Agenda Item No. 5

TREASURY MANAGEMENT REPORT - QUARTER TWO

To:	**Cabinet**		
Date:	**27 November 2012**		
From:	**Section 151 Officer Matt Bowmer**		
Electoral division(s):	**All**		
Forward Plan ref:	**2012/030**	*Key decision:*	**Yes**
Purpose:	**To provide the second quarterly update on the Treasury Management Strategy 2012-13, approved by Council in February 2012.**		
Recommendation:	**a) Cabinet is recommended to note the Treasury Management Report, Quarter Two 2012-13**		

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1. Purpose of Report

1.1 This report provides the second quarterly update on the Treasury Management Strategy 2012-13, approved by Council in February 2012.

2. Background

2.1 Treasury Management is regulated by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code). The Code has been developed to meet the needs of Local Authorities and its recommendations provide a basis to form clear treasury management objectives and to structure and maintain sound treasury management policies and practices.

2.2 The Code was adopted via the Treasury Management Strategy Statement (TMSS), which was approved by Council in February 2012. It requires the Council to produce an annual treasury report and a half yearly report. Alongside these Cabinet will be provided with quarterly updates on progress against the strategy.

2.3 This report provides a mid year update for the period to 30th September 2012.

2.4 This report has been developed in consultation with the Council's external investment managers and treasury advisers, Sector.

3. Summary of Key Headlines

3.1 The main highlights for the quarter are:

- In house investment returns received on cash balances continue to compare favourably to the benchmarks. A return of 0.84% was achieved compared to the 3 month London Interbank Bid Rate (LIBID) benchmark of 0.6% (see section 9.8).

- The Council has qualified for the Certainty Rate discount from the Public Works Loan Board and as a result interest rates on new loans taken from 1st November 2012 will be lower.

- Sector, the Councils treasury advisor was reappointed following a comprehensive joint procurement process exercise with Cambridgeshire County Council and Norwich City Council in which favourable terms have been agreed.

- No variance is currently projected against the Capital Financing and Interest budget for 2012-13.

4. The Economic Environment

4.1 Gross Domestic Product (GDP) growth in the quarter ended September looks set to be positive for the first quarter in a year. Although business surveys weakened in July, they recovered in August to a level consistent on past form with quarterly GDP growth of about 0.2%. Data published recently shows GDP grew by 1.0% during the quarter.

4.2 The labour market has continued to recover. Rise in employment was driven by growing self and part-time employment, rather than full-time.

4.3 The underlying trend in house prices still seems to be broadly down. Mortgage approvals for new house purchases have also remained weak. The total of 47,300 in July was below the average of 50,700 seen in the first half of 2012.

4.4 Banks' funding costs continued to ease over the quarter. This reflects the Bank of England's continued provision of low cost liquidity to banks in tranches of up to £5bn a month, the start of the Funding for Lending Scheme and the easing of tensions in Eurozone debt markets to which UK banks are exposed. But so far, quoted borrowing rates on most types of new mortgages have held broadly steady.

4.5 Inflation struggled to make further downward progress in Q3. Indeed, Consumer Prices Index (CPI) inflation rose from 2.4% in June to 2.6% in July, before falling back to 2.5% in August. Recent data published showed that inflation dropped to 2.2% in September, however further falls in inflation over the next few months look unlikely as a result of the recent increase in commodity prices. Oil prices rose from $97 per barrel at the end of June to around $113 per barrel at the end of September, while global agricultural prices have risen by around 25%.

4.6 The MPC voted in July to undertake £50bn additional asset purchases over the following four months. Although interest rate markets are pricing in a decent chance of a cut in official interest rates within the next few months, Mervyn King is opposed to this.

4.7 Asset prices in the UK and overseas largely continued to rise over the course of the third quarter. 10-year gilt yields fell from about 1.85% to 1.70% (although prices were volatile during this period), while the FTSE 100 recovered from 5,570 to 5,760. The pound also strengthened against both the euro and the dollar, from €1.23 to €1.25 and from $1.56 to $1.62 respectively.

4.8 In the Eurozone, market sentiment improved following the ECB's pledge to buy "unlimited" quantities of peripheral government's sovereign debt in early September, provided that those countries have formally requested a bail out. However, peripheral Eurozone bond yields began to rise again at the end of the quarter due to Greece increasingly looking as if it will now have to ask for a third bail out and Spain continued prevaricating over making a formal request for a bail out when all the evidence indicates that this will be unavoidable. GDP growth indicators points to a quarterly drop in GDP of about 0.4% in Q3 in the Eurozone.

5. Summary Portfolio Position

5.1 The Council's debt and investment position is shown in the table overleaf:-

5.2

	ATMS Forecast February 2012 (as agreed by Council)		Actual as at 31 March 2012		Movement		Actual as at 30th September 2012		Revised Forecast 31 March 2012	
					Repaid	Raised				
	£m	Rate %	£m	Rate %	£m	£m	£m	Rate %	£m	Rate %
Long term borrowing										
PWLB	294.6	4.3	276.6	4.3	-	10.0	286.6	4.3	316.6	4.3
Market	75.5	3.9	75.5	3.7	-	-	75.5	3.7	79.5	3.7
Total	370.1	4.3	352.1	4.3	-	10.0	362.1	4.2	396.1	4.2
Short Term Borrowing	-	-	25.0	0.8	25.0	-	0.0	-	0.0	0.0
Total Actual Borrowing	**370.1**	**4.3**	**377.1**	**4.0**	**5.0**	**-**	**362.1**	**4.1**	**396.1**	**4.0**
Investments In-house.	-	-	46.3	0.9	334.5	323.0	34.8	0.9	50.0	1.0
Total Actual Investments	**0**	**-**	**46.3**	**0.9**	**168.5**	**174.9**	**34.8**	**0.9**	**50.0**	**1.0**
Total Net Debt / Borrowing	**370.1**		**330.8**				**327.3**		**346.1**	

5.3 Further analysis of borrowing and investments is covered in the following two sections.

5.3.1 The projected under spend against the statutory Minimum Revenue Provision (MRP) is offset by higher interest payable and lower interest receivable. Overall no variance is currently projected against the budget.

	Budget £000	Actual £000	Estimated Outturn £000	Variance £000
MRP (net)	17,067	0	16,740	-327
Net interest payable	15,016	3,637	15,118	102
Internal interest payable	382	77	476	94
Internal interest receivable	-246	0	-153	93
Loan premium	165	0	165	0
Debt management expenses	100	31	100	0
Other	-38	0	0	38
Total	32,446	3,745	32,446	0

6. Long Term Borrowing

6.1 The Council is required to borrow in order to fund the spending for its Capital Programme for the benefit of Cambridgeshire. The amount of new borrowing required each year is determined by new capital schemes approved and included in the Capital Programme.

6.2 Long term borrowing is taken from 2 main sources:

- Public Works Loans Board (PWLB)
  - The PWLB is a statutory body operating within the UK Debt Management Office, an executive agency of H M Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies.
  - PWLB introduced the Certainty Rate in November 2012 which provides a discount of 0.2% to the published rates provided councils disclose greater information and clarity on capital funding. CCC has been successful in qualifying for these favourable interest rates on any new loans raised.
- Money Markets
  - Money market loans are arranged through approved brokers with international banking institutions and other Local Authorities.

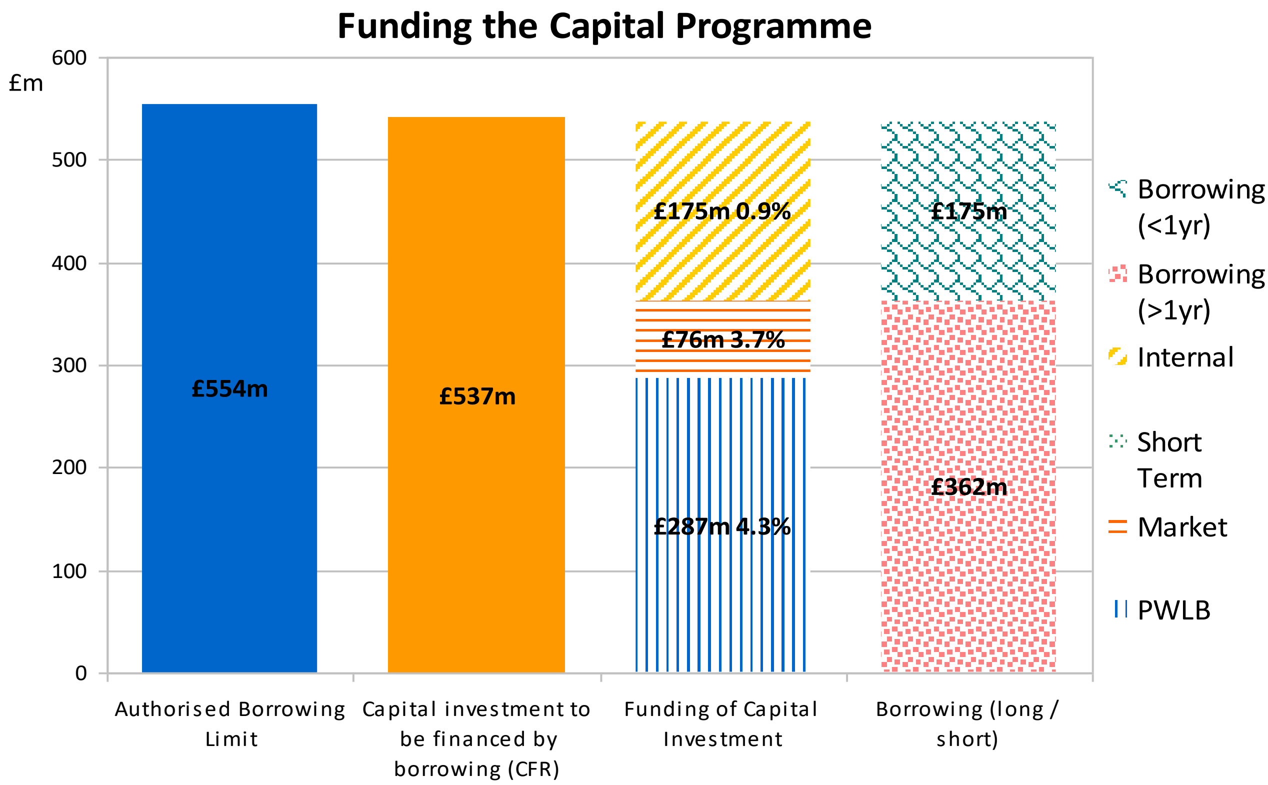
6.3 When market conditions are favourable long term loans can be restructured to:

- to generate cash savings
- to reduce the average interest rate
- to enhance the balance of the portfolio by amending the maturity profile and/or the level of volatility. (Volatility is determined by the fixed/variable interest rate mix.)

During the quarter there were no opportunities for the Council to restructure its borrowing due to the position of the Council's borrowing portfolio compared to market conditions. Further debt rescheduling will be considered subject to conditions being favourable. The position will be kept under review, and when opportunities for savings do arise, debt rescheduling will be undertaken to meet business needs.

6.4 The TMSS sets out the plan for treasury management activities over the next year. It identifies where the authority expects to be in terms of borrowing and investment levels. When the 2012-13 TMSS was set, it was anticipated that the Capital Financing Requirement (CFR), the Council's liability for financing the agreed Capital Programme, would be £554m (including Guided Bus financing). This figure is naturally subject to change as a result of changes to the approved capital programme.

6.5 The graph below compares the maximum the Council can borrow in 2012-13 with the forecast CFR at 31st March 2013 and the actual position of how this is being financed at 30th September 2012. The final column shows the split between short (internal and external borrowing with duration of less than one year) and long term borrowing.



6.6 The graph shows the Council's current capital investment that is to be funded via borrowing is £17m below the Authorised Borrowing Limit set for the Council at the start of the year. Note that the CFR includes the Guided Bus financing.

6.7 In addition, the graph shows how the Council is currently funding its borrowing requirement. As at 30th September the Council was using £178m of internal borrowing to finance capital investment. Internal borrowing is the use of the Council's surplus cash to finance the borrowing liability instead of borrowing externally.

6.8 The strategy anticipates that the Council continues to fund capital expenditure from a mixture of long term borrowing, short term borrowing and internal cash resources. However, due to the increasing CFR in the medium term, it is anticipated that long term borrowing will be undertaken to reduce interest rate risk. This is the risk that the Council will need to finance spend in future years when interest rates are expected to be higher.

7. Investments

7.1 The Investment Strategy approved by Council in February 2012, sets out the investment priorities as being the security of capital, liquidity and yield in this order. The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate and the heightened credit concerns it is considered appropriate to keep investments short term.

7.2 The Council has strict criteria which it uses to assess the financial institutions it can invest its surplus cash with. These criteria are monitored closely so as to minimise credit risk and expert advice and a methodology is provided by Sector. However, the Council does not solely rely on this advice or information from the credit rating agencies, and has excluded most Eurozone countries and the Spanish controlled Santander group from its counterparty list.

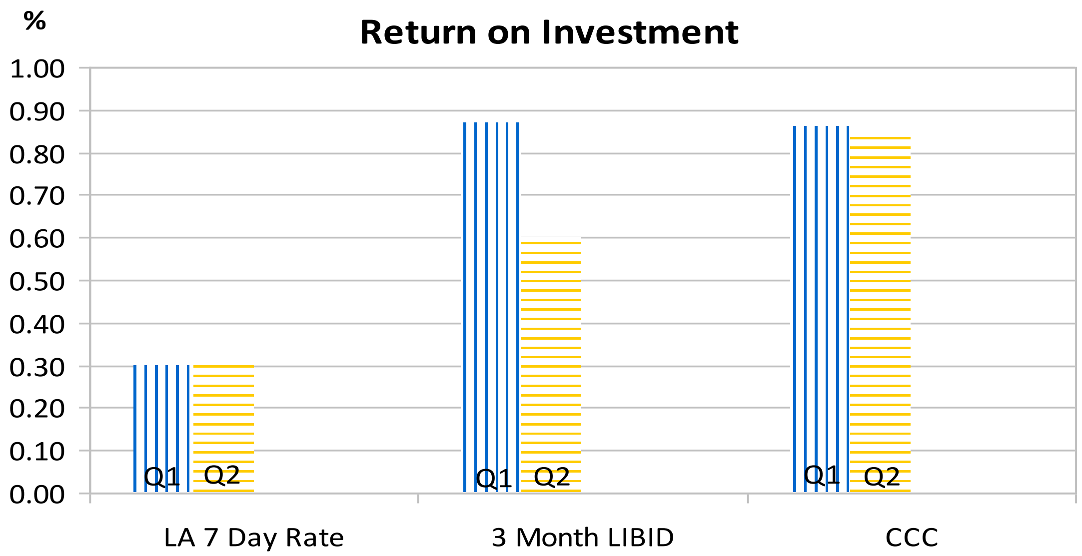
7.3 The Council has also taken action to limit its investment exposure to the financial markets by using its cash resources to fund capital expenditure.

7.4 The Council has exposure to AAA rated Money Market Funds as a way to diversify and manage investment risk whilst providing daily liquidity. These are pooled funds which invest in a range of high credit quality institutions, not always accessible by individual investors. Money Market Funds are highly regulated and must comply with specific credit quality criteria and meet certain liquidity requirement.

7.5 The Council has opened a facility with a King and Shaxson who provide custody services. The facility will enable the Council to invest directly in Certificates of Deposits, gilts and treasury bills should an opportunity arise.

7.6 As at 30th September 2012 the level of investment totalled £34.8m.

7.7 The graph below compares the returns on investments with the relevant benchmarks for each quarter this year.



- In house funds returned 0.84% during the quarter which compares favourably with both the both the 7 day (0.3%) and 3 month LIBID (0.6%) benchmarks.

8. Compliance with Treasury Limits and Prudential Indicators

8.1 With effect from 1st April 2004 The Prudential Code became statute as part of the Local Government Act 2003 and was revised in November 2009.

8.2 The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable. To ensure compliance with this the Council is required to set and monitor a number of Prudential Indicators.

8.3 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 (TMSS) and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in **Appendix 1**.

11. Alignment with priorities and ways of working

11.1 Developing the local economy for the benefit of all

There are no significant implications for this priority.

11.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

11.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

11.4 Ways of Working

There are no significant implications for this priority.

12. Significant Implications

12.1 Resource and Performance Implications

This report provides information on performance against the Treasury Management Strategy. Section 7 shows the impact of treasury decisions which are driven by capital spend on the Council's revenue budget.

12.2 Statutory, Risk and Legal Implications

The Council continues to operate within the statutory requirements for borrowing and investments. Further details can be found within the Prudential Indicators in **Appendix 1**.

12.3 Equality and Diversity Implications

There are no significant implications for any of the prompt questions within this prompt category.

12.4 Engagement and Consultation Implications

There are no significant implications for any of the prompt questions within this prompt category.

12.5 Public Health Implications

There are no significant implications for any of the prompt questions within this prompt category"

List of Appendices

Appendix 1: Treasury related Prudential Indicators: comparison of current position (30th September 2012) to indicators approved by Council in February 2012.
Appendix 2: New long term borrowing 2012-13.

Source Documents	**Location**
None	N/A

Treasury related Prudential Indicators: comparison of 31 March 2013 to indicators approved by Council in February 2012.

1. Has Council adopted CIPFA Code of Practice for Treasury Management in the Public Services?

   Yes – latest version adopted by Council in October 2004 and is key element of Treasury Strategy 2012-13 which was approved by Council in February 2012.

2. Capital Financing Requirement (estimated borrowing liability excluding PFI). The Guided Bus receipt has also been added back to the calculation (which increases the financing requirement in 2012-13.

Original 2012-13 Capital Financing Requirement (CFR) £m	2012-13 CFR (based on latest capital information) £m	Actual Borrowing £m	Difference between actual borrowing and original CFR £m	Difference between actual borrowing and latest CFR £m
553.9	537.0	362.1	191.8	174.9

3. Ratio of financing costs to net revenue stream

2012-13 Original Estimate %	2012-13 Revised Estimate %	Difference %
9.4	9.4	0.0

4. Authorised limit for external debt

2012-13 Authorised Limit £m	Actual Borrowing £m	Headroom £m
553.9	362.1	191.8

The Authorised limit is the statutory limit on the Councils level of debt and must not be breached.
This is the absolute maximum amount of debt the Council may have in the year.
(Please see section 8 for more information)

5. Operational boundary for external debt

2011-12 Operational Boundary £m	Actual Borrowing £m	Headroom £m
523.9	362.1	161.8

The operational boundary is set as a warning signal that debt has reached a level nearing the Authorised limit and must be monitored carefully.

6. Limits for exposure to fixed and variable rate net borrowing (Borrowing less investments)

	Limits set Feb 2012	**As at 30th September 2012**
Fixed rate	70% to 100%	101%
Variable rate	0% to 30%	-1%
Total		100%

The Interest rate exposure is calculated as a percentage of the net debt figure. The formula is shown below:

$$\frac{\text{Total Fixed (or Variable) rate exposure}}{\text{Total borrowing – short term investments}}$$

The level of Investments at 30th September result in the effect that fixed rate borrowing is greater than net borrowing and this results in a number greater than 100%.

7. Limits for maturity structure of borrowing

	Upper Limit	**Current**
under 12 months	40%	8%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	10%
5 years and within 10 years	20%	20%
10 years and above	50-100%	60%

8. Total principal sums invested for periods longer than 364 days

None. The Council does not invest for periods over one year.

New Long Term Borrowing taken between 01/04/12 and 30/09/12:

Lender	Date	£m	Interest Rate %	Duration (yrs)	Risk
PWLB	28-May-12	10	3.60	16	Low
Siemens*	29-Mar-13	4	2.85	15	Med

The Risk column for borrowing assesses the risk to the Council of premature repayment request by the counterparty.
* The lender of this loan has the option after 5 and 10 years to change the interest rate and the Council has the option to repay the loan if the new rate isn't acceptable.