Bath & North East Somerset Council		
MEETING:	**Council**	
MEETING DATE:	**13th November 2014**	
TITLE:	**Treasury Management Monitoring Report to 30th September 2014**	
WARD:	All	
AN OPEN PUBLIC ITEM		
List of attachments to this report: **Appendix 1** – Performance Against Prudential Indicators **Appendix 2** – The Council's Investment Position at 30th September 2014 **Appendix 3** – Average monthly rate of return for 1st 6 months of 2014/15 **Appendix 4** – The Council's External Borrowing Position at 30th September 2014 **Appendix 5** – Arlingclose's Economic & Market Review Q2 of 2014/15 **Appendix 6** – Interest & Capital Financing Budget Monitoring 2014/15 **Appendix 7** – Summary Guide to Credit Ratings **Appendix 8** – Proposed amendments to the 2014/15 Treasury Management Strategy		

1 THE ISSUE

1.1 In February 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan 2014/15 for the first six months of 2014/15.

2 RECOMMENDATION

The Council agrees that:

2.1 the Treasury Management Report to 30th September 2014, prepared in accordance with the CIPFA Treasury Code of Practice, is noted

2.2 the Treasury Management Indicators to 30th September 2014 are noted.

2.3 The proposed amendments to the 2014/15 Treasury Management Strategy set out in paragraphs 5.19-23 and Appendix 8 are approved.

3 RESOURCE IMPLICATIONS

3.1 The financial implications are contained within the body of the report.

4 STATUTORY CONSIDERATIONS AND BASIS FOR PROPOSAL

4.1 These are detailed in paragraphs 2.1 – 2.3 above.

5 THE REPORT

Summary

5.1 The average rate of investment return for the first six months of 2014/15 is 0.43%, which is 0.04% above the benchmark rate.

5.2 The Council's Prudential Indicators for 2014/15 were agreed by Council in February 2014 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels, with the exception of one voluntary indicator, measuring the liquidity of the council's investments, as detailed in 5.13 and Appendix 1(8).

Summary of Returns

5.3 The Council's investment position as at 30th September 2014 is given in **Appendix 2**. The balance of deposits as at 30th June 2014 and 30th September 2014 are also set out in the pie charts in this appendix.

5.4 The Council is the accountable body for the West of England Revolving Investment Fund (RIF) and received grant funding of £57 million at the end of the 2011/12 financial year. The Council acts as an agent and holds these funds on behalf of the West of England Local Enterprise Partnership until they are allocated in the form of repayable grants to the constituent Local Authorities to meet approved infrastructure costs. Since these funds are invested separately from the Council's cash balances and have been placed short term with the Debt Management Office and other Local Authorities, they are excluded from all figures given in this report. The current value of the fund is £44.8 million.

5.5 Gross interest earned on investments for the first six months totalled £81k. Net interest, after deduction of amounts due to Schools, the West of England Growth Points, CHC and other internal balances, is £43k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.43%, which was 0.04% above the benchmark rate of average 7 day LIBID +0.05% (0.39%).

Summary of Borrowings

5.6 No new borrowing has taken place in the first half of 2014/15. The Council's total borrowing was £70 million as at the 30th September 2014. The Council's Capital Financing Requirement (CFR) as at 31st March 2014 was £153 million with a projected total of £215 million by the end of 2014/15 based on the capital programme approved at February 2014 Council. This represents the Council's underlying need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

5.7 Subsequent to the end of the reporting period, £8 million of borrowing was arranged on 2nd October with two Local authorities for a two year period. The borrowing was undertaken to replenish cash-flow used to fund a specific commercial estate investment opportunity.

5.8 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2014 apportioned to Bath & North East Somerset Council is £14.54m. Since this borrowing is managed by Bristol City Council and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 5.6.

5.9 The borrowing portfolio as at 30th September 2014 is shown in **Appendix 4**.

Strategic & Tactical Decisions

5.10 As shown in the charts at **Appendix 2**, investments continue to be focussed on UK banks and building societies that have either already or are likely to receive support from the UK Government should they experience financial difficulties. To increase diversification, the Council invests in AAA rated Money Market funds, with a balance of £3.7m invested in these as at 30th September 2014.

5.11 The Council continues to not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Council's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

5.12 The Council's average investment return is running slightly above the budgeted level of 0.35%.

5.13 The Council has adopted a voluntary indicator of its exposure to liquidity risk, which is that the amount of cash available from maturing investments, to meet unexpected payments within a rolling three month period without additional borrowing, should not fall below £15m. The liquidity balance figure on 30th September 2014 was below the indicator (£9.85m). This was due to delaying the planned borrowing by a week in order to take advantage of short term inter-authority rates dropping at the beginning of each month. This borrowing of £8m was arranged on 2nd October at a lower cost than the market was offering during the previous weeks.

Future Strategic & Tactical Issues

5.14 Our treasury management advisors economic and market review for the second quarter 2014/15 is included in **Appendix 5**.

5.15 The Bank of England base rate has remained constant at 0.50% since March 2009. The stronger economic growth seen in the UK over the past six months is likely to use up spare capacity more quickly than previously assumed and the Council's treasury advisors, Arlingclose, have brought forward their estimate of the timing for the first rise in Bank Rate to Q3 2015.

5.16 In their opinion, in addition to two MPC members having voted for a rate rise in August and September, the rhetoric from MPC members has certainly become more hawkish, but the lack of inflationary signals is expected to allow policymakers to hold off monetary tightening for longer than the market currently expects. However, the near-term risk is that the Bank Rate could rise sooner than anticipated.

5.17 The benefits of the Council's current policy of internal borrowing are monitored regularly against the likelihood that long term borrowing rates are forecast to rise in future years. The focus is now on the rate of increase and the medium-term peak and, in this respect, the current forecast is that rates will rise slowly and to a lower level than in the past.

5.18 Future borrowing is therefore likely to be driven by a need to maintain an appropriate working cash balance rather than any immediate changes to interest rates.

5.19 The UK is implementing the final bail-in provisions of the EU Bank Recovery and Resolution Directive to commence in January 2015, a year ahead of most other countries. Credit rating agencies have stated they plan to review EU banks' ratings in line with each country's implementation of the directive. Many UK banks have standalone ratings in the "BBB" category, with uplifts for potential government support taking them into the "A" category. Arlingclose advise there is therefore a realistic risk that some major UK banks' credit ratings will fall below A- this financial year if this uplift is removed.

5.20 The Council has two broad options to respond to this risk:

a) amend the Treasury Management Strategy to allow investment in lower rated UK banks, or

b) prepare to invest without using any of the major UK banks.

5.21 Although it may be possible to operate without these banks, by investing more money in Money Market Funds, for example, Arlingclose have stated that they may continue to advise on investments in the major UK banks if they become rated BBB+.

5.22 It is therefore recommended that the Council is asked to respond by amending the 2014/15 Treasury Management Strategy in line with the changes shown at Appendix 8 in order to be able to respond to the changes that may occur in January 2015.

5.23 The s.151 Officer will consider the investment advice provided by Arlingclose at the time of any ratings change, should it occur, before any investments are made with potentially affected UK counterparties.

Budget Implications

5.24 A breakdown of the revenue budget for interest and capital financing and the forecast year end position based on the period April to September is included in **Appendix 6**. This is currently forecast to remain on target for 2014/15.

5.25 This position will be kept under review during the remainder of the year, taking into account the Council's cash-flow position and the timing of any new borrowing required.

6 RATIONALE

6.1 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

7 OTHER OPTIONS CONSIDERED

7.1 None.

8 CONSULTATION

8.1 Consultation has been carried out with the Cabinet Member for Community Resources, Section 151 Finance Officer and Monitoring Officer.

8.2 Consultation was carried out via e-mail.

9 RISK MANAGEMENT

9.1 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

9.2 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

9.3 In addition, the Council maintains a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year.

Contact person	*Tim Richens - 01225 477468 ; Mark Angus - 01225 477180* *Tim_Richens@bathnes.gov.uk Mark_Angus@bathnes.gov.uk*
Background papers	*2014/15 Treasury Management & Investment Strategy* *1st Quarter Treasury Performance Report (Cabinet)*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2014/15 Prudential Indicator	**2014/15 Actual as at 30th Sep. 2014**
	£'000	£'000
Borrowing	215,000	70,000
Other long term liabilities	2,000	0
Cumulative Total	**217,000**	**70,000**

2. Operational limit for external debt
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2014/15 Prudential Indicator	**2014/15 Actual as at 30th Sep. 2014**
	£'000	£'000
Borrowing	177,000	70,000
Other long term liabilities	2,000	0
Cumulative Total	**179,000**	**70,000**

3. Upper limit for fixed interest rate exposure
This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2014/15 Prudential Indicator	**2014/15 Actual as at 30th Sep. 2014**
	£'000	£'000
Fixed interest rate exposure	**177,000**	**50,000***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the rate increase).

4. Upper limit for variable interest rate exposure
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2014/15 Prudential Indicator	2014/15 Actual as at 30th Sep. 2014
	£'000	£'000
Variable interest rate exposure	**127,000**	**20,000**

5. Upper limit for total principal sums invested for over 364 days
This is the maximum amount of total investments which can be over 364 days. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

	2014/15 Prudential Indicator	2014/15 Actual as at 30th Sep. 2014
	£'000	£'000
Investments over 364 days	**50,000**	**0**

6. Maturity Structure of borrowing
This indicator is set to control the Council's exposure to refinancing risk.

	Upper Limit	Lower Limit	2014/15 Actual as at 30th Sep. 2015
	%	%	%
Under 12 months	50	Nil	29*
12 months and within 24 months	50	Nil	0
24 months and within 5 years	75	Nil	0
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	71

* The CIPFA Treasury management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date (which are at 6 monthly intervals for the £20m of LOBO's). However, the Council would only consider repaying these loans if the Lenders exercised their options to alter the interest rate.

7. Average Credit Rating
The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**.

	2014/15 Prudential Indicator	2014/15 Actual as at 30th Sep. 2014
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A**	**AA**

8. Liquidity
The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	2014/15 Prudential Indicator	**2014/15 Actual as at 30th Sep. 2014**
Total cash available within 3 months	**£15m**	**£9.85m**

The above indicator is a voluntary indicator the Council has chosen to maintain. The liquidity balance figure on 30th September 2014 was below the indicator (£9.85m). This was due to delaying the planned borrowing by a week in order to take advantage of short term inter-authority rates dropping at the beginning of each month. This borrowing of £8m was arranged on 2nd October at a lower cost than the market was offering during the previous weeks.

APPENDIX 2

The Council's Investment position at 30th September 2014
The term of investments, from the original date of the deal, are as follows:

	Balance at 30th Sep. 2014
	£'000's
Notice (instant access funds)	4,850
Up to 1 month	0
1 month to 3 months	0
Over 3 months	5,000
Total	**9,850**

The investment figure of £9.850 million is made up as follows:

	Balance at 30th Sep. 2014
	£'000's
B&NES Council	-8,401
B&NES CHC	9,572
West Of England Growth Points	688
Schools	7,991
Total	**9,850**

The Council had an average net positive balance of £37.7m (including Growth Points & B&NES CHC Funding) during the period April 2014 to September 2014.

Chart 1: Council Investments (£9.85m) as at 30th Sept 2014

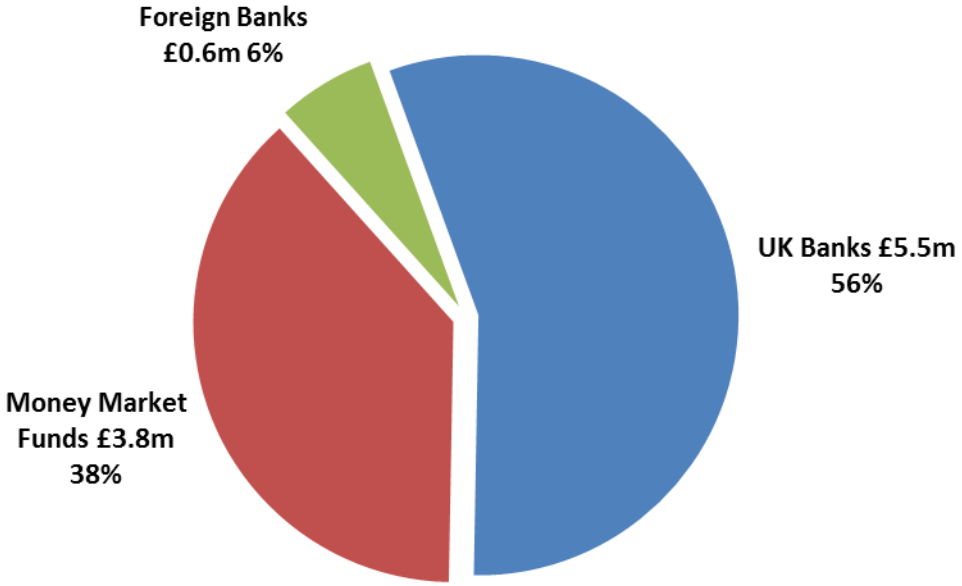


Chart 2: Council Investments (£37.0m) as at 30th June 2014

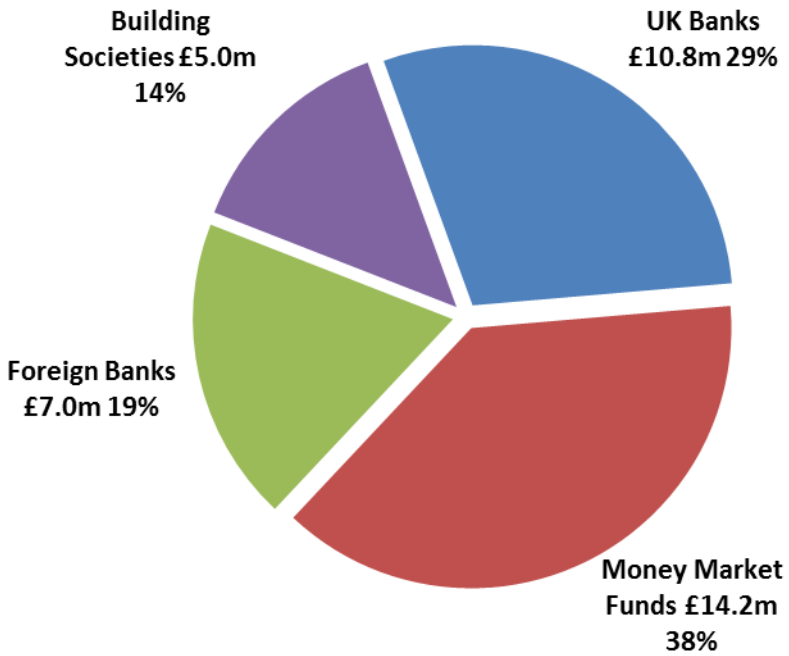


Chart 3: Council Investments per Lowest Equivalent Long-term Credit Ratings (£9.85m) 30th Sept 2014

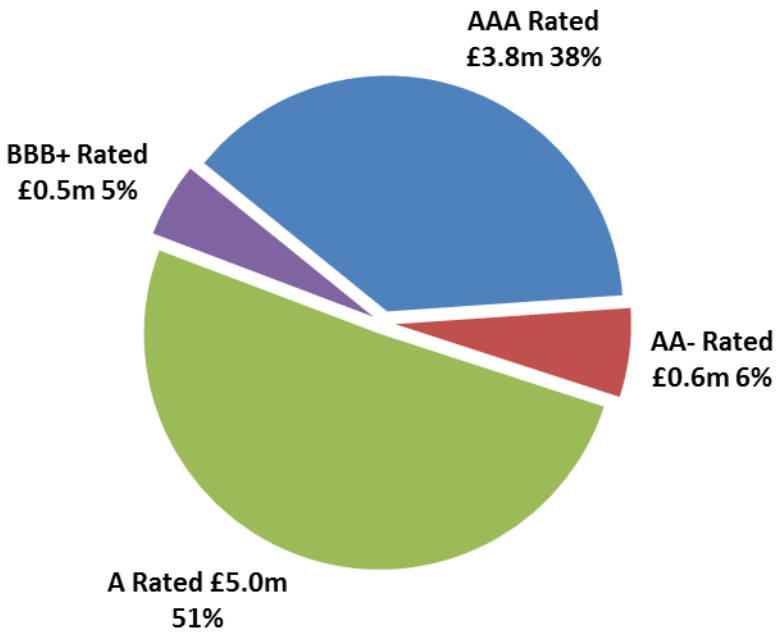
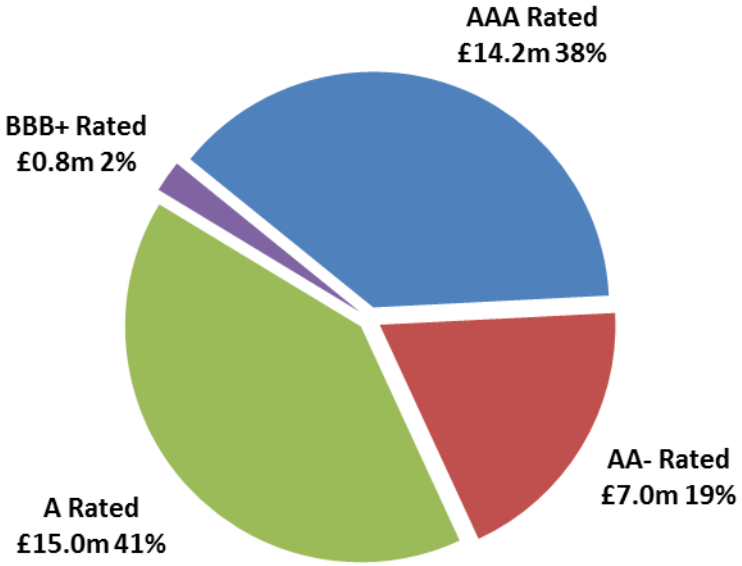


Chart 4: Council Investments per Lowest Equivalent Long-term Credit Ratings (£37.0m) 30th June 2014



APPENDIX 3

Average rate of return on investments for 2014/15

	April %	May %	June %	July %	Aug %	Sep %	Average for Period
Average rate of interest earned	0.40	0.43	0.44	0.47	0.42	0.42	**0.43%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.39	0.39	0.40	0.39	0.40	0.40	**0.39%**
Performance against Benchmark %	+0.01	+0.04	+0.04	+0.08	+0.02	+0.02	**+0.04%**

APPENDIX 4

Councils External Borrowing at 30th September 2014

LONG TERM	Amount	Start Date	Maturity Date	Interest Rate
PWLB	10,000,000	15/10/04	15/10/35	4.75%
PWLB	5,000,000	12/05/10	15/08/35	4.55%
PWLB	5,000,000	12/05/10	15/08/60	4.53%
PWLB	5,000,000	05/08/11	15/02/31	4.86%
PWLB	10,000,000	05/08/11	15/08/29	4.80%
PWLB	15,000,000	05/08/11	15/02/61	4.96%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
Eurohypo Bank*	10,000,000	27/04/05	27/04/55	4.50%
TOTAL	**70,000,000**			
TEMPORARY	**NIL**			
TOTAL	**70,000,000**			**4.71%**

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower also has the option to repay the loan without penalty.

APPENDIX 5

Economic and market review for July to September 2014 (provided by Arlingclose)

Growth and Inflation: The recent strong performance of the UK economy continued with output growing at 0.8% in Q1 2014 and at 0.9% in Q2. The services sector once again grew strongly. On the back of strong consumption growth, business investment appeared to be recovering quickly, albeit from a low base. The annual CPI inflation rate fell to 1.5% year-on-year in August.

Revisions to the GDP methodology, now compliant with the European System of Accounting 2010, mean that growth is now estimated to be 2.7% above its pre-recession peak in Q1 2008 rather than just 0.2% higher, the general theme being that the recession was not as deep and the recovery was earlier than initially estimated. In anticipation of these revisions, the MPC has forecast growth at 3.4% in 2014.

Unemployment: The labour market continued to improve, with strong employment gains and the headline unemployment rate falling to 6.2%. However, earnings growth remained very weak, rising just 0.6% for the three months May-July 2014 when compared to the same period a year earlier. The growth in employment was masked by a large number of zero-hour contracts and involuntary part-time working.

UK Monetary Policy: The MPC made no change to the Bank Rate of 0.5% and maintained asset purchases at £375bn. However, there was a marked shift in tone from the Bank of England's Governor and other MPC members. In his Mansion House speech in June Governor Mark Carney warned that interest rates might rise sooner than financial markets were expecting. Following some mixed messages from Governor Carney later in the summer, the minutes of the August and September MPC meetings revealed a split vote with regards to the Bank Rate. Ian McCafferty and Martin Weale voted to increase Bank Rate by 0.25%, arguing economic circumstances were sufficient to justify an immediate rise. The MPC emphasised that when Bank Rate did begin to rise, it was expected to do so only gradually and would likely remain below average historical levels for some time to come.

In the Bank of England's August Inflation Report the Bank forecast growth to be around 3½% in 2014, easing back thereafter to around its pre-crisis historical average rate. Inflation was forecast to remain at, or slightly below, 2% before reaching the target at the end of the 2-year forecast period.

The Bank's Financial Policy Committee also announced a range of measures to cool the UK's housing market to avert the potential of spiralling house prices derailing a sustainable economic recovery. Key recommendations included lenders stress-testing mortgage applicants can cope with a 3% rise in interest rates; putting a 15% cap on the number of mortgages at more than 4.5 times the borrower's income; and a separate Treasury pledge banning anyone applying for a loan through the Help to Buy scheme borrowing more than 4.5 times their income. The Prudential Regulation Authority also announced that it intends to consult on capital requirements for mortgages.

The result of the Scottish referendum in the end was close, but not as close as many believed it might be. However, the political upheaval set in motion (the Prime Minister's linking of a more devolved Scotland to giving greater powers to English MPs over English-only legislation, the prospect of Scotland's potential freedom to raise taxes not being replicated elsewhere in the UK) is arguably likely to be just as problematic in the run-up to and beyond next year's general election.

Eurozone inflation continued to fall towards zero (HICP inflation registered just 0.3% in September), and there was mounting evidence that the already feeble recovery was losing pace. The unemployment rate remained stubbornly high at 11.5%. The European Central Bank lowered its official benchmark interest rate from 0.15% to 0.05%. The rate it pays on commercial bank balances held with it was also cut further into negative territory from -0.1% to -0.2% and the Marginal Lending Facility rate cut further to 0.3%. The ECB also announced a programme of acquiring Asset Backed Securities (ABS) from banks in an effort to encourage lending which was viewed as being one step away from full blown

Quantitative Easing (QE) adopted by the US, UK and Japanese central banks. The minutes of the Bank of England's MPC meeting in September noted that "*weakness in the euro area had been the most significant development during the month"* and that, if it led once again to uncertainty about the sustainability of euro-area public and external debt, it could damage confidence and disrupt financial markets

There was no change from the US Federal Reserve as the central bank kept policy on its current track with a reduction in asset purchases by $10 billion per month. Asset purchases are expected to end by October 2014, expectations therefore turned towards the timing of rate increases. The US economy rebounded strongly in Q2 with annualised growth of 4.6%.

Market reaction: Gilt yields have continued to decline and hit a financial year low at the end of August, before ticking upwards in the run up to the Scottish referendum. What has driven yields lower is a combination of factors but the primary drivers have been the escalation of geo-political risk within the Middle East and Ukraine alongside the slide towards deflation within the Eurozone (EZ).

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2014/15 (April to September)

April to September 2014	YEAR END FORECAST			ADV/FAV
	Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	
Interest & Capital Financing				
- Debt Costs	3,862	3,862	0	
- Internal Repayment of Loan Charges	(8,182)	(8,182)	0	
- Ex Avon Debt Costs	1,388	1,388	0	
- Minimum Revenue Provision (MRP)	6,120	6,120	0	
- Interest on Balances	(110)	(110)	0	
Sub Total - Capital Financing	**3,078**	**3,078**	**0**	

APPENDIX 7

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.

A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.

APPENDIX 8

Proposed amendments to the 2014/15 Treasury Management Strategy

Approved Investment Counterparties

The Council may invest its surplus funds with any of the counterparties in the flowing table, subject to the cash and time limits shown:

Counterparty		Cash limit	Time limit
UK Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£15m each	10 years
	AA+		
	AA		5 years
	AA-		
	A+		2 years
	A	£10m each	
	A-	£5m each	18 months
	BBB+	£5m each	100 days

Non-Specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign

currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown below.

	£m
Total long-term investments	50
Total investments without credit ratings or rated below A-	15
Total investments in foreign countries rated below AA+	0
TOTAL	**60**

Security: average credit rating

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

	2014/15
Minimum Portfolio average credit rating	A-