

DECISION-MAKER:	GOVERNANCE COMMITTEE COUNCIL		
SUBJECT:	TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS MID YEAR REVIEW 2014		
DATE OF DECISION:	17 NOVEMBER 2014 19 NOVEMBER 2014		
REPORT OF:	CHIEF FINANCIAL OFFICER		
<u>CONTACT DETAILS</u>			
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STATEMENT OF CONFIDENTIALITY
N/A

BRIEF SUMMARY

The Council approved a number of indicators at its meeting of the 12 February 2014. Following the September update of the Capital Programme and an analysis of Treasury Management activity in 2013/14 and between April and September 2014, these indicators have been reviewed for 2014/15 and are reported in accordance with CIPFA's code of practice on Treasury Management, (the "CIPFA TM Code"), and in line with the approved Treasury Management Strategy (TMS).

The core elements of the 2014/15 strategy are :

- To continue to make use of short term variable rate debt to take advantage of the current market conditions of low interest rates.
- To constantly review longer term forecasts and to lock into 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.

With overall annual expenditure in excess of £600M and an extensive capital programme, the Council is required to actively manage its cash-flows on a daily basis. The requirement to invest or to borrow monies to finance capital programmes, and to cover daily operational needs is an integral part of daily cash and investment portfolio management.

RECOMMENDATIONS:

GOVERNANCE COMMITTEE

- i) To note the current and forecast position with regards to these indicators and endorse any changes;
- ii) To note that the continued proactive approach to Treasury Management (TM) has led to reductions in borrowing costs and safeguarded investment income during the year whilst increasing the yield; and
- iii) To endorse the increase in the non-specified investment limit for institutions falling below our minimum limit investment limit A- be increased to £5M, as detailed in paragraph 29.

COUNCIL

- i) To approve any changes to the Council's Prudential Indicators as detailed within the report;
- ii) Continue to delegate authority to the Chief Financial Officer, following consultation with the Cabinet Member for Resources to approve any changes to the Prudential Indicators or borrowing limits that will aid good treasury management. For example increase the percentage for variable rate borrowing to take advantage of the depressed market for short term rates. Any amendments will be reported as part of quarterly financial and performance monitoring and in revisions to this strategy;
- iii) To note that the continued proactive approach to Treasury Management (TM) has led to reductions in borrowing costs and safeguarded investment income whilst increasing the yield; and
- iv) To approve the increase in the non-specified investment limit for institutions falling below our minimum investment limit of A- be increased to £5M, as detailed in paragraph 29.

REASONS FOR REPORT RECOMMENDATIONS

1. The TM 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

2. No alternative options are relevant to this report.

DETAIL (Including consultation carried out)

CONSULTATION

3. The capital programme update on which this report is based has been subject to its own consultation processes.

BACKGROUND

4. The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). The Authority's Treasury Management Strategy for 2014/15 was approved by full Council on 12 February 2014, item 87, which can be accessed on <http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MId=2469&Ver=4>

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

5. 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 in the term.
6. 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.*"
7. 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. The main risks to the Council's treasury activities are:
 - Liquidity Risk (Inadequate cash resources)
 - Market or Interest Rate Risk (Fluctuations in interest rate levels and thereby in the value of investments).
 - Inflation Risks (Exposure to inflation)
 - Credit and Counterparty Risk (Security of Investments)
 - Refinancing Risks (Impact of debt maturing in future years).
 - Legal & Regulatory Risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).
8. 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 treasury management transactions during 2014/15 to date, and

e) confirms compliance with treasury limits and Prudential Indicators.

BORROWING REQUIREMENT AND DEBT MANAGEMENT

9. 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. This was estimated at £446M as at the 31/03/2015 when the TM strategy was approved and has been revised down to £431M following a revision of the capital programme and adjusting for 2013/14 actual position.
10. The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2016/17 (£439M). 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.
11. 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.

	Balance on 01/04/2014	Debt Maturing or Repaid	New Borrowing	Balance as at 30/9/2014	Increase/ (Decrease) in Borrowing for Year	Average Life / Average Rate %	
	£M	£M	£M	£M	£M	Life	%
Short Term Borrowing	10	(10)	0	0	(10)	23 Years	3.20
Long Term Borrowing	264	(6)	0	258	(6)		
Total Borrowing	274	(16)	0	258	(16)		

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

	31-Mar-14 Actual	31-Mar-15 Approved	Current Portfolio	31-Mar-15 Current Estimate	31-Mar-16 Current Estimate	31-Mar-17 Current Estimate
	£M	£M	£M	£M	£M	£M
External Borrowing:						
Fixed Rate – PWLB Maturity	139	148	139	139	167	204
Fixed Rate – PWLB EIP	81	81	75	69	58	46
Variable Rate – PWLB	35	35	35	35	35	35
Variable Rate – Market	9	9	9	9	9	9
Long Term Borrowing	264	273	258	252	269	294
Short Term Borrowing						
Fixed Rate – Market	10	10	0	20	30	40
Other Long Term Liabilities						
PFI / Finance leases	62	61	62	67	65	62
Deferred Debt Charges	16	17	16	16	15	14
Total Gross External Debt	352	361	336	355	379	410
Investments:						
Deposits and monies on call and Money Market Funds	(66)	(40)	(73)	(40)	(40)	(40)
Financial Instruments	(3)	(3)	(6)	(13)	(13)	(13)
Total Investments	(69)	(43)	(79)	(53)	(53)	(53)
Net Borrowing Position	283	318	258	302	326	357

Public Works Loan Board (PWLB) Borrowing

12. The PWLB remains the Council's preferred source of long term borrowing given the transparency, flexibility and control it offers.

PWLB Certainty Rate

13. The Council successfully qualified for borrowing at the 'Certainty Rate', (0.20% below the PWLB standard rate) following the submission of the Certainty Rate form to the Department of the Environment, which included details of the capital expenditure and borrowing plans for the Council over the next three years. In April the Council submitted a further application along with the 2014/15 Capital Estimates Return to access this reduced rate for a further 12 month period from 1 November 2014.

Loans at Variable Rates

14. Included within the PWLB portfolio is £35M of variable rate loans, which are currently averaging 0.58% and are helping to keep overall borrowing costs down. Whilst in the current climate of low interest rates this remains a sound strategy, the Council need to review these regularly and if appropriate switching into fixed rate loans.
15. In order to mitigate these risks further, the Council approved the creation of an Interest Equalisation Reserve in 2009 to help manage volatility in the future and ensure that there was minimal impact on annual budget decisions or council tax in any single year. At that point a major debt restructuring exercise had taken place in order to take advantage of market conditions and produce net revenue savings. As reported in the outturn report in preparation of the banking regulation reform, this reserve was renamed 'Treasury Risk Reserve' to recognise the wider risk. The level of this reserve is reviewed on a regular basis.

Internal Borrowing

16. Given the significant reductions to 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 during 2013/14 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%).
17. 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 to long 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 September 2014, the Council is expected to borrow up to £74M between 2014/15 and 2016/17. Of this £40M relates to new HRA capital spend (GF has no new requirement at this stage) and the remainder to the refinancing of existing debt and externalising internal debt to cover the expected fall in balances.
18. However due to the continued and increased uncertainty in the markets and the expectations of interest rates staying lower for longer it may be appropriate to

maintain the council use of internal resources for part or all of this amount; providing that balances can support it. No long term borrowing has been taken to date and is none is expected to be taken until the third quarter of the year and will be assessed in conjunction with the development of the capital programme, cash balances and advice from the Council's treasury advisor.

INVESTMENT ACTIVITY

19. The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. There has been an increase in balances since the beginning of the year (£66M), peaking at £125M in mid- May. Based on previous years balances this is expected to fall around December when we have traditionally needed to borrow short term from the money markets due to uncertainty on the capital programme and the need to borrow long term. Projected balances to the end December indicate that on present levels of spend we should have about £20m more than this time last year, around £60M, so unless there is significant capital spend between now and then, there should be no need to borrow short term unless we feel this is prudent to protect our investments in the higher returning call accounts.
20. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its TM Strategy Statement for 2014/15.
21. Counterparty credit quality is assessed and monitored with reference to: Credit Ratings. The Council's minimum long-term counterparty rating is A- (or equivalent across rating agencies Fitch, S&P and Moody's); credit default swaps; financial statements, information on potential government support and reports in the quality financial press.

Externally Managed Investments

22. On the 1 April the Council invested £5M in property funds which offer the potential for enhanced returns over the longer term, but may be more volatile in the shorter term. These funds are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. This investment has returned an average of £20k per month, which will generate an additional £200k for the year. Consideration is also being given on whether to invest an additional £1M in the fund as the yield is attractive but this will increase our risk. The value of the fund at 30th September was £4,947,879, a "loss" of £52k against initial investment. Even allowing for this the fund still returned a yield of 3.67%.

Internally Managed Investments

23. The rolling programme of yearly investments has been stopped due to lower balances last year and the difficulty in placing at attractive rates, plus we are preparing for lower investment limits as part of the TM strategy for 2014 in anticipation of "bail in".
24. Following advice from our advisors, Arlingclose, enquires on options for longer term deposits with covered bonds / Floating Rate Notes (FRN's) and similar instruments are ongoing with a view of investing up to our £30M limit for long term investments (currently £11M, plus commitment to invest another £7M in October) to optimise

investment income. These deals will generate around £125k in a full year and about £59k for 2014/15.

25. The Authority has internally managed investments amounting to £78.5M as at the end of September and the tables below show a breakdown by credit rating and maturity and summarises activity during the year: It also shows the new committed deals

	Balance on 01/04/2014	Investments Repaid	New Investments	Balance as at 30/9/2014	Increase/ (Decrease) in Investment for Year
	£M	£M	£M	£M	£M
Short Term Investments	18.3	(24.0)	18.0	12.3	(6.0)
Money Market Funds & Call Accounts	48.1	(207.0)	219.1	60.2	12.1
Bonds	3.0	0.0	3.0	6.0	3.0
Long Term Investments	0.0	0.0	0.0	0.0	0.0
Total Investments	69.4	(231.0)	240.1	78.5	9.1

Current Investments	At 30th September 2014 £'000	Date of Maturity	Yield %	Rating
Lloyds Bank Plc	2,000	15/12/2014	0.65	A
Lloyds Bank Plc	2,000	15/12/2014	0.57	A
Nationwide Building Society	5,000	15/12/2014	0.50	A
Nationwide Building Society	1,000	01/10/2014	0.74	A
Nationwide Building Society	1,000	15/10/2014	0.76	A
Nationwide Building Society	1,000	17/11/2014	0.78	A
Money Market Funds	23,967	Call	Average 0.41	A+ to AA-
Santander UK Plc	10,000	Call	0.80	A
Bank of Scotland Plc	2,951	Call	0.40	A
Svenska Handelsbanken – A SHS	4,401	Call	0.40	AA-
HSBC Bank PLC	9,093	Call	0.80	AA-
Barclays Bank PLC	9,790	Call	0.65	A
European Investment Bank - Bond	1,000	15/04/2025	5.27	AAA
European Investment Bank - Bond	1,000	07/06/2025	5.16	AAA
European Investment Bank - Bond	1,000	07/06/2025	5.49	AAA
Yorkshire Building Society Covered Bond	3,333	12/08/2018	2.034	AA+
Committed Investments				
Volkswagen	2,007	20/08/2015	1.00	A
Rabobank Nederland	2,062	10/09/2015	0.95	AA-
Leeds Building Society	3,005	01/10/2019	3m Libor +0.36%	AAA

Counterparty Update

26. The European Parliament approved the EU *Bank Recovery and Resolution Directive (BRRD)* on April 15, 2014. Taking the view that potential extraordinary government support available to banks' senior unsecured bondholders will likely diminish within its two-year rating horizon for investment-grade entities, in April Standard & Poor's revised the Outlook of Barclays, Deutsche Bank, Credit Suisse and ING Bank from Stable to Negative (note, this is not the same as a rating review negative). In May, Moody's also changed the outlook from stable to negative for 82 European banks and from positive to stable for two European banks. The institutions affected on the Authority's lending list are Nationwide Building Society, Svenska Handelsbanken.
27. In August Moody's changed its outlook for the UK banking system from stable to negative, citing the reduction of government support for systemic banks as the reason. Although the agency believes that the stand-alone financial strength of UK institutions is improving they believed that this is more than offset by the potential bail-in risk now faced by investors. Similarly, in August S&P revised the outlooks for major Canadian banks to negative following the government's announcement of a potential bail-in policy framework.
28. Banks in the UK and EU face banks face stress tests this autumn, which may result in some institutions having to additionally bolster their capital buffers. The extent to which this might be required and the form they will have to take casts uncertainty over capital requirements in the system.
29. The UK is implementing the final bail-in provisions of the EU Bank Recovery and Resolution Directive to commence in January 2015, a year ahead of most other countries. Credit rating agencies have stated they plan to review EU banks' ratings in line with each country's implementation of the directive. Many UK banks, have standalone ratings in the "BBB" category, with uplifts for potential government support taking them into the "A" category. There is therefore a realistic risk that some major UK banks' credit ratings will fall below A- this financial year if this uplift is removed. We are not proposing to lower our counterparty to below A- to accommodate these banks but we may wish to continue investing in them through instant access as part of our non-specified investments. In order to accommodate this it is recommended that this limit be increased from the current level of £3M to £5M.

Authority Banking Arrangements

30. As reported previously following the downgrading of the Co-op bank and the end of our contract with them, the Authority has moved its banking arrangements to Lloyds Bank from 1st October 2014 with a cross over period of 3 months up to the 31st December 2014 when all banking with Co-op will cease. Until this time we will continue to mitigate our exposure to credit risk as reported in the review of Prudential Limits and Treasury Management Outturn 2013/14 submitted to council on the 16 July and can be found as item 13 via the following link:
<http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MId=2832&Ver=4>

BUDGETED INCOME AND EXPENDITURE

Investments

31. The Council does not expect any losses from non-performance in relation to its investments by any of its counterparties. The UK Bank Rate has been maintained at 0.5% since March 2009 and is not expected to rise this financial year. As a consequence short-term money market rates have remained at relatively low levels with new deposits being made at an average rate of 0.55%, investments in Money Market Funds and call accounts generated an average rate of 0.49%. Average cash balances were £102.5M during the quarter; these are expected to decline towards the end of the financial year as the incidence of government grant income and council tax income is skewed towards the earlier part of the year.
32. The Authority's budgeted investment income for the year was estimated at £0.3M, the Authority currently anticipates an investment outturn of £0.8M for the year based on current and committed deals. However following advice from our treasury advisors and our continued high investment balances the Authority has estimated it will have sufficient cash balances over the medium term to consider investing in further longer term financial instruments which will generate a better return.

Expenditure

33. 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 in 2014/15 of financing the Authority's loan debt is currently expected to be £9.8M compared with an approved estimate of £11.2M, a saving of £1.4M, of which £0.8M relates to the HRA. This is mainly due to variable interest rates being lower than those estimated, no new long term borrowing being taken in 2013/14, slippage on the HRA capital programme to 2015/16 and deferring any new borrowing to later in the year.

COMPLIANCE WITH PRUDENTIAL INDICATORS

34. All indicators to date complied with the Prudential Indicators approved by Council on 12 February 2014, item 87.

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

Details of the performance against key indicators and any proposed changes are shown below:

Capital Financing Requirement Gross and Actual External Debt

35. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the CFR in the preceding year, plus the estimates of any additional capital financing requirement for the current and next two financial years. It differs from actual borrowing due to decisions taken to use internal balances and cash rather than borrow. The table below shows the actual position as at 31 March 2014 and the estimated position for the current and next two years based on the capital programme submitted to council on the 17 September 2014.

Capital Financing Requirement	2013/14 Actual £M	2014/15 Approved £M	2014/15 Forecast £M	2015/16 Revised Estimate £M	2016/17 Revised Estimate £M
Balance B/F	433.2	430.2	425.0	431.0	438.9
Capital expenditure financed from borrowing (inc PFI)					
General Fund (GF)	10.8	10.7	7.5	0.5	0.0
HRA	0.0	23.1	16.0	21.2	3.1
GF Temporary Funding (Repayment)	(5.8)	(3.4)	(3.7)	0.0	0.0
HRA Voluntary Repayment of Debt	(5.6)	(5.1)	(5.1)	(5.1)	(5.1)
GF Revenue provision for debt Redemption.	(4.5)	(6.9)	(6.2)	(6.0)	(5.9)
Movement in Other Long Term Liabilities	(3.1)	(2.4)	(2.5)	(2.7)	(3.1)
Cumulative Maximum External Borrowing Requirement	425.0	446.2	431.0	438.9	427.9

36. The Council reports that it has not borrowed in advance of need and that it has continued the use of internal resources in lieu of borrowing as this has been the most cost effective means of funding past capital expenditure to date. In the Prudential Code (November 2011), it states '*Where there is a significant difference between the net and gross borrowing position the risks and benefits associated with this strategy should be clearly stated in the annual strategy*'. The Council has had no difficulty in meeting this requirement so far in 2014/15, nor is there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

	31/03/2014 Actual £M	31/03/2015 Approved £M	31/03/2015 Estimate £M	31/03/2016 Estimate £M	31/03/2017 Estimate £M
General Fund CFR	266.4	261.1	261.5	253.3	244.3
Housing CFR	158.6	185.1	169.5	185.6	183.6
CFR	425.0	446.2	431.0	438.9	427.9
Gross Long term Debt	342.0	351.0	335.0	349.0	370.0
Difference	83.0	95.2	96.0	89.9	57.9
Short Term Debt	10.0	10.0	20.0	30.0	40.0
Difference	73.0	85.2	76.0	59.9	17.9
Borrowing in excess of CFR? (Y/N)	N	N	N	N	N
Investments	(69)	(43)	(53)	(53)	(53)

Authorised Limit and Operational Boundary for External Debt

37. The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Council's **Affordable / Authorised Borrowing Limit** was set at £760M for 2014/15 (£674M for borrowing and £86M for other long term liabilities).
38. The **Operational Boundary** is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the

additional headroom included within the Authorised Limit. The Operational Boundary for 2014/15 was set at £750M (£672M for borrowing and £78M for other long term liabilities).

39. The above limits are set to allow maximum flexibility within TM, for example a full debt restructure. Actual borrowing as detailed in paragraph 11 is significantly below this and reflects decisions taken to use internal balances and cash rather than to physically borrow and shows the position at a point in time. No new borrowing is expected to take place until later in the financial year.
40. The Chief Financial Officer (CFO) confirms that there were no breaches to the Authorised Limit and the Operational Boundary and during the period to the end of September 2014, borrowing at its peak was £274M (other long term liabilities £78M) and there is no proposal to change these limits at this time.

Upper Limits for Fixed and Variable Interest Rate Exposure

41. These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2014/15 %
Upper Limit for Fixed Rate Exposure	100
Compliance with Limits:	Yes
Upper Limit for Variable Rate Exposure	50
Compliance with Limits:	Yes

42. The Upper limit represents the maximum proportion of borrowing which is subject to variable rate interest and was set at 50%, although in practice it would be unusual for the exposure to exceed 25% based on past performance, the highest to date is 15.8%. The limit was set at a higher level to allow for a possible adverse cash flow position, leading to a need for increased borrowing on the temporary market and to take advantage of the low rates available through the PWLB for variable debt. There has been no adverse cash flow to date but it is proposed that the limit remain at 50%, to allow for flexibility in case of any slippage in expected capital receipts.

Total principal sums invested for periods longer than 364 days

43. This indicator allows the Council to manage the risk inherent in longer term investments; the limit for 2014/15 was set at £30M. As detailed in paragraph 24 we currently have £11M invested in long term instruments with commitment for another £7M during October.

Liquidity

44. The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available within a rolling three month period with the view of looking to borrow short term if cash available in instant access accounts falls below £25M.

Maturity Structure of Fixed Rate Borrowing

45. This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period.

	Lower Limit	Upper Limit	Actual Fixed Debt as at 30/9/2014	Average Fixed Rate as at 30/9/2014	% of Fixed Rate as at 30/9/2014	Compliance with set Limits?
	%	%	£M	%		
Under 12 months	0	45	9.4	2.44	4.20	Yes
12 months and within 24 months	0	45	0.0	0.00	0.00	Yes
24 months and within 5 years	0	50	0.0	0.00	0.00	Yes
5 years and within 10 years	0	75	75.2	3.23	33.66	Yes
10 years and within 15 years	0	75	0.0	0.00	0.00	Yes
15 years and within 20 years	0	75	0.0	0.00	0.00	Yes
20 years and within 25 years	0	75	0.0	0.00	0.00	Yes
25 years and within 30 years	0	75	10.0	4.68	4.48	Yes
30 years and within 35 years	0	75	5.0	4.60	2.24	Yes
35 years and within 40 years	0	75	42.0	3.99	18.80	Yes
40 years and within 45 years	0	75	50.6	3.62	22.65	Yes
45 years and within 50 years	0	75	31.2	3.56	13.98	Yes
50 years and above	0	100	0.0	0.00	0.00	Yes
			223.4	3.43	100.00	

For this indicator, all of the Council LOBO loans are within the call period so the maturity date of the loans is treated as due in the year.

Credit Risk

46. The Council confirms it considers security, liquidity and yield, in that order, when making investment decisions. Credit ratings remain an important element of assessing credit risk, but they are not the sole feature in the Council's assessment of counterparty credit risk. The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP);
- Corporate developments, news, articles, markets sentiment and momentum;
- Corporate developments, news, articles, markets sentiment and momentum.

The Council can confirm that all investments were made in line with minimum credit rating criteria set in the 2014/15 TMSS.

Housing Revenue Account (HRA) Limit on Indebtedness

47. Local authorities are required to report the level of the HRA CFR compared to the level of debt which was imposed by the CLG of self-financing at the time of implementation. The following tables show this plus the movement in year.

HRA Summary of Borrowing	2013/14 Actual £m	2014/15 Approved £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Brought Forward	163.8	167.1	158.6	169.5	185.6
Maturing Debt	(5.6)	(5.1)	(5.1)	(5.1)	(5.1)
New borrowing	0.4	23.1	16.0	21.2	3.1
Carried forward	158.6	185.1	169.5	185.6	183.6
HRA Debt Cap (as prescribed by CLG)	199.6	199.6	199.6	199.6	199.6
Headroom	41.0	14.5	30.1	14.0	16.0

Ratio of Financing Costs to Net Revenue Stream

48. This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The definition of financing costs is set out at paragraph 87 of the Prudential Code. The ratio is based on costs net of investment income. The increase in the HRA financing costs is due to the reform of HRA of council housing finance which took effect from 28 March 2012. During 2013/14 the HRA made a voluntary debt repayment of £5.6M, which has led to an increase in the financing ratio for the year. This will result in lower borrowing costs for future years. The upper limit for this ratio is currently set at 10% for the General Fund to allow for known borrowing decision in the next two years and to allow for additional borrowing affecting major schemes.

Ratio of Financing Costs to Net Revenue Stream	2013/14 Actual %	2014/15 Approved %	2014/15 Forecast %	2015/16 Forecast %	2016/17 Forecast %
General Fund	6.95%	6.96%	5.97%	7.46%	8.58%
HRA	16.24%	16.33%	14.88%	15.75%	16.01%
Total	10.28%	10.39%	9.27%	10.94%	12.19%

SUMMARY

49. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity up to the 30 September 2014. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield
50. In addition to the CIPFA's requirement to produce a mid and year end report, each quarter as part of corporate monitoring a summary of Treasury Management activity is prepared. This is presented to Cabinet as part of the Quarterly Revenue Financial Monitoring report.
51. For further information please see the following links:

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>

Treasury Management Outturn Report on 16th July 2014, item 35.
<http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MId=2832&Ver=4>

Quarterly Revenue Financial Monitoring report, item 23 (Appendix 11)

RESOURCE IMPLICATIONS

Capital

52. The Capital implications were considered as part of the Capital Update report submitted to Council on the 17 September 2014.

Revenue

53. The revenue implications are considered as part of ongoing monitoring which is reported to Cabinet each Quarter and as part of the budget setting process.

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? No

WARDS/COMMUNITIES AFFECTED:	All
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SUPPORTING DOCUMENTATION

Appendices

1.	Economic performance to date and outlook for Q3 and Q4 2014/15
2.	Glossary of Treasury Terms

Documents In Members' Rooms

1.	None
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Equality Impact Assessment

Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.	No
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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.	TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2014/15 to 2016/17 – Council 12 February 2014
2.	REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT OUTURN 2013/14 – Council 16 July 2014
3.	CORPORATE REVENUE FINANCIAL MONITORING FOR THE PERIOD TO THE END JUNE 2014– Cabinet 19 August 2014