Report of the Director of Policy & Resources

Agenda Item No: 11
Meeting: 22 January 2015

NORTH LINCOLNSHIRE COUNCIL

Audit Committee

QUARTERLY TREASURY MANAGEMENT AND STRATEGY REPORT 2014/15

1. **OBJECT AND KEY POINTS IN THIS REPORT**

1.1 To provide a review of the treasury strategy approved by council as part of the 2014/15 budget. The report gives details of progress to date.

1.2 It covers treasury management performance for the nine months between April and December 2014. The report explains how the strategy has been implemented during the year, the state of the financial markets, and the response to changing conditions in those markets.

2. **BACKGROUND INFORMATION**

2.1 **The investment strategy for 2014/2015** aims to;

- Invest for periods up to twelve months
- Only investing directly in UK institutions with a minimum of an adequate credit rating or equivalent
- Applying a maximum investment limit of £7m or lower for counter-parties (except the council's own bankers)
- Applying a maximum limit to financial groups rather than separate institutions
- Investing in a wider range of institutions through Money Market Funds.

2.2 **The borrowing strategy for 2014/2015** aims to**;**

- Resume borrowing for capital investment in 2014/15
- Track short-and long-term interest rates to determine the best timing of that borrowing
- Consider borrowing from a range of institutions to ensure the best value for money
- Generally borrow only to support the capital programme
- Borrow for shorter periods if cash flow requires

2.3 The council’s budget was framed against the state of financial markets at the time of approval and prospects for the year ahead. This included the Bank of England Base Rate which was set on 5th March 2009 at 0.5% and continues at that level. The Monetary Policy Committees decision to retain this rate followed a prolonged period of low CPI inflation levels and high levels of unemployment which they felt reflected spare capacity within the global economy. By retaining the rate at this level it was hoped that it would aid economic recovery and reduce spare capacity.

2.4 The budget provides for an average annual cost of interest at 4% and principal repayment over 20 years for future external borrowing once internal borrowing is no longer an option. The strategy for 2014/15 anticipated that the council would be required to move to external borrowing during the financial year.

2.5 Existing debt is based on a mix of borrowing terms. The rates are taken into account when the council sets prudential indicators for the treasury function. Performance is monitored against these targets to ensure the capital investment programme remains affordable and sustainable.

3. OPTIONS FOR CONSIDERATION

3.1 The report considers the implementation of an agreed strategy. There are therefore no options to consider.

4. ANALYSIS OF OPTIONS

Investment strategy

4.1 The prospects for growth in the economy, while still positive, appears less optimistic than earlier in the year, due to sluggish growth recovery in Europe, tensions in the Ukraine and the Middle East and a slowing of growth in China. Also the reduction in the price of oil is anticipated to have a destabilising effect.

4.2 Gross Domestic Product (GDP) is the main indicator of economic growth and the latest figures from the Office for National Statistics show that GDP increased by 0.7% in the third quarter of the calendar year. This represents a fall of 0.2% from the previous quarter. Also the year on year growth figure for GDP in the third quarter was 2.6%. This was below the expectations of the main forecasting agencies and has led to a general downgrading of future growth forecasts to 2.5% for 2015.

4.3 With this backdrop and the continuing low level of CPI inflation the Bank of England has continued to hold the bank base rate at 0.5%. It is now believed unlikely that an interest rate rise will be seen until late 2015. While this is seen as a positive for business investment this rate offers little for those seeking returns from investments, as is suggested by the rates currently offered by the Councils counter parties.

4.4 The focus of cash management remains to maximise security and liquidity. Cash is currently being held in a range of call accounts with UK banks and building societies, who maintain an adequate credit rating.

4.5 In addition to this investments have been placed with Money Market funds meeting the council's investment criteria. These offer more competitive rates that many of the bank and building society counter parties while diversifying credit and interest rate risk.

4.6 Investments realised during the first nine months were returned with interest or reinvested. At the end of December outstanding investments were £14.0m, mostly with the council's own bankers. Of these investments £5.8m relate to the Regional Growth Fund and returns on these investments are paid over to the fund (**Appendix 1).**

4.7 The low base rate means returns on investments continue to be very modest. So far an average return of 0.45% has been achieved. Although the investment limits and risk criteria set in the strategy have been relaxed a little this year to maximise potential yields when funds are at their highest, this has been negated somewhat by short term cash flow requirements which have prevented significant funds being invested to the limits allowed within the strategy. Investment income of £117k had been achieved to date exceeding the annual budget by £25k.This is at a time when counterparties are reducing their investment interest rates.

Borrowing strategy

4.8 In setting the current strategy it had been anticipated that the level of repayment of maturing debt, the extent of capital investment to be funded directly by the council and a reduction in the level of surplus balances would mean that the council would be unable to continue the practise of internal borrowing during 2014-15.

4.9 The anticipated impact of these factors has not however materialised due to the extent of capital investment rephasing, the retained level of balances following a positive 2013-14 outturn position and the influx of new external funding. It is therefore anticipated that additional borrowing to finance capital investment may not be required in 2014-15. There is however a possibility that short term borrowing to meet periodic cash flow shortfalls, may be necessary towards the end of the financial year.

4.10 In order to ensure value for money for the council, a balance has to be struck between avoiding external borrowing in the short-term to maximise revenue savings now, and the longer term costs if interest rates rise. At the end of December the long term borrowing rate (25 year PWLB annuity rate) had fallen to 3.1%. With the bank base interest rate anticipated to remain at 0.5% until late 2015 and the prospect of increased returns on investment remaining low, the difference between borrowing and lending rates would suggest that, while affordable, the use of balances for internal borrowing continues to offers the best value for money to the council.

4.11 Scheduled debt repayments continue to be made and at the end of December 2014 debt outstanding was £107.2m. By the end of March 2015 this will have been reduced further to £105.8m.

4.12 Over the next three financial years the council will be required to repay a total of £15m of maturing debt. Having used set aside funds in place of borrowing over the last seven years it will be necessary to borrow to cover these commitments. The timing of such borrowing will be crucial and early borrowing to achieve lower rates may provide better value for money over the long term than borrowing at higher rates at the time of repayment. The interest rates continue to be carefully monitored and an appropriate case for borrowing will be made at the most opportune time.

4.13 Key performance indicators have been updated following the rephasing of the capital programme since the start of the financial year and the inclusion of additional grant funded capital schemes. (see **Appendix 2)**.

5. RESOURCE IMPLICATIONS (FINANCIAL, STAFFING, PROPERTY, IT)

5.1 The treasury strategy aims to minimise risk to the council's finances from further instability in financial markets while seeking to achieve a favourable return from investment income.

5.2 The projected costs of financing debt are within budget and the prudential ratio of financing costs to net revenue streams (**Appendix 2 11a & 11b**) below the 10% **-**12% range set by council.

5.3 There has been an adjustment to the capital programme in 2014/15 largely due to approved rephasing of programme spending and changes to programme financing. This is reflected in **Appendix 2.**

6. OUTCOMES OF INTEGRATED IMPACT ASSESSMENT (IF APPLICABLE)

6.1 Not applicable

7. OUTCOMES OF CONSULTATION AND CONFLICTS OF INTERESTS DECLARED

7.1 Not applicable.

8. RECOMMENDATIONS

8.1 That the Audit Committee notes the treasury management performance.

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Background Papers used in the preparation of this report

Treasury Management Strategy Report 2014/15

APPENDIX 1

INVESTMENT POSITION AS AT 31 DECEMBER 2014

CALL ACCOUNT BALANCES		£	
Barclays Bank plc - Flexible Interest Bearing Current Account	0.55%	13,919,292	On call
Bank of Scotland Plc - Call Account	0.4%	3,715	On call
HSBC Bank Plc - Call Account	0.3%	299	On call
National Westminster Bank Plc - Corporate Cash Manager Plus Account (formerly known as Special Interest Bearing Account)	0.25%	5,897	On call
OTHER INVESTMENTS			
CCLA - Public Sector Deposit Fund	(variable)	25,000	Money Market Fund (On Call)
TOTAL		**13,954,203**	

In addition to those specified above, the only counterparties with whom any investments have been placed in the period up until 31st December 2014 are the Coventry Building Society, Leeds Building Society, Virgin Money Plc and the Yorkshire Building Society.

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APPENDIX 2

APPROVED PRUDENTIAL GUIDELINE INDICATORS	2014/15 Budget (Feb 2014)	2014/15 Revised
(i) Estimates of capital expenditure	£m 68.045	£m 92.495
(ii)a General Fund ratio of financing costs to the net revenue stream % (Including Capital Grants) (Based on Prudential Code 2011)	% 7.77	% 6.73
(ii)b General Fund ratio of financing costs to the net revenue stream % (Excluding Capital Grants) (Based on Prudential Code 2013)	% 9.34	% 9.10
(iii) an estimate of the capital financing requirement	£m 180.21	£m 183.38
(iv) the authorised limit for external debt borrowing other long term liabilities total	£m 233 5 238	£m no change
(v) the operational boundary for external debt borrowing other long term liabilities total	£m 181 2 183	£m no change
(vi) upper limit for fixed rate exposure	% 100	no change
(vii) upper limit for variable rate exposure	 20	no change
(viii) upper and lower limits for maturity structure of borrowing UPPER LIMIT under 12 months	 15	

12 months and within 24 months 24 months and within 5 years 5 years and within 10 years 10 years and above LOWER LIMIT under 12 months 12 months and within 24 months 24 months and within 5 years 5 years and within 10 years 10 years and above	15 50 75 90 0 0 0 0 25	no change no change
(ix) total principal sums invested for periods longer than 364 days	£000 0	£000 0

(i) Capital Programme expenditure has significantly changed due to rephasing of £8.9m from the 2013-14 programme and in year slippage. Also due to the inclusion of additional grant funded schemes, in particular the Building Foundations for growth Scheme at £14.9m & the University technical College construction £7m.

(ii)a The ratio has fallen by 1.04% due to an increase in capital grant funding and a reduction in MRP capital financing charges following the rephasing of 2013-14 capital investment.

(ii)b The ratio has fallen by 0.24% due a reduction in MRP capital financing charges following the rephasing of 2013-14 capital investment.