Agenda Item No. 13

TREASURY MANAGEMENT REPORT QUARTER ONE

To:	**Cabinet**		
Date:	**17 September 2012**		
From:	**Section 151 Officer Matt Bowmer**		
Electoral division(s):	**All**		
Forward Plan ref:	**N/a**	*Key decision:*	**No**
Purpose:	**To provide the first 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 One 2012-13**		

	Officer contact:		***Member contact:***
Name:	Mike Batty	Name:	Councillor Steve Count
Post:	Senior Accountant – Treasury & Investments	Portfolio:	Resources and Performance
Email:	Mike.Batty@Cambridgeshire.gov.uk	Email:	Steve.Count@cambridgeshire.gov.uk
Tel:	01223 699942	Tel:	01223 699173

1. Purpose of Report

1.1 This report provides the first 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 an update for the period to 30th June 2012.

3. Consultation and Scrutiny

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

3.2 The report will also be subject to scrutiny.

4. Alternative Options Considered

4.1 This report has been based on factual information in accordance with Cabinet requirements.

5. Summary of Key Headlines

5.1 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 0.9% was achieved compared to the 3 month London Interbank Bid Rate (LIBID) benchmark of 0.9% (see section 9.8).

- The Council maintains a fluid counterparty list and monitors the creditworthiness of institutions daily. The UK's AAA rating is affirmed by Standard and Poor's, but remain on negative outlook under the other rating agencies (see 9.2).

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

- Further long term borrowing was taken at favourable interest rate levels (see section 8.10).

- The Public Works Loan Board (PWLB) Certainty Rate deal is announced by the Treasury, which will enable the Council to take PWLB borrowing at a discount to the normal rates of 0.2% (see 8.4).

6. The Economic Environment

6.1 The economic outlook has generally weakened since April 2012. Output shrunk by 0.3% during the first quarter of the calendar year and initial estimates showed the recession deepening with a further contraction of 0.7% for the second quarter, but this has been revised upwards to 0.5% recently. The Bank of England recently revised downwards its growth forecast for 2012-13 to 0%.

6.2 The labour market continued to perform relatively better. The Labour Force Survey measure of employment rose by 201,000 in the three months to June, whilst unemployment fell by 46,000 in the same period. The scale of the decline was more modest than the rise in employment, with the number of people looking for work outpacing jobs growth. The narrower claimant count measure of unemployment fell by 6,000 in July.

6.3 Banks' funding costs eased over the quarter, reflecting actions by the Bank of England and Treasury to boost liquidity. Two initiatives were announced in June - a 'funding for lending' scheme which would allow banks to temporarily "swap" their assets with the Bank of England in return for money they could lend to customers, and an emergency scheme that offered six month low cost liquidity to banks in tranches of £5bn a month.

6.4 Trade data showed a sharp deterioration in April. The UK posted its second largest monthly trade deficit on record, driven in large part by a widening of the gap between exports and imports with countries outside the EU. Exports to the Eurozone also fell, with weakness extending from the peripheral countries to economies that had previously been perceived as strong such as Germany.

6.5 Inflation fell further in the quarter ended June 2012. Consumer Prices Index (CPI) inflation fell from 3.5% in March to 2.4% in June, driven by declines in fuel and food prices. July inflation, published recently, shows an increase to 2.6%. Core inflation, which strips out food and fuel, fell from 2.5% to 2.2%. The most striking development in inflationary pressures was in the price of oil, which fell from $125 at the beginning of April to around $96 at the end of June, its lowest level since early 2011.

6.6 The MPC voted narrowly against pursuing more quantitative easing (QE) at its June meeting, but in July it was decided that the Bank of England should finance a further £50bn of asset purchases over the next four months implying a total quantity of £375bn.

6.7 As a result of, safe-haven flows from the Eurozone and the impact of QE, government bond yields fell during the quarter, with ten year yields at one point dropping below 1.5%, their lowest level ever.

6.8 Market sentiment towards the Eurozone remained volatile as successive 'rescue packages' first raised, and then disappointed, expectations. The economic news suggested that the Eurozone economy contracted sharply in the second quarter, while Eurozone unemployment rose to 11.1% in May, the highest rate since the creation of the euro in 1999.

7. Summary Portfolio Position

7.1 The Council's debt and investment position is shown in the table below:-

	TMSS Forecast February 2012 (as agreed by Council)		Actual as at 31 March 2012		Movement		Actual as at 31 June 2012		Revised Forecast 31 March 2013	
					Repaid	Raised				
	£m	Rate %	£m	Rate %	£m	£m	£m	Rate %	£m	Rate %
Long term borrowing										
PWLB	294.5	4.3	276.6	4.3	-	10.0	286.6	4.3	286.6	4.3
Market	75.5	3.9	75.5	3.7	-	-	75.5	3.7	79.5	3.7
Total	370.0	4.3	352.1	4.3	-	10.0	362.1	4.2	366.1	4.2
Short Term Borrowing	-	-	25.0	0.8	15.0	-	10.0	0.9	0.0	0.0
Total Actual Borrowing	**362.0**	**4.3**	**377.1**	**4.0**	**5.0**	**-**	**372.1**	**4.1**	**377.1**	**4.0**
Investments										
In-house.	-	-	46.3	0.9	168.5	174.9	52.7	0.9	20.0	1.0
External fund manager.	-	-	-	-	-	-	-	-	-	-
Total Actual Investments	**-**	**-**	**46.3**	**0.9**	**168.5**	**174.9**	**52.7**	**0.9**	**20.0**	**1.0**
Total Net Debt / Borrowing	**362.0**		**330.8**				**324.4**		**357.1**	

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

7.3 No variances are currently projected against this budget.

8. Long Term Borrowing

8.1 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.

8.2 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.

- Money Markets
  - Money market loans are arranged through approved brokers with international banking institutions and other Local Authorities.

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

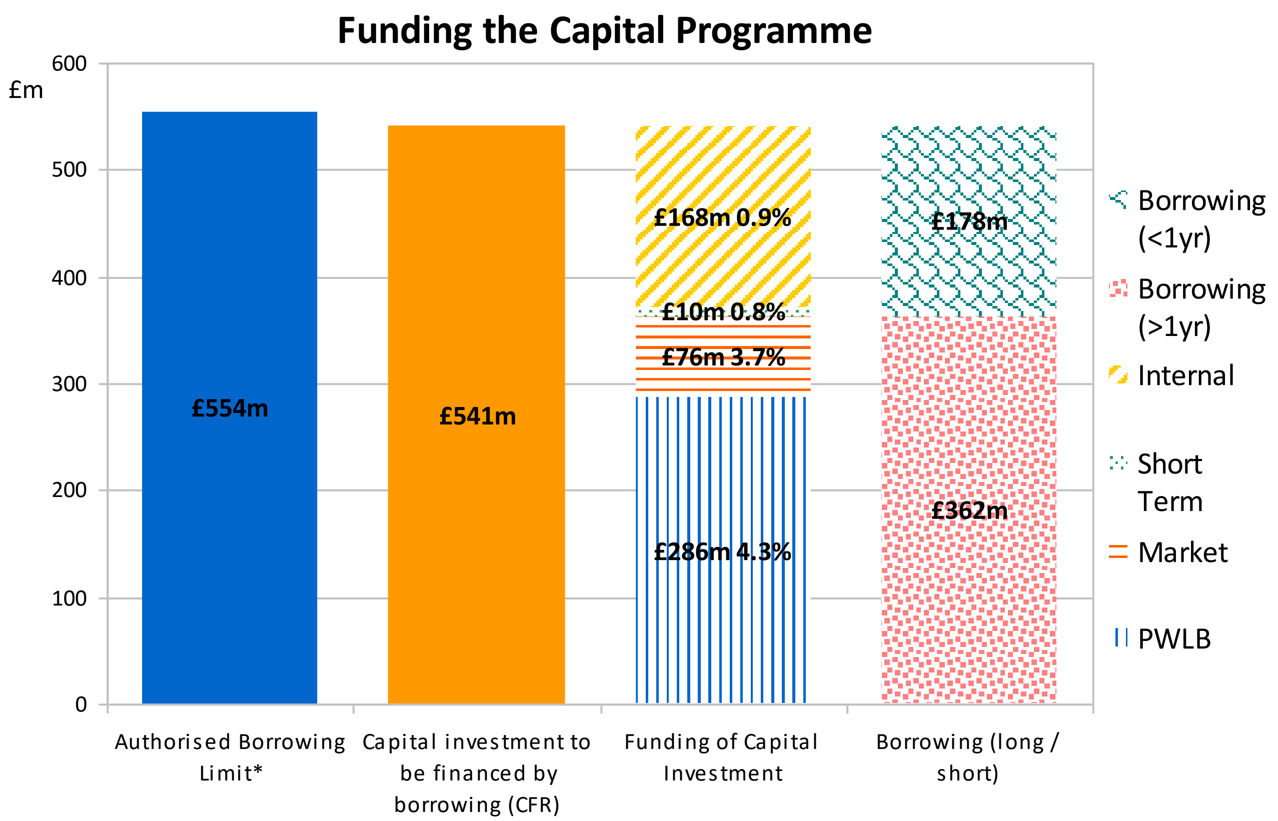
- to generate cash savings
- to reduce the average interest rate
- to enhance the balance of the portfolio by amending the maturity profile and/or the level of volatility. (Volatility is determined by the fixed/variable interest rate mix.)

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.

8.4 In the Budget 2012 the Government announced that they will introduce a 0.2% discount on loans from the Public Loans Work Board. In August the Treasury revealed details of the 'certainty rate' which will enable local authorities to access cheaper borrowing provided they operate the CIPFA Prudential Code and certain information is provided to government. The Certainty Rate will be available to English, Scottish and Welsh local authorities for those who complete the necessary documentation and will apply to new loans taken from November 2012. It is unlikely that savings will be achieved this year as a result because no new long term loans are required, however the Council will benefit in future years.

8.5 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 £540m (including Guided Bus financing). This figure is naturally subject to change as a result of changes to the approved capital programme.

8.6 The graph below on the next page 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 June 2012. The final column shows the split between short (internal and external borrowing with duration of less than one year) and long term borrowing.



8.7 The graph shows the Council's current capital investment that is to be funded via borrowing is £13m below the Authorised Borrowing Limit set for the Council at the start of the year. Note that the CFR includes the Guided Bus financing.

8.8 In addition, the graph shows how the Council is currently funding its borrowing requirement. As at 30th June the Council was using £168m 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.

8.9 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.

8.10 A 15 year Market Loan (Siemens) for £4m was arranged in June with a forward start date in March 2013 at a rate of 2.85%. The lender of this loan has options to change the terms at years 5 and 10 and the Council has the option to accept or repay. As a result the Council pays a lower rate of interest. A 16 year PWLB loan was taken in May at a point where interest rates reached another low point at a rate of 3.60%.

9. Investments

9.1 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.

9.2 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.

9.3 Bloomberg, a premier system for business news and financial information, provides additional information independent from the Council's advisors and money brokers which has enhanced decision making.

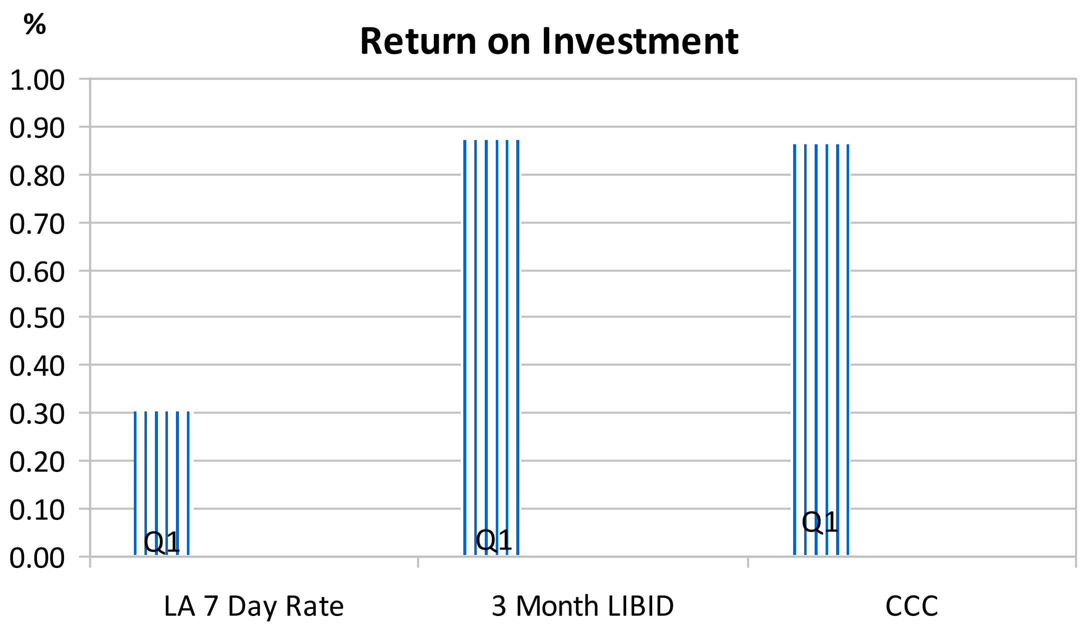
9.4 The Council has also taken action to limit its investment exposure to the financial markets by using its cash resources to fund capital expenditure.

9.5 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.

9.6 Custodian services are being evaluated to enable the Council to invest directly in Certificates of Deposits, gilts and treasury bills should an opportunity arise.

9.7 As at 31st March 2012 the level of investment totalled £52.7m.

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



- In house funds returned 0.86% during the quarter which favours comparably with both the both the 7 day and 3 month LIBID benchmarks.

10. Compliance with Treasury Limits and Prudential Indicators

10.1 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.

10.2 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.

10.3 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

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

12.2 Statutory, Risk and Legal Implications

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

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 June 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 calculations (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	540.6	372.1	181.8	168.5

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	372.1	181.8

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	372.1	151.8

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 30 Jun 2013**
Fixed rate	80% to 100%	104%
Variable rate	0% to 20%	-4%
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 June 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%	11%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	6%
5 years and within 10 years	20%	11%
10 years and above	50-100%	72%

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 30/06/12:

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.