

**CORPORATE GOVERNANCE COMMITTEE – 20<sup>TH</sup> FEBRUARY 2015****REPORT OF THE DIRECTOR OF CORPORATE RESOURCES****QUARTERLY TREASURY MANAGEMENT REPORT****Purpose of the Report**

1. To update the Corporate Governance Committee about the actions taken in respect of treasury management in the quarter ended 31<sup>st</sup> December 2015.

**Background**

2. Treasury Management is defined as:-

“The management of the organisation’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”.

3. A quarterly report is produced for the Corporate Governance Committee to provide an update on any significant events in the area of treasury management.

**Economic Background**

4. The UK economy slowed marginally from its growth in the first half of the year, but the growth was still robust by both historic UK standards and relative to how most other economies are currently faring. The growth remains based on consumer spending and the housing market, with manufacturing continuing to lag. Forecasts for economic growth in 2015 and 2016 were revised down as a result of the narrow nature of the factors that are leading the recovery, but the significant fall in the oil price that happened towards the end of the year is expected to be positive for growth and forecasts might ultimately be revised upwards again.
5. Unemployment levels continued to fall and, for the first time in many years, wage growth was higher than inflation. Although wage growth outstripping inflation was more down to the fall in inflation than any major change to wage growth, survey evidence suggests that wage growth will accelerate and that real pay growth will occur for at least the next two years. Labour productivity levels in the UK, however, continue to be disappointing and an improvement in productivity will be key to whether employers can afford the higher wages that the surveys suggest will follow.
6. Consumer Price Inflation in December 2014 was just 0.5%, its joint-lowest level since this index commenced over 25 years ago. The significant fall in petrol prices and an intense supermarket price war were key factors in the fall of inflation, and there is a distinct possibility that inflation will fall further in the period ahead (and it may even turn negative for a short while). If the UK does experience deflation it is unlikely to be damaging in the same way as the deflation that threatens Eurozone,

which is due to lack of demand and risks becoming ingraining into expectations and encouraging consumers to postpone spending.

7. The US economy continues to show healthy growth, and their Quantitative Easing programme came to an end in October 2014. In comparison the Eurozone is close to recession and is likely to commence a huge Quantitative Easing programme early in 2015.

#### **Action Taken during September Quarter**

8. The balance of the investment portfolio decreased from £190.4m at the end of September to £164.1m at the end of December 2014. This fall in the balance is normal during this time of the year, and particularly in December, as it is a period during which relatively low levels of grant income and precept are received. Given the lack of available counterparties, and the fact that the portfolio is already up to the allowed limit for most acceptable counterparties, action taken can generally be classified as 'care and maintenance' of the portfolio.
9. A loan of £5m with Bank of Scotland (originally for 1 year and at a rate of 0.98%) matured during the quarter and was renewed for a fresh 1 year period at a rate of 1%. Four loans, totalling £25m, to local authorities that were originally placed for 1 year at an average rate of 0.608% also matured during the quarter.
10. The December quarter saw many local authorities become short of cash and the rates of interest that they were willing to pay for borrowing increased meaningfully as a result of the change in the demand/supply balance, which is a repeat of what happened in 2013. Advantage was taken of this situation and £72.2m in new loans were lent to 9 different local authorities at rates between 0.49% and 0.71%. The majority of these loans will mature either before or soon after the 2015/16 financial year, at which time it is possible that an expanded list of acceptable counterparties will become available (subject to approval of the change in methodology by the County Council). Given the current position of money markets it is expected that better rates will be available from some of the additional counterparties than the rates available from local authorities, hence the wish to have the majority of the loans maturing at around the commencement of the new financial year.
11. A 3 month loan to HSBC for £15m matured and was renewed for a further 3 month period at a slightly higher rate (0.56% from 0.556%). The overall impact of the activity on the average rate was to increase the average rate being earned from 0.596% at the end of September to 0.644% at the end of December. Part of the reason for the increase was the movement of loans from Money Market Funds to Local Authorities at higher rates, but the fall in the overall balance also played a major part as this meant that there was much less money held in Money Market Funds. As the rates available within Money Market Funds are below the average rate earned elsewhere within the portfolio, higher Money Market Fund balances will always bring down the average rate.

12. The loan portfolio at the end of December was invested with the counterparties shown in the list below.

	£m
Lloyds Banking Group/Bank of Scotland	40.0
HSBC	25.0
Local Authorities	80.2
Money Market Funds	<u>18.9</u>
	<u>164.1</u>

13. At the quarter end the loans to Local Authorities were amounts of £10m to each of Staffordshire County Council, Birmingham City Council, Lancashire County Council, London Borough of Islington and Plymouth City Council, £8.2m to Knowsley MBC, £8m to Exeter City, £5m to each of Herefordshire Council and Salford City Council and £4m London Borough of Newham. With the exception of the loan to Lancashire (maturing in November 2015), all of these loans will mature in either mid-April or before.
14. The current list of acceptable counterparties is very short and comprises:
- Lloyds Banking Group (£40m, for up to 1 year)
  - HSBC (£25m, for up to 2 years)
  - Local Authorities (£10m per Authority, for up to 1 year)
  - Money Market Funds (£25m limit per fund, maximum £125m in total)
  - UK Debt Management Office (unlimited, for up to 1 year)
  - UK Government Treasury Bills (unlimited, for up to 1 year)
15. Subject to approval by the County Council as part of the Annual Investment Strategy, the list of acceptable counterparties will be meaningfully increased from 1<sup>st</sup> April 2015. The Corporate Governance Committee received a report about this proposed change in November 2014.
16. There are also five further loans with Lloyds Banking Group which are classified as 'service investments' for the Local Authority Mortgage Scheme (LAMS). These do not form part of the treasury management portfolio, but are listed below for completeness:
- 5 year loan for £2m, commenced 5<sup>th</sup> September 2012 at 2.72%
  - 5 year loan for £1.4m, commenced 27<sup>th</sup> November 2012 at 2.19%
  - 5 year loan for £2m, commenced 12<sup>th</sup> February 2013 at 2.24%
  - 5 year loan for £2m, commenced 1<sup>st</sup> August 2013 at 2.31%
  - 5 year loan for £1m, commenced 31<sup>st</sup> December 2013 at 3.08%
17. The Leicestershire Local Enterprise Fund has been making financing available to small and medium sized Leicestershire companies, via an association with Funding Circle, since December 2013. There are a number of hurdles that companies must clear before being able to access this funding, and any loans made will be classed as 'service investments'. As such, these loans are not covered within the Treasury Management Policy but at the end December 2014 there had been 31 loans made totalling £289,660 and the average interest rate on these loans was 8.6%.

**Resource Implications**

18. The interest earned on revenue balances and the interest paid on external debt will impact directly onto the resources available to the Council.

**Equal Opportunities Implications**

19. There are no discernable equal opportunity implications.

**Recommendation**

20. The Committee is asked to note this report.

**Background Papers**

None

**Circulation under the Local Issues Alert Procedure**

None

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