Report No. FSD14040	**London Borough of Bromley**	**Agenda Item No.**

PART 1 - PUBLIC

Decision Maker:	**Resources Portfolio Holder** **Council**		
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 5th June 2014** **Council 21st July 2014**		
Decision Type:	Non-Urgent	Non-Executive	Non-Key
Title:	**TREASURY MANAGEMENT - ANNUAL REPORT 2013/14**		
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Chief Officer:	Director of Finance		
Ward:	Alll		

1. Reason for report

1.1 This report summarises treasury management activity during the March quarter and includes the Treasury Management Annual Report for 2013/14, which is required to be reported to full Council. The report also includes an update on the Council's investment with Heritable Bank (paragraph 3.15). Investments as at 31st March 2014 totalled £247.4m (excluding the balance of the Heritable investment) and there was no outstanding external borrowing.

RECOMMENDATION(S)

The PDS Committee, the Portfolio Holder and The Council are asked to:

(a) Note the Treasury Management Annual Report for 2013/14 and

(b) Approve the actual prudential indicators within the report.

Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £1.591m (net) in both 2013/14 and 2014/15; surplus of £653k achieved in 2013/14 (including £311k from part-reversal of Icelandic Bank impairment)

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.25 fte

2. If from existing staff resources, number of staff hours: 9 hours per week

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Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments:

3. COMMENTARY

General

3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year comparing actual activity to the strategy. In practice, the Director of Finance has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end. This report includes details of investment performance in the final quarter of 2013/14 and the annual report for the whole of the financial year 2013/14.

3.2 Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members. The Director of Finance confirms that he has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Executive and Resources PDS Committee before they were reported to the full Council.

Treasury Performance in the quarter and year ended 31st March 2014

3.2 **Borrowing:** The Council's healthy cashflow position continued through the whole of 2013/14, as a result of which no borrowing has been required at all since 2010/11, when one small overnight loan (for £800k) was taken out (in March 2011).

3.3 **Investments:** The following table sets out details of investment activity during the March quarter and during the whole of the financial year 2013/14:-

	Qtr ended 31/3/14		**Year ended 31/3/14**	
Main investment portfolio	**Deposits**	**Ave Rate**	**Deposits**	**Ave Rate**
	£m	**%**	**£m**	**%**
Balance of "core" investments b/f	180.00	0.79	167.50	1.88
New investments made in period	58.50	0.63	211.00	0.74
Investments redeemed in period	-66.50	0.70	-206.50	0.99
"Core" investments at end of period	172.00	0.83	172.00	0.83
Money Market Funds	19.30	para 3.10	19.30	para 3.10
RBS 95 day notice account	15.00	para 3.11	15.00	para 3.11
Svenska Handelsbanken instant access	15.00	0.60	15.00	0.60
Deutsche Bank 95 day notice	5.00	0.74	5.00	0.74
Standard Chartered Bank - Corporate Bond	1.10	0.70	1.10	0.70
CCLA Property Fund	5.00	para 3.12	5.00	para 3.12
Payden Sterling Reserve Fund	15.00	para 3.12	15.00	para 3.12
Total investments at end of period	**247.40**	**n/a**	**247.40**	**n/a**
Heritable deposit - frozen (para xxxx)				

3.4 Details of the outstanding investments at 31st March 2014 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. The average return on all new "core" investments during the March quarter was 0.63% which may be compared with the average 3 month LIBID rate of 0.40% and the average 7 day rate of 0.34%. The average return on new investments placed in the year 1st April 2013 to 31st March 2014 was 0.74% compared to the average 3 month rate of 0.39% and the average 7 day rate of 0.35%.

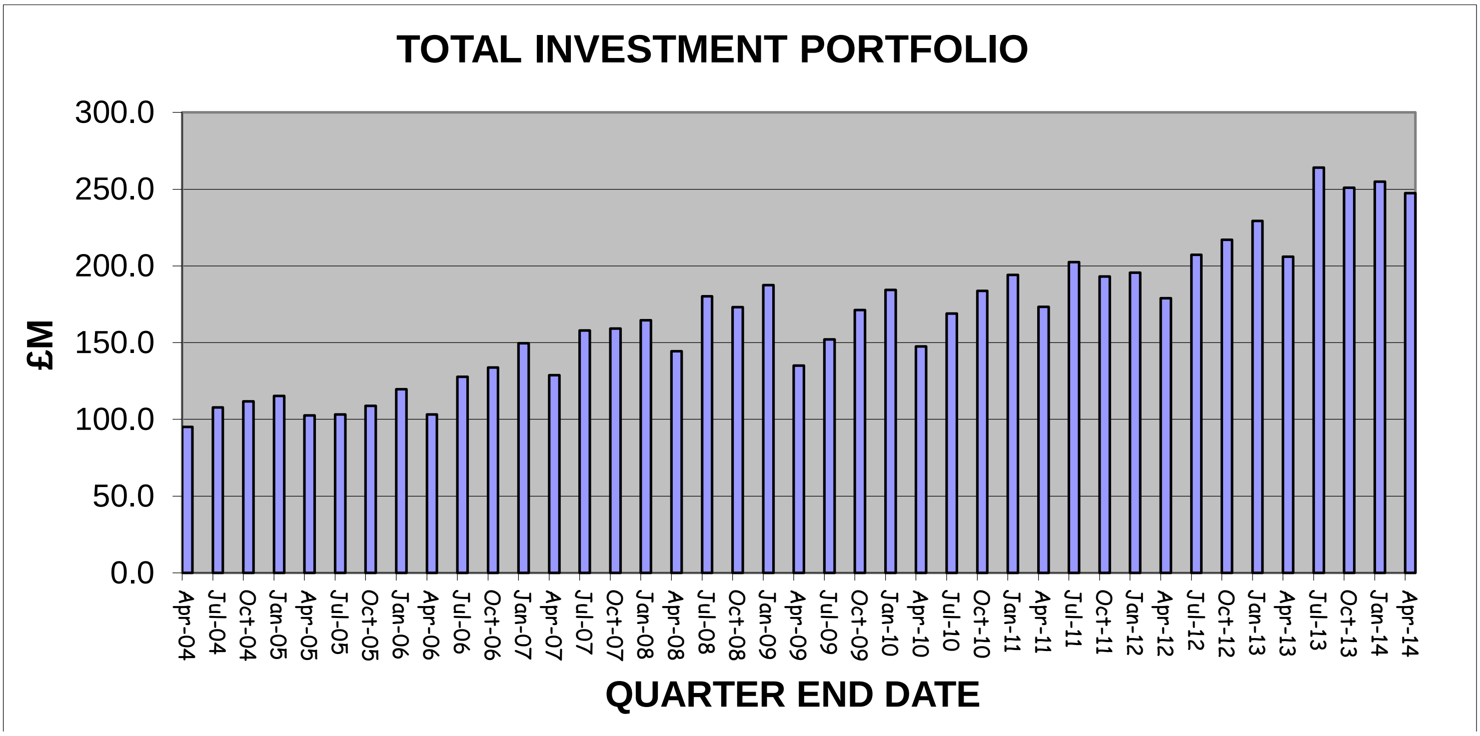
3.5 Base rate has now been 0.5% since March 2009 and the latest forecast by Sector (in May 2014) is for it to remain at that level until late-2015 and to then slowly rise to 1.75% by mid-2017. The estimated date for the next increase in base rate has slipped back significantly in the last two to three years and it is possible that it will slip further. Reports to previous meetings, most recently to the February meeting, have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited due to bank credit rating downgrades. Changes to lending limits and eligibility criteria have in the past been temporarily successful in alleviating this, but we are now back in the position of not having many investment options other than placing money with instant access accounts at relatively low interest rates. Active UK banks on our list now comprise only Lloyds TSB, RBS, HSBC, Barclays, Santander UK and Nationwide and all of these have reduced their interest rates significantly.

3.6 Our external advisers, Sector, continue to recommend caution and, between September 2011 and January 2013, were recommending that no investment be placed for longer than 3 months with any bank other than Lloyds and RBS (a maximum of 1 year was recommended in their case). In January 2013, however, they lifted their temporary investment duration cap due to a perceived improvement in market conditions, namely a reduction in some of the excess fears surrounding the continued existence of the Eurozone and improvements in liquidity in financial markets. Since then, we have been able to invest with some of our eligible UK counterparties for up to 6 months instead of 3, which will have had a small beneficial impact on interest earnings.

3.7 In recent quarters, in consultation with Sector, we have been looking at other options and have placed investments for periods between one and three years with a number of other local authorities. We have also opened a new account with Deutsche Bank (£5m in a 95-day notice account paying around 0.74%) and have made our first corporate bond investment, with Standard Chartered Bank (£1.1m at 0.70% maturing in April 2014). These investments are all included in Appendices 1 and 2. In the March quarter, as well as a number of short-term investments, we placed two further 3 year investments with other local authorities (at 1.45% and 1.60% respectively) and invested £5m in the CCLA Property Fund. While these rates do not sound particularly attractive, they are better than we are currently able to obtain for the same periods elsewhere in the market and are, in the view of Sector and other experts, likely to prove good deals in the fullness of time. Since the end of March, we have placed a 2-year deposit with RBS linked to the 3-month Libor rate, but with a floor of 1.15% and a ceiling of 1.37%, a 2 year deposit with another local authority at 1.14% and we have made our first CD (certificate of deposit) investments with two banks for one year at around 0.83%.

3.8 Lloyds TSB has consistently offered better rates than other UK banks, but has reduced its rates significantly in the last year and is currently offering 0.70% for 3 months up to 0.95% for 1 year (they were paying 3.00% for 1 year as recently as July 2012). All the other UK banks and building societies on our lending list are now paying around 0.46% for 3 months and around 0.57% for 6 months. The Director of Finance will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

3.9 The graph below shows total investments at quarter-end dates back to 1st April 2004 (including the Heritable deposit) and shows how available funds have increased steadily over the years, largely due to increased and earlier government funding. This has been a significant contributor to the over-achievement of investment income against budget in recent years, although this has now been fully factored into the revenue budget.



Other accounts

3.10 Money Market Funds

The Council currently has 7 AAA-rated Money Market Fund accounts, with Prime Rate, Ignis, Insight, Morgan Stanley, Blackrock, Fidelity and Legal & General, all of which have a maximum investment limit of £15m. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years. The Ignis fund currently offers the best rate (around 0.43%), which is only slightly below the level currently being offered for 3 months by most of our eligible UK banks and building societies. The total balance held in Money Market Funds has fluctuated considerably during the year, moving from £6.1m as at 1st April 2013 to £64.1m as at 30th June 2013, £21.0m as at 30th September 2013, £18.9m as at 31st December 2013 and £19.3m as at 31st March 2014. If and when other investment options become available, this balance will reduce, as Money Market Funds currently offer the lowest interest of all our eligible investment vehicles with the exception of the Government Debt Management and Deposit Fund (currently 0.25%).

Money Market Fund	**Date Account Opened**	**Ave. Rate 2013/14**	**Ave. Daily Balance 2013/14**	**Actual Balance 31/03/14**	**Actual Balance 23/05/14**	**Current Rate 23/05/14**
		%	**£m**	**£m**	**£m**	**%**
Prime Rate	15/06/2009	0.42	12.7	-	15.0	0.40
Ignis	25/01/2010	0.43	14.7	15.0	15.0	0.44
Insight	03/07/2009	0.39	6.9	4.3	15.0	0.40
Morgan Stanley	01/11/2012	0.41	7.5	-	-	0.36
Legal & General	23/08/2012	0.34	2.2	-	5.5	0.38
Blackrock	16/09/2009	0.31	0.1	-	-	0.31
Fidelity	20/11/2002	n/a	-	-	-	0.30
TOTAL			44.1	19.3	50.5	

3.11 Notice Accounts

Svenska Handelsbanken

In August 2013, the Council placed £15m in a new instant access account with the Swedish Bank, Svenska Handelsbanken. The account pays 0.60% and the £15m was still invested as at 31st March 2014. The average daily balance in 2013/14 was £9.7m.

RBS

In March 2013, RBS announced a new 95-day notice account paying a rate of 0.80%. The Council made an initial deposit of £12.5m in March and increased this to £15m in April 2013. The rate was reduced to 0.60% in October 2013, but the £15m remained invested as at 31st March 2014. The average daily balance in 2013/14 was £14.8m and an average rate of 0.71% was earned in the year. RBS informed us in April that the rate will reduce to 0.30% at the end of July, so we have given notice to close the account.

Deutsche Bank

In the autumn of 2013, Sector notified the Council that they had negotiated a 95-day notice account facility with Deutsche Bank at a rate of 0.75%. Deutsche is an eligible counterparty on our lending list with a maximum investment sum of £5m and, on 25th November 2013, this sum was deposited. The average daily balance in 2013/14 was £1.7m.

3.12 Corporate Bonds, Payden Sterling Reserve Fund and CCLA Property Fund

At its meeting on 12th November 2012, the Council approved the addition of corporate bonds (minimum credit rating AA-, maximum period 5 years) and the Payden Sterling Reserve Fund to our lending list. On 27th November, following advice from Sector, we made our first investment in a corporate bond, with Standard Chartered Bank. The bond matured after the year end on 28th April 2014 and a coupon value of 0.70%. In November 2012, £15m was invested in the Payden Fund and that sum was still invested as at 31st March 2014. The longer-term nature of the Payden Fund means that a better return will be secured by holding to maturity, although we could at any time withdraw our money by giving 3 days' notice. As at 31st March 2014, our share of the Payden Sterling Reserve Fund was valued at £15,160,775, which represented a return of 0.78% since inception. A further £5m was invested in the CCLA Property Fund in January.

3.13 External Cash Management

External cash managers, Tradition UK Ltd, currently manage £20m of our cash portfolio and provide useful advice and information on treasury management matters. In 2012/13, Tradition UK achieved a return of 1.53% (mainly as a result of two longer term investments placed with Lloyds TSB in August 2011 and July 2012, when rates were around 3%, both of which matured in the 2nd quarter of 2013/14). Tradition UK work to the same counterparty list as the Council's in-house team and so have also been constrained by strategy changes approved after the Icelandic Bank crisis and by recent ratings downgrades. Details of externally managed funds placed on deposit as at the time of writing this report are shown below.

Bank	Sum	Start Date	Maturity	Period	Rate
HSBC	£5m	26/03/14	26/06/14	3 months	0.55%
Lloyds TSB	£2.5m	04/07/13	04/07/14	1 year	1.01%
Lloyds TSB	£5m	16/08/13	18/08/14	1 year	1.01%
West Dumbartonshire Council	£2.5m	26/03/14	24/03/17	3 years	1.60%
Perth & Kinross Council	£5m	23/03/14	24/03/17	3 years	1.45%

3.14 Investment in CCLA Property Fund

In September 2013, the Portfolio Holder and Full Council approved the inclusion of collective (pooled) investment schemes as eligible investment vehicles in the Council's Investment Strategy with an overall limit of £25m and a maximum duration of 5 years. Such investment would require the approval of the Director of Finance in consultation with the Resources Portfolio Holder. Following consultation between the Director of Finance and the Resources Portfolio Holder, an account was opened in January with the CCLA Local Authorities' Property Fund and an initial deposit of £5m was made.

3.15 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki, when it was placed in administration in early-October 2008 at which time our investment was, and still is, frozen. An initial dividend was paid to the Council in July 2009 and, since then, a further 13 dividends have been received. To date, 94.0% (£4,783k) of our total claim (£5,087k) has been returned to us, leaving a balance of £304k (6.0%). Council officers and our external advisers remain hopeful of a full recovery.

For information, the claim we were obliged to submit consisted of the principal sum (£5m) plus interest due to the date on which Heritable was placed in administration (around £87,000). We were not able to lodge a claim for the full amount of interest (£321,000) that would have been due at the original investment maturity date (29/6/09). In accordance with proper accounting practice and guidance from CIPFA, we made provision in our 2008/09 accounts for an impairment loss of £1.64m and met this from the General Fund in that year. In line with revised guidance from CIPFA relating to the 2009/10 accounts, we were able to reduce the impairment by £300k and this sum was credited to the General Fund. An improvement in the administrator's recovery estimate in 2011 to between 86% and 90% (previously it was between 79% and 85%) enabled us to reverse a further £730k of the impairment in 2011/12. The Council's accounts include a provision for a net loss of £610k as at 31st March 2013 (12% of the claim, based on the midpoint of the administrator's estimate), but, as we had recovered 94% as at 31st March 2014, we were able to reverse more of the impairment in 2013/14 (£311k). We are currently waiting for an update from the administrator.

Actual prudential indicators for 2013/14

3.16 The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2013/14 were approved by the

Executive and the Council in February 2013 and Appendix 3 sets out the actual performance against those indicators.

Economic Background (provided by Sector)

3.17 The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns, although levels of counterparty risk had subsided somewhat. The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to start gently rising from quarter 1 2015. This forecast rise has now been pushed back to a start in quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the year. Consequently there was no additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While CPI inflation had remained stubbornly high and substantially above the 2% target during 2012, by January 2014 it had, at last, fallen below the target rate to 1.9% and then fell further to 1.7% in February. It is also expected to remain slightly below the target rate for most of the two years ahead.

3.18 Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality (see paragraph 4.) The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That part of the Scheme which supported the provision of credit for mortgages was terminated in the first quarter of 2014 as concerns rose over resurging house prices.

3.19 The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative, (in the Autumn Statement and the March Budget), reduction in the forecasts for total borrowing, of £97bn over the next five years, culminating in a £5bn surplus in 2018-19.

3.20 The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the ECB statement in July 2012 that it would do “whatever it takes” to support struggling Eurozone countries; this led to a return of confidence in its banking system which has continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. Upcoming stress tests of Eurozone banks could also reveal some areas of concern.

Regulatory Framework, Risk and Performance

3.21 The Council’s treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;

- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;

- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.22 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

5. FINANCIAL IMPLICATIONS

5.1 An average rate of interest of 0.78% was achieved in 2013/14, including 0.74% on all new "core" investments placed during the year (compared to the budget assumption of 1%). The final outturn for net interest on investments and borrowing in 2013/14 was £2,244k compared to the budget of £1,591k. This was partly due to a part-reversal of the Heritable Bank impairment loss originally included in the 2009/10 accounts (£311k), but also due to the fact that average investment balances during the year (£260m) were considerably higher than expected.

5.2 With regard to 2014/15, an average rate of 1% has again been assumed for interest on new investments in the 2013/14 revenue budget, in line with the estimates provided by the Council's external treasury advisers, Sector, earlier in the year and with officers' views. The Bank of England base rate is still expected to rise, but the expected start of the rise has been put back to late-2015 and could be even later. The latest financial forecast assumes 1% for new investments in all years from 2014/15 to 2017/18. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £400k pa from 2014/15. At this stage in the year, it is forecast that the 2014/15 outturn will be broadly in line with the budget.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Sector Treasury Services