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

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 2014/15**	
Responsible Officer	Ian O'Donnell: Executive Director of Corporate Resources. Maria G. Christofi : Director of Finance	
Author(s)	Bridget Uku, Group Manager, Treasury & Investments Tel: 020 8825 5981. E-mail: ukub@ealing.gov.uk Feyisayo Adekugbe, Treasury & Investment Accountant Tel: 020 8825 8294, E-mail: adekugbef@ealing.gov.uk	
Portfolio	Finance and Performance - Cllr Yvonne Johnson	
For Consideration By	Audit Committee	
Date to be Considered	23 September 2014	
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 2014/15 ending 30 June 2014. 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 prevailing economic conditions during the first quarter of 2014/15.

1. Recommendations

Members are recommended to:

1.1 Note the Treasury Management activities and performance against targets for the first quarter to 30 June 2014.

1.2 Note the Council's investments balance of £230.988m as at 30 June 2014 of which £45.1m was invested in other Local Authorities (set out in Appendix 1).

1.3 Note the Council's current lending list (set out in confidential Appendix 2).

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 the prevailing economic conditions and considers Treasury Management Performance measured against the benchmark 7 day LIBID rate.

2.2 Treasury management is defined as "the management of the council'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".

Summary

2.3 The key messages from this report are that:

- All treasury management activities were executed by authorised officers within the parameters agreed by the Council.
- All investments were made to counterparties on the Council's approved lending list and within agreed limits.
- The Council's remaining investment of £0.407m with the Glitnir bank that is still retained in an Icelandic escrow account has now increased in value to £0.441m as a result of interest being accrued.
- There was no long-term borrowing raised during the period to 30 June 2014.
- The existing long-term debt reduced from £492.950m to £486.313m in the first quarter due to debt maturing.
- The Council earned an average investment return of 0.558% on short term lending, outperforming the rolling average 7 Day Libid rate of 0.341%.
- The Council currently holds no investments with overseas financial institutions (excluding the balance of £0.441m of the retained Icelandic investment).
- The HRA debt is managed separately from General Fund debt.

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

3. Treasury Management Strategy 2014/15

3.1 The Council's Treasury Management Strategy for 2014/15 was approved on the 25 February 2014 by Full Council. The strategy comprehensively outlined how the treasury function would operate throughout the financial year 2014/15 and the addressed the following:

- update on Pension Fund cash/Treasury limits and current portfolio position
- treasury budget and current position;
- treasury and prudential indicators that 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;
- Housing Revenue Account (HRA) Self Financing
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

3.2 The Council complied with the strategy during the period to 30 June 2014

Investment of Pension Fund Cash

3.3 The Pension Fund surplus cash has been invested in accordance with the Council's Treasury Management Strategy agreed by Full Council on the 25 February 2014, under the delegated authority of the Director of Finance to manage within agreed 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 Pension Fund Panel (PFP) is updated on Pension Fund investment activity and the Chair of the PFP is briefed regularly.

4. Economic Background

4.1 The following is a summary of key economic issues during the first quarter of financial year 2014/15: -

- Forward surveys about strong UK GDP growth are encouraging.
- The Monetary Policy Committee (MPC) broadened its forward guidance by incorporating five qualitative principles.
- Inflation fell to 1.5% in May, the lowest rate since 2009.
- The Eurozone faces an increasing threat from deflation.

4.2 After strong UK GDP growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, 2014 continued the trend with 0.8% in Q1 2014 and finally 0.8% in the three months to June 2014. Indicators show that recovery is starting to broaden away from historical reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. Consequently, unemployment has fallen much faster through the threshold of 7%, set by the Monetary Policy Committee (MPC) last August. The MPC has now broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators to gauge how quickly slack is being used up. Accordingly, markets are expecting a first UK interest rate increase around the end of 2014 or in early 2015.

4.3 UK inflation has remained below its target 2% with a sharp fall in inflation (CPI), reaching 1.5% in May, the lowest rate since 2009, but rising back up to 1.9% in June 2014. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn

Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018/19. However, monthly public sector deficit figures have disappointed in this quarter.

4.4 In June, the USA Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December. Asset purchases have now fallen from $85bn to $35bn and are expected to stop by Q3 2014, providing strong economic growth continues this year.

4.5 The Eurozone is facing an increasing threat from deflation. In May, the inflation rate fell further, to reach 0.5%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June to loosen monetary policy in order to promote growth. Further significant steps have been taken in September with all three main ECB rates being reduced by 10 basis points together with the introduction of a form of quantitative easing light.

Economic Forecast

4.6 The Council's treasury advisor, Capita Asset Services, has provided the following forecast; Capital Economics Bank Rate forecast has been provided for comparison.

	Sept 14	Dec 14	Mar 15	June 15	Sept 15	Dec 15	Mar 16	June 16
	%	%	%	%	%	%	%	%
Bank rate : Capita Asset Services	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25
Bank rate : Capital Economics	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25
10yr PWLB rate	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.20
25yr PWLB rate	4.40	4.50	4.60	4.70	4.70	4.70	4.80	4.80
50yr PWLB rate	4.40	4.50	4.60	4.70	4.70	4.70	4.80	4.80

5. Treasury Management Strategy Statement

Annual Investment Strategy

5.1 The Council's Annual Investment Strategy, is an integral part of the approved Treasury Management Strategy 2014/15, it 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 proper levels of security and liquidity.

5.3 The Council managed its investments in-house and invested with institutions on the Council's approved lending list (Appendix 2). Following the global financial crises and persistent uncertainties, the Council remains relatively risk averse and operates a restricted lending list and a summary of the institutions to which the Council invested with is outlined below:

1. The UK Government directly (Debt Management Office)
2. The UK Government (Treasury Bill via King & Shaxson)
3. RBS and Lloyds (because of the UK government's stake in these institutions)
4. The Council's banker (Lloyds) *
5. HSBC
6. Standard Chartered Bank (Certificate of Deposit via King & Shaxson)
7. Barclays Bank
8. Nationwide Building Society
9. Local Authorities

**The Council changed its banker from RBS to Lloyds in June 2014.*

Overall Treasury Cash Flow Position as at 30 June 2014

5.4 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 31 March 2014	-	(219.290)	(219.290)
Raised/ (lent) during period	-	(2,952.597)	(2,952.597)
Repayments during period	-	2,940.899	2,940.899
Outstanding 30 June 2014	-	**(230.988)**	**(230.988)**

5.5 Over the 3 months to 30 June 2014, the Council's cashflows were maintained through borrowing and lending activities on the wholesale money market and the net position outstanding at 30 June 2014 is temporary lending of £230.988m.

5.6 No temporary borrowing was required during the period.

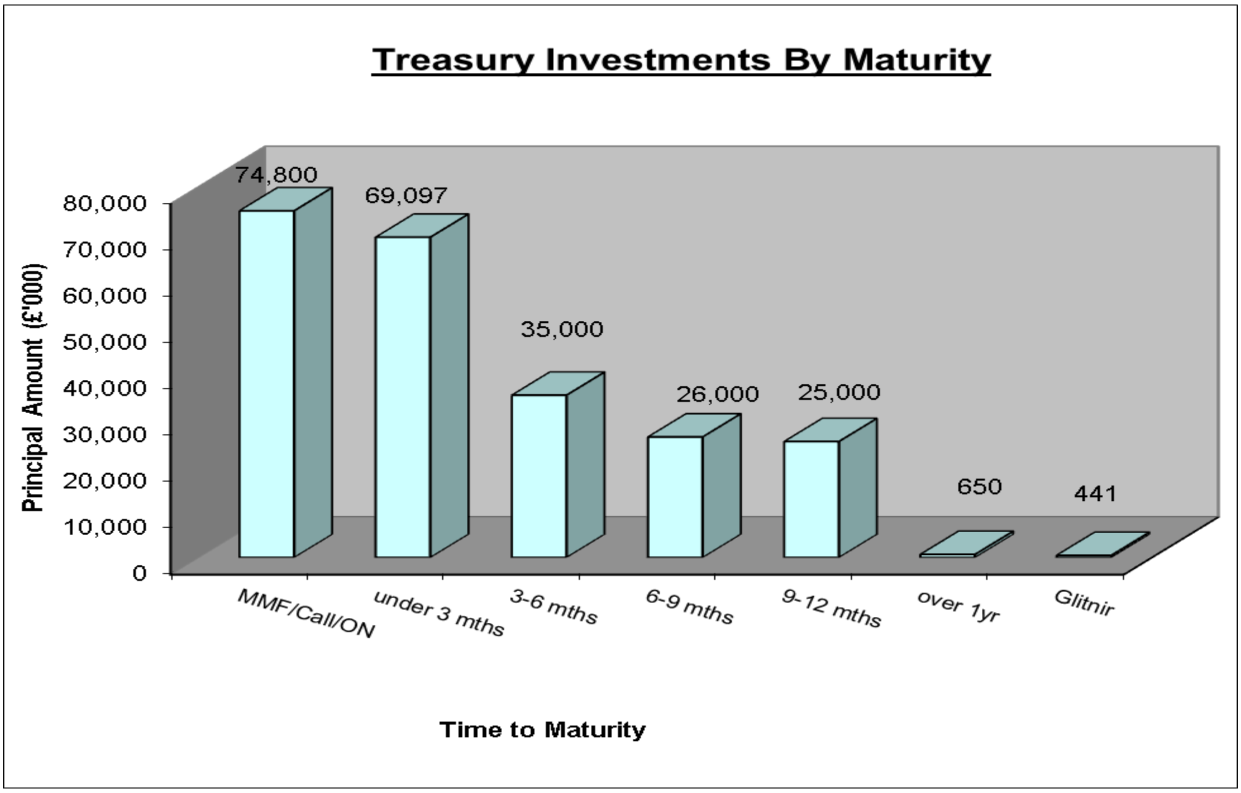
5.7 Members are advised that the Council continues to place investments with a number of local authorities and these are considered to be of high credit quality and are therefore on the Council's approved list of counterparties. In the DCLG's Investment Guidance issued to Councils, Local Authority deposits are deemed to offer "high security and high liquidity". The Council had 10 investments placed across a number of councils totaling £45.1m as at 30 June 2014, these are set out in Appendix 1.

5.8 The Councils total Investments held at 30 June 2014 are outlined below

Counterparty Name	Total Investment as at 31/03/14 (£m)	Total Investment as at 30/06/14 (£m)
Local Authorities	(59.600)	(45.100)
Debt Management Office	(33.600)	(24.800)
Glitnir Bank HF	(0.441)	(0.441)
HSBC	(30.000)	(30.000)
Standard Chartered Bank	(10.000)	(20.000)
Lloyds TSB Bank Call Account	(30.000)	(30.000)
Royal Bank of Scotland	(10.000)	(30.000)
Barclays	(20.000)	(20.000)
Treasury Bills	(4.999)	(9.997)
Nationwide Building Society	(20.000)	(20.000)
Future Ealing Ltd	(0.600)	(0.600)
Ealing Community Resource Centre	(0.050)	(0.050)
Total Investment	**(219.290)**	**(230.988)**

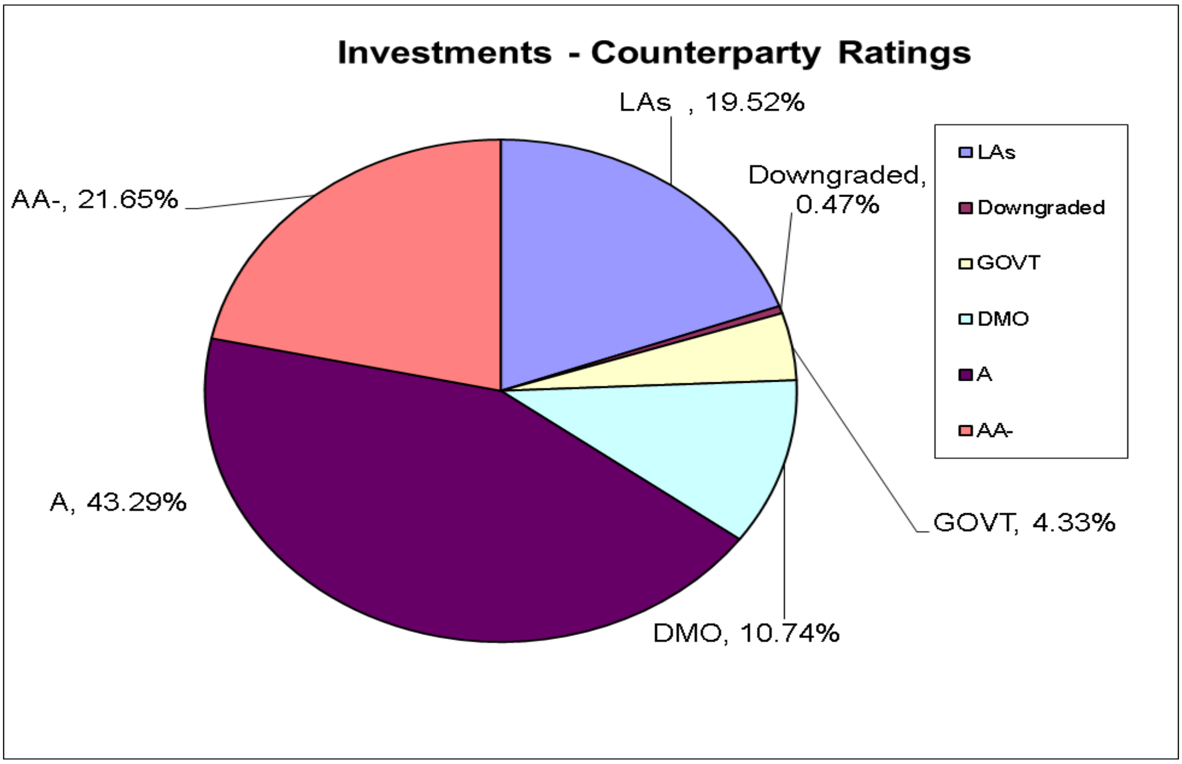
5.9 Investment activities during the quarter conformed to the approved strategy, and the Council did not experience any liquidity difficulty.

Investment Maturity Profile at 30 June 2014



- *The Council currently has two investments that have a maturity period of over one year – Future Ealing and Ealing Community Resource Centre*

Investments by Counterparty Rating at 30 June 2014



Downgraded : includes Glitnir of 0.19%, Future Ealing of 0.26% and Ealing Community of 0.02%
AA, A – Fitch credit rating.

Performance vs Benchmark

5.10 Council investment returns outperformed the benchmark (7 day LIBID rate) during the financial year. The table below outlines this performance.

Month	Council Performance %	Benchmark Rate (7day LIBID rate) %	Outperformance %
April 2014	**0.553**	**0.338**	**0.215**
May 2014	**0.561**	**0.337**	**0.224**
June 2014	**0.561**	**0.348**	**0.213**
Average	**0.558**	**0.341**	**0.217**

5.11 The Council maintained an average balance of internally managed funds of £242.562m over the quarter and had an outstanding balance of £230.988m as at 30 June 2014. The internally managed funds earned an average rate of return of 0.558%, whilst the comparable performance indicator, the average 7-day LIBID rate, returned 0.341%. The Council's budgeted investment return for quarter 1 based on an even profile over the full year was £0.250m; this was exceeded by the actual accrued interest of £0.338m. The Council's key investment philosophy remained the prudent approach to counterparty selection and an emphasis on security of capital and liquidity ahead of yield.

5.12 The ongoing uncertainties in the current economic climate have led TRIB to continue to place investments with high quality counterparties such as the DMO and other local authorities. The outcome of this policy is a reduction in the investment income received by the Council.

Icelandic Investment update

5.13 As reported previously Council has received the settlement in respect of the Council's £2m impaired Icelandic bank investment from the Glitnir winding up board. However, due to capital controls that restrict the flow of funds out of Iceland, £0.441m of this amount is retained within an escrow account in Iceland earning interest of 4.2%. The position remains that the Council like other authorities affected, has experienced delays in recovering the current balance of £0.441m while Icelandic currency controls persist, however, all efforts are being made to find other avenues to secure repatriation of the funds held in escrow.

6 Long Term Borrowing Requirement and Debt

6.1 The Council's Treasury Management Strategy Report approved in February 2014 outlined the Council's long term borrowing strategy for the year.

HRA Self Financing

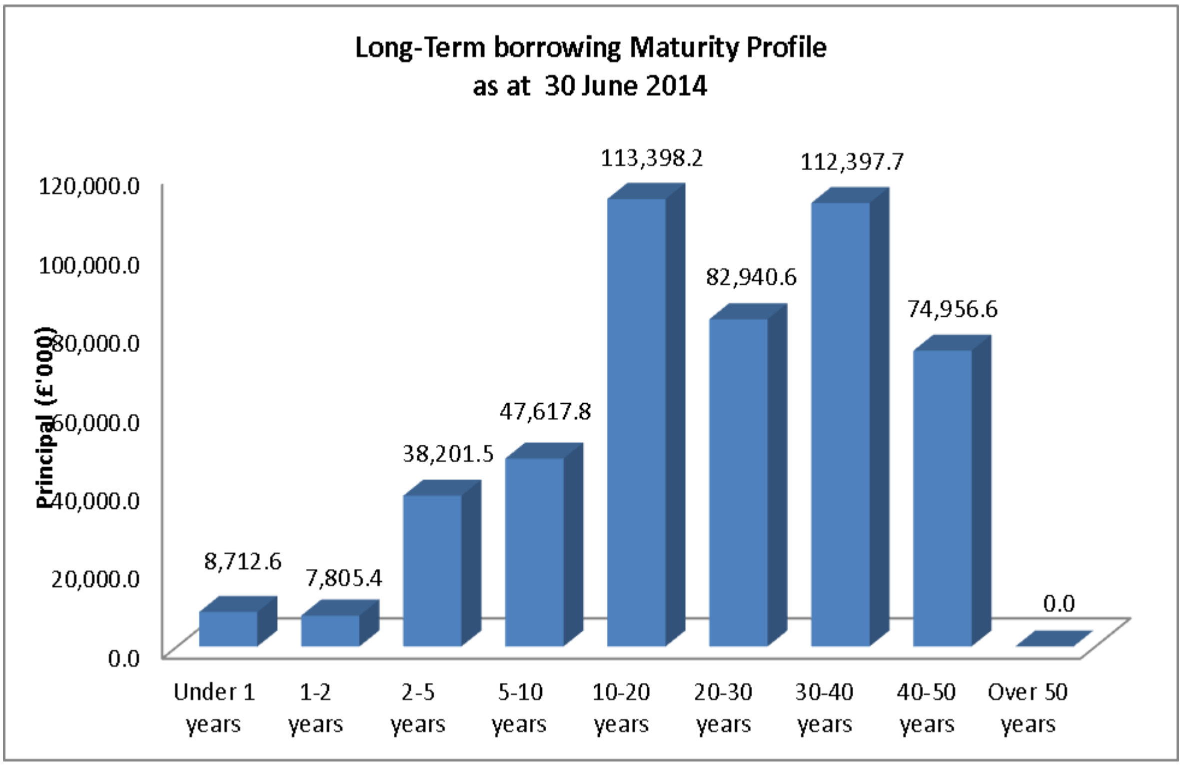
6.2 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

6.3 Total long term borrowing stood at £486.313m (including Mortlake Crematorium Board) as at 30 June 2014. The following table shows the split between General Fund and HRA borrowing, and that overall debt fell by £6.637m from £492.950m at the start of the financial year.

Source	Debt as at 31/03/14 £m	Loans raised £m	Loans repaid £m	Debt as at 30/06/14 £m
General Fund				
PWLB	285.228	-	(4.723)	280.505
Market Loans	62.016	-	-	62.016
*Mortlake Crematorium	0.218	0.065	-	0.283
Total General Fund	**347.462**	**0.065**	**(4.723)**	**342.804**
HRA				
PWLB	119.505	-	(1.979)	117.526
Market Loans	25.983	-	-	25.983
Total HRA	**145.488**	**-**	**(1.979)**	**143.509**
Total Long Term Borrowing	**492.950**	**0.065**	**(6.702)**	**486.313**
**Memo Item: PFI Obligation	132.860	-	(0.871)	131.989

Notes:
**The £0.065m 'loan raised' figure relates to the arrangement with Mortlake Crematorium where monies are passed by Mortlake Crematorium Board for investment by the Council on the Boards behalf*
***PFI schemes are shown on the balance sheet as long term creditors and are not classified under accounting rules as debt so are shown as a memo item here for completeness.*

6.4 The Council's actual borrowing at the end of the quarter of £486.313m was within the anticipated year end Capital Financing Requirement (CFR) of £622.771m. No long term borrowing was raised in the first quarter in view of the level of investments held which allowed the Council to internally borrow; hence actual borrowing was behind the Council's CFR.



- *The above graph does not include the Mortlake loan of £0.283m.*

Debt Rescheduling

6.5 Movements in interest rates over time can produce dislocations, which can present opportunities for the Council to replace 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.

6.6 No debt rescheduling opportunities have arisen during the year, as the cost of premium to repay debt outweighs savings that could be achieved from the lower PWLB borrowing rates.

PWLB Certainty Rate

6.7 The government launched a discounted borrowing rate as part of the Budget in March 2012. The PWLB Certainty Rate was introduced by the PWLB in November 2012, allowing the Council to borrow at a reduction of 0.2% on the Standard Rate.

6.8 Although there has been no need to borrow in the first quarter, the Council retains its eligibility 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 In addition to the regular quarterly reports to audit committee, regular monitoring of Treasury Management activities is carried out by senior management, the portfolio holder for Finance and the Treasury Risk and Investment Board (TRIB) which is chaired by the Executive Director of Corporate Resources.

Training

7.3 Members received refresher training on Treasury management at the Audit Committee meeting in March 2013 in preparation for the 2013/14 financial year. This is to ensure they maintain the relevant knowledge and skills required to fulfil their scrutiny role in the most effective manner.

8 Financial implications

Budget 2014/15 £m	Forecast 2014/15 £m	Variance 2014/15 £m
38.694	38.694	-

8.1 The current forecast for 2014/15 shows spending to be on budget.

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 in which the indicators were amended to highlight any deviations from expectations.

10 Legal

10.1 The lending of surplus funds and any borrowing must comply with the Local Government Act 2003 as amended by regulations from time to time by the Government. Local authorities by virtue of section 15 (1) (a) of the 2003 Act must have regard to any guidance on investments issued by the Secretary of State, the latest such guidance was issued in April 2010. Further, local authorities must have regard to other guidance specified by the Secretary of State under section 15 (1) (b) of the 2003 Act. Section 24 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 specifically mentions that local authorities shall also have regard to CIPFA’s Code of Practice on Treasury Management in the Public Services, the latest version of which was published in 2011.

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 in Q1 of 2014/15 and PWLB borrowing was monitored throughout the year, the budgeted target rate was 5.00%. In addition, the treasury function operated within budget over the reporting period.

12 Risk Management

12.1 There is no treasury management activity without risk. Risk management plays a fundamental role in treasury activities, due to the value of transactions involved. When placing investments with counterparties, risk management and security of capital always remain the priority over returns.

12.2 The adoption of the CIPFA Code for Treasury Management in Public Services, the use of a Lending List and receiving advice from Capita Asset Services mitigate 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 /Workforce and Accommodation Implications

16.1 None

17 Any Other Implications

17.1 None

18 Consultation

18.1 Capita Asset Services provide the Council with advice on treasury management.

19 Timetable for implementation

19.1 Not applicable

BACKGROUND INFORMATION
Lending and borrowing investments files kept on the 5th floor Perceval House.

Consultation

Name of consultee	Department	Date sent to consultee	Date response received	Comments appear in report para:
Maria G Christofi	Director of Finance	08-09-14	10-09-14	Throughout
Nigel Watson	Assistant Director of corporate Finance	08-09-14	09-09-14	Throughout
Matthew Bunyon	Head of Financial Planning & Investments	08-09-14	09-09-14	Throughout
Helen Harris	Head of Legal	08-09-14	09-09-14	
Catherine Taylor		08-09-14		
Cllr Murtagh	Chair of the Audit Committee	08-09-14		

Report History

Decision type: For Action/Information	Urgency item? No

Authorised by Cabinet member:	Date report drafted:	Report deadline:	Date report sent:
	03 Sept 2014	15 Sept 2014	Sept 2014

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.