DECISION-MAKER:		GOVERNANCE COMMITTEE COUNCIL		
SUBJECT:		REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT OUTTURN 2013/14		
DATE OF DECISION:		15 JULY 2014 17 JULY 2014		
REPORT OF:		HEAD OF FINANCE & IT (CHIEF FINANCIAL OFFICER)		
CONTACT DETAILS				
AUTHOR:	**Name:**	**Andrew Lowe**	**Tel:**	**023 8083 4049**
	E-mail:	**Andrew.Lowe@southampton.gov.uk**		
Director	**Name:**	**Mark Heath**	**Tel:**	**023 8083 2371**
	E-mail:	**Mark.Heath@southampton.gov.uk**		

STATEMENT OF CONFIDENTIALITY
NOT APPLICABLE

BRIEF SUMMARY

The purpose of this report is to inform the Governance Committee and Council of the Treasury Management activities and performance for 2013/14 against the approved Prudential Indicators for External Debt and Treasury Management.

This report specifically highlights that:

i. Borrowing activities have been undertaken within the borrowing limits approved by Council on 13 February 2014.

ii. Investment returns during 2013/14 continued to remain low as a result of low interest rates, returning £0.65M. However, the average rate achieved for fixed term deals (0.78%) exceeded the performance indicator of the average 7 day LIBID rate (0.41%), mainly due to the rolling programme of yearly investments which was reintroduced in November 2012, following recommendations from our Treasury Management advisors, Arlingclose.

iii. The Council's strategy was to minimise borrowing to below its Capital Financing Requirement (CFR), the difference representing balances, reserves, provisions and working capital. This approach lowers interest costs, reduces credit risk and relieves pressure on the Council's counterparty list. Throughout the year, capital expenditure levels, market conditions and interest rate levels were monitored to minimise borrowing costs over the medium to longer term and to maintain stability. The differential between debt costs and investment earnings continued to be acute, resulting in the use of internal resources in lieu of borrowing often being the most cost effective means of financing capital expenditure. As a result the average rate for repayment of debt, (the Consolidated Loans & Investment Account Rate – CLIA), at 3.32%, is lower than that budgeted for and slightly lower than last year (3.35%) as no new loans were taken due to slippage in the capital programme and higher than expected balances. The predicted forecast for longer term debt is a steady increase in

the longer term and so new long term borrowing is likely to be taken out above this rate, leading to an anticipated increase in the CLIA. A Public Works Loan Board (PWLB) 25 year fixed rate maturity loan is currently around 4%.

iv. In achieving interest rate savings the Council has exposed itself to interest rate risk by taking out variable debt. This was and continues to be very financially favourable in current markets but does mean that close monitoring of the markets is required to ensure that the Council can act quickly should the situation begin to change. During 2014/15 the Council will continue to review the position and take action as necessary to lessen this risk through a balanced combination of:

- longer term fixed maturity loans,
- medium term Equal Instalment of Principle (EIP) loans which are currently cheaper than longer term fixed,
- longer term PWLB variable loans which have the option to be fixed at very short notice for a small fee, and
- variable rate investments to take advantage of increasing interest rates, mainly through the use of call accounts and money market funds (MMF).

v. Net loan debt decreased during 2013/14 from £315M to £283M as detailed in paragraph 16.

vi. The Council can confirm that it has complied with the Prudential Indicators approved by Full Council on 13 February 2013.

vii. Action has been taken in response to the continued uncertainties and difficulties of the Authority's Bankers, (the Co-operative Bank), as set out in paragraphs 45 to 48.

RECOMMENDATIONS:

GOVERNANCE COMMITTEE

It is recommended that Governance Committee:

(i) Notes the Treasury Management (TM) activities for 2013/14 and the outturn on the Prudential Indicators

(ii) Notes that the continued proactive approach to TM has led to reductions in borrowing costs and safeguarded investment income during the year.

(iii) Notes the continued action taken in response to the down rating of the Authority's current Bankers, (the Co-operative Bank).

(iv) Notes the proposed extended scope of the Interest Equalisation Reserve to include the risk associated with 'bail – in' following the banking regulation reform which in future would force losses on investors before taxpayers are asked to support failing banks, and the subsequent change of name of this reserve to the Treasury Risk Reserve.

COUNCIL

It is recommended that Council:

i) Notes the Treasury Management (TM) activities for 2013/14 and the outturn on the Prudential Indicators

ii) Notes that the continued proactive approach to TM has led to reductions in borrowing costs and safeguarded investment income during the year.

iii) Notes the immediate action taken in response to down rating of the Authority's current Bankers, (the Co-operative Bank).

iv) Approves the extended scope of the Interest Equalisation Reserve to include the risk associated with 'bail – in' following the banking regulation reform which in future would force losses on investors before taxpayers are asked to support failing banks (see paragraphs 23 and 31- 32 for more details), and the subsequent change of name of this reserve to the Treasury Risk Reserve.

REASONS FOR REPORT RECOMMENDATIONS

1. The reporting of the outturn position for 2013/14 forms part of the approval of the statutory accounts. The Treasury Management (TM) Strategy and Prudential Indicators are approved by Council in February each year in accordance with legislation and the Chartered Institute of Public Finance & Accountancy (CIPFA) Code of Practice.

2. The Treasury Management Code requires public sector authorities to determine an annual TM Strategy and now, as a minimum, formally report on their treasury activities and arrangements to full Council mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and enable those with ultimate responsibility/governance of the TM function to scrutinise and assess its effectiveness and compliance with policies and objectives.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

3. No alternative options are relevant to this report

DETAIL (Including consultation carried out)

CONSULTATION

4. Not applicable

BACKGROUND

5. The Local Government Act 2003 introduced a system for borrowing based largely on self-regulation by local authorities themselves. The basic principle of the new system is that local authorities will be free to borrow as long as their capital spending plans are affordable, prudent and sustainable.

6. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services, (the "CIPFA TM Code"), and the Prudential Code require local authorities to determine a

Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also incorporates the Annual Investment Strategy (AIS), which is a requirement of the Department for Communities and Local Government's (CLG) Investment Guidance.

7. In summary the core elements of the Treasury Management (TM) strategy for 2013/14 were:

- To make use of short term variable rate debt to take advantage of the continuing market conditions of low interest rates.
- To constantly review longer term forecasts and to lock in to longer term rates through a variety of instruments as appropriate during the year, in order to provide a balanced portfolio against interest rate risk.
- To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio.
- To invest surplus funds prudently, the Council's priorities being:
  - Security of invested capital
  - Liquidity of invested capital
  - An optimum yield which is commensurate with security and liquidity.
- To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries

8. In essence TM can always be seen in the context of the classic 'risk and reward' scenario and following this strategy will contribute to the Council's wider TM objective which is to minimise net borrowing cost short term without exposing the Council to undue risk either now or in the longer term.

9. Treasury management is defined as *"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

10. Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

11. This report:

a) is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code,
b) presents details of capital financing, borrowing, debt rescheduling and investment transactions,
c) reports on the risk implications of treasury decisions and transactions,
d) gives details of the outturn position on treasury management transactions in 2013/14, and
e) confirms compliance with treasury limits and Prudential Indicators.

12. Appendix 1 summarises our Treasury advisors view of the economic outlook and events in the context of which the Council operated its treasury function

during 2013/14.

BORROWING REQUIREMENT AND DEBT MANAGEMENT

13. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with balances and useable reserves, are the core drivers of TM Activity.

14. The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2016/17. The Authority is likely to only borrow in advance of need if it felt the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing is actually required.

15. The forecast movement in coming years is one of the Prudential Indicators (PIs). The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years and is shown in the tables below together with activity in the year.

16.

	31-Mar-13 Actual £M	31-Mar-14 Actual £M	31-Mar-15 Current Estimate £M	31-Mar-16 Current Estimate £M	31-Mar-17 Current Estimate £M
External Borrowing:					
Fixed Rate – PWLB Maturity	139	139	183	207	222
Fixed Rate – PWLB EIP	93	81	69	58	46
Variable Rate – PWLB	35	35	35	35	35
Variable Rate – Market	9	9	9	9	9
Long Term Borrowing	**276**	**264**	**296**	**309**	**312**
Short Term Borrowing					
Fixed Rate – Market	34	10	20	30	30
Other Long Term Liabilities					
PFI / Finance leases	57	62	67	65	62
Deferred Debt Charges	17	16	16	15	14
Total Gross External Debt	384	352	399	419	418
Investments:					
Deposits and monies on call and Money Market Funds	(66)	(66)	(50)	(50)	(50)
Supranational bonds	(3)	(3)	(3)	(3)	(3)
Total Investments	(69)	(69)	(53)	(53)	(53)
Net Borrowing Position	**315**	**283**	**346**	**366**	**365**

17.

	Balance on 01/04/2013 £M	Debt Maturing or Repaid £M	New Borrowing £M	Balance as at 31/3/2014 £M	Increase/ (Decrease) in Borrowing for Year £M
Short Term Borrowing	34	(44)	20	10	(24)
Long Term Borrowing	276	(12)	0	264	(12)
Total Borrowing	**310**	**(56)**	**20**	**274**	**(36)**

Please note that these figures do not reflect the accounting convention of moving loans maturing in the year from long term to short term.

18. The Council's underlying need to borrow as measured by the CFR as at 31/3/2014 was estimated at £430M in February 2014 when the strategy was last updated, (see Table 1, Appendix 3). The Council's actual CFR at the end of the year was £425M.

19. The PWLB remains the Council's preferred source of long term borrowing given the transparency and control that its facilities continue to provide. However due to the continued depressed markets and the 'cost of carry' associated with long term debt, the Council deferred long term borrowing and raised £20M of new loans (including the replacement of maturing debt) from other Local Authorities through the short term market at an average rate of 0.54%.

Loans at Variable Rates

20. The 'cost of carry' has resulted in an increased reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Authority's exposure to shorter dated and variable rate borrowing is kept under regular review by reference to the difference or spread between variable rate and longer term borrowing costs. A significant narrowing in the spread (e.g. by 0.5%) between the variable rate and the 30 year fixed maturity will result in an immediate and formal review of the borrowing strategy to determine whether the exposure to shorter dated and variable rates is maintained or altered.

21. The Council has exposed itself to interest rate risk by taking out variable debt. This was and continues to be very financially favourable in current markets but does mean that the Council must monitor markets to ensure it is not caught out by rising interest rates. During 2014/15 the Council will continue to review and take action as necessary to lessen this risk through a balanced combination of:

    - longer term fixed maturity loans,
    - medium term Equal Instalment of Principle (EIP) loans which are currently cheaper than longer term fixed,
    - longer term PWLB variable loans which have the option to be fixed at very short notice for a small fee and
    - variable rate investments to take advantage of increasing interest rates, mainly through the use of money market funds (MMF).

22. In order to mitigate these risks further, the Council approved the creation of an Interest Equalisation Reserve in 2009. At that point a major debt restructuring exercise was undertaken in order to take advantage of market conditions and produce net revenue savings. In achieving this, the Council exposed itself to short term variable interest rate risk and whilst in the current climate of low interest rates this remains a sound strategy, at some point when the market starts to move, the Council will need to act quickly to lock

into fixed long term rates which may be at similar levels to the debt it restructured. It was therefore recommended that an Interest Equalisation Reserve be created to help to manage volatility in the future and ensure that there was minimal impact on annual budget decisions or council tax in any single year. The Reserve will be maintained at an appropriate level to protect the Council from future increase in debt charges where it is prudent to do so. In a speech given by Mark Carney, Governor of the Bank of England on the 12 June 2014, he indicated that the official interest rate could move earlier than the markets expect. Markets have priced the first rise in official interest rates for February/ March 2015.

23. In addition to interest rise risk, the Authority now has to cover the risk associated with 'bail – in' (following the banking regulation reform, see paragraph 32) which in future would force losses on investors before taxpayers are asked to support failing banks. It is recommended that the 'Interest Equalisation Reserve' be renamed 'Treasury Risk Reserve' to recognise this wider risk and the level is reviewed on a regular basis.

Internal Borrowing

24. Given the significant reductions in local government funding putting pressure on Council finances, the strategy followed was to minimise debt interest payments without compromising the longer-term stability of the portfolio. The differential between the cost of new longer-term debt (3.18% average rate for a 20 year PWLB fixed rate maturity) and the return generated on the Council's temporary investment returns was significant (2.4%).

25. As at the 31 March 2014 the Council used £73M of internal resources in lieu of borrowing which has been the most cost effective means of funding past capital expenditure to date. This has lowered overall treasury risk by reducing both external debt and temporary investments. However, this position will not be sustainable over the medium term and the Council will need to borrow to cover this amount as balances fall. Following the latest update of the Capital Programme, approved by Council in February 2014, the Council is expected to borrow up to £83M between 2014/15 and 2016/17. Of this £51M relates to new capital spend (£6M GF and £45M HRA) and the remainder to the refinancing of existing debt and externalising internal debt to cover the expected fall in balances and also the need to lock back into longer term debt prior to interest rises.

Lender's Option Borrower's Option Loans (LOBOs)

26. The 2011 revision to 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. All of our LOBOs are in their call period so are treated as due within the year for analysis purposes (see Table in paragraph 38). We do not however expect them to be called during the year, but if they were it is likely that they would be replaced by a PWLB loan.

INVESTMENT ACTIVITY

27. Both the CIPFA and DCLG's Investment Guidance requires the authority to invest prudently and have regard to the security and liquidity of investments

before seeking the optimum yield.

28. Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its TM Strategy Statement for 2013/14 which defined "high credit quality" organisations as those having a long-term credit rating of A- or higher, that domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. Investments during the year included:

- Deposits with other Local Authorities
- Investments in AAA-rated Stable Net Asset Value Money Market Funds
- Call accounts and deposits with UK Banks and Building Societies
- Bonds issued by Multilateral Development Banks

29. The table below summarises activity during the year:

	Balance on 01/04/2013	Investments Repaid	New Investments	Balance as at 31/3/2014	Increase/ (Decrease) in Investment for Year	Average Life / Average Rate %	
	£M	£M	£M	£M	£M	Life	%
Short Term Investments	26	(34)	26	18	(8)	3 Months	0.78
Money Market Funds & Call Accounts	40	(409)	417	48	8	1 Day	0.59
EIB Bonds	3	0	0	3	0	8 Years	5.40
Long Term Investments	0	0	0	0	0		
Total Investments	**69**	**(443)**	**443**	**69**	**0**		

Credit Developments and Credit Risk Management

30. The Authority assessed and monitored counterparty credit quality with reference to credit ratings; credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP and share price. The minimum long-term counterparty credit rating determined by the Authority for the 2013/14 treasury strategy was A- across rating agencies Fitch, S&P and Moody's.

31. The debt crisis in Cyprus was resolved by its government enforcing a 'haircut' on unsecured investments and bank deposits over €100,000. This resolution mechanism, in stark contrast to the bail-outs during the 2008/2009 financial crisis, sent shockwaves through Europe but allowed banking regulators to progress reform which would in future force losses on investors through a 'bail-in' before taxpayers were asked to support failing banks.

32. The Financial Services (Banking Reform) Act 2013 gained Royal Assent in December, legislating for the separation of retail and investment banks and for the introduction of mandatory bail-in in the UK to wind up or restructure failing financial institutions. EU finance ministers agreed further steps towards banking union, and the Single Resolution Mechanism (SRM) for resolving problems with troubled large banks which will shift the burden of future restructurings/rescues to the institution's shareholders, bondholders and unsecured investors. This means that if 'Bail In' was applied to an institution with which the Council has deposits, the Council would be required to part fund the losses from its investments held (the amount lost in a default

is usually about 50% of the sum lent). This is commonly referred to as a 'Hair Cut'.

33. Proposals were also announced for EU regulatory reforms to Money Market Funds which may result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple-A' credit rating wrapper in the future.

34. The material changes to UK banks' creditworthiness were (a) the strong progress made by the Lloyds Banking Group in strengthening its balance sheet, profitability and funding positions and the government reducing its shareholding in the Group to under 25%, (b) the announcement by Royal Bank of Scotland of the creation of an internal bad bank to house its riskiest assets (this amounted to a material extension of RBS' long-running restructuring, further delaying the bank's return to profitability) and (c) substantial losses at Co-op Bank which forced the bank to undertake a liability management exercise to raise further capital and a debt restructure which entailed junior bondholders being bailed-in as part of the restructuring.

35. In July Moody's placed the A3 long-term ratings of Royal Bank of Scotland and NatWest Bank and the D+ standalone financial strength rating of RBS on review for downgrade amid concerns about the impact of any potential breakup of the bank on creditors. As a precautionary measure the Authority reduced its duration to overnight for new investments with these banks. In March Moody's downgraded the long-term ratings of both banks to Baa1. As this rating is below the Authority's minimum credit criterion of A-, the banks were withdrawn from the counterparty list for further investment.

36. As reported previously along with many other authorities the Council uses the Co-operative Bank as its banker which no longer meets the minimum credit criteria of A- (or equivalent) long term. The Co-op's long-term ratings were downgraded by Moody's and Fitch to Caa1 and B respectively, both sub-investment grade ratings. The Co-op Bank's capital raising plans to plug a capital shortfall include a contribution from the Co-op Group which is committed to injecting £313m in 2014. However, in order to cover future expected losses and to meet the Prudential Regulation Authority's capital targets, a further £400m is being sought from shareholders, of which Co-operative Group's share is approximately £120m. Given the Co-op Group's own financial position, payment of these sums is by no means certain, leaving the bank with a precarious capital position. Further information is set out in paragraphs 45-48.

37. The table below summarises the nominal value of the Council's investment portfolio at 31 March 2014, and confirms that all investments were made in line with the Council's approved credit rating criteria:

Outstanding Investments as at 31 March 2014

Counterparty	Credit Rating Criteria Met When Investment Placed	Credit Rating Criteria Met on 31 March 2014	Under 1 Month	1-3 Months	3-6 Months	6-9 Months	9-12 Months	Over 12 Months	Total
	YES/NO	**YES/NO**	**£000's**	**£000's**	**£000's**	**£000's**	**£000's**	**£000's**	**£000's**
UK									
Bank Deposits	YES	YES	30,929	7,000	4,000	3,000			**44,929**
Building Societies	YES	YES	1,000		2,000				**3,000**
Government & Local Authority Deposits	YES	YES							**0**
Money Market Funds	YES	YES	18,122						**18,122**
Bonds							0	3,036	**3,036**
Total Investments			**50,051**	**7,000**	**6,000**	**3,000**	**0**	**3,036**	**69,087**

Liquidity Management

38. In keeping with the DCLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and call accounts. There is no perceived risk that the Council will be unable to raise finance to meet its commitments. The Council also has to manage the risk that it will be exposed to replenishing a significant proportion of its borrowing at a time of unfavourable interest rates. The Council would only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities. The maturity analysis of the nominal value of the Council's debt at 31 March 2014 was as follows:

Outstanding 31 March 2013	% of Total Debt Portfolio	Total Borrowing	Outstanding 31 March 2014	% of Total Debt Portfolio
£000's	**%**	**Source of Loan**	**£000's**	**%**
267,320	86	Public Works Loan Board	254,815	93
42,673	14	Other Financial Institutions	19,376	7
309,993	**100**		**274,191**	**100**
		Analysis of Loans by Maturity		
55,178	18	Less than 1 Year *	30,881	11
11,505	4	Between 1 and 2 years	11,505	4
34,515	11	Between 2 and 5 years	34,515	13
69,948	23	Between 5 and 10 years	58,443	21
0	0	Between 10 and 15 years		0
0	0	Between 20 and 25 years		0
5,000	2	Between 25 and 30 years	10,000	4
10,000	3	Between 30 and 35 years	5,000	2
42,000	13	Between 35 and 40 years	42,000	15
50,600	16	Between 40 and 45 years	54,850	20
31,247	10	Over 45 years	26,997	10
309,993	**100**		**274,191**	**100**

Yield

39. The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate has been maintained at 0.5% since

March 2009 and short-term money market rates have remained at very low levels, which continued to have a significant impact on investment income. The average 3-month LIBID rate during 2013/14 was 0.45%, the 6-month LIBID rate averaged 0.53% and the 1-year LIBID rate averaged 0.78%, (See Appendix 2 Table 1). The low rates of return on the Authority's short-dated money market investments reflect prevailing market conditions and the Authority's objective of optimising returns commensurate with the principles of security and liquidity.

40. The Council's investment income for the year was £0.65M and new fixed term deposits for periods up to one year have been made at an average rate of 0.78%. This was mainly as a result of the reintroduction of the rolling programme of yearly deals which was restarted in November 2012 following advice from our Treasury Advisors.

41. Income earned on longer-dated investments (£3M) made in 2007/08 at an average rate of 5.4% provided some cushion against the low interest rate environment.

42. The Authority has estimated it will have sufficient cash balances over the medium term to consider using property funds which offer the potential for enhanced returns over the longer term, but may be more volatile in the shorter term. These funds, which are managed by professional fund managers, will allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. The Council subsequently invested £5M in a Property fund on the 1 April 2014; further details will be reported as part of the Mid Year Treasury report.

COMPLIANCE WITH PRUDENTIAL INDICATORS

43. The Council can confirm that it has complied with its Prudential Indicators for 2013/14, approved by Full Council on 13 February 2013. The 2013/14 Treasury Strategy can be found as Item 100 on the Council Meetings Agenda found via the following web link:

http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MId=2322&Ver=4

These were subsequently revised as part of the Council's Treasury Management Strategy Statement for 2014 on 12 February 2014, item 87.

http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MId=2469&Ver=4

44. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of TM activity during 2013/14. None of the Prudential Indicators has been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. Details can be found in Appendix 3.

OTHER ITEMS

Authority Banking Arrangements:

45. The Authority banks with the Co-operative Bank which does not currently meet the Authority's minimum credit criteria of A- (or equivalent) long term and, as reported previously, has been subject to financial difficulties in recent months.

A rescue package for the Co-operative Bank was agreed in December 2013, and the bank also announced its withdrawal from the local authority market. As the Authority's contract with the Co-operative Bank is due to end in September 2014, a project to tender jointly for banking services was already underway with five other Local Authorities also with the Co-operative Bank, led by the Authority. Following the successful conclusion of the joint tender exercise, the Authority is now in the process of moving its banking arrangements to the successful bidder, Lloyds Bank. This exercise will be complete by September 2014, when the contract with the Co-operative Bank ends.

46. Until the transfer of our banking arrangements to Lloyds Bank is complete, the Authority will continue to take the following actions to mitigate our exposure to credit risk:

- **Pooling Arrangements –** It is common for local authorities to hold a number of accounts at the same bank and to group these together for overdraft limit and interest purposes under a netting-off or pooling arrangement. Under this arrangement, some accounts will have a substantial credit balance while others will have a large overdraft, but the total balance is kept close to zero. Procedures in place were such that staff who manage the TM activity on a daily basis previously aimed for the net closing daily balances across all our accounts to be close to our current 'free' overdraft limit of £50,000. However, Arlingclose advised that it is likely in the event of any insolvency/banking resolution procedure that this netting down may not apply and that we would need to repay our overdrawn accounts in full and credit balances could also be at risk (in part or in full).

  As a consequence procedures have been changed so that at the start of each day any account that has a balance in excess of £5,000 will be cleared back to the general account to minimise credit balances and limit our exposure (i.e. we will "sweep" the accounts and action inter-account transfers).
- **Cleared and Ledger Balances –** Overdraft interest charges are calculated in reference to the "cleared balance" and previously staff who manage the TM activity on a daily basis aim for this balance to be close to our current 'free' overdraft limit of £50,000. However, the total sum of money held in the current account is the ledger balance which is normally higher than the cleared balance. Arlingclose have advised that in the event of insolvency or other banking resolution procedure the "ledger balance" at the date of failure represents our exposure. Therefore, we now use the "ledger balance" to calculate our position and inform the action required. We currently aim to have an overdrawn

ledger balance of £300,000.

- **Intraday Exposure –** Arlingclose advice is that although any action by resolution authorities is likely to take place outside banking hours to prevent a disorderly impact on the UK banking system, it cannot be ruled out that a bank will halt operations during the business day. Therefore we aim to reduce our daylight exposure by making outgoing payments at the beginning of the day. In addition, where it is known in advance that a large receipt is expected, (for example, the first day of the month when council tax is collected), we now set up payments to leave the Council's bank account at the commencement of business. Furthermore, arrangements have been made to change the automatic sweep on the pay-point account from weekly to daily, although the balance on this account will still be subject to timing differences.
- **Government Grants and Capital Receipts -** large sums of money such as government grants and capital receipts are channelled through a Barclays current account which was set up to act as a 'parachute' account until the new banking contract had been awarded. These monies are transferred to the Co-op once appropriate Treasury action for the day has taken place so that the account is never in credit.
- **Imprest Accounts –** A review of Imprest Accounts (which are held locally to manage small transactions) was undertaken to ensure that the levels held are minimised and we sweep any balances over £5,000 out over the weekend.
- Advice to Schools – Advice has been sent to schools updating them on action that it is appropriate for them to take in respect of any locally held accounts.

47. These changes impact on the level of staff resource required to manage TM activity and is resulting in increased bank charges but this is seen as an acceptable trade off in light of the priority given to security. Staff resource is being redirected to TM activity and priorities have been reassessed in order that this can be managed within existing employee budgets. Additional bank charges can be met from within the current TM estimates. For 2013/14 bank charges totalled £4,100 an increase of £3,800 over the previous year.

48. These actions minimise credit risk but cannot eliminate it entirely.

Investment Training

49. The needs of the Authority's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. During 2013/14 staff attended training courses, seminars and conferences provided by Arlingclose and CIPFA

RESOURCE IMPLICATIONS

Capital/Revenue

50. The report is a requirement of the TM Strategy, which was approved at Council on 13 February 2014.

51. The interest cost of financing the Authority's long term and short term loan

debt is charged corporately to the Income and Expenditure account. The interest cost of financing the Authority's loan debt amounted to £9.7M in 2013/14 compared with an approved estimate of £11.7M, a saving of £2M. This is mainly due to variable interest rates being lower than those estimated and the use of temporary borrowing in place of long term debt.

52. In addition interest earned on temporary balances invested externally is credited to the Income and Expenditure account. In 2013/14 £0.65M was earned against a budget of £0.3M, an increase of £0.36M and was mainly due to the use of Money Market Funds and call accounts which currently pay a higher rate than short term fixed rates and the reintroduction of the rolling yearly investment programme from November 2012.

53. The expenses of managing the Authority's loan debt consist of brokerage and internal administration charges. These are pooled and borne by the HRA and General Fund proportionately to the related loan debt. Debt management expenses amounted to £127,400 in 2013/14 compared to an estimate of £161,400. This decrease was mainly due a reduction in brokerage costs due to fewer treasury deals being undertaken and deferring PWLB borrowing to 2014/15 resulting in a saving on commission paid in year.

Property/Other

54. None

LEGAL IMPLICATIONS

Statutory power to undertake proposals in the report:

55. Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System. From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1)(a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.

Other Legal Implications:

56. None

POLICY FRAMEWORK IMPLICATIONS

57. This report has been prepared in accordance with the CIPFA Code of Practice on TM.

KEY DECISION? Yes/No

WARDS/COMMUNITIES AFFECTED:	

SUPPORTING DOCUMENTATION

Appendices

1.	2013/14 Economic Background
2.	Summary of Interest Rates Movement During 2013/14
3.	Compliance with Prudential Indicators During 2013/14
4.	Glossary of Treasury Terms

Documents In Members' Rooms

1.	None

Equality Impact Assessment

Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.	Yes/No

Other Background Documents

Equality Impact Assessment and Other Background documents available for inspection at:

Title of Background Paper(s)		Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)
1.	None	