Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE

10 FEBRUARY 2014

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 31st December 2013.

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. Based on survey evidence, it appears that UK growth in the December quarter was higher than the 0.8% experienced in the September quarter. It also appears that the recovery is broadening away from reliance on consumer spending into construction, manufacturing, business investment and exporting. Unemployment is falling much more quickly than expected towards the 7% threshold set by the Governor of the Bank of England before he said base rate increases would be considered.

5. Markets are now expecting a first increase in base rates in early 2015, although recent comments by Monetary Policy Committee (MPC) members have emphasised that they would want to see strong growth well established, and an increase in real income, before they would consider raising rates. For the first time in many years, there now appears to be differences of opinion between economists about the timing and extent of base rate increases.

6. The UK has been unusual in recent years in that its inflation level has been above the official target and the level of Consumer Price Inflation (CPI) has been stubbornly high – many other countries are fighting a battle against deflation. However, the level of CPI has recently fallen quite sharply and the December figure was exactly in line with the target at 2%. Most commentators expect inflation to stay in a tight range around the inflation target for many months to come.

7. In December the US Federal Reserve felt sufficiently confident that strong growth had been established in America that it announced that it would taper its asset purchase activity by $10bn per month from January, although it will still remain at $75bn per month. Markets took this announcement in their stride, which was a contrast to the sell-off that occurred in June 2013, when the possibility of future tapering was first raised by the Fed’s Chairman. It does appear that investors are becoming more confident that economic growth is becoming self-sustainable.

Action Taken during December Quarter

8. The balance of the investment portfolio decreased to £179.6m at the end of September 2013, from £150.5m at the end of the previous quarter. This decrease in balances is quite normal, especially given the front-loading of many Central Government grants early in the financial year.

9. During the December quarter a £5m loan to Barclays at a rate of 3.03% matured and was not renewed, as they are no longer an acceptable counterparty. A £5m loan with Lloyds Banking Group at a rate of 1.9% matured and was replaced with a new 1 year loan to the same counterparty at a rate of 0.98%, but the most notable action was the placing of a number of loans with other Local Authorities at rates that are attractive, relative to both the expected level of base rates and also the alternative option for investment (which would be to invest in Money Market Funds, at rates no higher than 0.4%). Of the loans to Local Authorities, £30m is for a 1 year period, £5m is for 9 months, £10m is for 6 months, £10m is for 3 months and £3m was for a two week period. There were 10 different loans to 10 different counterparties, totalling £58m at an average rate of 0.57%.

10. Local Authorities have been active borrowers within markets for some time, but the rates that they were willing to pay have been unattractive to us as a lender. There appears to have been a tightening of supply to them and, as a result the rates that we could achieve, became attractive. It is thought that most of the authorities are borrowing to finance the funding gap caused by their decision to repay long term debt a number of years ago and whether there continues to be an active Local Authority market that is attractive to lenders such as ourselves remains to be seen.

11. The average rate of interest rate of the investments at the end of December was exactly the same as it had been at the end of the previous quarter at 0.67%, despite the maturity of two £5m loans that were at very attractive rates. Although these two loans were for a relatively small part of the

portfolio, their impact onto the average rate was significant. Maintaining the same average rate was a function of both the reduction in the portfolio balance and also the loans that were made to Local Authorities – the level of balance held in Money Market Funds (at an average rate of c.0.4%) decreased by £79.5m.

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

	£m
Lloyds Banking Group/Bank of Scotland	40.0
HSBC	25.0
Local Authorities	58.0
Money Market Funds	27.5
	150.5

13. 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)

14. There are also four 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 5th September 2012 at 2.72%
- 5 year loan for £1.4m, commenced 27th November 2012 at 2.19%
- 5 year loan for £2m, commenced 12th February 2013 at 2.24%
- 5 year loan for £2m, commenced 1st August 2013 at 2.31%

15. In mid-December 2013 the 'Leicestershire Local Enterprise Fund' was launched, which makes financing available to small and medium-sized Leicestershire companies via an association with Funding Circle. There are a number of hurdles that companies must be 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 summary information (number of loans made, total amount, average interest rate) will be included in each quarterly treasury management report. No loans had been made by the end of December.

Resource Implications

16. 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

17. There are no discernable equal opportunity implications.

Recommendation

18. The Committee is asked to note this report.

Background Papers

None

Circulation under the Local Issues Alert Procedure

None

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