~~Council~~ ~~12th December 2013~~	~~Agenda Item 56~~ ~~Brighton & Hove City Council~~

Subject:		**Treasury Management Policy Statement 2013/14 (including Annual Investment Strategy 2013/14) – Mid Year Review**
Date of Meeting:		**Council 12th December 2013** Policy & Resources Committee - 5th December 2013
Report of:		**Executive Director of Finance & Resources**
Contact Officer:	**Name:**	**Mark Ireland** **Tel: 29-1240**
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Wards Affected:	**All**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT:

1.1 The Treasury Management Policy Statement 2013/14 (TMPS) and the Treasury Management Practices (including the schedules) for the year commencing 1 April 2013 were approved by the Policy & Resources Committee on 21 March 2013. Full Council approved the Annual Investment Strategy 2013/14 (AIS), which forms part of the TMPS, on 28 March 2013. The policy statement sets out the key role for treasury management, whilst the practices and schedules set out the annual targets for treasury management and the methods by which these targets shall be met. The AIS sets out the parameters within which investments can be made.

1.2 The purpose of this report is to advise of the action taken during the period April to September 2013 to meet the policy statement and practices and the investment strategy. In order to address the continuing difficulties of finding sufficient investment counterparties of suitable financial standing this report also recommends changes to the AIS which will need to be agreed by full Council. These proposals have been discussed and finalised with our treasury management advisers in the light of benchmarking data from other councils and recommendations include a doubling of our investment limits with the higher rated UK financial institutions, the inclusion of a few highly rated foreign banks with UK based branches and the addition of some different types of investment used by other local authorities where returns can be higher but investment risks are lower.

2. RECOMMENDATIONS:

2.1 That Policy & Resources Committee endorses the action taken during April - September 2013 to meet the Treasury Management Policy Statement 2013/14 and associated treasury management practices and the Annual Investment Strategy 2013/14.

2.2 That Policy & Resources notes the maximum indicator for risk agreed at 0.05%, the authorised borrowing limit and operational boundary have not been exceeded.

2.3 That Policy & Resources recommend that Full Council agree changes to the Annual Investment Strategy 2013/14 as set out in paragraphs 3.12 to 3.16 and appendix 3 of this report.

3. CONTEXT / BACKGROUND INFORMATION

Overview of markets

3.1 The last few months have seen fewer headlines about problems within the Euro Zone but this does not mean the problems have gone away and over the coming months Greek debt refinancing will need to be resolved and countries such as Slovenia may find themselves requiring financial bailouts. The UK economy has shown continued positive growth, unemployment is down and the inflation outlook is weaker but analysts have concerns about whether this improvement is sustainable particularly given continued weakness in our main trading partners.

3.2 The new Governor of the Bank of England, Mark Carney, has with the Federal Reserve and the European Central Bank, tried to stabilise the markets by setting out a forward guidance strategy which indicates that the Bank Rate is likely to remain at its historic low until late 2016. This has had the bizarre impact that the markets now perceive good economic news as bad as it may bring forward the date when interest rates are increased and other economic stimuli are reduced. Various government initiatives particularly those to stimulate the housing market have meant that the UK money markets are awash with cheap cash and short and medium term investment rates are exceptionally low.

Treasury management strategy

3.3 A summary of the action taken in the six months to September 2013 is provided in Appendix 1 to this report. 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 0.015% which is well below the maximum set of 0.05%;
- The return on investments by the in-house treasury team and cash manager has exceeded the target rate but the return achieved by the in-house team is well below the budget forecast due to the very low rates achievable in the current money markets. There is scope to improve returns slightly by investing for longer periods whilst keeping within the maximum risk indicator;
- The two borrowing limits approved by Budget Council in February 2013 have not been exceeded in the first half of the year.

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

	Amount invested 1 April to 30 Sept 2013			
	Fixed deposits	Money market funds	Total	
Up to 1 week	£27.3m	£165.0m	£192.3m	55%
Between 1 week & 1 month	£28.0m	-	£28.0m	8%
Between 1 month & 3 months	£98.7m	-	£98.7m	28%
Over 3 months	£31.0m	-	£31.0m	9%
	£185.0m	£165.0m	£350.0m	100%

3.5 Security and liquidity of the investment portfolio continues to be the main objective for the council's investment strategy. It is however increasingly difficult to find suitable investment counterparties using the current investment list and changes are recommended in paragraphs 3.11 to 3.15. The average period for fixed deposits (i.e. excluding money market funds) was around 35 days.

Summary of treasury activity April to September 2013

3.6 The table below summarises the treasury activity in the half-year to September 2013 with the corresponding period in the previous year.

	Apr to Sep 12	Apr to Sep 13
Long-term borrowing repaid	-	-
Short-term borrowing repaid	-	-
Investments made	£348.4m	£350.0m
Investments maturing	(£308.6m)	(£311.0m)

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

	Apr to Sep 12	Apr to Sep 13
Cash flow surplus	£39.8m	£39.0m
Decrease in long-term borrowing	-	-
Decrease in short-term borrowing	-	-
Decrease / (increase) in investments	(£39.8m)	(£39.0m)

Security of investments

3.8 A summary of investments made by the in-house treasury team and outstanding as at 30 September 2013 is tabled below. The table shows that investments continue to be held in good quality, short-term instruments.

	Balance o/s 30 Sept 2013	
‘AAA’ rated funds	£26.9m	39%
‘A’ rated institutions	£26.4m	38%
‘BBB’ rated institutions	£16.0m	23%
	£69.3m	100%
Period – less than one week	£26.9m	39%
Period – between one week and one month	£15.7m	23%
Period – between one month and three months	£22.5m	32%
Period – more than three months	£4.2m	6%
	£69.3m	100%

3.9 The end of year report considered at the July meeting of Policy & Resources informed Members that the Coop Bank had been downgraded to below investment grade and that it had unveiled a rescue plan to deal with the £1.5bn hole in its balance sheet. Agreement with its bondholders has now almost been reached but this means that the hedge funds and the other bondholders will own about 70% of the bank. The bank has been removed from our lending list until their credit rating improves. In a review of its operations the Coop has recently written to all councils saying that it will no longer provide banking services to local authorities but will honour existing contracts. The council’s banking contract with the Coop is due to end on 31 March 2015 and officers have already started to work up an options strategy to procure a new banking contract.

Risk

3.10 As part of the investment strategy for 2013/14 the Council agreed a maximum risk benchmark of 0.05%. 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 0.004% and 0.015% between April and September 2013. 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.

Performance

3.11 The following table summarises the performance on investments compared with the budgeted position and the benchmark rate. The council has recently joined a regional benchmark club to share investment strategies and performance on a confidential basis.

(*) Annualised rates	In-house investments		Cash manager investments	
	Average balance	Average rate (*)	Average balance	Average rate (*)
Budget 2013/14– full year	£52.9m	0.63%	£25.0m	0.75%
Actual to end Sept 2013	£90.2m	0.47%	£25.1m	0.53%
Benchmark rate (i.e. 7 day LIBID Rate) to end Sept 2013	-	0.36%	-	0.36%

Proposed Revision to Annual Investment Strategy 2013/14

3.12 The Annual Investment Strategy 2013/14 (AIS) was presented to full Council on 28th March 2013 and agreed.

3.13 The government's funding for lending scheme has amongst other initiatives significantly increased the amount of cash available in the UK money markets making it extremely hard to place cash investments with good quality counterparties and significantly reducing the rate of return. It is unlikely that this position will change in the medium term and has prompted a review of the current AIS by officers and our advisors.

3.14 Benchmarking with other council's with a similar sized investment portfolios has shown that the investment limits set by the council with the higher rated UK financial institutions (i.e. those with long term credit ratings of AAA, AA and A) are low and it is proposed that these are doubled from current levels. Given the added security of government support for the part nationalised banks it is proposed that their investment limits are raised slightly higher to £25m. The part nationalised banks are currently offering some of the best investment rates over the 6 months to 1 year period which to date the council has been able to take only limited advantage due to the restricted limits.

3.15 Our advisors have also suggested that our counterparty list should be enlarged to include a few Non-UK banks but only of the very high AA credit quality that are based in AAA rated countries. There are 5 banks that fall into this category who are active in the UK money markets:

- Toronto Dominion (Canada)
- Nordea (Finland)
- RABOBANK (Netherlands)
- Commonwealth Bank of Australia
- National Australia Bank

3.16 By adding these institutions to our list it should be possible to increase returns and reduce risk by investing in negotiable instruments (already authorised under the current AIS) such as Certificates of Deposit (CDs). Proposed changes to the AIS are set out in full in appendix 3.

3.17 It was announced by Lloyds Bank on 18 November the Scottish Widows Investment Partners (SWIP), our external cash managers, would be sold to Aberdeen Asset Management to create the biggest firm of investment managers in Europe. The sale is likely to take place in 3 or 4 months time and is unlikely to impact on the arrangements the council has currently in place with SWIP and has the potential to improve future returns given the influence the larger company will have on the markets.

4 EVALUATION OF ANY ALTERNATIVE OPTION(S):

4.1 This report sets out action taken in the six months to September 2013 and proposed changes to the AIS. The changes to the AIS are designed to optimise flexibility in investment decisions and potentially improve investment returns whilst keeping within agreed risk parameters. An alternative would be to keep the AIS unchanged but this could lead to lower returns and higher risk.

5. CONSULTATION

5.1 The council's external treasury advisors have been consulted in the drafting 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 looks at the first 6 months of the year. This report fulfils this requirement..

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 The financial implications arising from the action taken under the TMPS are included in Financing Costs. The month 6 forecast for financing costs shows a contribution to the Financing Costs Reserve of £25,000 as a result of higher than anticipated net cashflows for the year which have been largely offset by lower investment returns achieved as a result of lower interest rates in the money markets. Without the proposed changes to the AIS investment returns are likely to fall in line with money market rates. The proposed changes should allow officers to achieve slightly higher returns whilst maintaining or even reducing current risk parameters.

Finance Officer Consulted: Mark Ireland Date: 08/11/13

Legal Implications:

7.2 Action under the TMPS must be in accordance with Part I of the Local Government Act 2003 and associated regulations. Relevant guidance also needs to be taken into account.

7.3 Under the council's constitution approval of the Annual Investment Strategy, and of any revisions to it, is reserved to full Council. This requirement is reflected in recommendation 2.3 of this report.

Lawyer Consulted: Oliver Dixon Date: 21/11/13

Equalities, Sustainability and other implications:

7.4 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. A summary of the action taken in the period April to September 2013

2. September 2013 Treasury Management Bulletin

3. Proposed changes to the Annual Investment Strategy

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 2013/14 approved by Policy & Resources on 21 March 2012

3. The Annual Investment Strategy 2013/14 approved by full Council on 28 March 2013

4. Treasury Management Policy Statement 2012/13 (including Annual Investment Strategy 2012/13) – End of year Review approved by Policy & Resources Committee on 11 July 2013.

5. Papers held within Strategic Finance, Finance & Resources Directorate

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