

Finance and Resources Committee

10.00am, Thursday, 27 November 2014

Treasury Management – Mid Term Report 2014/15

Item number	7.5
Report number	
Executive/routine	
Wards	

Executive summary

The purpose of this report is to give an update on Treasury Management activity in 2014/15.

In accordance with the Strategy set in March 2014 the Council completed no borrowing during the first half of the financial year and funded capital expenditure temporarily from investments. This approach will generate significant short-term savings in Loans Charges for the Council, in following this strategy account is also being taken of the likely movement in interest rates in the medium and longer term and the Council's future estimated borrowing requirement.

The investment return for 2014/15 continues to show significant out-performance against the Fund's benchmark, although low in absolute terms, while maintaining the security of the investments.

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Treasury Management: Mid Term Report 2014/15

Recommendations

- 1.1 It is recommended that the Committee:
- 1.1.1 notes the mid term report on Treasury Management for 2014/15; and
 - 1.1.2 refers the report to Council for approval and subsequent referral by Council to the Governance Risk and Best Value Committee for scrutiny.

Background

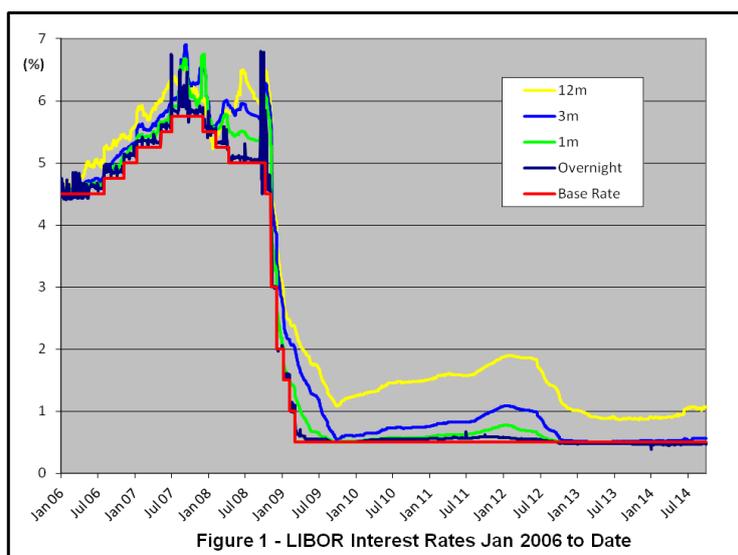
- 2.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in the Public Sector, and under the code, the mid-term report has been prepared setting out activity undertaken.

Main report

3.1 Interest Rate Background

- 3.1.1 Throughout the 6 months, the Bank of England's Monetary Policy Committee kept Quantitative Easing (QE) at £375bn and UK Bank Rate at 0.50%. QE has remained at that level since July 2012 and UK Bank Rate at 0.50% since March 2009.

- 3.1.2 Figure 1 below shows Inter-Bank Lending Rates since the start of 2006.



3.1.3 Figure 1 shows that the overnight and 1 month rates continued to follow the Bank Rate and the 3 and 12 month rates started to increase in June but then levelled out.

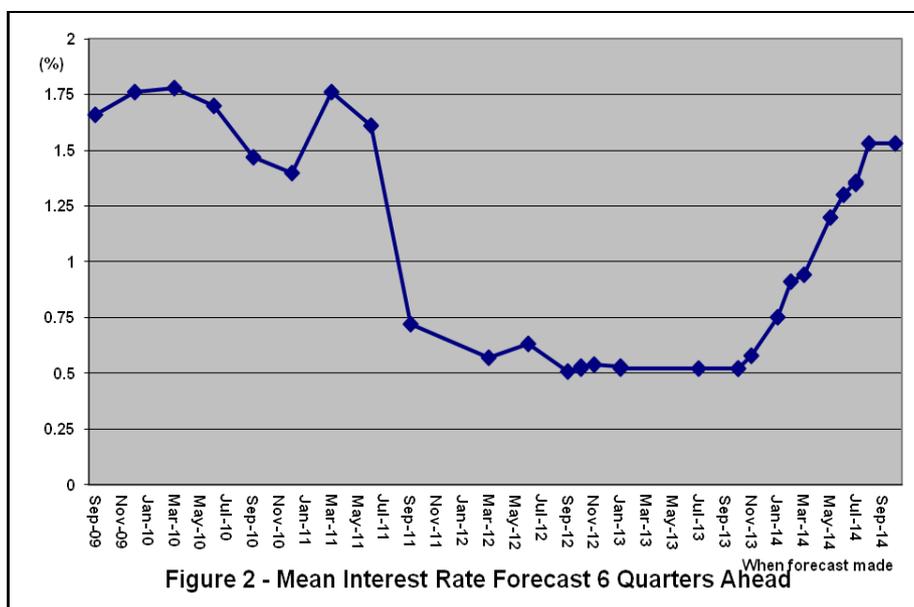
3.2 Interest Rate Forecast

3.2.1 Table 1 below gives a Reuters poll of up to 60 economists, taken 1st October, showing their forecasts for UK Bank Rate until Quarter 1 2016. This shows the market expectations of Bank Rate beginning to increase. Some predicting a rise as early as Q1 2015 with others estimating a delay until Q3 2015.

	2014		2015			
	Q4/14	Q1/15	Q2/15	Q3/15	Q4/15	Q1/16
Median	0.5	0.75	1	1.25	1.25	1.5
Mean	0.53	0.75	0.91	1.14	1.34	1.53
Mode	0.5	0.75	1	1.25	1.5	1.25
Highest	0.75	1	1.5	1.5	1.75	2
Lowest	0.5	0.5	0.5	0.75	1	1
Count	60	60	55	49	46	29

Table 1 – Economists’ Forecasts for UK Bank Rate

3.2.2 Figure 2 below shows the mean interest rate forecast of economists 6 quarters ahead of the date the survey was taken. This illustrates the market expectation of Bank Rate increases during 2015 although the Treasury section views the likelihood and magnitude of increases in UK Bank Rate to be lower than the general market perception.



3.2.3 The Annual Rate of CPI dropped from 1.9% in April 2014 to 1.2% over the quarter and is now closing in on the bottom of the Bank of England’s target range.

3.3 Investment Strategy

3.3.1 The Treasury Management strategy is to ensure that surplus funds are invested in accordance with the list of approved organisations for investment, minimising the risk to the capital sum and optimising the return on these funds consistent with those risks. The Cash Fund's Investment Strategy continues to be based around security of the investments.

3.3.2 Figure 3 below shows the Weighted Average Life (WAL) – i.e. the average time to maturity of the Cash Fund investments since inception.

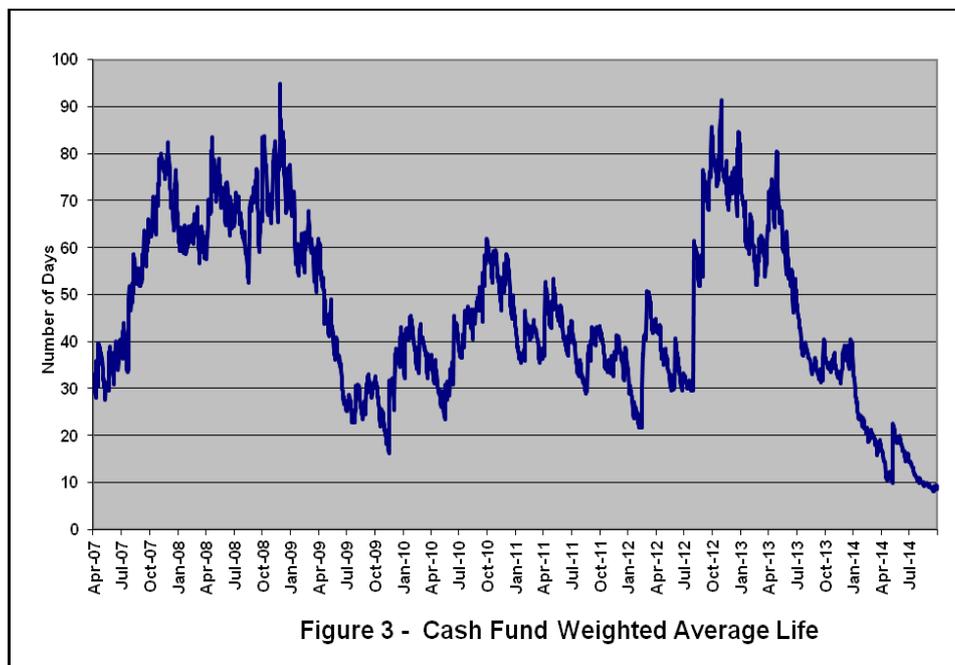
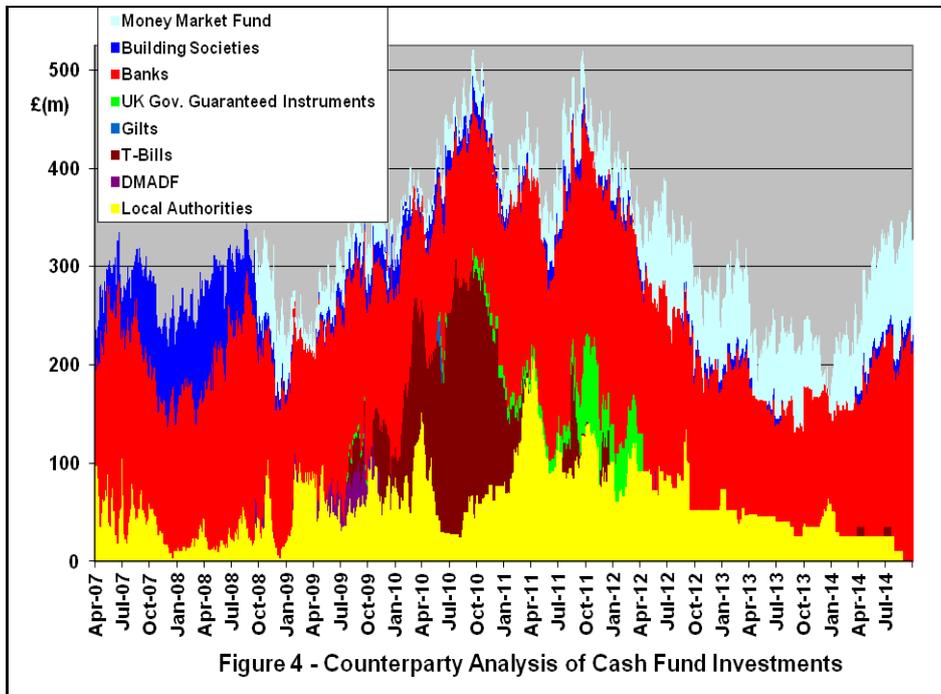


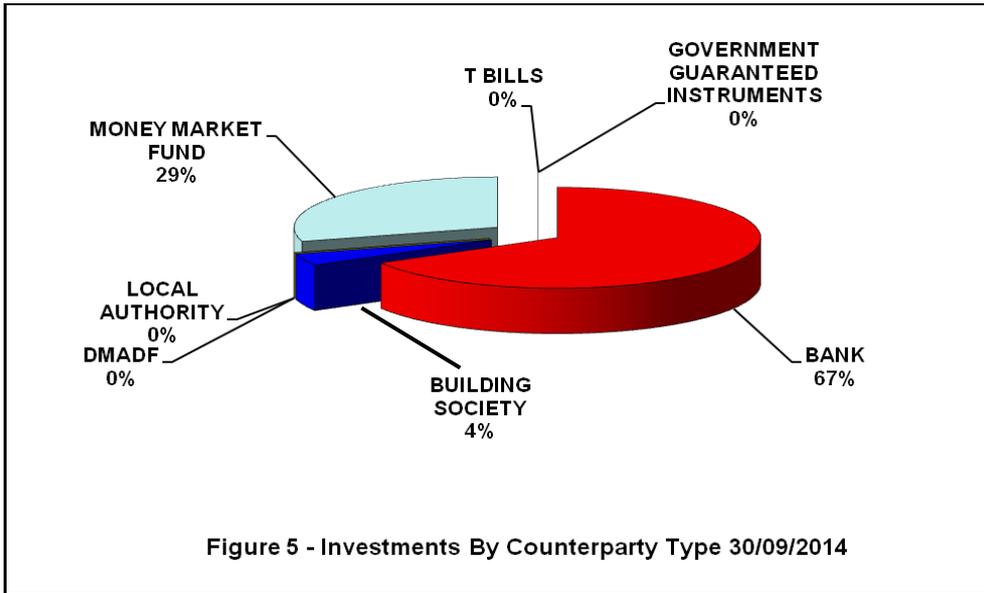
Figure 3 - Cash Fund Weighted Average Life

3.3.3 The WAL (weighted average time to the final maturity of investments) has decreased since the start of the financial year from 18.09 days on 31 March to 8.67 days on 30 September, the spike upwards in April 2014 was due to a purchase of a Rabobank CD which matures in May 2015. This was purchased at an attractive rate of interest for a highly rated institution.

3.3.4 Figure 4 below shows the distribution of Cash Fund deposits since inception.



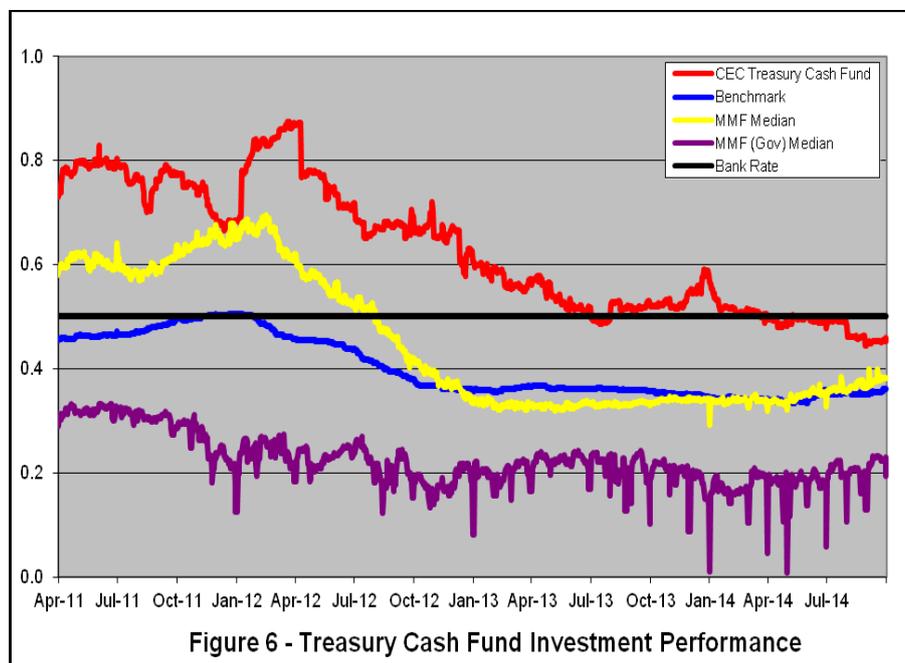
3.3.5 With Local Authorities continuing to lend to each other at low rates of interest the Treasury team continue to find difficulty in striking the balance between high levels of security and achieving an adequate return.



3.3.6 As can be seen in Figure 5 above over half of the fund remains invested with Banks, including higher rated institutions such as HSBC, Svenska Handelsbanken and Rabobank. All Bank deposits with the exception of the Rabobank CD are placed in instant access call accounts and the Treasury team remain in dialogue with these institutions to maintain the best interest rates. There are no deposits outstanding with Building Societies and as mentioned previously, rates on offer in the inter-local authority market have remained extremely low. Treasury bill rates have increased slightly and the Council has held some during the quarter.

3.4 Cash Fund Performance

3.4.1 The annualised rate of return for the Cash Fund for the six months to September 2014 was 0.479%, outperforming the benchmark by 0.131% on an annualised basis. Figure 6 below shows the daily investment performance of the Cash Fund against its benchmark and the Money Market Fund median since April 2011.

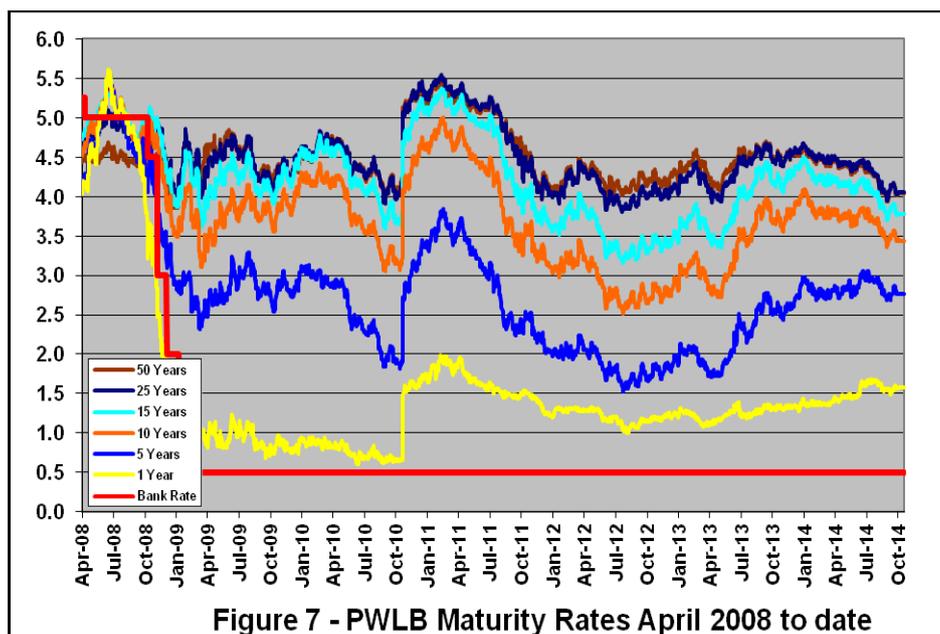


3.4.2 The 7-Day LIBID Benchmark continued to remain fairly static during the first half of the financial year. The effect of the Bank of England's Funding for Lending scheme which offers lower interest rate funding for the banks, reducing the need for interbank funding, has continued to depress interest rates on offer.

3.5 Debt Management Activity

3.5.1 The Treasury strategy for 2014/15 is to continue to use the Council's Investment balances to fund capital expenditure. There has been no PWLB borrowing, on behalf of the Council, completed since December 2012.

3.5.2 Figure 7 below shows the PWLB borrowing interest rates since the start of the 2008/09 financial year.



3.5.3 PWLB rates have fallen during the first half of 2014/15, due to a combination of heightened geo-political risk and concerns over the outlook for world growth. Bond yields fell across the world as the West become further involved in conflict in the Middle East and Russia with Ukraine. With market perception now that global growth is not as strong as many had previously considered, the likelihood of early interest rate rises in the UK and US has diminished. The attraction of holding Sovereign bonds even at their low rates combined with flights to safety has driven sovereign bond yields to exceptionally low level, pulling PWLB rates down with them.

3.5.4 At the start of the new financial year the Council was £110m under borrowed from 2013/14, this includes £58m from the previous financial year. The strategy for 2014/15 has been to reduce the Council’s investments and temporarily fund capital expenditure from cash rather than long term borrowing. Based on approved capital programme and any known slippage it is estimated that the Council will be under borrowed in the region of £123m, including under borrowing from previous years as above, at the end of the financial year if no further borrowing is undertaken. Therefore capital expenditure is being funded in the short-term at the marginal cost of foregone interest on the Council’s investments which is very low in absolute terms. This is a culmination of a four year strategy where long and medium term borrowing has been secured at historically low rates The strategy will result in the Council having significantly lower cash balances than in the past and if it became necessary to complete any borrowing, it would be likely that the Treasury team would look to borrow for short maturity period from the inter local authority market.

Measures of success

- 4.1 The success of the Treasury Section can be measured by the out-performance of the Treasury Cash Fund against its benchmark and managing the Council's debt portfolio to minimise the cost to the Council while mitigating risk.

Financial impact

- 5.1 The Council continues to manage its debt portfolio so as to minimise the medium term cost of funding its capital projects.
- 5.2 The Treasury Cash Fund has generated significant additional income for the Council.

Risk, policy, compliance and governance impact

- 6.1 The Council complies with the relevant CIPFA code of practice whilst undertaking Treasury Management activities. The significant financial risks associated with Treasury Management activities have been successfully managed during the first half of 2014/15.

Equalities impact

- 7.1 There are no adverse equality impacts arising from this report.

Sustainability impact

- 8.1 There are no adverse sustainability impacts arising from this report.

Consultation and engagement

- 9.1 None.

Background reading / external references

None.

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Links

Coalition pledges	P30 - Continue to Maintain a sound financial position including long-term financial planning
Council outcomes	C025 - The Council has efficient and effective services that deliver on objectives
Single Outcome Agreement	SO1 - Edinburgh's Economy Delivers increased investment, jobs and opportunities for all
Appendices	