Agenda Item No:		**Report No:**	
Report Title:	**Finance Update**		
Report To:	**Cabinet**	**Date:**	**20 November 2014**
Cabinet Member:	**Councillor Andy Smith**		
Ward(s) Affected:	**All**		
Report By:	**John Magness, Director of Finance**		

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Purpose of Report:

To provide an update on financial matters affecting the General Fund Revenue Account, the Housing Revenue Account and the approved Capital Programme.

Officers Recommendation(s):

That Cabinet:

1. Notes that Treasury Management activity since the last report to Cabinet has been consistent with the Council's approved Treasury and Investment Strategy.
2. Notes the mid-year position for the Council's 2014/2015 Treasury Management and Investment Strategy.
3. Agrees that an account be established with Svenska Handelsbanken, for investment purposes.
4. Reviews the latest Medium Term Finance Strategy Forecast through to 2020 and the savings target delivery update.
5. Approves a variation to the 2014/2015 Capital Programme in respect of work at Lewes Cemetery Chapel, explained in paragraph 7.
6. Approves the use of up to £300,000 from the Special Projects Element of the Housing Revenue Account Working Balance to progress proposals that will increase the Council's Housing Stock.
7. Notes the remainder of the report.

Recommends to Council:

8. That Council approves the Mid-Year Treasury Management Report 2014/2015.

Reasons for Recommendations

1 A report on funding issues in relation to the Council's General Fund Revenue Account, Housing Revenue Account and Capital Programme is made to each meeting of the Cabinet to ensure that the Council's financial health is kept under continual review. It is essential to ensure that the Council has a sound financial base from which to respond to changing activity levels and demand for statutory services and to ensure that, when appropriate, its finances are adjusted in response to reducing income levels and inflationary pressures on expenditure.

2 The Council's Treasury Management function deals with very large value transactions on a daily basis. It is essential that the Council is satisfied that appropriate controls are in place and in accordance with the Code of Practice on Treasury Management in the Public Services prepared by CIPFA (the Chartered Institute of Public Finance and Accountancy) and adopted by the Council.

Information

3 Treasury Management

3.1 Appendix 1 gives details of the Treasury Management activity between 13 September 2014 and 31 October 2014. All activity was consistent with the Council's approved Treasury and Investment Strategies for 2014/2015.

3.2 In accordance with the Council's approved Treasury Strategy Statement, the Audit and Standards Committee reviews all treasury activity that takes place in order to confirm that it has been undertaken in accordance with the approved Strategy. Should the Audit and Standards Committee have any observations they would be recorded in its minutes and referred to Cabinet.

Mid Term Treasury Management and Investment Strategy Review

3.3 CIPFA's Code of Practice recommends that all councillors are informed of Treasury Management activities at least twice a year. A Mid-year Report for 2014/2015, which covers the period 1 April 2014 to 30 September 2014, is attached at Appendix 2. The Report confirms that the key elements of the approved Treasury and Investment Strategy have been complied with during the first half of the year.

3.4 Cabinet is asked to recommend that Council approves the Mid-year Report at its meeting on 3 December 2014. The Audit and Standards Committee will be presented with the Report on 1 December 2014 - any comments that it may wish to pass on to Council will be reported verbally.

3.5 As noted in Section 3 of the Mid-Year Report, the Treasury and Investment Strategy outlines the considerations of using internal reserves and balances to fund the Council's Capital Financing Requirement (CFR) as an alternative to external long-term borrowing from, for example, the Government's Public Works Loans Board (PWLB).

3.6 The advantage of using internal reserves and balances is a reduction in investment risk. This option is particularly useful where positive balances are forecast over the medium term. If the interest rate for long-term borrowing is higher than the return on short-term investments, there is a net saving to be made.

3.7 The disadvantage is that there is the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise.

3.8 The Council currently has external loans with a total value of £56.7m. The loan portfolio has remained unchanged since March 2012, when significant borrowing was required on the introduction by the Government of self-financing for housing. The portfolio includes a £5m PWLB variable rate loan with a maturity date in March 2022. The rate of interest on this loan is reviewed by the Government every six months (in September and March).

3.9 A review of the Council's position supports the repayment of the £5m PWLB variable rate loan in February/March 2015. This external borrowing would be replaced by utilising internal reserves and balances, reducing the amount held for investment and its associated risk. The unused level of these balance is currently estimated to be £14.6m at 31 March 2015.

3.10 Arlingclose, the Council's Treasury Advisors support this approach and (subject to market conditions not changing significantly and with the confirmation of the Cabinet Member for Corporate Services) the Director will arrange for repayment of the loan towards the next six monthly loan review date in March 2015.

3.11 Section 5 of the Mid-Year report highlights the limited number of investment counterparties which are available to officers when carrying out day to day treasury management activity and the need to extend the range of investments made within the remit of the current Strategy in response to banking reforms. A potential counterparty, which meets the Council's agreed lending criteria, which are subject to continual review by Arlingclose , is the Swedish bank. Svenska Handelsbanken. In accordance with Council Financial Procedure Rule 4.3, Cabinet are requested to approve that an account be opened with Svenska Handelsbanken, which will enable deposits to be made with that bank.

4 Medium Term Financial Outlook

4.1 At its meeting in February 2014, Council set the General Fund budget for 2014/2015 in the context of the financial outlook through to 2019/2020. The outlook, requiring savings of £2.9m by 2020, was confirmed in June 2014 when Cabinet adopted the Organisational Development Strategy for the Council.

4.2 The outlook has been updated (Appendix 3) to take account of the latest business rates retention projections, together with the progress on delivering the current year's savings target. It has also been updated to lower the tax rises from 2016/2017 onwards to be the same as the estimated rate of CPI inflation (2%). This rate reflects the referendum criteria issued by the Secretary of State for the last two years.

4.3 At this stage, it is too early to include within the outlook adjustments for the possible impact on recurring or non-recurring expenditure of the Devolution of assets to Town and Parish Councils.

4.4 The changes and commentary made at this mid year point are:

- Line 8 is the 2014/2015 recurring budget approved by Council in February 2014 with future year adjustments for inflation and the savings target.

- The savings target at lines 16 and 17 has been increased by £102,000 in 2017/2018 and by £140,000 in 2018/2019. The overall savings target for the period through to 2020 is now £3.2m.

- Lines 28, 29 & 47 reflect the latest projections of the Council's share from the Business Rates retention revenue stream from 2015/2016 onwards. No allowance has been made for additional resources from the recently submitted East Sussex Business Rates Pool application.

- Line 33 Service Priority Budget has been increased by £145,320 over the strategy period.

- The budget provision at line 34 equalises the delivery of the savings target over the current year. It is also used to pay for costs arising from the change management process. This budget will be fully utilised by the end of the year.

- At this stage no Collection Fund balance has been estimated for 2015/2016 (line 48). Good collection rates this year have mirrored those of previous years and a review of the Collection Fund position will be made in December. The impact of a positive Collection Fund balance will be an increase in the budget for service priorities (line 33).

- The General Fund Working Balance (line 58) at 1 April 2014 has been updated to show the amount held on the closure of the 2013/2014 accounts. The balance remains healthy over the period to 2020 and remains in line with predictions.

4.5 The overall message is that the MTFS remains robust and will be fairly accurate in the short term through to 31 March 2016, which is the expiry of the indicative funding window provided by the Government.

4.6 The next spending review will set some of the key parameters for future years. A change in the distribution methodology of an ever decreasing pot is more than likely.

4.7 An independent commission has been tasked with making recommendations for the reform of local government finance and finding better ways to fund local services and promote economic growth in England.

The Independent Commission on Local Government Finance http://www.localfinancecommission.org/ is to be chaired by Darra Singh, partner in the Government and Public Sector team at EY (formerly Ernst & Young).

Early in 2015 its recommendations will be presented to all of the main political parties with the aim of shaping the debate on the future of local government finance and influencing the next government.

The Commission has been established by the Local Government Association (LGA), the national voice of local government, and the Chartered Institute for Public Finance (CIPFA), the professional body for public finance professionals.

Last year both the LGA and CIPFA individually set out proposals for the urgently needed reform of public services to make them fit for the 21st century.

The commission will build on this work. It will examine the need for reform of local government finance and the ways in which the current system stands in the way of the transformation needed to tackle real world problems from the need to create more jobs and grow local economies to tackling the housing shortage.

It will explore how an improved local government finance system could help to address five key challenges facing the country within the context of lower public spending:

- promoting economic growth and investment in infrastructure
- ensuring sufficient housing is provided in every place
- integrating the health and social care systems to promote independent living, including preventing unnecessary health interventions
- achieving a welfare benefits system that promotes work and protects the vulnerable
- supporting families and developing young lives through early intervention.

4.8 The Commission published an Interim Report at the end of October 2014 which can be found at this web address: http://www.localfinancecommission.org/-/media/iclgf/documents/l14536%20interim_report_web_v2.pdf

5 Progress on the Savings Plan to 2020

5.1 Appendix 4 sets out the position on the Council's savings plan through to 2020.

5.2 Considerable progress has been made since the plan was reviewed by Cabinet in June 2014 as part of the Organisational Change report.

5.3 This year's savings target has now been achieved and considerable progress has been made with the identification and delivery of next year's target of £550,000.

6 Procurement

6.1 With the prior agreement of the Cabinet Member for Corporate Services, a supplier has been directly awarded a contract for the supply of artwork required for the Big Parks Project.

6.2 It was not practicable to obtain quotations for the work for the following reasons:

- finding two other companies who could carry out the work would be difficult due to the specialist nature of the proposal and the materials used
- the timeframe to carry out these works was tight and officers were looking to place an order as soon as possibleto a delay in a high profile project
- the supplier is a known and trusted supplier, experienced in preparing bespoke artworks of the required style

6.3 In accordance with Contract Procedure Rules, this procurement is now reported to Cabinet.

7 Repairs to Lewes Cemetery Chapel

7.1 The approved 2014/2015 Capital Programme includes a provision of £12,640 in respect of work at Lewes Cemetery Chapel. The Chapel is currently closed to public use pending remedial work to the plaster inside the building.

7.2 A building survey of the Chapel has taken place, identifying an underlying problem with damp. The estimated cost of work required to the Chapel is in the region of £45,000. It is recommended that an additional £32,360 is released from the unallocated balance held in the Capital Programme for Asset Backlog Repairs, to enable the work at the Chapel to take place.

8 Increasing the Council's Housing Stock in the Housing Revenue Account (HRA)

8.1 At its meeting on 28 September 2014 Cabinet received an update on the Lewes District Property Portfolio. The negotiations and Heads of Terms are making good progress and completion of these is anticipated before the ordinary Cabinet meeting in January 2015.

8.2 An element of this contract is the delivery of rented housing into the Councils HRA. Allied to this strand is the opportunity to secure significant grant funding from the Homes and Communities Agency (HCA) for new homes to be built.

8.3 The preferred bidder has committed to applying for the HCA grant funding prior to conclusion of negotiations and legal formalities.

8.4 As soon as the Heads of Terms have been agreed the contracting partner aims to immediately commence work on submission of planning applications and procurement of information to support planning applications, on the Council's behalf.

8.5 Until a scheme receives approval the expenditure is chargeable to the HRA and Cabinet is requested to authorise up to £300,000 to be utilised from the Special Projects element of the HRA Working Balance. Once a planning application is approved and the scheme commences the expenditure can be classified as Capital Expenditure.

8.6 If a planning application is submitted by the consortium with the agreement of the Council as landowner and planning permission is granted and then the Council decides, for some reason unconnected with the commercial negotiation of the Development Agreement, to withdraw from the project and does not proceed to complete the Development Agreement, then the Council will pay for the reasonable cost of the work incurred in working up and submitting the planning application, including the planning application fee. (This is to cater for the unlikely situation in which the Council encourages our potential development partner to spend time and money on progressing a planning application with which the Council as landowner agrees and then, prior to the conclusion of a binding contract between the Council and the consortium, the Council, for no good reason, simply decides that it no longer wishes to proceed with the project).

8.7 If a planning application is submitted, but planning permission is not granted, the proposal is that the Council will pay half of the reasonable planning application costs, including the cost of any appeal providing both the Council and the consortium agree to appeal;

8.8 The Council will have the benefit of the designs prepared for the planning application.

8.9 The homes to be built will be on Council land

9 University Technical College (UTC)

9.1 At its meeting in February 2014, Council agreed total funding of £1.683m in respect of the UTC project. This allocation supports the construction cost of the UTC, the riverside boardwalk, and expenditure on promotion and planning in advance of the commencement date for revenue funding of the UTC from the Department for Education. It was agreed that a statement of the funding sources and the tendered costs of the whole project would be reported to Cabinet once available.

9.2 The contract for the design and build of the UTC has now been finalised, at a total cost of £13.389m and the Education Funding Agency (EFA) has confirmed its contribution towards the cost of the project, £11.909m. The Council's share of the capital cost of the project, including the boardwalk, will be £1.480m. This is £0.203m within the total funding agreed by the Council, providing capacity for both promotion and planning costs, as well as a contingency. Promotion and planning costs confirmed to date comprise expenditure on PR (£9,800) and a contribution towards the Principal Designate post (£26,700).

9.3 The college, *UTC@harbourside*, is due to open for students in September 2015.

10 Financial Appraisal - referred to under individual items above.

11 Sustainability Implications

I have not completed the Sustainability Implications Questionnaire as this Report is exempt from the requirement because it is a budget monitoring report.

12 Legal Implications

The legal services unit has been consulted on and contributed to para 8 above. A Deed of Undertaking will need to be drawn up and signed by the parties to effect the proposals set out in para 8.

13 Risk Management Implications

13.1 The Council maintains an overview of its policy programme, its Medium Term Financial Strategy and the external factors that affect them. Without this constant analysis and review there is a risk that the underlying recurring revenue budgets will grow at a faster rate than the resources available to fund them. This risk is mitigated through regular reports to Cabinet on the Council's overall revenue and capital position and Cabinet's correcting actions taken in accordance with the objectives and principles it set for management of the Council's finances.

13.2 An additional risk in the current climate is that reserves and balances will be drawn upon sooner than is necessary unless an assessment is made of resource implications where activity levels have fallen or risen to any significant degree. This risk is mitigated by identifying such areas, making an assessment covering the short and medium term and taking corrective action.

14 Equality Screening

The Equality Screening process for this Report took place in October 2014. No potential negative impacts were identified.

15 Background Papers

Treasury Strategy Statement http://www.lewes.gov.uk/council/20987.asp

Appendices

Appendix 1 - Statement of Investment Activity: 13 September to 31 October 2014

Appendix 2 - Mid-year Treasury Management Report 2014/2015

Appendix 3 – Medium term Budget Outlook to 2020

Appendix 4 - The Savings Plan to 2020

Appendix 1

Statement of Treasury Management Activity:
13 September to 31 October 2014

1. Fixed Term Deposits

Loan	Counterparty	Principal £	From	To	Capital O/s £	Capital Repaid £	Interest Rate %
	Current investments at 31 October 2014						
220714	Barclays Bank plc	1,000,000	13 Aug 14	13 Aug 15	1,000,000		1.000
220914	Nationwide Building Society	1,000,000	01 Sep 14	02 Mar 15	1,000,000		0.640
221014	Nationwide Building Society	1,000,000	01 Sep 14	02 Feb 15	1,000,000		0.580
221614	Cornwall County Council	2,000,000	07 Oct 14	12 Feb 15	2,000,000		0.430
	Total				5,000,000		
	Investments that have matured since last report						
220014	Barclays Bank plc	1,000,000	12 Jun 14	13 Oct 14		1,000,000	0.490
221414	Debt Management Office	2,250,000	15 Sep 14	22 Sep 14		2,250,000	0.250
221514	Debt Management Office	1,500,000	06 Oct 14	13 Oct 14		1,500,000	0.250
221714	Debt Management Office	4,000,000	13 Oct 14	22 Oct 14		4,000,000	0.250
221814	Debt Management Office	3,000,000	15 Oct 14	20 Oct 14		3,000,000	0.250
	Total					11,750,000	

2. Money Market Funds

	Average held £'000	Average return %
Goldman Sachs Sterling Liquid Reserves Fund	764	0.52
Deutsche Managed Sterling Fund	976	0.56

3. Deposit Accounts

	Average held £'000	Interest rate %
Co-operative Bank Public Sector Reserve Acc	1	Minimal
Santander UK plc Business Reserve Account	2,144	0.40
Lloyds Bank Current Account *	1,610	0.40

*Following change of bank, now replaces Bank of Scotland Corporate Deposit Account

4. Treasury Bills

	Purchased	£'000	Return %
Held at 31 October 2014			
UK Treasury Bills 0% 03 Nov 2014	04 Aug 14	2,000	0.420
UK Treasury Bills 0% 10 Nov 2014	11 Aug 14	2,000	0.410
UK Treasury Bills 0% 30 Mar 2015	29 Sep 14	2,000	0.570
UK Treasury Bills 0% 10 Nov 2014	13 Oct 14	491	0.360

	Purchased	£'000	Return %

Matured in period			
UK Treasury Bills 0% 22 Sep 2014	23 Jun 14	995	0.420
UK Treasury Bills 0% 06 Oct 2014	07 Jul 14	2,000	0.459
UK Treasury Bills 0% 15 Sep 2014	18 Aug 14	2,000	0.330
UK Treasury Bills 0% 13 Oct 2014	15 Sep 14	2,000	0.400
UK Treasury Bills 0% 13 Oct 2014	15 Sep 14	1,000	0.420
UK Treasury Bills 0% 27 Oct 2014	29 Sep 14	1,000	0.420
UK Treasury Bills 0% 27 Oct 2014	29 Sep 14	1,000	0.400

5. Borrowing

No new long term borrowing undertaken in the period.
Long-term loans outstanding £56.6m.

APPENDIX 2

Lewes District Council

Mid-year Treasury Management Report 2014/2015

Contents

1. Background

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) recommends that full Council should receive every year reports on Treasury Management policies and activity before the start of the year, mid-year and after the end of the year. The intention is that those with ultimate responsibility for the Treasury Management function appreciate fully the implications of Treasury Management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

1.2 The Council defines its Treasury Management activities as:

"the management of the Council'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."

1.3 This mid-year report covers the period 1 April 2014 to 30 September 2014.

2. Overall Summary of Activity

2.1 At its meeting in February 2014, the Council agreed its Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17. The table below lists the key elements of that Strategy and records actual performance in the first six months of the year against each one of them.

Key Element	Required by Strategy	Actual Performance	
Borrowing			
Underlying need to borrow (CFR) at year end	£70.291 million	£70.800 million (projection 31 March)	-
Internal borrowing at year end	£13.618 million	£19.127 million (projection 31 March)	-
New external long-term borrowing in year	None anticipated	None undertaken Apr to Sept '14. Potential prudential borrowing in early 2015.	✓
Debt rescheduling in year	Review options but not anticipated	Options kept under review, none undertaken Apr to Sept' 14. Potential identified for Feb/March 2015	✓
Interest payments on external borrowing	£1.730 million	£0.864m (to date)	✓
Investments			
Minimum counterparty credit ratings for investments of up to 1 year	Long-term A/ Short-term F1 (does not apply to Government and other local authorities which have the highest ratings)	At least Long-term A/ Short-term F1 where required	✓

Key Element	Required by Strategy	Actual Performance	
Sovereign status of counterparties	UK plus 10 specified nations	Only UK counterparties used	✓
Overnight exposure guideline for deposits with Cooperative	Maximum £1 million	Guideline not exceeded.	✓
Interest receipts from external investments	£0.050m	£0.039m (to date)	✓
Appointment of Investment Consultants			
Independent Treasury Adviser to be retained	Arlingclose to be retained as Treasury Adviser	Arlingclose retained as Treasury Adviser	✓
Banking Arrangements			
Procurement of bank to replace The Cooperative following its withdrawal from the sector	Switch to new bank by April 2015	Lloyds Bank plc appointed as banker. Project to transfer arrangements in progress and accounts opened	✓
Reporting and Training			
Reports to be made to Audit and Standards Committee and Cabinet	Every meeting	Every meeting	✓
Briefing sessions for Councillors and Staff	Treasury Adviser to provide	Arlingclose met with Councillors and Staff September 2014	✓

2.2 For those who are looking for more than this overall confirmation that all treasury management and investment activity in 2014/2015 has been carried out in accordance with the Council's agreed Strategy, the remainder of this report analyses each of the key elements in more depth. Appendix A, supplied by Arlingclose explores the economic background to the year's activity and Appendix B lists all term deposits made in the first half of the year. Appendix C sets out the Authorised Counterparty list at 30 September 2014. A Glossary appears at the end of the document to explain the technical terms which could not be avoided when writing this report.

3. Detailed Analysis - Borrowing

3.1 Other than for temporary cash flow purposes, local authorities are only allowed to borrow to finance capital expenditure (eg the purchase of property, vehicles or equipment which will last for more than one year, or the improvement of such assets).

3.2 In accounting terms, the underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). This, together with Balances and Reserves, are the core drivers of Treasury Management activity.

3.3 The CFR is, in simple terms, the amount of capital expenditure which has been incurred by the Council but which has not yet been paid for (by using, for example, grants, capital receipts, reserves or revenue income) and in the meantime is covered by internal or external borrowing. External borrowing is where loans are raised from the Public Works Loans Board or banks. Alternatively it is possible to use the significant levels of cash which has been set aside in Balances and Reserves and which would otherwise need to be invested with banks or other borrowers as a means to avoid taking on external loans. This is known as internal borrowing.

3.4 As noted above, the level of CFR increases each year by the amount of unfinanced capital expenditure and is reduced by the amount that the Council sets aside for the repayment of borrowing. The original CFR projection for 2014/2015, along with an updated analysis, is shown in the table below. The increases in capital expenditure and financing shown reflect the approved capital programme as at September 2014, and assume that all projects are completed in the year. That outcome is unlikely, however - the capital programme represents an allocation of funds to specific long-term projects many of which span financial years. In November 2014, Cabinet will consider a report in respect of installing photo-voltaic panels on Council-owned homes. If approved, this will increase the General Fund CFR by £2.7m. At this stage, this has not been incorporated in the analysis below.

3.5 As at 30 September 2014, capital expenditure with a total value of £2.8m had been incurred (excluding commitments) compared with the approved capital programme of £16.8m (including £3.5m brought forward from 2013/2014). With the exception of spending on completion of the Southover House office refurbishment project and the Community Hub in Newhaven, for which it is expected that the proceeds from the disposal of assets in future years will be used as retrospective funding, all other capital expenditure has been funded from grants, capital receipts, reserves or revenue income.

	2014/15 Original £m	2014/15 Projected £m
Opening CFR	71.880	71.448
Capital expenditure in year (projected)	7.746	16.797
Less financed	(7.473)	(15.584)
Less amount set aside for debt repayment	(1.862)	(1.861)
Closing CFR	70.291	70.800

3.6 The overall CFR can be split between the General Fund and Housing Revenue Account as follows:

	2014/15 Original £m	2014/15 Projected £m
General Fund CFR	4.512	5.402
Housing Revenue Account CFR	65.779	65.398
Total CFR	70.291	70.800

3.7 The following table compares the CFR with the amount that the Council holds in balances and reserves as well as working capital (day to day cash movements as well as grants, developer contributions and capital receipts held pending use):

	31/3/15 Original £m	31/3/15 Projected £m
(a) Capital Financing Requirement	70.291	70.800
(b) Actual external borrowing	(56.673)	(51.673)
(c) Use of Balances and Reserves and working capital as alternative to borrowing (a)–(b)	13.618	19.127

3.8 Total interest paid on long-term borrowing in the period to 30 September 2014 was £0.864 million, representing the first of two instalments of interest due on the Council's loans from the PWLB and a £5 million market Lender's Options Borrower's Option (LOBO) loan at the rate of 4.5% with a term of 50 years. Under the terms of the LOBO, the Lender will next review the rate/terms of the loan in April 2015 and if it proposes an increase, the Council will have an option to repay.

3.9 The Council qualifies for new borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) in 2014/2015.

3.10 Through the year, officers, supported by Arlingclose, monitor opportunities for the rescheduling of external loans and the possibility of repayment utilising cash balances that would otherwise be invested. The borrowing portfolio (£56.673m in total) includes a £5m PWLB variable rate loan with a maturity date in March 2022. The rate of interest on this loan is reviewed by the Government every six months (in September and March).

3.11 A review of the Council's position in September 2014, supports the repayment of a £5m PWLB variable rate loan in February/March 2015. This external borrowing would be replaced by utilising reserves and balances and working capital, reducing the amount held for investment and its associated risk. At 31 March 2015, a minimum of £19.6m is expected to be held, comprising reserves and balances, £14.6m, and working capital, £15.0m.

3.12 Arlingclose, the Council's Treasury Advisors support this approach and (subject to market conditions not changing significantly and with the confirmation of the Cabinet Member for Corporate Services) the Director will arrange for repayment of the loan towards the next six monthly loan review date in March 2015. The repayment is incorporated in line (b) of the table at paragraph 3.7 above.

4. Detailed Analysis - Investments

4.1 The Council held on average £18.96 million available for investment in the period to 30 September 2014. This comprised working cash balances, capital receipts, earmarked reserves and developer contributions held pending use.

4.2 The Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities have continued to be:

highest priority - security of the invested capital;
followed by - liquidity of the invested capital;
finally - an optimum yield commensurate with security and liquidity.

4.3 All of the Council's investments have been managed in-house. Security of capital has been maintained by following the counterparty policy set out in the Investment Strategy for 2014/2015. Investments during the period included:

- Deposits with the Debt Management Office (total £59.10 million)
- Deposits with other Local Authorities (total £2.00 million)
- Investments in AAA-rated Constant Net Asset Value Money Market Funds (MMFs) (average balance held in year £1.68 million)
- United Kingdom Treasury Bills (average balance £5.87 million)

- Deposit accounts with UK Banks/Building Societies (average balance held in year £4.41 million)
- Overnight deposits with the Council's banker, Cooperative Bank (average balance held in year £0.02 million)

4.4 The Council has approved the use of two MMFs, DB Advisors – Deutsche Global Liquidity Series and Goldman Sachs Asset Management International.

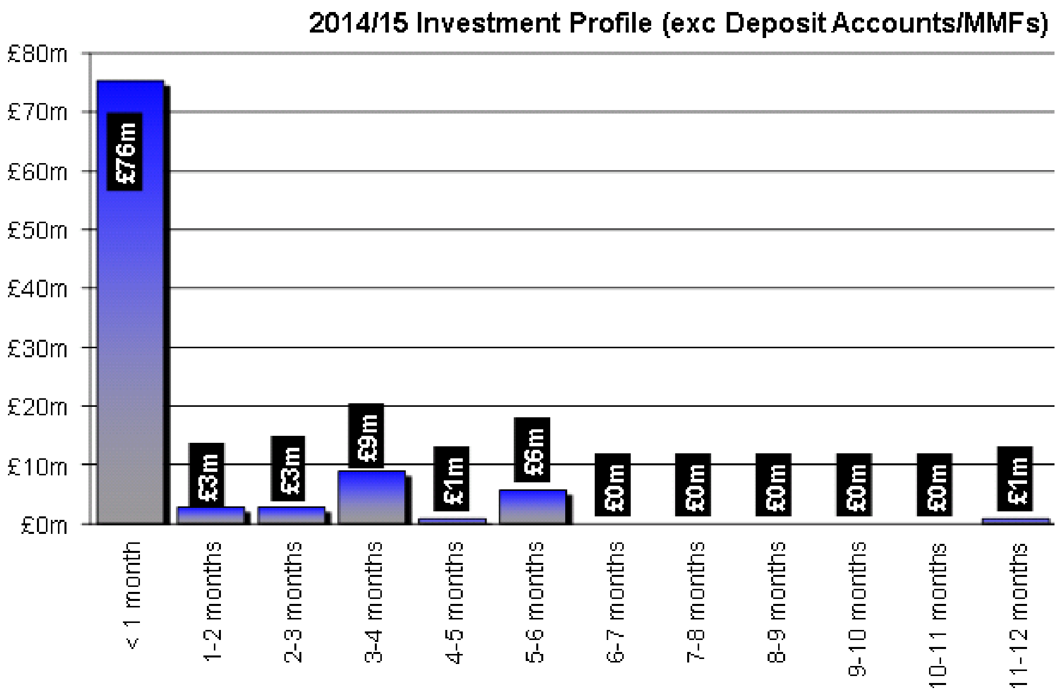
4.5 The guideline within the approved Strategy for use of the Cooperative Bank for overnight deposits is an overnight exposure limit of £1 million. In response to market conditions, the Council's day to day approach has been to hold an overdrawn balance at the Bank – the average daily overdrawn balance in the period was £0.211m.

4.6 Counterparty credit quality was assessed and monitored with reference to credit ratings (a minimum long-term counterparty rating of A across all three rating agencies Fitch, Standard and Poors, and Moody's applied); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price.

4.7 In keeping with Government guidance on investments, the Council maintained a sufficient level of liquidity through the use of MMFs, overnight deposits and deposit accounts.

4.8 The Council sought to optimise returns commensurate with its objectives of security and liquidity. As expected when setting the investment income budget for 2014/2015, the UK Bank Rate has been maintained at 0.5%.

4.9 A full list of temporary deposits made in the year is given at Appendix B. All investments were made with UK institutions, and no new deposits were made for periods in excess of one year. The chart below gives an analysis of fixed term deposits by duration.



4.10 Interest generated from external deposits in the year to date was £0.039 million and the total 2014/2015 budget for investment income £0.050 million, is expected to be exceeded. This favourable position has arisen as a result of higher than anticipated levels of cash being held pending expenditure on capital programme projects, etc.

5. Counterparty Update

5.1 The Council has monitored prospective counterparties against the approved investment criteria on a continual basis through the period. At the end of the period, the authorised lending list was as shown in Appendix C.

5.2 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.

5.3 The Council has two options to respond to this risk:

a) amend the Treasury Management Strategy to allow investment in lower rated banks, or

b) prepare to invest without using any of the major UK banks

At the present time, it is not proposed to amend the 2014/2015 Treasury Management Strategy. Supported by Arlingclose, officers will look to diversify the approach to investments made on a day to day basis within the remit of the current Strategy, for example by extending the use of Treasury Bills, utilising non-UK counterparties and seeking opportunities to purchase corporate bonds or bonds issued by Multilateral Development Banks, or to make term deposits with credit rated housing associations.

5.4 Officers will continue to keep the position under review and it is possible that changes to the investment criteria are proposed in the draft Treasury Management Strategy 2015/2016 which will be reported to Council in February 2015.

6. Banking Arrangements

The Council participated in a procurement exercise with other East Sussex District and Borough Councils to appoint a common bank. This followed the decision of the Cooperative Bank to withdraw from the local authority market sector.

The outcome of the procurement has been the appointment of Lloyds Bank plc as the Council's banker. The transfer of the Council's banking arrangements is currently taking place. Accounts at Lloyds Bank have been in operation since 1 September 2014. It is the intention to close the accounts at the Cooperative Bank by the end of the year.

7. Internal Borrowing

7.1 Following the national reform of housing finance, since 1 April 2012 the Council has adopted a 'two pool' approach to the accounting treatment of loans. Under this approach, interest on any external borrowing in respect of expenditure on General Fund services is to be charged to the General Fund, and interest on any external borrowing in respect of the Council's housing stock (Housing Revenue Account (HRA)) is to be charged to the HRA. At the start of the year, all external borrowing was attributed to the HRA.

7.2 Where the HRA or General Fund has surplus cash balances which allow either account to have external borrowing below its level of CFR (internal borrowing), the approved Treasury Strategy explains that the rate charged on this internal borrowing will be based on the rate of interest applicable to a one-year maturity loan from the PWLB at the start of the financial year.

7.3 It is expected that an interest payment will be made from the HRA to the General Fund in 2014/2015, but the final amount will not be determined until the close of the year, dependent on the capital programme outturn for the year. The HRA capital programme at 30 September 2014 includes £0.36m in respect of the acquisition of new properties, to be part-funded by borrowing but it is not expected to take new loans from the PWLB or other source. This constitutes internal borrowing by the HRA from the General Fund and an interest charge will be made as outlined above.

8. Compliance with Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2014/2015, which were set in February 2014 as part of the Council's Treasury Management Strategy Statement. Actual borrowing has remained within the Authorised Limit for External Debt (£72.5m) and the Operational Boundary for External Debt (£67.0m).

9. Reporting and Training

9.1 The Director of Finance has reported the details of treasury management activity to each meeting of the Audit and Standards Committee and Cabinet (with the exception of a special Cabinet meeting on 15 May 2014) held to date in 2014/2015.

9.2 All councillors tasked with treasury management responsibilities, including scrutiny of the treasury management function, were offered the opportunity to attend a local briefing session led by Arlingclose on 23 September 2014.

9.3 The training needs of the Council's treasury management staff continue to be reviewed as part of the annual corporate staff appraisal/training needs assessment process for all Council employees. Staff continue to attend Arlingclose workshops, when appropriate to their needs, alongside colleagues from other local authorities during 2014/2015.

10. Investment Consultants

Arlingclose have been retained as the Council's treasury advisor through the period covered by this report, under the terms of a four year contract which runs to 31 August 2016.

Appendix A – Economic Background explained by Arlingclose

Growth and Inflation: The recent strong performance of the UK economy continued with output growing at 0.8% in Q1 2014 and at 0.9% in Q2. The services sector once again grew strongly. On the back of strong consumption growth, business investment appeared to be recovering quickly, albeit from a low base. The annual CPI inflation rate fell to 1.5% year-on-year in August.

Revisions to the GDP methodology mean that growth is now estimated to be 2.7% above its pre-recession peak in Q1 2008 rather than just 0.2% higher, the general theme being that the recession was not as deep and the recovery was earlier than initially estimated. In anticipation of these revisions, the MPC has forecast growth at 3.4% in 2014.

Unemployment: The labour market continued to improve, with strong employment gains and the headline unemployment rate falling to 6.2%. However, earnings growth remained very weak, rising just 0.6% for the three months May-July 2014 when compared to the same period a year earlier. The growth in employment was masked by a large number of zero-hour contracts and involuntary part-time working.

Monetary Policy: The MPC made no change to the Bank Rate of 0.5% and maintained asset purchases at £375bn. However, there was a marked shift in tone from the Bank of England's Governor and other MPC members. In his Mansion House speech in June Governor Mark Carney warned that interest rates might rise sooner than financial markets were expecting. The minutes of the August and September MPC meetings revealed a split vote with regards to the Bank Rate, with two members voting to increase Bank Rate by 0.25%, arguing economic circumstances were sufficient to justify an immediate rise. The MPC emphasised that when Bank Rate did begin to rise, it was expected to do so only gradually and would likely remain below average historical levels for some time to come.

In its August Inflation Report the Bank forecast growth to be around 3½% in 2014, easing back thereafter to around its pre-crisis historical average rate. Inflation was forecast to remain at, or slightly below, 2% before reaching the target at the end of the 2-year forecast period.

The Bank's Financial Policy Committee also announced a range of measures to cool the UK's housing market to avert the potential of spiralling house prices derailing a sustainable economic recovery. Key recommendations included lenders stress-testing mortgage applicants can cope with a 3% rise in interest rates.

The result of the Scottish referendum in the end was close, but not as close as many believed it might be. However, the political upheaval set in motion is arguably likely to be just as problematic in the run-up to and beyond next year's general election.

The minutes of the Bank of England's MPC meeting in September noted that "weakness in the euro area had been the most significant development during the month" and that it could damage confidence and disrupt financial markets

Market reaction: Gilt yields have continued to decline and hit a financial year low at the end of August, before ticking upwards in the run up to the Scottish referendum. What has driven yields lower is a combination of factors but the primary drivers have been the escalation of geo-political risk within the Middle East and Ukraine alongside the slide towards deflation within the Eurozone (EZ).

Outlook: The stronger economic growth seen in the UK over the past six months is likely to use up spare capacity more quickly than previously assumed. Arlingclose has brought forward the timing for the first rise in Bank Rate to Q3 2015. The near-term risk is that the Bank Rate could rise sooner than anticipated, which is captured in the 'upside risk' range of our forecast table below. The focus is now on the rate of increase and the medium-term peak and, in this respect, expectations are that rates will rise slowly and to a lower level than in the past.

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Official Bank Rate											
Upside risk	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**	**1.50**
Downside risk				0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00

Appendix B – Term deposits made and/or maturing April to September 2014

Deal	Counterparty	£	From	To	Rate
216013	Conwy County Borough Council	2,000,000	29/11/13	30/05/14	0.4500%
216213	Nationwide Building Society	1,000,000	07/11/13	07/05/14	0.5300%
217213	Nationwide Building Society	1,000,000	24/01/14	24/04/14	0.4700%
217713	Nationwide Building Society	1,000,000	28/03/14	28/04/14	0.4000%
217814	Debt Management Office	1,750,000	01/04/14	04/04/14	0.2500%
217914	Debt Management Office	5,000,000	01/04/14	09/04/14	0.2500%
218014	Debt Management Office	1,500,000	15/04/14	17/04/14	0.2500%
218114	Debt Management Office	1,500,000	15/04/14	25/04/14	0.2500%
218214	Debt Management Office	1,000,000	25/04/14	30/04/14	0.2500%
218314	Nationwide Building Society	1,000,000	28/04/14	30/06/14	0.4400%
218414	Debt Management Office	2,000,000	01/05/14	07/05/14	0.2500%
218514	Debt Management Office	2,000,000	01/05/14	08/05/14	0.2500%
218614	Debt Management Office	2,250,000	01/05/14	09/05/14	0.2500%
218714	Barclays Bank plc	1,000,000	07/05/14	09/06/14	0.3800%
218814	Barclays Bank plc	1,000,000	07/05/14	07/07/14	0.4100%
218914	Barclays Bank plc	1,000,000	07/05/14	07/08/14	0.4400%
219014	Debt Management Office	2,500,000	08/05/14	12/05/14	0.2500%
219114	Debt Management Office	3,000,000	09/05/14	19/05/14	0.2500%
219214	Debt Management Office	2,500,000	12/05/14	22/05/14	0.2500%
219314	Debt Management Office	2,600,000	15/05/14	22/05/14	0.2500%
219414	Nationwide Building Society	1,000,000	30/05/14	29/08/14	0.4800%
219514	Debt Management Office	2,500,000	02/06/14	19/06/14	0.2500%
219614	Debt Management Office	2,500,000	02/06/14	10/06/14	0.2500%
219714	Debt Management Office	1,000,000	02/06/14	12/06/14	0.2500%
219814	Debt Management Office	1,000,000	05/06/14	25/06/14	0.2500%
219914	Debt Management Office	1,500,000	11/06/14	23/06/14	0.2500%
220014	Barclays Bank plc	1,000,000	12/06/14	13/10/14	0.4900%
220114	Debt Management Office	1,750,000	16/06/14	23/06/14	0.2500%
220214	Debt Management Office	5,000,000	01/07/14	02/07/14	0.2500%
220314	Nationwide Building Society	1,000,000	01/07/14	01/09/14	0.4500%
220414	Debt Management Office	4,000,000	01/08/14	08/08/14	0.2500%
220514	Debt Management Office	2,000,000	01/08/14	11/08/14	0.2500%
220614	Debt Management Office	2,000,000	07/08/14	08/09/14	0.2500%
220714	Barclays Bank plc	1,000,000	13/08/14	13/08/15	1.0000%
220814	Debt Management Office	2,000,000	15/08/14	18/08/14	0.2500%
220914	Nationwide Building Society	1,000,000	01/09/14	02/03/15	0.6400%
221014	Nationwide Building Society	1,000,000	01/09/14	02/02/15	0.5800%
221114	Debt Management Office	1,000,000	01/09/14	08/09/14	0.2500%
221214	Debt Management Office	1,000,000	02/09/14	12/09/14	0.2500%
221314	Debt Management Office	2,000,000	08/09/14	12/09/14	0.2500%
221414	Debt Management Office	2,250,000	15/09/14	22/09/14	0.2500%

Appendix C – Authorised Lending List at 30 September 2014

Last updated / checked	Institution - PARENT COMPANY ONLY Subsidiaries are NOT Authorised Counterparties	Country	Lowest Equivalent Short Term Rating **	MaximumTerm allowed for Lewes DC (lowest value)
01/10/2014	Australia & New Zealand Banking Group Limited	AUS	F1+	13 months
01/10/2014	Commonwealth Bank of Australia	AUS	F1+	13 months
01/10/2014	National Australia Bank Limited **[part of NAB Group]**	AUS	F1+	13 months
01/10/2014	Westpac Banking Corporation	AUS	F1+	13 months
01/10/2014	Bank of Montreal	CAN	F1+	13 months
01/10/2014	Bank of Novia Scotia	CAN	F1+	13 months
01/10/2014	Canadian Imperial Bank of Commerce	CAN	F1+	13 months
01/10/2014	Royal Bank of Canada	CAN	F1+	13 months
01/10/2014	Toronto-Dominion Bank	CAN	F1+	13 months
01/10/2014	Nordea Bank Finland plc	FIN	F1+	13 months
01/10/2014	Pohjoa Bank	FIN	F1	13 months
01/10/2014	Deutsche Bank AG	GER	F1+	6 months
01/10/2014	Bank Nederlandse Gemeenten	NL	F1+	13 months
01/10/2014	ING Bank NV	NL	F1+	3 months
01/10/2014	Rabobank	NL	F1+	13 months
01/10/2014	Svenska Handelsbanken	SWE	F1+	13 months
01/10/2014	Credit Suisse	SWI	F1	3 months
01/10/2014	Bank of Scotland Plc **[part of Lloyds Group]**	UK	F1	13 months
01/10/2014	Barclays Bank plc	UK	F1	13 months
01/10/2014	HSBC Bank plc	UK	F1+	13 months
01/10/2014	Lloyds TSB Bank **[part of Lloyds Group]**	UK	F1	13 months
01/10/2014	Nationwide Building Society	UK	F1	13 months
01/10/2014	Santander UK plc **[part of Banco Santander]**	UK	F1	13 months
01/10/2014	Standard Chartered Bank	UK	F1+	13 months
01/10/2014	JP Morgan	US	F1	13 months

Glossary of Terms

Affordable Borrowing Limit	Each local authority is required by statute to determine and keep under review how much money it can afford to borrow. The Prudential Code (see below) sets out how affordability is to be measured.
Base Rate	The main interest rate in the economy, set by the Bank Of England, upon which other rates are based.
Basis Point	A convenient way of measuring an interest rate (or its movement). It represents 1/100th of a percentage point, ie 100 basis points make up 1%, and 250 basis points are 2.5%. It is easier to talk about 30 basis points than "point three of one per cent".
Bonds	Debt instruments issued by government, multinational companies, banks, multilateral development banks and corporates. Interest is paid by the issuer to the bond holder at regular pre-agreed periods. The repayment date of the principal is also set at the outset.
Capital Expenditure	Spending on the purchase, major repair, or improvement of assets eg buildings and vehicles
Capital Financing Requirement (CFR)	Calculated in accordance with government regulations, the CFR represents the amount of Capital Expenditure that it has incurred over the years and which has not yet been funded from capital receipts, grants or other forms of income. It represents the Council's underlying need to borrow.
Chartered Institute of Public Finance and Accountancy (CIPFA)	CIPFA is one of the leading professional accountancy bodies in the UK and the only one that specialises in the public services. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. CIPFA has responsibility for setting accounting standards for local government.
Counterparty	Organisation with which the Council makes an investment
Credit Default Swaps	CDS are a financial instrument for swapping the risk of debt default and are effectively an insurance premium. Local authorities do not trade in CDS but trends in CDS prices are monitored as an indicator of relative confidence about the credit risk of counterparties.
Credit Rating	A credit rating is an independent assessment of the credit quality of an institution made by an organisation known as a rating agency. The rating agencies take many factors into consideration when forming their view of the likelihood that an institution will default on their obligations, including the institution's willingness and ability to repay. The ratings awarded typically cover the short term outlook, the long term outlook, as well as an

	assessment of the extent to which the parent company or the state will honour any obligations. The three main agencies providing credit rating services are Fitch Ratings, Moody's and Standard and Poor's.
Fixed Deposits	Loans to institutions which are for a fixed period at a fixed rate of interest
Gilts	These are issued by the UK government in order to finance public expenditure. Gilts are generally issued for set periods and pay a fixed rate of interest. During the life of a gilt it will be traded at price decided in the market.
Housing Revenue Account (HRA)	There is a statutory requirement for local authorities to account separately for expenditure incurred and income received in respect of the dwellings that they own and manage.
Internal Borrowing	The temporary use of surplus cash which would otherwise be invested, as an alternative to borrowing from the PWLB or a bank in order to meet the cost of capital expenditure.
International Financial Reporting Standards (IFRS)	The set of accounting rules applicable to all local authorities from 1 April 2010.
Lenders' Option Borrower's Option (LOBO)	A long term loan with a fixed interest rate. On pre-determined dates (eg every 5 years) the lender can propose or impose a new fixed rate for the remaining term of the loan and the borrower has the 'option' to either accept the new fixed rate or repay the loan.
LIBID	The rate of interest at which first-class banks in London will bid for deposit funds
Minimum Revenue Provision (MRP)	The minimum amount which must be charged to an authority's revenue account each year and set aside as provision for the repayment of debt.
Operational boundary	This is the most likely, prudent view of the level of gross external indebtedness. A temporary breach of the operational boundary is not significant.
Prudential Code/Prudential Indicators	The level of capital expenditure by local authorities is not rationed by central government. Instead the level is set by local authorities, providing it is within the limits of affordability and prudence they set themselves. The Prudential Code sets out the indicators to be used and the factors to be taken into account when setting these limits
Public Works Loan Board (PWLB)	A central government agency which provides long- and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow.
Treasury Management Strategy Statement (TMSS)	Approved each year, this document sets out the strategy that the Council will follow in respect of investments and financing both in the forthcoming financial year and the following two years.