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This report is in draft format for presentation to Cabinet on 10 December 2013

TITLE OF REPORT : TREASURY MANAGEMENT SECOND QUARTER REPORT 2013/14

REPORT OF THE STRATEGIC DIRECTOR OF FINANCE, POLICY & GOVERNANCE
PORTFOLIO HOLDER: COUNCILLOR T.W. HONE

1. SUMMARY

1.1 To inform Cabinet of the Treasury Management activities in the second quarter 2013/14 to the end of September.

1.2 To inform Cabinet of the performance against the Prudential and Treasury indicators.

2. RECOMMENDATIONS

2.1 Cabinet is asked to note the position of Treasury Management activity as at the end of September 2013.

3. REASONS FOR RECOMMENDATIONS

3.1 To ensure the Council's continued compliance with CIPFA's code of practice on Treasury Management and the Local Government Act 2003 and that the Council manages its exposure to interest and capital risk.

4. ALTERNATIVE OPTIONS CONSIDERED

4.1 Considerations for the Treasury Strategy can be summarised under the headings; Security, Liquidity and Yield. These considerations are listed in order of importance but all have an influence on the adopted Strategy. In particular the yield from investments is an important income stream for the general fund. The current strategy enables an above average yield compared to other Herts authorities of approximately £0.681M of interest in the financial year. Our Treasury advisors from Sector Treasury Services Ltd promote a different approach to an investment strategy that would not currently allow investment with most Building Societies. This would result in a lower yield but the option has been dismissed, following consideration, on the basis of Members' appetite for risk and the impact on the general fund.

5. CONSULTATION WITH EXTERNAL ORGANISATIONS AND WARD MEMBERS

5.1 There is ongoing dialogue with the Authority's Cash Managers (Sterling and Tradition) and regular meetings with Treasury advisors (Sector).

6. FORWARD PLAN

6.1 This Report does contain a recommendation on a key decision that was first included in the Forward Plan on 26 June 2013.

7. BACKGROUND

7.1 Members adopted the 2013/14 Treasury Strategy at the meeting of full Council on the 13 February 2013. The Treasury Strategy Statement contained no major changes from the 2012/13 Strategy.

7.2 Sector Treasury Services Ltd were contracted to provide Treasury advice for the financial year 2012/13 and this arrangement has been continued for 2013/14. The service includes regular updates on economic and political changes which may impact on the Council's borrowing and investment strategies, advice on rescheduling, information and prudent parameters in respect of investment counterparty creditworthiness, document templates, access to technical updates and to the Technical Advisory Group.

8. ISSUES

8.1 Appendix A provides the Treasury Management update at the end of the second quarter. This document contains economic background, an interest rate forecast and summary outlook provided by Sector for background context to Treasury activities. The remainder of the document contains an update on the Council's investment strategy.

8.2 In summary, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

8.3 The Council generated £0.165M of interest during the second quarter of 2013/14 (£0.394M for first six months). The average interest rate agreed on new deals during the quarter by the cash managers (Sterling and Tradition) was 1.07% (0.75% in first quarter). The average interest rates on all outstanding investments (including in house deals) at the 30th September was 1.57% (1.56% at 30th June).

8.4 The Council's activities expose it to a variety of risks (credit, liquidity and market). The Treasury Strategy sets out the Authority's appetite for the level of exposure to these risks. Firstly, **Credit Risk** – The possibility that other parties fail to pay amounts due to the Authority.

8.5 The Council's counterparty list comprises mostly UK banks with a Fitch (a credit rating agency) credit rating greater than BBB and UK building societies but also includes other Local Authorities and Public Corporations. The treasury strategy limits the maximum investment with any one counterparty in order to spread the risk of default.

8.6 The last few months has proved challenging to find counterparties willing to pay a reasonable return on cash investments, either long or short term. Sector advised this could be in part be due to the Government scheme to lend money to counter-parties who are willing to then lend to businesses (this "funding for lending" scheme has been extended to January 2015). As a result there is less of a demand for Local Authority funds. This issue is expected to continue during 2013/14 and is coupled with a reduction in the rate the Council will receive on the Nat West call account (for short term deposits). The rate of interest on this account for the majority of 2012/13 was 0.9%. This was reduced to 0.5% in March.

8.7 **Liquidity Risk** – the possibility that the Authority may not have funds available to meet its commitments to make payments.

8.8 Investments are split between two Cash Managers and the In-House team. The In-House investments cover the day to day cash flow activity of the Council whilst the Cash Managers' investments take advantage of higher long term interest rates when they become available. The Council was able to meet all its commitments to make payments during the second quarter without any additional borrowing.

8.9 **Market Risk** - the possibility that financial loss might arise as a result of changes in interest rates.

8.10 Investing long term (greater than one year) currently achieves higher interest rates than short term deals. The risk of long term deals are two fold:

(i) The longer the time period the longer the investment is exposed to default.
(ii) If the investment has a fixed interest rate, interest rates could rise and the potential to invest at a higher rate will be lost until the investment matures.

8.11 Members have indicated that they are prepared to accept this risk within the limits expressed in the Treasury Strategy which allows no more than £20M (out of a total of just over £47M) to be invested for longer than 364 days at any one time. At the end of the second quarter the Council had £11.5M invested for longer than 364 days. Two deals were placed during the quarter for longer than one year totalling £3.75M.

9. LEGAL IMPLICATIONS

9.1 The Cabinet has a responsibility to keep under review the budget of the Council and any other matter having substantial implications for the financial resources of the Council.

9.2 Section 151 of the Local Government Act 1972 states that:
".every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs."

9.3 The Prudential Indicators comply with the Local Government Act 2003.

10. FINANCIAL IMPLICATIONS

10.1 The amount of investment interest expected to be generated during the year is £0.681M. This is £2k more than the original budget figure of £0.679M. The estimated interest at the first quarter was £0.656M. This increase is due to higher rates of interest being achieved on new investments placed during the second quarter compared to the 0.75% estimate.

10.2 Potential options for inclusion in the Treasury Strategy are considered as and when identified. Any proposals to amend the Strategy are reported to Full Council, via Cabinet, for approval.

10.3 AAA Money Market Funds were added to the counterparty list to give another outlet for our investments when the Strategy was approved for 2013/14. No funds have been placed with any Money Market Funds during the current year although the expectation is that these will be utilised during 2014/15 if rates are advantageous.

10.4 A long term funding strategy to be explored is the inclusion of Property Funds within the Treasury Strategy for 2014/15. This option is being considered in consultation with the Portfolio Holder and more information is being sought on the relative benefits and risks.

11. RISK IMPLICATIONS

11.1 Risks associated with treasury management and procedures to minimise risk are outlined in the Treasury Management Practices document, TMP1, which was adopted by Cabinet in July 2003. The risk on the General Fund of a fall of investment interest below the budgeted level is dependant on banks and building societies need for borrowing. The introduction of the Funding for Lending Scheme, which allows financial institutions access to low cost funding from Government for an extended period has impacted on their need to borrow and the rates at which they are prepared to borrow.

12. EQUALITIES IMPLICATIONS

12.1 The Equality Act 2010 came into force on the 1 October 2010, a major piece of legislation. The Act also created a new Public Sector Equality Duty, which came into force on the 5 April 2011. There is a General duty, described in 12.2, that public bodies must meet, underpinned by more specific duties which are designed to help meet them.

12.2 In line with the Public Sector Equality Duty, public bodies must, in the exercise of its functions, give **due regard** to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not.

12.3 There are no equalities implications arising from this report.

13. SOCIAL VALUE IMPLICATIONS

13.1 There are no social value implications arising from this report.

14. HUMAN RESOURCE IMPLICATIONS

14.1 There are no direct human resource or equality implications.

15. APPENDICES

15.1 Appendix A - Annual Treasury Management Update Sept 2013.

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17. BACKGROUND PAPERS

Treasury Strategy 2013/14
CIPFA Prudential Code for Capital Finance in Local Authorities