REPORT FOR DECISION

Bury COUNCIL

Agenda Item	

DECISION OF:	**CABINET** **OVERVIEW & SCRUTINY COMMITTEE** **COUNCIL**
DATE:	**27 NOVEMBER 2013** **4 DECEMBER 2013** **11 DECEMBER 2013**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY – MID YEAR REVIEW 2013/14**
REPORT FROM:	**CABINET MEMBER FOR FINANCE & CORPORATE AFFAIRS**
CONTACT OFFICER:	**STEPHEN KENYON, ASSISTANT DIRECTOR OF RESOURCES (FINANCE AND EFFICIENCY)**
TYPE OF DECISION:	**COUNCIL**
FREEDOM OF INFORMATION/STATUS:	The report is within the public domain
SUMMARY:	This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following: • An economic update for the 2013/14 financial year to 30 September 2013 • 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 2013/14 • A review of the Council's borrowing strategy for 2013/14 • A review of any debt rescheduling undertaken during 2013/14 • A review of compliance with Treasury and Prudential Limits for 2013/14

OPTIONS & RECOMMENDED OPTION	It is recommended that, in accordance with CIPFA's Code of Practice on Treasury Management, the report be noted.

IMPLICATIONS:	
Corporate Aims/Policy Framework:	Do the proposals accord with the Policy Framework? Yes
Statement by the S151 Officer: Financial Implications and Risk Considerations:	Treasury Management is an integral part of the Council's financial framework and it is essential that the correct strategy is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.
Statement by Executive Director of Resources:	There are no additional resource implications. Treasury management activities so far have produced a projected underspending for the year of £0.934m. This will help to support other areas of the Council's budget that are under pressure from user demand or economic conditions.
Equality/Diversity implications:	No
Considered by Monitoring Officer:	Yes
Wards Affected:	All
Scrutiny Interest:	Overview & Scrutiny Committee

TRACKING/PROCESS **DIRECTOR: STEVE KENYON**

Chief Executive/ Strategic Leadership Team	Cabinet Member/Chair	Ward Members	Partners
No	Yes	N/a	N/a
Scrutiny Commission		Committee	Council
Overview & Scrutiny Committee		Cabinet 27/11/13	11/12/13

1.0 BACKGROUND

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

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 borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

As a consequence treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

1.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management was adopted by this Council on 24 February 2010.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is: Overview & Scrutiny Committee.

1.3 This report fulfils the requirement to produce a mid-year review.

2.0 ECONOMIC UP-DATE

2.1 Economic Performance to date

2.1.1 During 2013/14 economic indicators suggested that the economy is gradually recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion, the economy grew 0.7% in Q2.

There have been signs of increases in household spending in the summer, with a pick-up in retail sales, mortgages, house prices and new car registrations.

2.1.2 The strengthening in economic growth appears to have been reflected in the labour market, with employment rising at a modest pace. Pay growth also increased slightly in April, by 1.0%; well below the rate of inflation causing continuing pressure on household's disposable income.

2.1.3 The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years pre 2008.

2.1.4 Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 looked to be broadly in line with last year's figures, highlighting the Government's difficulty in reducing borrowing while economic growth was relatively lacklustre. The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan, and monetary policy was unchanged in advance of the new Bank of England Governor, Mark Carney, arriving. Bank Rate remains at 0.5% and quantitative easing also stayed at £375bn. In August, the MPC provided forward guidance that Bank Rate is unlikely to change until unemployment first falls to 7%, which was not expected until mid 2016. However, 7% is only a point at which the MPC would review Bank Rate, not necessarily take action to change it. The three month to July average rate was 7.7%.

2.1.5 CPI inflation (MPC target of 2.0%), fell marginally from a peak of 2.9% in June to 2.7% in September. The Bank of England expects inflation to fall back to 2.0% in 2015.

2.1.6 Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth in Q2, so ending six quarters of Eurozone recession.

2.2 Outlook for the next six months of 2013/14

2.2.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds. Downside risks to UK gilt yields and PWLB rates include:

- A return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations
- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- The Italian political situation is frail and unstable: the coalition government fell on 29 September
- Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) could also generate safe haven flows into UK gilts.

- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK.
- Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds.

2.2.2 Upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- Increased investor confidence that sustainable robust world economic growth is expected, together with a reduction or end of QE operations in the US, causing a further flow of funds out of bonds into equities.
- A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.
- In the longer term - a 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.
- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and sustained recovery of economic growth, causing the ratio of total Government debt to GDP to rise to levels that provoke major concern.

2.2.3 The overall balance of risks to economic recovery in the UK is now weighted to the upside . However, only time will tell just how long this period of strong economic growth will last, and it remains exposed to vulnerabilities in a number of key areas. The longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Near-term, there is some residual risk of further QE if there is a dip in strong growth or if the MPC were to decide to take action to combat the market's expectations of an early first increase in Bank Rate. If the MPC does takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years, such action could cause gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The tension in the US over passing a federal budget for the new financial year starting on 1 October and raising the debt ceiling in mid October could also see bond yields temporarily dip until agreement is reached between the opposing Republican and Democrat sides. Conversely, the eventual start of tapering by the Fed will cause bond yields to rise.

2.2.4 Capita Asset Service's (formerly Sector) Interest Rate Forecast

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB rate	2.50%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
10yr PWLB rate	3.70%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
25yr PWLB rate	4.40%	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
50yr PWLB rate	4.50%	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%

The Capita Assets Services forecasts above are for PWLB certainty rates.

Capita Assets Services take the view that the unemployment rate is not likely to come down as quickly as the financial markets are currently expecting and that the current MPC view is more realistic. The prospects for any increase in Bank Rate before 2016 are therefore seen as being limited. However, some forecasters are forecasting that the Bank of England is too optimistic as to when the 7% level will be reached and so do not expect the first increase in Bank Rate until spring 2017.

3.0 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UP-DATE

The Treasury Management Strategy Statement (TMSS) for 2013/14 was approved by the Council on 20 February 2013.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

4.0 THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

4.1 Prudential Indicator for Capital Expenditure

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

Capital Expenditure	2013/14 Original Estimate £m	2013/14 Revised Estimate £m
Non HRA	8,855	16,664*
HRA	7,628	8,226
Total	16,483	24,890

Note* - Increase due to approved slippage.

4.2 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table 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.

	2013/14 Original Estimate £m	2013/14 Revised Estimate £m
Prudential Indicator - Capital Financing Requirement (CFR)		
CFR – non HRA	129,764	129,514
CFR – HRA	40,107	40,531
Housing Reform Settlement	78,253	78,253
Total CFR	248,124	248,298
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	189,400	189,400
Other long term liabilities	7,300	7,300
HRA Settlement	79,300	79,300
Total	**276,000**	**276,000**

4.3 Limits to Borrowing Activity

The first 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. Gross 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 2013/14 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.

The Assistant Director of Resources reports that 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	**2013/14 Original Indicator**	**2013/14 Revised Indicator**
Borrowing	293,800	293,800
Other long term liabilities	7,400	7,400
Total	301,200	301,200

5.0 INVESTMENT PORTFOLIO 2013/14

5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades. Indeed, the introduction of the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

5.2 The Council held £48.2m of investments as at 30 September 2013 (£18.6m at 31 March 2013) and the investment portfolio yield for the first six months of the year is 0.89% against Sector's suggested investment earnings rate for returns on investments placed, for periods up to three months in 2013/14, of 0.50%.

Type of Investment	£ million
Call Investments (Cash Equivalents) - NatWest £34.7m - Bank of Scotland £3.9m	38.6
Fixed Investments (Short Term) - Bank of Scotland £9.6m	9.6
Total	**48.2**

5.3 The Assistant Director of Resources confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2013/14.

5.4 The Council's budgeted investment return for 2013/14 is £1m, and performance for the year to date is in line with the budget.

5.5 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 Council's capital financing requirement (CFR) for 2013/14 is £248.3m. 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 below shows the Council has borrowings of £209.7m and has utilised £38.6m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevail.

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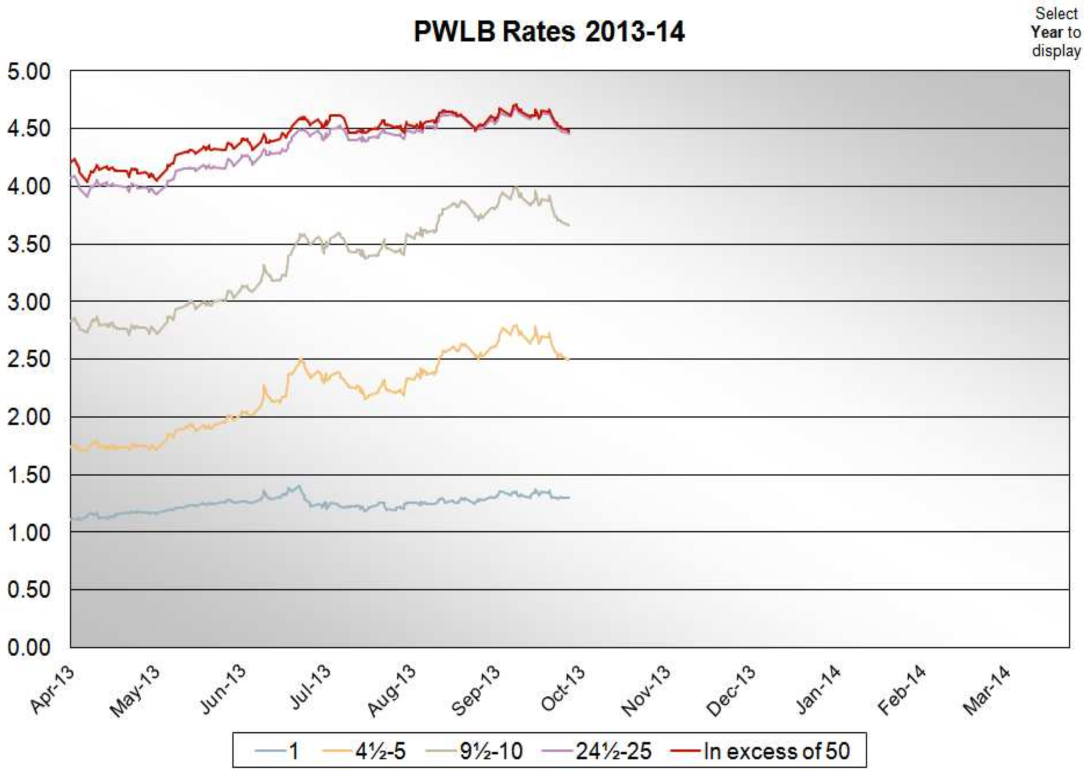
	30th September 2013			Forecast 31st March 2014		
	Principal		Avg. Rate	Principal		Avg. Rate
	£'000	£'000		£'000	£'000	
Fixed rate						
PWLB Bury	153,862			146,362		
PWLB Airport	4,829			4,078		
Market Bury	46,000	204,691		57,500	207,940	
Variable rate funding						
PWLB Bury	0			0		
Market Bury	0	0		0	0	
Temporary Loans / Bonds	5,003	5,003		2,003	2,003	
Total Debt		**209,694**	**4.43%**		**209,943**	**4.15%**

Lender	Rate	Amount	Start Date	End Date
Buckinghamshire County Council	1.13%	£5m	05/04/13	05/07/16
Humberside Fire Authority	0.39%	£2m	15/07/13	14/07/14
West Midlands Police	0.68%	£2m	08/08/13	24/07/16
Total		**£9m**		

6.3 The graph below shows the movement in PWLB rates for the first six months of the year to 30.09.13:



7.0 CO-OP BANK

7.1 Earlier this year the Co-op Bank, the Council's bankers, saw its credit rating downgraded. Whilst advice, and our own analysis, suggested that there was no increased risk as a result of this it was felt prudent to ensure that any overnight cash balances were reduced to an absolute minimum and this remains the policy. The authority holds no longer-term investments with the bank.

7.2 The Co-op have now announced that they intend to withdraw from the local government banking sector in 2015. Whilst this is disappointing, because the Co-op offers an ethical banking service that is in line with the Council's ethos, there is no immediate impact or risk to the Council and, co-incidentally, this date coincides with the end of our current contract with the Bank.

7.3 The authority will now begin to work with the Bank and with colleagues from other authorities that use the Co-op to look carefully at options for the way forward. Of course when a major player withdraws from the market then there is the danger that the reduced level of competition can lead to increased costs and so we will be looking at all procurement options including the pros and cons of tendering jointly with other councils.

8.0 DEBT RESCHEDULING

8.1 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 2013/14.

Councillor John Smith
Deputy Leader and Cabinet Member for Finance and Corporate Affairs

List of Background Papers:- None

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