

## WAVERLEY BOROUGH COUNCIL

EXECUTIVE - 2 JULY 2013

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**Title:**

### **TREASURY MANAGEMENT PERFORMANCE**

**[Portfolio Holder for Finance: Cllr Mike Band]**

**[Wards Affected: N/A]**

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#### **Summary and purpose:**

The purpose of this report is to summarise Waverley's investment performance for the year 2012/2013, and for the period 1<sup>st</sup> April 2013 to date, in accordance with Waverley's Treasury Management Policy and the Code of Practice on Treasury Management in Local Authorities, to propose amendments to current investment limits.

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#### **How this report relates to the Council's Corporate Priorities:**

The management of Waverley's finances is a key function that helps ensure sufficient funds are available to provide services and pay the Council's commitments. Regular monitoring reports demonstrate that the Council's financial resources have been properly managed and used in support of the Council's key objective of providing good value for money.

#### **Financial and legal Implications:**

The report identifies a potential shortfall in interest received on investments in 2013/14 with the projected General Fund element being £50,000.

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#### **Introduction and Background**

1. Waverley's Treasury Management Strategy was subject to a fundamental review in February 2010 and further amended in the light of the revised CIPFA Treasury Management Code of Practice, issued in November 2011. Waverley's 2013/14 Treasury Management Policy accords with the current CIPFA Code of Practice on Treasury Management in the Public Services. The Corporate Overview and Scrutiny Committee is charged with reviewing Treasury Management operations periodically.
2. Members will recall that the refinancing of the HRA on 27<sup>th</sup> March 2012 required Waverley to buy itself out of the previous subsidy system by making payment to the Government of some £188m. This was largely financed by PWLB borrowing over a range of terms but the need to borrow externally was reduced by a £5m internal long-term borrowing by the HRA from the General Fund. This action has several benefits including reduced interest charges and increased flexibility for the HRA and reduced counterparty risk for Waverley as a whole.
3. This report covers the period 1 April 2012 to 31 March 2013 and also includes the period from 1 April 2013 to date.

## **Investment rate of return %**

4. Members have identified the 3-month Sterling LIBOR rate, published by the Government's National Office of Statistics, as the appropriate target rate. In recent years a 3-month comparison is in line with Waverley's typical activity, however, currently a large proportion of Waverley's surplus cash is invested on a shorter term basis or is on call.
5. The Local Performance Indicator LI8, which relates to investment performance, is shown below. Despite the static base rate, the 3 month LIBOR rate has, for some time, been above the actual market rates for a 3 month term. While the LIBOR rate started to gradually reduce in 2012/13, counterparty rates have reduced lower and quicker.

### **Average rate of return on external investments compared to target rate**

2012/13 Target	2012/13 Actual	2013/14 Target	2013/14 Actual to date
0.25% above the average 3 month Sterling LIBOR rate	0.16% above the average 3 month Sterling LIBOR rate	0.25% above the average 3 month Sterling LIBOR rate	0.16% above the average 3 month Sterling LIBOR rate

6. The rate of return on the Council's external investments for 2012/2013 was 0.87%. At 31 March 2013 the typical rate offered for a 3 month term by most counterparties on Waverley's lending list was less than 0.44%. The LIBOR rate in March 2013 was 0.51% but started the year at 1.03% - a weighted average of 0.71% for the year. As at 24<sup>th</sup> May 2013 the rate of return being achieved was 0.67% and 3 month rates from approved counterparties ranged from around 0.35% to 0.45%. The LIBOR rate, however, remains at 0.51% and the target at 0.25% above that – 0.76% currently. Performance will need to be monitored closely during the year, particularly in the light of recent reductions in the interest rates paid on some of Waverley's key call accounts.
7. The performance indicator referred to above reflects only external investments ie. typically surplus cash placed with banks, building societies. In addition, Waverley also has £5m invested internally with the HRA earning 3.5% interest over the longer term. Also, a recent acquisition of land at Farnham using cash balances to finance the cost, is generating a healthy return from the lease of part of the land for use as a commercial car park. This investment is currently generating income equivalent to a return of 3.3%.

## **Yield**

8. Waverley set a budget of £275,000 for external investment income in 2012/13, in anticipation of low market-interest rates continuing over both the short and medium term. The improvements identified in the budget monitoring forecasts have been achieved and actual external investment income of £321,000 was received in 2012/13. Most of the excess above budget related to the HRA but the general Fund element was £10,000. The 2013/14 budget for external investment income is £305,000 and, while it is early in the year to be able to make accurate predictions, this target will be challenging to achieve given the large reductions in the rates

Waverley is now able to achieve on its instant access accounts. Consequently, the latest budget management report indicates a potential shortfall against budget in 2013/14 of £50,000 at this stage.

9. The average daily external investment in 2012/2013 was around £36,400,000 compared with £35,800,000 in 2011/12. To date in 2013/14 the average is £40,500,000.

### **Security of investment**

10. Waverley's policy and practice is to put security of investment at the highest priority followed by liquidity and finally rate of return/yield. The cornerstones of recent policy/practice are: (1) to restrict lending to only those institutions which fit the Council's policy in terms of financial standing, credit ratings etc (2) to opt for short-term investments or lend to cover precept dates and (3) to fix financial limits to each institution depending the quality of their financial ratings. These restrictions inevitably have a negative impact on the rate of return achievable but are necessary to maintain the approved level of security on investment. The relatively small number of financial institutions that meet Waverley's counterparty criteria was the most significant factor in day-to-day Treasury Management. Waverley did not invest with the Debt Management Office where rates are below market rates.
11. On 31 March 2013 Waverley had £30,000,000 invested externally and £22,500,000 of that was on instant access/call arrangements and no investment had a remaining maturity period exceeding 3 months. This represented only 8 external investments all of which were A rated (or better) counterparties.
12. As at 28th May 2013, Waverley had 9 external investments all with specified investors i.e. only counterparties with a formal credit rating of A or above. By way of comparison, as at 30 June 2008 (just before the start of the credit crunch) Waverley had 23 external investments 16 of which were with non-specified institutions. This demonstrates the changing practice in respect of preferred counterparties and mitigation of risk.

### **Risk**

13. Waverley's approach to management of risk in respect of investments is set out most recently in the Treasury Management report to the Executive on 5<sup>th</sup> February 2013. Whereas that report is, strictly, the 2013/14 strategy, practice during 2012/13 was largely the same as the 2013/14 strategy sets out. That report sets out 8 identified risk categories and the means of managing those risks. The mitigation of risk is touched on a number of times in this report but the following brief comments relate to the 3 most commonly identified risks.
14. Exposure to interest rate fluctuation risk is minimised by having a realistic but prudent approach to budgeting and by using only fixed term instruments – generally on a short (3 month) term.

15. Counterparty and credit risk is managed by a number of processes including having a 'preferred investor' list consisting currently of only 'A' rated institutions, by constant monitoring of credit ratings and by having organisational investment limits (both financial and time) which reflect a prudent approach to the market.
16. Waverley operates investment activity only in GBP Sterling, as a matter of policy, and only in fixed term deposits as a matter of practice. Its policies deliberately avoid the more speculative and complex types of financial instruments which are often associated with exchange rate risk specifically and increased risk generally.

### **General cash management**

17. Waverley's primary objective is to manage daily cash balances to meet cash flow commitments and to minimise investment risk. Recent market conditions mean that it can be more economic to borrow short-term, to meet expenditure commitments, than for Waverley to recall its investments. During 2012/13 Waverley made 3 short-term borrowings from other Local Authorities totaling £6,000,000 at a cost of £684 in interest charges. No temporary borrowing has occurred in 2013/14 to date and whereas it is an attractive option for borrowers given the low borrowing costs it is equally unattractive for lenders unless the lending period is long or the sums borrowed are large.
18. In 2012/13 Waverley's turnover on outgoing investments was £113m and £107m for incoming investments. The average daily balance in Waverley's general bank accounts at the close of business was around £20,000.
19. The table below shows the total transactions during 2012/13:

	Balance at 1 April 2012 £	Total lent £	Total repaid £	Balance at 31 March 2013 £
Temporary investments	23,500,000	113,400,000	106,900,000	30,000,000

### **Long term borrowing:**

20. Waverley has generally been debt free for some years. However, a long term borrowing was approved in February 2011. That borrowing was to re-finance externally some HRA internal borrowing. In accordance with Council approval, Waverley borrowed £3.238m at 5.36% for a period of 29.5 years repayable on maturity. In addition, the HRA reform in March 2012 required Waverley to borrow some £189m largely from the PWLB although £5m was met by internal borrowing. This borrowing was profiled to match the repayment capacity within the HRA business plan over the next 30 years. A series of loans was taken from PWLB with repayment terms from 5.5 years to 23.5 years at interest rates varying between 1.37% and 3.41%. These loans were taken on 27 March 2012 so the financial impact in 2011/12 was minor.
21. The first interest repayment on these loans was due at the end of September 2012 in the sum of £2.7m and again in March 2013. Cash flow forecasting ensures that Waverley has the resources to meet such commitments as they arise.

22. The amendments to Waverley's Treasury Management 2012/13 Strategy which were submitted to the Executive in September 2012 (which were essentially an increase in investment £limits with approved counterparties) have proved to be useful in day-to-day investment practice. These limits were increased as a result of increased cash becoming available to Waverley for investment arising from the Housing reform. In the future, further cash balances are likely to become available which may necessitate further amendments to the Treasury Management Strategy in order to maintain security and take financial advantage of such balances. The current strategy allows for the Executive to agree changes to the investment limits during the year. If this proves to be necessary a further report will be submitted to the Executive for approval. Waverley's investment potential now often exceeds £40m per day and is likely to continue to increase.

### **Recommendation**

It is recommended that the Executive:

1. notes the Treasury Management Performance for 2012/13 and 2013/14 to date; and
2. endorses the approach to Treasury Management activity.

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### **Background Papers**

There are no background papers (as defined by Section 100D(5) of the Local Government Act 1972) relating to this report.

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