Sutton

Report to:	Audit Committee	**Date:**	10 December 2015
Report title:	Treasury Management Mid Year Review 2015/16		
Report from:	Gerald Almeroth, Strategic Director, Resources		
Ward/Areas affected:	Borough Wide		
Chair of Committee/Lead Member:	Councillor David Hicks		
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Corporate Plan Priorities:	• A Smart Council		
Open/Exempt:	Open		
Signed:		**Date:**	25 November 2015

1. Summary

1.1 This report is the mid year treasury management review for 2015/16. It summarises the Council's Treasury Management operations during the first six months of 2015/16. It is presented for the purpose of monitoring and review and meets best practice as suggested by the Treasury Management Code of Practice.

1.2 The Council invested surplus funds when available and complied with the requirements of the Prudential Code. The Council has continued operating the agreed Treasury Management Strategy for 2015/16. The report also sets out the main themes to be included within the 2016/17 strategy due to be presented to Full Council in March 2016.

2. Recommendation

The Audit Committee is recommended to:

2.1 Note the Treasury Management activity undertaken during the first six months of the year.

2.2 Adopt this report as the mid year treasury management review and recommend that it is reported to Full Council.

3. Background

3.1 The Council approved the Treasury Management Strategy for operation during 2015/16 at its meeting on 2 March 2015. The strategy is carried out under delegated authority and quarterly monitoring reports are brought to this Committee. This is in line with best practice as outlined in the CIPFA Treasury Management Code of Practice.

3.2 The treasury management function covers the borrowing and investment of Council money. This includes both the management of the Council's day-to-day cash position and the management of its long-term debt. All transactions are conducted in accordance with the Council's Treasury Management Policy Statement, which complies with the latest CIPFA Code of Practice. Good treasury management plays an important part in underpinning the Council's sound financial health.

4 Treasury Management Activity from April to September 2015

Long Term Borrowing

4.1 Under the Prudential Code, the Council has freedom to borrow to support new capital investment as long as certain criteria are met. In order to support decisions on borrowing the Council is required to set a number of Prudential Indicators that confirm that such borrowing is affordable, prudent and sustainable. These indicators were approved by Full Council on 2 March 2015 as part of the Treasury Management Strategy. Performance against these indicators for quarter 2 is set out in Appendix A.

4.2 Indicator 8 requires that no more than 15% of the debt portfolio should mature in any year. This is to minimise the risk of needing to refinance a large part of the portfolio at one time when interest rates might be unfavourable. There is a planned exception to this in 2042 when the loan to fund the HRA self-financing payment matures. It is intended that an element of the HRA surpluses will be set aside in future years so that the loan can be repaid on maturity without needing to refinance. In the light of this the indicator has been RAG rated as Green despite the exception.

4.3 Under the prudential regime the Council can borrow as required as long as this falls within the 2015/16 Prudential Limits. The Authorised Limit and Operational Boundary are shown in Appendix A. The Council's overall external debt at 30 September 2015 totalled £215.7m of which £190.4m was with the Public Works Loan Board (PWLB) and £25.3m was with individual banks. This falls within the Authorised Limit and Operational Boundary. The average annual interest rate of the Council's long term debt is 3.87%.

4.4 No new long term borrowing was undertaken in the first six months of the year as the level of internal balances such as reserves and general fund balances was sufficient to enable them to be used rather than resort to external borrowing.

Temporary borrowing

4.5 The Council set an original temporary borrowing limit of £55.4m for 2015/16. During the first six months of the year, there has been no need for the Council to raise any temporary loans. Due to a higher proportion of investments being placed on a fixed term basis to secure more favourable interest rates, there have been lower levels of liquid cash. It is possible that there may be a requirement to undertake temporary borrowing during the remainder of 2015/16.

Investments

4.6 During the first six months of the financial year, the Council has had surplus funds available for investment. The amount fluctuates on a day to day basis, although investment balances were still high during the first six months of the year, largely due to the advance receipt of revenue support grant and the levels of general fund balances and earmarked reserves being held. The Council's investment balances are shown in Appendix B.

4.7 The following table shows the breakdown of investments as at the end of September. Colour ratings are explained in paragraph 4.22:

Counterparty	Investment Type	Investment Duration	£'000	Colour Rating	Interest Rate %
Lloyds	Fixed rate	6 months	15,000	Red	0.70
Goldman Sachs	Fixed rate	6 months	5,000	Red	0.75
Nationwide	Fixed rate	6 months	5,000	Red	0.66
HSBC	Notice a/c	3 months notice	15,000	Orange	0.62
Svenska Handelsbanken	Notice a/c	35 day notice	10,000	Orange	0.50
Standard Life (Ignis)	MMF	Instant	15,000	N/A	0.49
Federated	MMF	Instant	12,750	N/A	0.48
Legal & General	MMF	Instant	2,450	N/A	0.47
Blackrock Heritage Fund	MMF	Instant	500	N/A	0.46
Municipal Bond Agency	Shares	Open	100	N/A	N/A
Total			**80,800**		

4.8 The average level of funds available for investment purposes in the first six months of 2015/16 was £87m. These funds were available on a temporary basis, with the amount largely dependent on the timing of payments, receipt of council tax and grants and progress of the capital programme. Interest earned during that period on these deposits totalled £236k and represented a weighted average interest rate earned by the Council of 0.53%. This compares favourably with the average of the 7 day and 3 month LIBID (London Interbank Bid Rate) figure of 0.41%.

4.9 During the first six months of 2015/16 the Council continued to make use of Money Market Funds (MMFs) to manage liquidity risk. A 3 month notice account with HSBC and a 35 day notice account with Svenska Handelsbanken also continued to be used, as these provide access to higher yields than MMFs.

4.10 In June, notice was given on a deposit of £10m with Deutsche Bank. This was due to Capita's colour rating for Deutsche Bank changing from "green" to "no colour" in response to market uncertainty caused by the Greek debt crisis. In accordance with its Treasury Strategy, the Council does not invest in institutions that do not have a colour rating. This investment was returned at the end of September.

4.11 Earlier in the year, Capita suggested that the Council should seek to reduce the extent of investments in liquid funds and place a higher proportion at longer durations. As well as benefitting from increased yield, these changes would help to protect the Council from international regulatory banking changes, which could see shorter duration deposits being phased out. The Council considered various fixed term investment options in order to place less reliance on lower yielding MMFs and notice accounts. Actions taken to progress this are summarised in the following paragraphs.

4.12 Capita carried out a review of Lloyds Banking Group's position in light of the Government's further divestment, taking holdings to below 20%. In May Capita decided that, for the purpose of their suggested investment limits, they would no longer treat Lloyds Bank, or The Bank of Scotland as part nationalised institutions. As such, these banks are now reviewed in the same way as other entities within Capita's methodology for suggested limits. The removal of implied sovereign support has resulted in reduced limits, however there is no change to the way in which the banks are being operated and the risk associated with investing in with them remains very low. Prior to this change the Council could place up to £20m for up to one year with these banks. Currently the limits are £15m for up to 6 months. In June the Council placed £15m with Lloyds Bank for 6 months at 0.70%.

4.13 The Council took advantage of preferential interest rates offered through Capita's Agency Treasury Services and in June £5m was placed with Goldman Sachs for six months at 0.75%. In the same month £5m was placed directly with Nationwide for 6 months at 0.66%.

4.14 During October the Council opened a 95 day notice account with Santander UK, which is currently paying 0.90% and placed £15m. This rate is not subject to any reduction during the notice period. Santander is currently rated "red" under Capita's creditworthiness methodology, which is assigned a limit of £15m for 6 months. This rating will be monitored in line with the Council's usual weekly ratings reviews. Should the rating for this bank drop at any time below its current level, the Council will consider giving notice as appropriate.

4.15 During December, the three fixed term investments with Lloyds, Goldman Sachs and Nationwide, totalling £25m will mature. Over the next month, the Council will look at the most beneficial options available to reinvest this sum, taking into account the expected cash flow position for the coming year. In conjunction with this, use of the notice account with Svenska will also be reviewed. This account has paid a rate of 0.50% since it was opened in December 2014 when £10m was placed and has remained since. It is possible that an alternative option would offer a similar rate and a level of liquidity which is not currently available from a notice account, or there are other fixed term options offering higher rates if there is scope to place this sum on a long term basis.

4.16 Within the Council's Treasury Strategy, there is scope to invest in alternative financial instruments, such as Certificates of Deposit (CDs). The Council has not previously exercised this option, however work is currently being undertaken to investigate different providers of custodial facilities, which are necessary to be able to deal in CDs.

4.17 In September 2014 the Council purchased 14,000 subscription shares in the Municipal Bond Agency for a consideration of £14,000, representing a price of £1 per share. During February 2015 a second purchase was made for £21,000, bringing the total share holding to 35,000 shares and completing the first phase of the investment. The first purchase of the second phase was made in June 2015 for £65,000. The total subscription now stands at £100,000.

4.18 Overall, the Council has achieved a reasonable yield on investments commensurate with proper levels of security and liquidity as expressed in the Council's annual investment strategy.

Treasury Management Strategy

4.19 The Council receives regular briefings from Capita Asset Services on the economic outlook for the UK and other key economies. These are used to inform treasury management decisions relating to future investment and borrowing strategies.

4.20 Growth for the UK economy is currently forecast at 2.7% for 2015, followed by 2.5% in 2016 and 2.6% in 2017. Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely to continue, as investor confidence responds to world events. The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in eventual world economic recovery, if sustained, is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities. However, the timing and magnitude of movements in rates remain uncertain.

4.21 The US did not fulfil expectations of a rate rise in September, due to concerns over the slowdown of growth in China and the knock on effect in emerging market countries, however those concerns have subsided and there is now a strong possibility that US interest rates will start to rise in December. In the Eurozone, the European Central Bank (ECB) announced a €1.1 trillion programme of quantitative easing in January 2015 to buy up the high credit quality government debt of selected Eurozone countries. This programme started in March 2015 and will run to September 2016. This seems to have had a beneficial impact in improving confidence and sentiment.

4.22 The Council continues to utilise Capita Asset Services' creditworthiness methodology, with the following individual investment limits assigned to individual counterparties:

- Yellow (AAA rated Government debt or its equivalent) up to 5 years
- Purple £20m, up to 2 years
- Blue £20m, up to 1 year (only applies to nationalised or semi nationalised UK banks)
- Orange £17.5m, up to 1 year
- Red £15m, up to 6 months
- Green £12.5m up to 100 days
- No colour - not to be used

4.23 In early November, Capita modified its methodology to take account of how the credit risk markets have behaved recently and how this has affected Credit Default Swaps (CDS) prices. These are incorporated into the methodology by an overlay process which compares them to a benchmark CDS index called the iTraxx. CDS market levels have fallen over the past few years and have remained at lower levels, which has prompted Capita to establish different tiers against the iTtraxx in order to take a new stepped approach to assessing CDS levels. Using this approach, the suggested limits for some banks will be more favourable than they would have been using the previous methodology process.

2016/17 Treasury Strategy

4.24 In March 2016 Full Council will be presented with a new Treasury Management Strategy for 2016/17 as part of the annual budget report. It is expected that the strategy will remain largely unchanged with focus on the following areas:

- Interest rate outlook for 2016/17
- Consideration of the need to refinance a £5m PWLB loan that is due to mature in July 2016
- Split of any loan repayments between the general fund and the Housing Revenue Account (HRA)
- Continuing to maximise opportunities to invest surplus cash balances for longer periods than overnight with suitable counterparties.
- Impact on the Capital Financing Requirement (CFR) of the appropriation of land and buildings from the general fund to the HRA and vice versa. This is in response to a number of planned transfers ready for development of new build housing
- Inclusion of loans to London Borough of Sutton wholly owned companies such as the Energy Services Company for the Decentralised Energy Company and the Housing Development Company
- Inclusion of loans to support the development of an Investment Property Portfolio

Interest rates

4.25 The bank base rate at the start of the year was 0.50% and it has remained at this level for the first six months of this year. Capita produced its latest interest rate forecast in November. They still expect the first interest rate rise to 0.75% in June 2016, with further increases by 0.25% to 1.0% in December 2016 and 1.25% in June 2017. Capita's projection is for the rate to reach 2.0% in September 2018.

Heritable Bank

4.26 In August 2015 the Council received the fifteenth instalment of the recovery of the £5.5m funds invested with Heritable Bank. The payment represented approximately 4p in the pound or £221k, which brings the total funds recovered to date to just over £5.4m, around 98p in the pound overall so far. It is still not clear whether this is a final dividend. The administrators have retained a reserve to provide for legal costs and expenses until the conclusion of the administration. They do not intend to make further distributions to unsecured creditors until all outcomes are fully known.

4.27 The Council has initiated a claim against Landisbanki, the parent company of Heritable Bank. The claim is dependant on the conclusion of the administration of Heritable, after which no further dividend payments will be made to creditors. If the Council receives any further amounts from Heritable, these will be offset against the subsequent claim against Landisbanki.

5 Impacts and Implications

Financial

5.1 The financial implications are addressed within the report.

Legal

5.2 There are no legal issues arising from this report.

6 Appendices and Background Documents

Appendix Letter	Title
A	Quarter one - Performance against Prudential Indicators
B	Council cash available for investment

Background Documents
Treasury Management Files
Capita Asset Services Reports
Ernst and Young Progress Report on the Administration of Heritable Bank

Audit Trail		
Version	Final	Date: 25 November 2015
Consultation with other officers		
Officer	**Comments Sought**	**Comments checked by**
Finance	Yes	Lyndsey Gamble
Legal	No	N/A

APPENDIX A

Quarter Two - Performance against Prudential Indicators

		Indicator 2015/16 £000		Actual at 30/09/2015 £000	Rag Status
	PRUDENTIAL INDICATORS				
(1)	Authorised Limit				
	Borrowing	301,768		215,721	
	Other Long Term Liabilities	3,392		2,234	
		305,160		217,955	Green
(2)	Operational Boundary				
	Borrowing	273,376		215,721	
	Other Long Term Liabilities	3,392		2,234	
		276,768		217,955	Green
(3)	Interest Rate Exposure				
	Upper limit for fixed rate exposure	301,768		150,121	Green
	Upper limit for variable rate exposure	75,442		(30,400)	Green
(4)	Upper limit on investments that go over a year	4,500		Nil	Green
(5)	Maturity Structure of Fixed Rate Borrowing	**Upper Limit**	**Lower Limit**	**Actual at 30/09/2015**	
	Under 12 months	15%	0%	3.24%	Green
	12 months – 24 months	15%	0%	0.12%	Green
	24 months – 5 years	45%	0%	0.16%	Green
	5 years – 10 years	75%	0%	2.09%	Green
	10 years & above	100%	0%	94.39%	Green
(6)	Adoption of CIPFA Code of Practice	Yes		Yes	Green
	LOCAL INDICATORS				
(7)	Temporary borrowing limit	55,354		Nil	Green
(8)	Maturity Structure –% of total debt maturing in any one year	< 15%		Planned exception	Green

APPENDIX B

Council cash balances available for investment