Report No. FSD15044	**London Borough of Bromley**	**Agenda Item No.**

PART 1 - PUBLIC

Decision Maker:	**Resources Portfolio Holder**		
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 9th July 2015** **Council 19th October 2015**		
Decision Type:	Non-Urgent	Executive	Non-Key
Title:	**TREASURY MANAGEMENT - ANNUAL REPORT 2014/15**		
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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 2014/15, which is required to be reported to full Council. The report ensures that the Council is implementing best practice in accordance with the CIPFA Code of Practice for Treasury Management. The report also includes an update on the Council's investment with Heritable Bank (paragraph 3.14). Investments as at 31st March 2015 totalled £254.8m (excluding the balance of the Heritable investment) and there was no outstanding external borrowing. For information and comparison, the balance of investments stood at £262.5m as at 31st December 2014 and £247.4m as at 31st March 2014 and, at the time of writing this report (25th June 2015) it stood at £287.3m.

RECOMMENDATION(S)

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

(a) Note the Treasury Management Annual Report for 2014/15 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 budget (net interest earnings) in 2014/15; surplus of £1.85m achieved in 2014/15. Budget for 2015/16 £2.741m

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 2014/15 and the annual report for the whole of the financial year 2014/15. The 2014/15 annual treasury strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was originally approved by Council in February 2014. The mid-year review and amendments to the strategy (comprising an increase in the limits for part-nationalised banks, Lloyds and RBS, a lowering of the minimum credit rating for bond investments and the inclusion of diversified growth funds as permitted investments) were approved by Council in December 2014.

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 actual position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

Treasury Performance in the quarter and year ended 31st March 2015

3.3 **Borrowing:** The Council's healthy cashflow position has continued through the whole of 2014/15, as a result of which no borrowing was required in the year.

3.4 **Investments:** The following table sets out details of investment activity during the March quarter and during the whole of the financial year 2014/15:-

	Qtr ended 31/03/15		**1/4/14 to 31/03/15**	
Main investment portfolio	**Deposits £m**	**Ave Rate %**	**Deposits £m**	**Ave Rate %**
Balance of "core" investments b/f	237.50	1.18	172.00	0.83
New investments made in period	15.00	1.34	226.50	1.22
Investments redeemed in period	-45.00	0.85	-191.00	0.79
"Core" investments at end of period	207.50	1.29	207.50	1.29
Money Market Funds	22.30	para 3.10	22.30	para 3.10
Svenska Handelsbanken instant access	0.00	para 3.11	0.00	para 3.11
Deutsche Bank 95 day notice	0.00	para 3.11	0.00	para 3.11
CCLA Property Fund	15.00	para 3.13	15.00	para 3.13
Diversified Growth Funds	10.00	para 3.13	10.00	para 3.13
Payden Sterling Reserve Fund	0.00	para 3.12	0.00	para 3.12
Total investments at end of period	**254.80**	**n/a**	**254.80**	**n/a**
Heritable deposit - frozen (para 3.13)			5.00	6.42

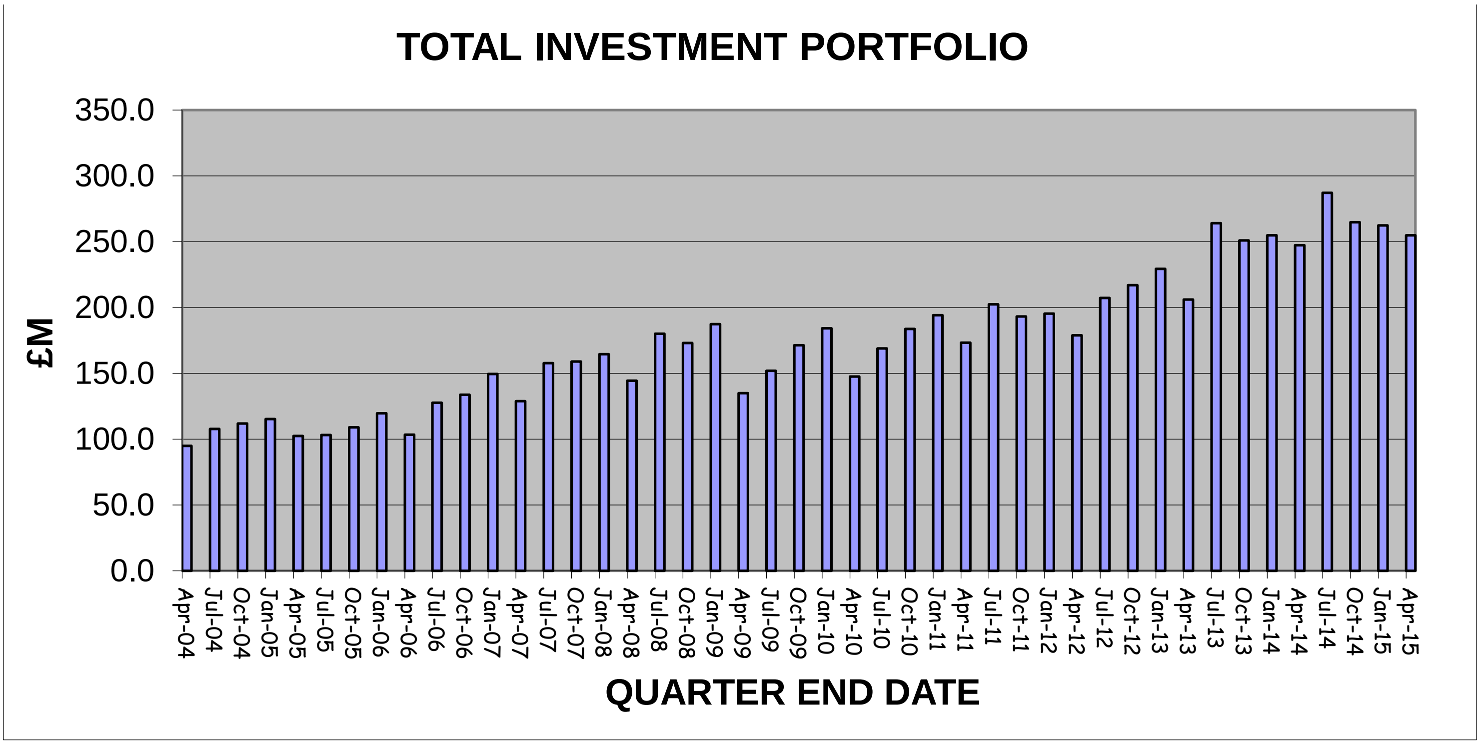
3.5 The following investments were placed in the March quarter:

- Lloyds Bank – fixed term deposit £5m for 1 year @ 1.00%
- RBS – CD £10m for 2 years @ 1.34%
- CCLA Property Fund – a further £5m, bringing the total up to £15m

3.6 Details of the outstanding investments at 31st March 2015 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. An average return of 1% was included for new investments in the 2014/15 budget and the average return on the two new "core" investments placed in the March quarter was 1.34%. For comparison, the average LIBID rates for the March quarter were 0.36% for 7 days, 0.44% for 3 months, 0.56% for 6 months and 0.84% for 1 year. The average rate achieved on new investments placed in the period 1st April 2014 to 31st March 2015 was 1.22%, compared to the average LIBID rates of 0.35% for 7 days, 0.43% for 3 months, 0.56% for 6 months and 0.87% for 1 year. The improved average rate earned on new investments placed in 2014/15 mainly reflects longer-term deposits placed with other local authorities and banks and compares favourably with the budget assumption.

3.7 Reports to previous meetings have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited in recent years following bank credit rating downgrades. Changes to lending limits and eligibility criteria, most recently in October 2014 (an increase of £40m (from £40m to £80m) in the lending limits of both Lloyds and RBS and an increase in the maximum period from 2 years to 3 years) have alleviated this to some extent, but we have still found ourselves 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, RBS, HSBC, Barclays, Santander UK and Nationwide and all of these have reduced their interest rates significantly in recent years. The Director of Finance will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

3.8 The graph below shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years. This has been a significant contributor to the over-achievement of investment income against budgeted income in recent years.



Interest Rate Forecast

3.9 Base rate has now been 0.5% since March 2009 and the latest forecast by Capita Treasury Solutions (in May 2015) is for it to begin to slowly rise from mid-2016 (around 6 months later than the previous estimate given in January 2015). For comparison, Capita's latest two interest rate forecasts are shown below.

Date	LATEST FORECAST (May 15)				PREVIOUS FORECAST (Jan 15)			
		3 month	6 month	1 year		3 month	6 month	1 year
	Base Rate	Libid	Libid	Libid	Base Rate	Libid	Libid	Libid
Jun-15	0.50%	0.50%	0.70%	1.00%	0.50%	0.50%	0.70%	1.00%
Sep-15	0.50%	0.50%	0.70%	1.00%	0.50%	0.60%	0.80%	1.10%
Dec-15	0.50%	0.60%	0.80%	1.10%	0.75%	0.80%	1.00%	1.30%
Mar-16	0.50%	0.70%	0.90%	1.20%	0.75%	0.90%	1.10%	1.40%
Jun-16	0.75%	0.80%	1.00%	1.30%	1.00%	1.10%	1.20%	1.50%
Sep-16	0.75%	0.90%	1.10%	1.40%	1.00%	1.10%	1.30%	1.60%
Dec-16	1.00%	1.10%	1.30%	1.60%	1.25%	1.30%	1.50%	1.80%
Mar-17	1.00%	1.30%	1.50%	1.80%	1.25%	1.40%	1.60%	1.90%
Jun-17	1.25%	1.40%	1.60%	1.90%	1.50%	1.50%	1.70%	2.00%
Sep-17	1.50%	1.50%	1.70%	2.00%	1.75%	1.80%	2.00%	2.30%
Dec-17	1.50%	1.80%	2.00%	2.30%	1.75%	1.90%	2.10%	2.40%
Mar-18	1.75%	1.90%	2.10%	2.40%	2.00%	2.10%	2.30%	2.60%

Other accounts

3.10 <u>Money Market Funds</u>

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 and Legal & General funds currently offer the best rate (around 0.47%). The total balance held in Money Market Funds has fluctuated considerably during the year, moving from £19.3m as at 1st April 2014 to £32.7m as at 30th June 2014, £24.4m as at 30th September 2014, zero as at 31st December 2014 and £22.3m as at 31st March 2015. The total peaked at £65.7m in May 2014 and averaged £35.0m over the whole year. The 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%). During the year, funds have been withdrawn to fund other, more attractive investments, most recently in the December quarter, when we placed investments of £40m with RBS and £10m in Diversified Growth Funds.

Money Market Funds	Date Account Opened	Ave. Rate 2014/15	Ave. Daily balance 2014/15	Actual balance 31/03/15	Latest Balance 25/06/15	Latest Rate 25/06/15
		%	£m	£m	£m	%
Prime Rate	15/06/2009	0.43	8.3	7.3	0.1	0.45
Ignis	25/01/2010	0.46	14.2	15.0	15.0	0.47
Insight	03/07/2009	0.41	6.1	0.0	0.0	0.44
Morgan Stanley	01/11/2012	0.37	0.1	0.0	0.0	0.43
Legal & General	23/08/2012	0.43	6.3	0.0	14.7	0.47
Blackrock	16/09/2009	-	-	0.0	0.0	0.36
Fidelity	20/11/2002	-	-	0.0		0.34
TOTAL			35.0	22.3	29.8	

3.11 <u>Notice Accounts</u>

<u>Svenska Handelsbanken</u>

In August 2013, the Council placed £15m in an instant access account with the Swedish Bank, Svenska Handelsbanken. The account originally paid 0.60%, but the rate was reduced to 0.50%

in July 2014. As investment options were limited and the rate was better than that we were earning on our Money Market Funds, the account was left open until after the Council approved the increased limits for Lloyds and RBS in October 2014. The account was, however, closed on 22nd October 2014 to provide part of the funding for the £40m 3 year CD investment with RBS. The average daily balance in the year was £8.5m and an average rate of 0.55% was achieved.

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 and, in April 2014, RBS informed us that the rate would reduce to 0.30% in August, so notice was given to close the account on 25th August 2014. The average daily balance in the year was £6.0m and an average rate of 0.55% was achieved.

Deutsche Bank

In November 2013, the Council opened a 95-day notice account with Deutsche Bank. At that time, Deutsche was an eligible counterparty on our lending list with a maximum investment sum of £5m, although a subsequent credit rating downgrade means it is no longer on the list. Following the downgrade, notice to terminate was given at the end of October 2014 and the principal sum plus interest was returned to us on 2nd February 2015. The average daily balance in the year was £4.2m and an average rate of 0.65% was achieved.

3.12 Other investments: Corporate Bonds and Payden Sterling Reserve 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 Capita, we made our first investment in a corporate bond, £1.1m with Standard Chartered Bank. The bond matured on 28th April 2014 with a coupon value of 0.70%. In October 2014, the Council agreed to a lowering of the minimum credit rating for corporate bonds to A-, which may provide us with more investment opportunities in the future. In November 2012, £15m was invested in the Payden Fund and that sum remained invested until it was withdrawn in December 2014 to part-fund other investments. The average daily balance in the year was £10.8m. Over the lifetime of the investment (November 2012 to December 2014) an average rate of 0.98% was achieved.

3.13 Pooled Investment Schemes

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 investments would require the approval of the Director of Finance in consultation with the Resources Portfolio Holder.

CCLA Property Fund
Following consultation between the Director of Finance and the Resources Portfolio Holder, an account was opened in January 2014 with the CCLA Local Authorities’ Property Fund and an initial deposit of £5m was made. Following more consultation, a further £5m deposit was made at the end of July 2014 and, finally, another £5.0m was deposited in March 2015. This is viewed as a medium to long-term investment. Dividends are paid quarterly and, in 2014/15, the investment returned 5.25% net of fees.

Diversified Growth Funds

In October 2014, the Council approved the inclusion of investment in diversified growth funds in our strategy and, in December, £5m was invested with both Newton and Standard Life. The Funds both performed very well in just over three months to 31st March 2015; the Newton Fund returning 21.5% and the Standard Life Fund returning 21.9%. In accordance with the Council decision, interest equivalent to 27% of the total dividend was transferred to the Parallel Fund, set up in 2014/15 with an opening balance of £2.7m to mitigate the potential revenue impact of future actuarial Pension Fund valuations.

3.14 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 frozen. An initial dividend was paid to the Council in July 2009 and, since then, a further 13 dividends have been received (most recently in August 2013). To date, a total of £4,783k has been received (94% of our total claim of £5,087k), leaving a balance of £304k (6.0%). Council officers and our external advisers remain hopeful of a full recovery and, in May 2015, the administrator advised that a further distribution (as yet unspecified) will be made to creditors in August.

3.15 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 2014/15, Tradition UK achieved a return of 1.28%, which compared with the in-house team rate of 1.55% (including investments with the pooled vehicles). 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 ratings downgrades in recent years. Details of externally managed funds placed on deposit as at the time of writing this report are shown below. All of their current deposits have been placed for periods of two years or three years.

Bank	**Sum**	**Start Date**	**Maturity**	**Period**	**Rate**
Lloyds	£7.5m	18/08/14	18/08/16	2 years	1.28%
RBS	£5.0m	26/08/14	26/08/16	2 years	Min 1.52%; max 2.00% (linked to 3 month Libor)
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%

Actual prudential indicators for 2014/15

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 2014/15 were approved by the Executive and the Council in February 2014 and were revised and updated in December 2014. Appendix 3 sets out the actual performance in 2014/15 against those indicators.

Economic Background during 2014/15 (provided by Capita Treasury Solutions)

3.17 The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in quarter 1 of 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises and inflation above the rate of pay rises meant that consumer disposable income was still being eroded and, in August, the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand. During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the ECB was going to do too little too late to ward off the threat of deflation and recession in the Eurozone. In mid-October, financial markets had a major panic for about a week. By the end of 2014, it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even become negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase moved back to around quarter 3 of 2016.

3.18 Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January; developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and ECB, it is very hard to quantify quite what the potential knock on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the EZ had been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing EZ government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central rate, probably by the end of 2015. The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around political risk from the general election due in May 2015.

Regulatory Framework, Risk and Performance

3.19 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 that may be undertaken (although no restrictions have been made to date);

- 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.

3.20 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 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 1.32% was achieved in 2014/15, including 1.22% 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 2014/15 was £3,441k compared to the budget of £1,591k. This was in no small part due to returns on the pooled investments placed with the CCLA Property Fund and the Newton and Standard Life Diversified Growth Funds during 2014.The other main contributory factor, apart from the higher interest rate earned on new investments, was the fact that average investment balances during the year (£286m) were higher than expected.

5.2 With regard to 2015/16, there is still no sign of interest rates improving and an average rate of 1% has again been prudently assumed for interest on new fixed term deposits in the 2015/16 revenue budget, in line with the estimates provided by the Council's external treasury advisers, Capita, 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 mid-2016 and could be even later. There have been no improvements to counterparty credit ratings, as a result of which the restrictions to investment opportunities that followed ratings downgrades in recent years have still been in place. However, the increases in the limits for the two part-nationalised banks (Lloyds and RBS) approved by the Council in October, together with higher rates from longer-term deals placed with other local authorities, higher average balances than anticipated and the strong performance of the CCLA Property Fund and the Diversified Growth Fund investments have enabled the 2015/16 budget to be increased to £2,741k.

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 Capita Treasury Solutions