TMAG) on 31 July a recommendation for diversifying the Council's investment portfolio went to Cabinet.

17. At its meeting on 16 September Cabinet agreed that a core investment portfolio of £75 million be established. This would invest in:

- (1) Absolute Return Funds - Pooled funds investing in a range of asset types including equities, fixed income and alternatives.
- (2) Equity Income Funds - Either UK or Global funds focussing on companies which produce strong income i.e. dividend returns.
- (3) Property Pooled Funds - Very large well established balanced funds and funds with high covenant and long leases linked to RPI
- (4) Other - Opportunistic investments potentially linked to local economic regeneration projects. These would need to be low risk and securitised.

Cabinet agreed a maximum exposure of £5million in any one fund.

18. A decision has since been made to invest £5million in the Pyrford absolute return fund, and following a presentation from the CCLA to TMAG on 13 November, a £5million investment in the Local Authorities Property Fund has been agreed.

19. A list of the Council's investments on 15 November is attached at Appendix 1.

20. The average cash balances during the 6 months were £407million representing the Council's reserves, working cash balances, capital receipts and schools balances etc. Cash balances are expected to fall towards the end of the financial year.

21. The UK Bank Rate has been maintained at 0.5% since March 2009 and is not expected to rise until 2016. Since April interest rates on call accounts and term deposits have fallen as banks access cheaper sources of finance. New investments were made at an average rate of 0.62% and the Council anticipates an investment outturn of £2.52million, 0.58% for the whole year.

Compliance With Prudential Indicators

22. The Council can confirm that it has complied with its Prudential Indicators for 2013/14 set as part of the Council's Treasury management Strategy Statement. Details can be found in Appendix 2.

Recommendation

23. Members are asked to note the report.

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KCC Investments as at 15 November 2013

Instrument Type	Counterparty	Principal Amount	End Date	Interest Rate	Territory
		£		%	
Fixed Deposit	Bank of Scotland	5,000,000	08/05/2014	0.75	UK Bank
Fixed Deposit	Bank of Scotland	5,000,000	22/01/2014	0.7	UK Bank
Fixed Deposit	Bank of Scotland	5,000,000	31/03/2014	0.75	UK Bank
Same Day Call Deposit	Bank of Scotland	7,550,000	n/a	0.4	UK Bank
Same Day Call Deposit	Barclays FIBCA	40,000,000	n/a	0.6	UK Bank
Fixed Deposit	Lloyds TSB	5,000,000	06/05/2014	0.75	UK Bank
Fixed Deposit	Lloyds TSB	5,000,000	19/11/2013	0.7	UK Bank
Fixed Deposit	Lloyds TSB	5,000,000	21/11/2013	0.7	UK Bank
Fixed Deposit	Lloyds Bank	5,000,000	27/12/2013	0.7	UK Bank
Fixed Deposit	Lloyds Bank	5,000,000	27/03/2014	0.75	UK Bank
Fixed Deposit	Lloyds Bank	5,000,000	22/04/2014	0.75	UK Bank
Same Day Call Deposit	Lloyds Bank	10,000,000	n/a	0.4	UK Bank
Same Day Call Deposit	NatWest	25,000,000	n/a	0.6	UK Bank
Same Day Call Deposit	Royal Bank of Scotland	50,000,000	n/a	0.85	UK Bank
Same Day Call Deposit	Santander UK	50,000,000	n/a	0.4	UK Bank
Certificate of Deposit	Standard Chartered	10,000,000	02/01/2014	0.53	UK Bank
Certificate of Deposit	Standard Chartered	10,000,000	06/01/2014	0.54	UK Bank
Certificate of Deposit	Standard Chartered	10,000,000	05/02/2014	0.56	UK Bank
Certificate of Deposit	Standard Chartered	10,000,000	12/02/2014	0.56	UK Bank
Certificate of Deposit	Standard Chartered	10,000,000	02/04/2014	0.54	UK Bank
Total UK Bank Deposits		277,550,000			
Fixed Deposit	Nationwide Building Society	10,800,000	25/11/2013	0.4	UK Building Society
Total UK Building Society Deposits		10,800,000			
Treasury Bill	Debt Management Office	5,000,000	25/11/2013	0.305	UK Govt.
Total UK Govt. Deposits		5,000,000			
Total Icelandic Bank Deposits		12,416,710			
Grand Total of All Deposits		305,766,710			

2013-14 Quarter 2 Monitoring of Prudential Indicators

1. Estimate of capital expenditure (excluding PFI)

Actuals 2012-13	£181.229m	
Original estimate 2013-14	£286.571m	
Revised estimate 2013-14	£291.057m	(this includes the rolled forward re-phasing from 2012-13)

2. Estimate of capital financing requirement (underlying need to borrow for a capital purpose)

	2012-13	2013-14	2013-14	2014-15	2015-16
	Actual	Original Estimate	Forecast as at 30-09-13	Forecast as at 30-09-13	Forecast as at 30-09-13
	£m	£m	£m	£m	£m
Capital Financing requirement	1,464.961	1,483.590	1,454.655	1,437.314	1,380.495
Annual increase/reduction in underlying need to borrow	-30.912	-2.825	-10.306	-17.341	-56.819

In the light of current commitments and planned expenditure, forecast net borrowing by the Council will not exceed the Capital Financing Requirement.

3. Estimate of ratio of financing costs to net revenue stream

Actuals 2012-13	14.55%
Original estimate 2013-14	13.42%
Revised estimate 2013-14	13.51%

4. Operational Boundary for External Debt

The operational boundary for debt is determined having regard to actual levels of debt, borrowing anticipated in the capital plan, the requirements of treasury strategy and prudent requirements in relation to day to day cash flow management.

The operational boundary for debt will not be exceeded in 2013-14

a) Operational boundary for debt relating to KCC assets and activities

	Prudential Indicator	Position as at 30.09.13
	£m	£m
Borrowing	993	969
Other Long Term Liabilities	1,134	1,155
	<u>2,127</u>	<u>2,124</u>

Appendix 2

(b) Operational boundary for total debt managed by KCC including that relating to Medway Council etc (pre Local Government Reorganisation)

	Prudential Indicator	Position as at 30.09.13
	£m	£m
Borrowing	1,040	1,011
Other Long Term Liabilities	1,134	1,155
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	2,174	2,166

5. **Authorised Limit for external debt**

The authorised limit includes additional allowance, over and above the operational boundary to provide for unusual cash movements. It is a statutory limit set and revised by the County Council. The revised limits for 2013-14 are:

a) Authorised limit for debt relating to KCC assets and activities

	Authorised limit for debt relating to KCC assets and activities	Position as at 30.09.13	Authorised limit for total debt managed by KCC	Position as at 30.09.13
	£m	£m	£m	£m
Borrowing	1,033	969	1,080	1,011
Other long term liabilities	1,134	1,155	1,134	1,155
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	2,167	2,124	2,214	2,166

The additional allowance over and above the operational boundary has not needed to be utilised and external debt, has and will be maintained well within the authorised limit.

6. **Compliance with CIPFA Code of Practice for Treasury Management in the Public Services**

The Council has adopted the Code of Practice on Treasury Management and has adopted a Treasury Management Policy Statement. Compliance has been tested and validated by our independent professional treasury advisers.

7. **Upper limits of fixed interest rate and variable rate exposures**

The Council has determined the following upper limits for 2013-14

Fixed interest rate exposure	100%
Variable rate exposure	30%

These limits have been complied with in 2013-14.

8. Upper limits for maturity structure of borrowings

	Upper limit	Lower limit	As at 30.09.13
	%	%	%
Upper 12 months	10	0	0.1
12 months and within 24 months	10	0	2.6
24 months and within 5 years	15	0	9.4
5 years and within 10 years	15	0	9.1
10 years and within 20 years	15	5	10.5
20 years and within 30 years	20	5	14.7
30 years and within 40 years	20	10	12.9
40 years and within 50 years	25	10	17.9
50 years and within 60 years	30	10	22.8

9. Upper limit for principal sums invested for periods longer than 364 days

Indicator	Actual
£30m	£0m