**TO: GOVERNANCE AND AUDIT COMMITTEE**
**28 JANUARY 2013**

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# TREASURY MANAGEMENT REPORT
**Borough Treasurer**

## 1 PURPOSE OF DECISION

1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing liquidity initially before considering maximising investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the longer term cash flow needs to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

1.3 The Local Government Act 2003 requires a local authority to "have regard to" guidance issued by, or specified by, the Secretary of State. As such, the Council is required to have regard to the Prudential Code and the Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

1.4 The Code of Practice requires the Council's annual Treasury Management Strategy to be examined and reviewed by a responsible body. An additional primary requirement of the code is for the receipt by Full Council of a Mid-Year Review Report of Treasury Management activities.

1.5 This report seeks to achieve both these requirements

## 2 RECOMMENDATIONS

**2.1 That the Committee consider and review the Mid-Year Review Report and share the report with members of the Full Council.**

**2.2 That the Committee review the Treasury Management Strategy prior to its approval by Council.**

## 3 REASONS FOR RECOMMENDATIONS

3.1 The reasons for the recommendations are set out in the report.

## 4 ALTERNATIVE OPTIONS CONSIDERED

4.1 The Code of Practice requires the Council's annual Treasury Management Strategy to be examined and reviewed by a responsible body. The Governance and Audit Committee has been nominated by Council to be that body.

## 5 SUPPORTING INFORMATION

### Mid-Year Review

5.1 This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first nine months of 2013/14
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- The Council's capital expenditure
- A review of the Council's investment portfolio for 2013/14;
- A review of compliance with Treasury and Prudential Limits for 2013/14

5.2 In the Eurozone (EZ) the sovereign debt crisis has eased during 2013 which has been a year of comparative calm after the hiatus of the Cyprus bailout in the spring. The EZ finally escaped from seven quarters of recession in quarter 2 of 2013 but growth is likely to remain weak and so will dampen UK growth. The ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bail out, has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession.

5.3 The US economy has managed to return to reasonable growth in Q2 2013 of 2.5% y/y and 2.8% in Q3, in spite of sharp cuts in federal expenditure that kicked in on 1 March, induced by the fiscal cliff, together with increases in taxation. The Federal Reserve has continued to provide huge stimulus to the economy through its $85bn per month asset purchases programme of quantitative easing. However an announcement was made in December 2013 to taper (reduce) this support and it is too early to judge how this will impact on global economies going forward. Consumer, investor and business confidence levels have improved markedly in 2013. The housing market has turned a corner and house sales and increases in house prices have returned to healthy levels.

5.4 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth stongly rebounded in 2013 - quarter 1 (+0.3%), 2 (+0.7%) and 3 (+0.8%), to surpass all expectations as all three main sectors, services, manufacturing and construction contributed to this strong upturn. The Bank of England has, therefore, upgraded growth forecasts in the August and November quarterly Inflation Reports for 2013 from 1.2% to 1.6% and for 2014 from 1.7% to 2.8%, (2015 unchanged at 2.3%). Whilst growth is expected to be strong for the immediate future, one downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent.

5.5 The Bank of England issued forward guidance in August which said that the Bank will not start to consider raising interest rates until the jobless rate (Labour Force Survey / ILO i.e. not the claimant count measure) has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years in August, but revised to possibly quarter 4 2014 in November. The UK unemployment rate currently stands at 2.5 million i.e. 7.6 % on the LFS / ILO measure. The Bank's guidance is subject to three provisos, mainly around inflation; breaching any of them would sever the link between interest rates and unemployment levels. This actually makes forecasting Bank Rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon.

5.6 While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS), aimed at encouraging banks to expand lending to small and medium size enterprises, has been extended

5.7 Economic forecasting remains difficult with so many external influences weighing on the UK. The overall balance of risks to economic recovery in the UK is currently evenly weighted. However, only time will tell just how long this period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas. UK strong economic growth is currently very dependent on consumer spending and recovery in the housing market. This is unlikely to endure much beyond 2014 as most consumers are maxed out on borrowing and wage inflation is less than CPI inflation, so disposable income is being eroded. In the longer term – an earlier than currently expected reversal of QE in the UK; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.

5.8 The Council has appointed Capita (previously known as Sector Treasury Services) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view on the future levels of the Bank Rate.

Medium-Term Rate Estimates (averages)

| **Annual Average %** | **Bank Rate** | **PWLB Rates*** | | |
|---|---|---|---|---|
| | | **5 year** | **25 year** | **50 year** |
| Dec 2013 | 0.50 | 2.50 | 4.40 | 4.40 |
| Mar 2014 | 0.50 | 2.50 | 4.40 | 4.40 |
| June 2014 | 0.50 | 2.60 | 4.40 | 4.40 |
| Sept 2014 | 0.50 | 2.70 | 4.50 | 4.50 |
| Dec 2014 | 0.50 | 2.70 | 4.50 | 4.60 |
| March 2015 | 0.50 | 2.80 | 4.60 | 4.70 |
| June 2015 | 0.50 | 2.80 | 4.70 | 4.80 |
| Sept 2015 | 0.50 | 2.90 | 4.80 | 4.90 |
| Dec 2015 | 0.50 | 3.00 | 4.90 | 5.00 |
| March 2016 | 0.50 | 3.20 | 5.00 | 5.10 |
| June 2015 | 0.50 | 3.30 | 5.10 | 5.20 |
| Sept 2016 | 0.75 | 3.50 | 5.10 | 5.20 |
| | | | | |

* Borrowing Rates

**Treasury Management Strategy Statement Review**

5.9 The Treasury Management Strategy Statement (TMSS) for 2013/14 was approved by the Council on 27th February 2013. There are no policy changes to the TMSS

**Capital Expenditure**

5.10 The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget. The Council is on target to achieve the original forecast Capital Financing Requirement and no external borrowing is forecast for the year.

| Department | Approved Budget 2013/14 £'000s | Cash Budget 2013/14 £'000s | Estimated Out-turn 2013/14 £'000s | Cash Budget 2014/15 £'000s | (Under) /Over Spend £'000s |
|---|---|---|---|---|---|
| Adult Social Care, Health & Housing | 5,673.7 | 5,312.0 | 5,312.0 | 361.7 | 0.0 |
| Children, Young People and Learning | 25,925.9 | 10,450.1 | 10,450.1 | 15,475.8 | 0.0 |
| Council Wide | 8,296.2 | 6,705.7 | 6,705.7 | 1,590.5 | 0.0 |
| Corporate Services | 698.0 | 683.0 | 686.0 | 15.0 | 3.0 |
| Environment, Culture and Communities | 10,326.0 | 8,061.1 | 8,068.2 | 2,264.9 | 7.1 |
| **TOTAL CAPITAL PROGRAMME** | 50,919.8 | 31,211.9 | 31,222.0 | 19,707.9 | 10.1 |

**Review of Investment Portfolio 2013/14**

5.11 The Council held £46.4m of investments as at 31 December 2013 and the investment portfolio yield for the first nine months of the year is 0.6% against a benchmark (Local Authority 7-Day Rate) of 0.4%.

| Investment | Maturity | Amount (£) | Average Rate (%) |
|---|---|---|---|
| **Money Market Funds** | | | |
| Prime Rate | 1 Day | 6,995,000 | 0.49 |
| Ignis | 1 Day | 6,992,500 | 0.39 |
| Goldman Sachs | 1 Day | 5,415,000 | 0.38 |
| | | **19,402,500** | |
| **Fixed Term Deposits** | | | |
| RBS | 24/04/2014 | 3,500,000 | 0.77% |
| Lloyds | 15/08/2014 | 3,500,000 | 1.01% |
| Lloyds | 30/10/2014 | 3,500,000 | 0.98% |
| Barclays | 03/02/2014 | 3,500,000 | 0.45% |
| Santander | 07/02/2014 | 2,500,000 | 0.46% |
| Nationwide BS | 07/02/2014 | 2,500,000 | 0.45% |
| Nationwide BS | 04/03/2014 | 2,500,000 | 0.45% |
| Barclays | 19/03/2014 | 3,500,000 | 0.47% |
| Santander | 24/03/2014 | 2,000,000 | 0.46% |
| | | **27,000,000** | |
| **Total Investments** | | **46,402,500** | |

5.12 The 2013/14 interest budget assumed that an average interest rate of 1.0% would be earned on the Council's investment portfolio. Taken together with the income generated by pre-funding the 2013/14 pension fund contribution, the interest budget was estimated to be £384,000. The Bank Rate (set monthly by the Bank of England) has remained at an historical low of 0.5% and, given the current weaknesses in both the UK and the Global economy, is likely to remain at this level for some months to come. Moreover the liquidity support provided by the Bank of England discussed above has had the impact of constraining the investment return available to the Council and the Council will not achieve the budgeted return of 1% as noted above.

5.13 However cash balances remain on the upside, creating additional opportunities to deposit surplus cash at longer fixed term maturities, rather than having to limit investments to overnight low-yielding money market funds although the Council is limited by the number of counterparties available to it. The Council continues to invest in only the most highly rated UK financial institutions, or those part-nationalised UK Banks. Notwithstanding this low-risk approach, given the opportunities presented by these longer-term maturities, the additional yield will contribute to the investment projections for 2013/14 and as such an additional £100,000 of investment income has been projected for the year.

**Compliance with Treasury and Prudential Limits for 2013/14**

5.14 The Borough Treasurer can confirm that the approved limits within the Annual Investment Strategy were not breached during the first nine months of 2013/14 and no changes to these limits are proposed for the remaining 3 months.

**Treasury Management Strategy 2014/15**

5.1 The Local Government Act 2003 requires a local authority to "have regard to" guidance issued by, or specified by, the Secretary of State. As such, the Council is required to have regard to the Prudential Code and Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

5.2 Under the requirements of the Prudential Code, the Council must set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The attached Treasury Management Report outlines the Council's Prudential Indicators for 2014/15 to 2016/17 and sets out the expected treasury operations for this period.

5.3 The Code of Practice recommends that a responsible body be nominated by the Council and having examined and assessed the effectiveness of the treasury management strategy and policies recommend them to Council. At its meeting on 2 March 2011 Council nominated the Governance and Audit Committee as the responsible body.

5.4 The attached Treasury Management Report (Annex D of the General Fund Revenue Budget 2014/15 report to the Executive) was approved on 10 December 2013. The Executive requested that the Governance and Audit Committee review each of the key elements. Following this review the Treasury Management Report and associated documents will be presented to Council for approval on 26 February 2014, as a part of the overall budget package and resolution on the Council Tax for 2014/15.

**6 ADVICE RECEIVED FROM STATUTORY AND OTHER OFFICERS**

Borough Solicitor

6.1 None.

Borough Treasurer

6.2 The financial implications are contained within the report.

Equalities Impact Assessment

6.3 None.

Strategic Risk Management Issues

6.4 The Treasury Management Report deals directly with the strategic management of risk associated with the Council's treasury management activities

## 7 CONSULTATION

7.1 The Executive approved the draft budget proposals for consultation on 10 December. Any representations made will be considered by the Executive on 11 February before recommending the final budget package to full Council.

Background Papers
None

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