Report for: AUDIT COMMITTEE SCRUTINY/REVIEW
Item Number: 8

Contains Private and Confidential Information	**YES** (appendix 1)	Pursuant to para. (3) of Schedule 12A of the Local Government Act 1972
Title	Treasury Management Quarter 1 Update 2013-14	
Responsible Officer	Maria G. Christofi : Director of Finance E-mail: MChristofi@ealing.gov.uk Tel: 020 8825 6193	
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Portfolio	Finance and Performance - Cllr Yvonne Johnson	
For Consideration By	Audit Committee	
Date to be Considered	19 September 2013	
Implementation Date if Not Called In	N/A	
Affected Wards	N/A	
Area Committees	N/A	
Keywords/Index	Treasury, borrowing, lending, investments	

Purpose of Report:
This report provides an update on the Council's borrowing and investment activities for the first quarter of 2013/14 ending 30 June 2013. This update ensures that the Council is delivering its Treasury Management service in an open and transparent manner and that the Council is fulfilling its obligations under the Local Government Act 2003 to provide regular reviews of its activities.The report is being submitted to the Audit Committee which carries out the scrutiny of the Treasury Management function as per CIPFA's Treasury Management Code of Practice. Over the reporting period, all treasury management activities have been carried out in accordance with the approved limits. The report also provides information on the economic conditions prevailing in the first quarter of 2013-14.

1. Recommendations

It is recommended that Members:

1.1. Note the Treasury Management activities and performance against target for the first quarter to 30 June 2013.

1.2. Note the Council's current governance and reporting arrangements in line with CIPFA's best practice recommendations, as set out in paragraph 7.

1.3. Note the Council's current lending list (set out in confidential Appendix 1);

1.4. Note that the Council continues to operate a dual Treasury Management strategy for managing the General Fund (GF) and the Housing Revenue Account (HRA) debt.

1.5. Note the position on Pension Fund investments, since Pension Fund cash is being invested separately from the Council.

1.6. Note the update on the Council's deposit retained in an Icelandic escrow account.

2. Reason for Decision and Options Considered

2.1. This report updates on both the borrowing and investment decisions made by the Director of Finance under delegated authority in the context of prevailing economic conditions and considers Treasury Management Performance measured against its benchmark.

2.2. Treasury management is defined as "the management of the council's investments and cashflows; 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".

<u>Summary</u>

2.3. The main points from this report are:

- All treasury management activities were effected by authorised officers within the limits agreed by the Council.

- All investments were made to counterparties within the Council's approved lending list.
- The Council's remaining investment of £407k with the Icelandic Bank, Glitner, is held in an escrow account in Islandsbanki (new Glitnir) and continues to earn interest at the rate of 4.2%.
- There has been no long-term borrowing raised so far this year.
- The Council earned 0.555% on its lending, outperforming the actual rolling average 7 Day Libid rate of 0.363%.
- The Council currently holds no investments with overseas financial institutions (apart from the balance of £407k retained in Iceland).
- The HRA debt is being managed separately from General Fund debt.

2.4. A glossary of terms used is set out at the end of this report, to make this technical report as user friendly as possible.

3. Treasury Management Strategy 2013/14

3.1. The Council's Treasury Management Strategy for 2013/14 was approved on the 26th February 2013 by Full Council. The Strategy comprehensively outlined how the treasury function would operate throughout the financial year 2013/14 and covered:

- update on Pension Fund cash/Treasury limits and current portfolio position
- treasury budget and current position;
- treasury and prudential indicators which will limit the treasury risk and activities of the Council;
- the minimum revenue provision (MRP) strategy;
- economic background and prospects for interest rates;
- the borrowing strategy and policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

3.2. The council complied with the strategy throughout the first quarter to 30 June 2013.

Investment of Pension Fund Cash

3.3. The Council retains some Pension Fund cash in house. This is the excess of employers and employees contributions over the payments of pension benefits and retirement grants that accrue from the Pension Fund revenue account, operated by the Council as the administering authority for the scheme. From time to time balances are transferred to external Fund Managers to invest, but a small amount is usually retained internally to manage cashflows, or larger amounts to facilitate an asset reallocation strategy.

3.4. As agreed by Members at the Pension Fund Panel meeting on the 09 March 2011 and in accordance with regulations, the Pension Fund cash was invested separately from the Council's cash in fixed term deposit bank accounts throughout the quarter. All Pension Fund transactions still flow through the Council's bank account; hence, at the year-end, the Pension Fund will receive interest from the Council for all internally managed balances in-between transfers of funds from the Council to a separate Pension Fund bank account.

3.5. The Pension Fund invests its surplus cash in accordance with the Council's Treasury Management strategy agreed by Full Council on the 26th February 2013, which is delegated to the Director of Finance to manage within set parameters. The Treasury Management Strategy is reviewed on a monthly basis at the Treasury Risk & Investment Board (TRIB), a meeting consisting of Corporate Finance officers, and chaired by the Executive Director of Corporate Resources. The Pensions Fund Panel is updated on Pension Fund investment activity and the Chair of the Pension Fund Panel (PFP) is briefed regularly.

4 Economic Background

4.1 Over the quarter ending 30th June 2013:-

- The UK economy grew 0.7%, up from 1.5% in the same quarter last year;
- There was stronger household spending, both on and off the high street;
- Inflation remained above the MPC's 2% target;
- The MPC was in a state of flux ahead of Mark Carney's arrival as the Bank of England Governor in July;
- 10-year gilt yields rose above 2.5% and the FTSE 100 fell below 6,100;
- The Federal Reserve discussed paring the pace of asset purchases under Quantitative Easing 3 (QE3).

4.2 After avoiding recession in the last quarter of 2012/13, with a 0.3% quarterly expansion, the UK economy grew 0.7% and the revised ONS data has shown that all four major sectors of the economy - services, industry, agriculture and construction - had expanded during the three months to June.

4.3 The UK has seen an increase in retail spending and the housing market has shown signs of renewed vigour. The pick-up in economic growth appears to have supported the labour market, with employment rising by 24,000 in the three months to April, which reduced the level of unemployment further

4.4 The Bank of England extended Its Funding for Lending Scheme (FLS) into 2015 and enhanced the incentives for banks to extend more business funding. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with the quoted interest rate reducing. The Government's Help to Buy scheme, provides equity loans to credit-constrained borrowers; this is helping to boost demand in the housing market.

4.5 Borrowing seems to be broadly at the same level as it was last year and the headline Government spending plan appears to be broadly flat in real terms.

4.6 CPI inflation fell from 2.8% to 2.4% in April, rising to 2.7% in May and 2.9% in June. June's inflation was lower than market expectation largely because of the reduction in airfares.

4.7 Equities fell and treasury yields rose in June after the Fed's comments on reigning in QE sparked a sharp selloff in the Treasury market and equity markets.

4.8 The Eurozone though calmer, still present a number of risks.

Economic Forecast

4.9 The Council's treasury advisors Sector provide the following forecast for interest rates; Capital Economics Bank Rate forecast has been provided for comparison:

	Sept 13	Dec 13	Mar 14	Jun 14	Sept 14	Dec 14	Mar 15	Jun 15
Bank rate Sector	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Bank Rate Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	Not available	Not available
10yr PWLB rate	3.30%	3.30%	3.30%	3.30%	3.30%	3.40%	3.50%	3.60%
25yr PWLB rate	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%
50yr PWLB rate	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%

5 Treasury Management Strategy Statement

Annual Investment Strategy

5.1 As outlined above the Treasury Management Strategy for 2013/14 was approved by Council on the 26th February 2013. The Council's Annual Investment Strategy outlines the Council's investment priorities as follows (in order of priority):

- Security of Capital
- Liquidity
- Yield

5.2 The Council aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity.

5.3 The Council manages its investments in-house and invests with institutions on the Council's approved lending list. In response to the global financial uncertainties, the Council continues to operate to a restricted lending list and a summary of the institutions to which the Council can lend to is outlined below:

1. The UK Government directly (Debt Management Office)
2. The UK Government (Treasury Bill via King & Shaxson)
3. Lloyds and RBS (because of the UK government's substantial stake in these institutions)

4. The Council's banker (NatWest)
5. HSBC
6. Standard Chartered Bank
7. Barclays Bank
8. Nationwide Building Society
9. Local Authorities

5.4 In the current economic climate the Council only invests with highly credible and credit rated financial institutions using Sector's (The Council's Treasury Advisers) suggested creditworthiness matrices, including Sovereign and Credit Default Swap (CDS) overlay information. Confidential Appendix 1 sets out the Council's current lending list and limits. Council officers use additional intelligence gleaned from the financial press to determine who to invest with.

5.5 Nationwide Building Society (the largest building society in the UK), was reinstated on to the Council's lending list under delegated authority in April, for a maximum duration of three months and with a limit of £20m and funds were deposited at a relatively higher rate.

Overall Treasury Cash Flow Position as at 30 June 2013

5.6 The Council's temporary borrowing and lending activity (that is 364 days or less) over the period is set out below.

Description	Borrowing £m	Lending £m	Net Position £m
Outstanding 31st March 2013	-	(252.106)	(252.106)
Raised/ (lent) during period	-	(2,632.129)	(2,632.129)
Repayments during period	-	2,587.644	2,587.644
Outstanding 30th June 2013	**-**	**(296.591)**	**(296.591)**

5.7 Over the 3 months to 30th June 2013, the Council's cashflows were maintained through lending activities on the wholesale money market and the net position outstanding at 30th June 2013 was a temporary lending balance of £296.59m.

5.8 No temporary borrowing was required during the period.

5.9 Investments held at 30 June 2013 are outlined below:

Counterparty Name	Total Deposited as at 31/06/13 (£'000)	Total Deposited as at 31/03/13 (£'000)
Local Authorities	(101,500)	(116,700)
Debt Management Office	(8,100)	(13,900)
Glitnir Bank HF	(407)	(407)
HSBC	(30,000)	(30,000)
Standard Chartered Bank	(10,000)	-
Lloyds TSB Bank Call Account	(30,000)	(30,000)
Natwest SIBA	(30,000)	(30,000)
Royal Bank of Scotland	(10,000)	(10,000)
Barclays	(20,000)	(20,000)
Treasury Bills	(35,984)	(499)
Nationwide Building Society	(20,000)	-
Future Ealing Ltd*	(600)	(600)
TOTAL INVESTED	**(296,591)**	**(252,106)**

- *Ealing's Local Education Partnership, a joint-venture company formed by the Council and Balfour Beatty Education to deliver Ealing's Building Schools for the Future programme.*

5.10 Investment activity during the quarter conformed to the approved strategy, and the Council did not experience any liquidity difficulties.

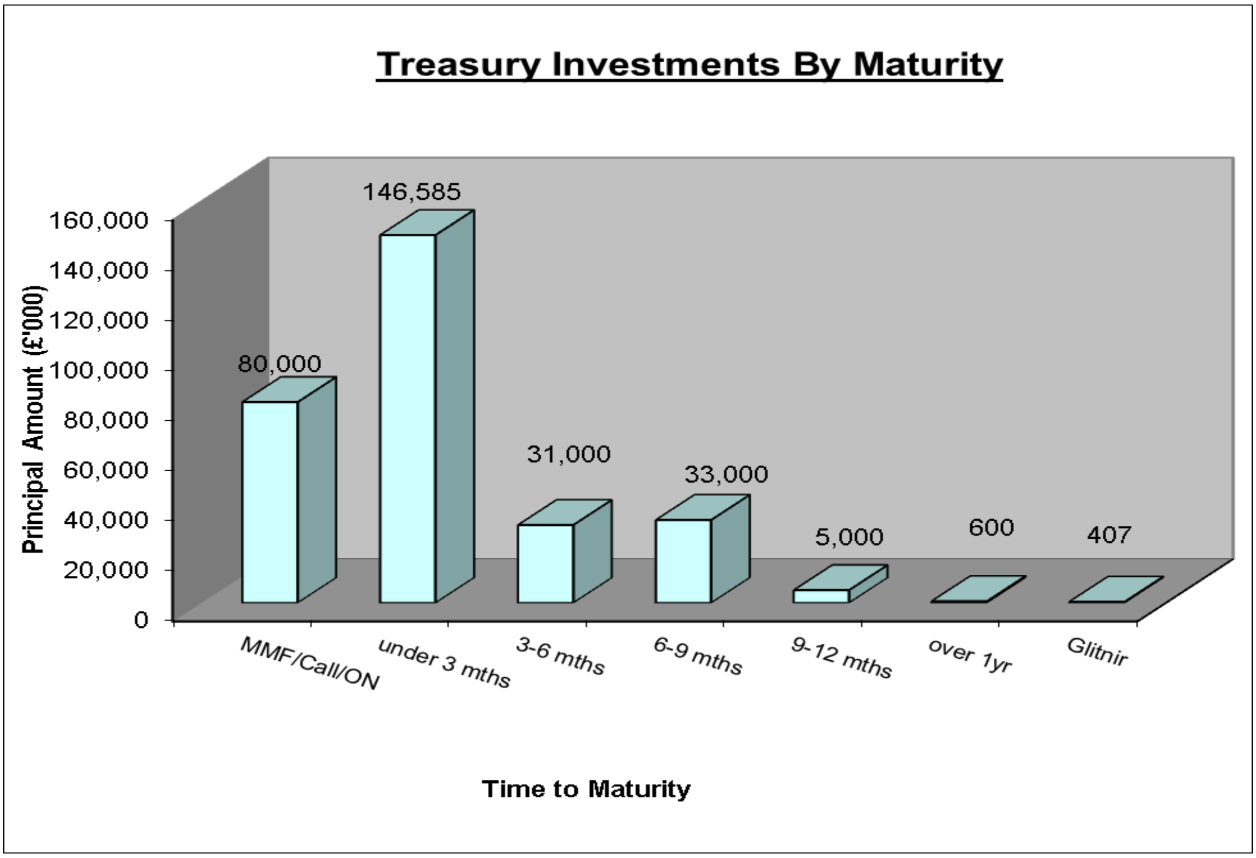
Icelandic Investment update

5.11 As previously reported to Members, the Council has received the bulk of its stranded investment in Glitnir i.e. £1.7m. Due to foreign exchange controls implemented by the Icelandic government to protect capital outflows, the balance of £380k which was revalued to £407k at the end of 2012/13, remains in an escrow account there. This balance is currently yielding interest at the rate of 4.2%, although the funds could be subject to currency losses from foreign exchange fluctuations.

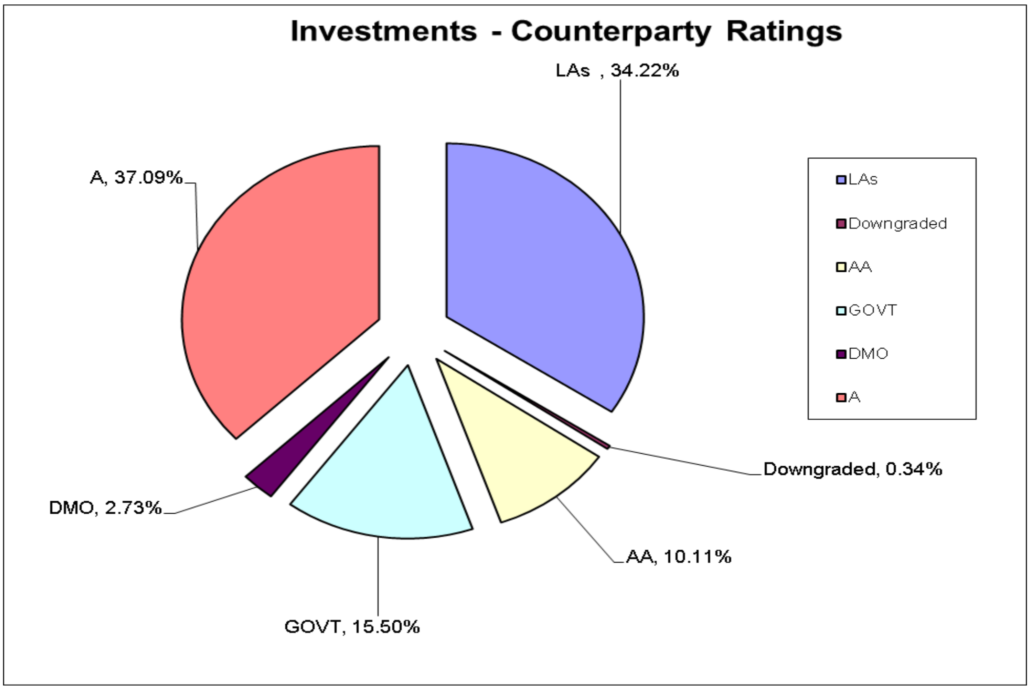
5.12 The Icelandic Winding Up Board finally supplied a statement showing the account balance as at 31 March 2013; which clearly shows a 20% deduction of withholding tax on the interest accrued in 2012/13.

5.13 The Local Government Association (LGA) has made a compelling proposal to assist local authorities to seek to recover the withholding tax from the Icelandic government, which the Council have accepted. The cost is a flat fee of £50 per authority plus a contingency fee of 1% of the value of tax reclaimed. The process for reclaim is long and convoluted with no guarantee of recovery.

Investment Maturity Profile at 30 June 2013



Investments by Counterparty Rating at 30 June 2013



**Downgraded includes Glitnir of 0.14% and Future Ealing of 0.20%*
AA, A – Fitch credit rating.

Performance Vs Benchmark

5.14 Council investment returns outperformed the benchmark (7 day LIBID rate) during the reporting period. The table below outlines this performance.

Month	Council Performance	Benchmark Rate (7day LIBID rate)	Over/(Under) Performance
April 2013	0.602%	0.366%	0.236%
May 2013	0.541%	0.362%	0.179%
June 2013	0.523%	0.361%	0.161%
Average	0.555%	0.363%	0.192%

5.15 The Council maintained an average internally managed investment balance of £297.82m over the quarter and had an actual investment balance of £296.59m as at 30 June 2013. The internally managed fund earned an average return of 0.555%; the comparable performance indicator is the average 7-day LIBID rate, which returned 0.363%. The Council's budgeted investment return for quarter 1 if income was accrued evenly over the full year is £375k; this was marginally exceeded by the actual accrued interest of £411k.

6 Long Term Borrowing

6.1 The Council's Treasury management Strategy Report approved in February

2013, outlined the Council's long term borrowing strategy for the year.

HRA Self Financing
The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

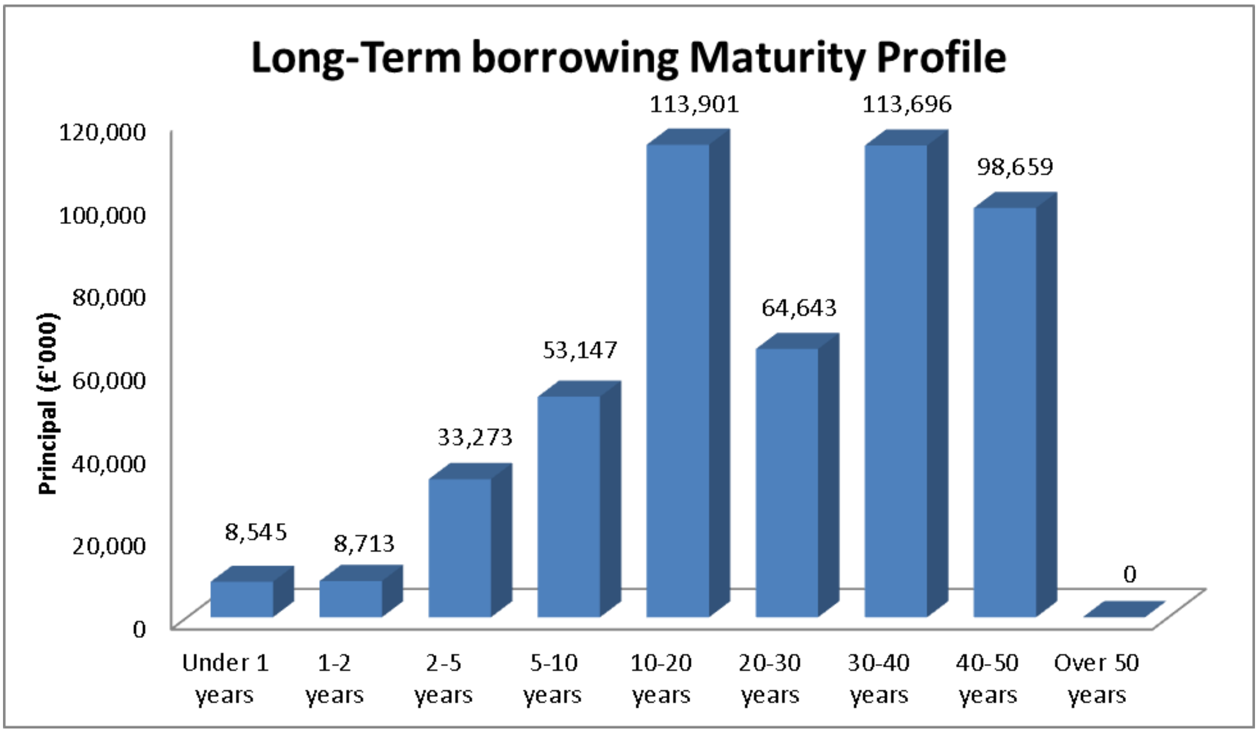
The Council continues to operate a dual Treasury Management strategy for managing the General Fund (GF) and the Housing Revenue Account (HRA) debt. Actual PWLB maturity loan interest rates over the reporting period were as follows

Period	RANGE		RATE
	Highest	Lowest	28 June 2013
5 year maturity	**1.61%**	**0.81%**	**1.48%**
10 year maturity	**2.7%**	**1.82%**	**2.61%**
50 year maturity	**3.7%**	**3.15%**	**3.64%**

6.2 The Council's actual borrowing at the end of the quarter of £494.75m was within the anticipated year end Capital Financing Requirement (CFR) of £549m. No borrowing was raised in the first quarter in view of the level of investments held which has allowed the Council to internally borrow. The table below shows the split between General Fund and HRA.

Source	**Debt 01.04.13 £m**		**Loans raised £m**	**Loans repaid £m**	**Debt 30.06.13 £m**
	GF	**HRA**			
PWLB :GF	286.8		-	-	286.8
:HRA		119.78	-	-	119.78
Market debt :GF	62.07		-	-	62.07
:HRA		25.93	-	-	25.93
Mortlake Crematorium	0.32	-	-	0.15	0.17
TOTAL	**349.19**	**145.71**	-	**0.15**	**494.75**
Memo Item:					
PFI Obligation*	140.14	-	-	-	140.14

*Notional interest approximately £2.8m per quarter.
Note: The notional Interest charges on the above PFI debt do not impact on the bottom line funded by the Council Tax payer.



- *The above graph does not include the Mortlake loan of £173k, hence long term borrowing per the above graph is £494.57m.*

Debt Rescheduling

6.3 Movements in interest rates over time can produce opportunities in financial markets, which allow the Council to take advantage of replacing existing loans with new loans at lower rates. This is known as debt rescheduling. The Council can also repay existing loans early without necessarily replacing the loans. These activities will attract a discount or premium depending on the prevailing market conditions.

6.4 No debt rescheduling opportunities have arisen during the quarter as the cost of premiums to repay debt outweighs savings that could be made from the lower PWLB borrowing rates.

PWLB Certainty Rate

6.5 The government launched a discounted rate as part of the Budget in March 2012. Cheaper borrowing rates are available from the Public Works Loans Board (PWLB) for councils that can provide improved information on borrowing plans.

6.6 The “certainty rate” is 20 basis points (0.2%) below the PWLB’s normal rate. The aim is to afford increased spending capacity from Council’s who will benefit from savings accrued from interest payments.

6.7 Although there was no plan to borrow, the Council renewed its application to remain qualified to borrow at the discounted certainty rate.

7. Treasury Management Governance and Scrutiny

7.1 The Council continues to review and ensure that it embraces best practice in the risk management, control, monitoring and reporting of its treasury management processes.

7.2 The Council's Treasury Management Strategy is approved annually by Full Council and there is also at a minimum a mid-year report which goes to Full Council. All reports to Full Council also go to Audit Committee which undertakes the scrutiny role for the Treasury Management function. As agreed at the Audit Committee Meeting on the 28 June 2012, Audit Committee will continue to receive quarterly Treasury Management Update Reports.

7.3 In addition there is regular monitoring of Treasury Management activities by Management, the portfolio holder for Finance and the Treasury Risk and Investment Board, which is chaired by the Executive Director of Corporate Resources..

7.4 The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the Treasury Management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regards to delegation and reporting.

7.5 The Council currently adheres to the following reporting structure:

Report	Full Council	Audit Committee
Annual Treasury Strategy (March)	✔	
Mid Year Treasury Strategy update	✔	
Treasury Strategy updates or revisions required as and when required.	✔	✔
Annual Scrutiny of Treasury Management Strategy (February)		✔
Treasury Management Performance Q1		✔
Treasury Management Performance Q2		✔
Treasury Management Performance Q3		✔
Treasury Outturn	✔	✔
Day to Day Treasury Oversight PORTFOLIO HOLDER FOR FINANCE ONGOING UPDATES		

8 Financial implications

Budget 2013/14 £'000s	Forecast 2013/14 £'000s	Variance 2013/14 £'000s
36,237	36,237	-

8.1 There was no projected variance at the end of June 2013. However, no borrowing has been raised as of yet and it is anticipated underspend will accrue from savings on interest which will be used towards direct revenue funding of capital schemes.

9 Prudential Indicators

9.1 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

9.2 The benefit of the indicators will be derived from monitoring them over time rather than from the absolute value of each. The indicators are not intended to be used as comparators between councils. A reporting process has been established, with a half-yearly report to Cabinet that highlights any significant deviations from expectations. Once determined, the indicators can be amended, subject to reporting to Council for approval.

10 Legal

10.1 Lending of surplus funds must comply with the Local Authorities (Capital Finance) (Approved investments) Regulation 1990, as amended from time to time by the Government.

10.2 To comply with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 requires full Council to approve an Annual Statement of Minimum Revenue Provision.

11 Value For Money

11.1 Assessment of value for money is achieved through:

- Monitoring against benchmarks
- Operating within budget

11.2 For example, internally managed investment returns exceeded the LIBID benchmark for 2013/14 and PWLB borrowing is being monitored in order to secure favourable rates below the budgeted target rate of 5.00%. In addition, the treasury function operated within budget in Q1 of 2013/14.

12 Risk Management

12.1 No treasury management activity is without risk. Risk management plays a fundamental role in treasury activities, due to the value of transactions involved. Risk management always remains the priority over returns. The adoption of the CIPFA Code for Treasury Management in Public Services, the use of a Lending List and receiving advice from Sector Treasury Services mitigates some of the risk associated with optimising performance returns. Security of capital remains the priority in the Council's investment with counterparties. The Treasury Team continue to be alert to concerns about the current Eurozone debt situation (e.g. Portugal, Ireland, Greece, Spain and Italy) and this is reflected in the Council's Lending List.

13 Community Safety

13.1 None

14 Links to Strategic Objectives

14.1 Proper and effective management of the Treasury Management function is an essential element of the financial administration process within the Council. Income generated from this source makes a significant contribution to the resources available to fund the Councils strategic objectives.

15 Equalities and Community Cohesion

15.1 None

16 Staffing Implications

16.1 The Director of Finance has delegated powers to make suitable arrangement for investment of Council's surplus funds, including amendment to the Council's lending list.

17 Any Other Implications

17.1 None

18 Consultation

18.1 See attached consultation

19 Timetable for implementation

19.1 Not Applicable

BACKGROUND INFORMATION

Lending and borrowing investments files kept on the 5th floor Perceval House. Cash fund manager reports.

Consultation

Name of consultee	Department	Date sent to consultee	Date response received	Comments appear in report para:
Maria G Christofi	Director of Finance	03-9-2013		
Nigel Watson	Assistant Director of corporate Finance	03-9-2013	06-9-2013	Throughout
Matthew Bunyon	Head of Financial Planning & Investments	03-9-2013	06-9-2013	Throughout
Helen Harris	Head of Legal	03-9-2013	04-9-2013	
Catherine Taylor		03-9-2013		
Cllr	Chair of the Audit Committee	03-9-2013		

Report History

Decision type: For Action/Information	Urgency item? No

Authorised by Cabinet member:	Date report drafted:	Report deadline:	Date report sent:
	30 August 2013	10th September 2013	09 September 2013

Report no.:	Report author and contact for queries:
	Bridget Uku, Treasury & Investments Manager, ext 5981

Glossary of terms used in the report

CFR - Capital Financing Requirement- a measure of the Council’s underlying need to borrow to fund capital expenditure.

Counterparties - Organisations the Council lends money to e.g. Banks; Local Authorities and MMF.

CPI & RPI - Consumer Prices Index & Retail Prices Index
The main inflation rate used in the UK is the CPI. The Chancellor of the Exchequer bases the UK inflation target on the CPI. The CPI inflation target is set at 2%. The CPI differs from the RPI in that CPI excludes housing costs. Also used is RPIX, which is a variation of RPI, one that removes mortgage interest payments.

Credit Default Swap (CDS) - A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.

Credit watch - Variety of special programs offered by credit rating agencies and financial institutions to monitor organisation/individual's (e.g. bank) credit report for any credit related changes. A credit watch allows the organisation/individuals to act on any red flags before they can have a detrimental effect on credit score/history.

DMO - Bank of England’s Debt Management Office.

Escrow Account – A money account held by an independent third party and disbursed upon fulfillment of certain contractual conditions.

Gilts - Bonds issued by the UK government. The holder is paid a fixed cash amount (coupon) every six months until maturity, at which point the final coupon is paid along with the principal.

IMF - The International Monetary Fund is an intergovernmental organisation which states its aims as to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

Impaired investment - An investment that has had a reduction in value to reflect changes that could impact significantly on the benefits expected from it.

LIBID - The London Interbank Bid Rate – it is the interest rate at which major banks in London are willing to borrow (bid for) funds from each other.

Market Loans - Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.

MMF - Money Market Fund – a ‘pool’ of different types of investments managed by a fund manager, that invests in lightly liquid short term financial instruments with high credit rating.

MPC - Monetary Policy Committee- Committee designated by the Bank of England, whose main role is to regulate interest rates.

MRP - Minimum Revenue Provision – this is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.

Premium - Cost of early repayment of loan to PWLB to compensate for any losses that they may incur.

Prudential Indicators - Set of rules providing local authorities borrowing for funding capital projects under a professional code of practice developed by CIPFA and providing measures of affordability and prudence reflecting the Council's Capital Expenditure, Debt and Treasury Management.

PWLB - Public Works Loan Board, a statutory body whose function is to lend money to Local Authorities (LAs) and other prescribed bodies. The PWLB normally are the cheapest source of long term borrowing for LAs.

QE - Quantitative Easing. Usually, central banks try to raise the amount of lending and activity in the economy indirectly, by cutting interest rates. Lower interest rates encourage people to spend, not save. But when short term interest rates can go no lower, a central bank can buy government bonds (including long-term bonds) or other financial assets (e.g. corporate bonds) in an effort to increase money supply and stimulate the economy. This is quantitative easing.

Treasury Bill – Short term debt instruments issued by the Government. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.