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BODY:	**AUDIT & GOVERNANCE COMMITTEE**
DATE:	**3 December 2014**
SUBJECT:	**Treasury Management Mid-year Review Report**
REPORT OF:	**Chief Finance Officer**
Ward(s):	All
Purpose:	To provide Members with a mid year review of treasury management activity.
Contact:	Janet Martin, Senior Accountant Telephone Number 01323 415983.
Recommendations:	Members are asked to note the contents of this report.

1.0 Introduction

1.1 Treasury Management is 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.

1.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management was adopted by Cabinet on 5 February 2014 and requires regular reports to this committee on the Treasury Management activities undertaken.

1.3 This mid year report covers the following:

- An economic update for the first six months of 2014/15;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2014/15;
- A review of the Council's borrowing strategy for 2014/15;
- A review of any debt rescheduling undertaken during 2014/15;
- A review of compliance with Treasury and Prudential Limits for 2014/15.

2.0 Economic Update

2.1 After strong UK GDP quarterly growth since Q2 2013, it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. Overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years.

2.2 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.2% in September, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008.

2.3 Capita's Interest rate forecast is shown in the table below**.**

	Mar-15	**Jun-15**	**Sep-15**	**Dec-15**	**Mar-16**	**Jun-16**	**Sept16**
Bank rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%
3m LIBID	0.60%	0.80%	0.90%	1.10%	1.30%	1.40%	1.60%
6m LIBID	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.80%
12m LIBID	1.00%	1.20%	1.30%	1.40%	1.70%	1.80%	2.10%
5yr PWLB rate	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB rate	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
25yr PWLB rate	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%
50yr PWLB rate	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%

Capita Asset Services undertook a review of its interest rate forecasts in October as a result of a major change of sentiment in financial markets in the previous few weeks. The latest forecast now includes a first increase in Bank Rate in quarter 2 of 2015 (previously quarter 1).

This Council has applied for and received confirmation that having complied with Prudential Indicators the PWLB Certainty Rate would be applied to future borrowing. This would reduce the interest rate by 0.2%.

3.0 Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Cabinet on 5 February 2014. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the

Council's investment priorities as follows:

- Security of capital
- Liquidity.

There are no policy changes to the TMSS.

3.2 The Council aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

3.3 There is still uncertainty and volatility in the financial and banking market globally. In this context, it is considered that the strategy approved on 5 February 2014 is still fit for purpose in the current economic climate.

4.0 The Council's Capital Position (Prudential Indicators)

4.1 Prudential Indicator for Capital Expenditure

The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2014/15 Original Estimate £000	Position as at 30.9.14 £000	2014/15 Revised Estimate £000
General Fund	15,661	2,202	17,323
HRA	9,771	3,966	13,266

4.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2014/15 Original Estimate £000	2014/15 Revised Estimate £000
Total spend	**25,432**	**30,589**
Financed by:		
Capital receipts	3,708	4,978
Capital grants	6,715	8,053
Capital reserves	6,229	6,147
Revenue	1,798	1,716

Total financing	**18,450**	**20,894**
Borrowing need	**6,982**	**9,695**

The increase in the revised estimated capital spend in 2014/15 is mainly due to re-profiling of previously approved schemes and the following new approved schemes:

- Increase of Supporting Housing and Economic Progress Initiative (SHEP);
- Increase of LA New Build;
- Home Rescue Emergency Fund;
- Congress Theatre;
- Solar Panels.

4.3 **Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary.**

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

	2014/15 Original Estimate £m	2014/15 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	27.5	31.2
CFR – housing	38.8	40.0
Total CFR	66.4	71.2
Net movement in CFR	6.2	8.7
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	65.1	
Serco Paisa Loans	1.3	
Total debt 31 March	66.4	

The revised estimate has been increased from the original forecast Capital Financing Requirement due to the increased borrowing for SHEP, LA New Build, Home Rescue Emergency Fund, Solar Panels and the Congress Theatre.

4.4 **Limits to Borrowing Activity**

One key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2014/15 Original Estimate £m	Position As at 30.9.14 £m	2014/15 Revised Estimate £m
Gross borrowing	40.7	40.7	42.0
Serco Paisa Loans	1.2	1.3	1.3
Less investments	-	(2.8)	(0.5)
Net borrowing	41.9	39.2	42.8
CFR (year end position)	66.4	71.2	71.2

No difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2014/15 Original Indicator	Current Position
Borrowing	80.1	40.7
Other long term liabilities	1.3	1.3
Total	81.4	42.0

5.0 Investment Portfolio 2014/15

5.1 Investment rates available in the market continue at a historical low point. The average level of temporary funds available for investment purposes in the first six months of 2014/15 was £4.9m arising from the timing of precept payments, receipt of grants and progress on the capital programme.

5.2 A full list of investments held as at 30th September 2014, during the first six months of 2014/15 is shown in appendix 1, and summarised below:

Investments	30th September 2014	Rate of Return
Counterparty	£000	%
Foreign Banks	0	
British Banks	2,800	0.73
Building Societies	0	
Total	2,800	0.73

The above excludes £221,000 cash invested overnight on 30th September with the Council's own bankers, the Co-op.

Approved limits within the Annual Investment Strategy were not breached during the first six months of 2014/15.

5.3 Investment performance against benchmark was as follows:

Benchmark	Benchmark Return	Council Performance	Interest Earnings
7 day	0.35%	0.65%	£16,000

5.4 The authority outperformed the benchmark by 0.30%. The budgeted investment return for 2014/15 is £50,000. Performance for the year to date is below target. This is due to the continuous use of internal balances during the first 6 months which has reduced the amount of interest paid on loans by a greater amount.

5.5 **Investment Counterparty criteria**
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

6.0 Borrowing

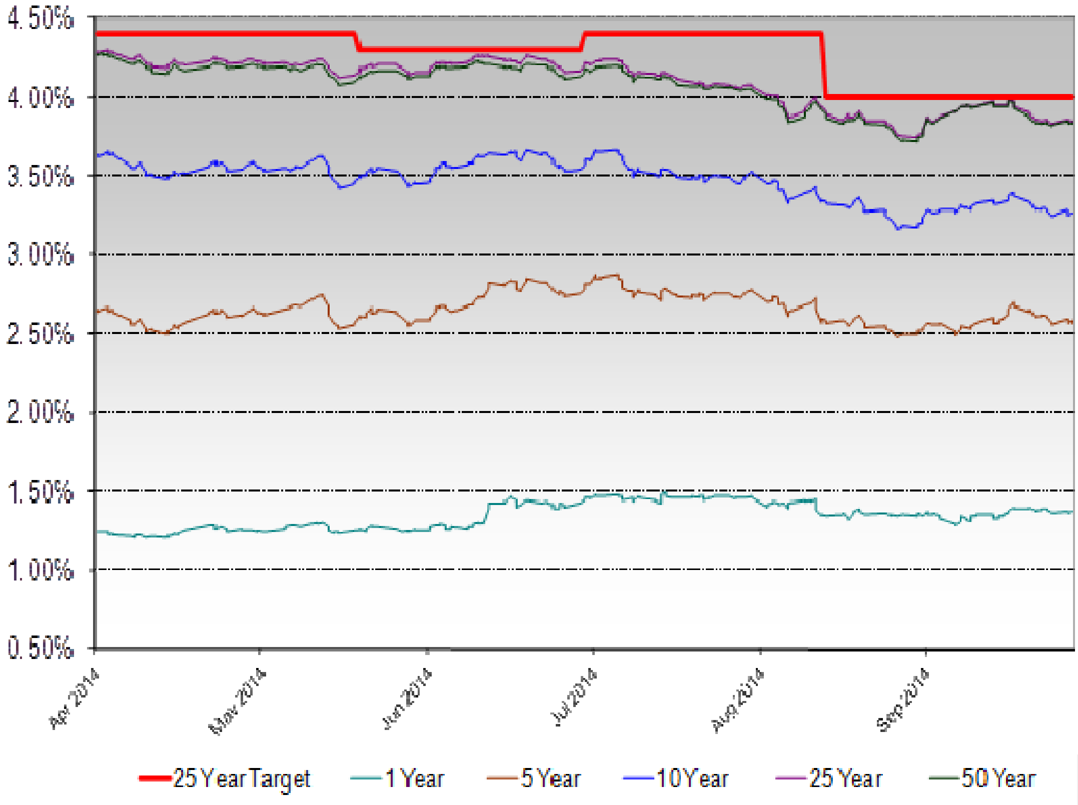
6.1 The following temporary debt has been taken and repaid during the first 6 months.

Lender	Amount £m	Interest Rate %	Start Date	Repayment Date
Portsmouth CC	2.5	0.35	31 March	30 April
Worcester CC	3.0	0.27	30 April	16 June

A long term loan of £2m was taken from the Public Works Loan Board on 5th September 2014 for 45.5 years at 3.85%.

6.2 The Council's revised estimated capital financing requirement (CFR) for 2014/15 is £71.2m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table above at 4.4 shows the Council has borrowings of £42.0m and has utilised £29.2m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

6.3 The graph below shows the movement in PWLB rates for April to September 2014.



7.0 Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2014/15.

8.0 Compliance with Treasury and Prudential Limits

8.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved TMSS.

8.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

9.0 <u>Consultation</u>

9.1 None.

10.0 <u>Resource Implications</u>

10.1 None

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Background Papers:

The Background Papers used in compiling this report were as follows:

- CIPFA Treasury Management in the Public Services code of Practice (the Code)
- TMSS Policy
- Annual Investment Strategy

To inspect or obtain copies of background papers please refer to the contact officer listed above.