Agenda Item No:8

TREASURY MANAGEMENT OUTTURN REPORT

To:	**General Purposes Committee**
Meeting Date:	**20th May 2014**
From:	**Chief Finance Officer**
Electoral division(s):	**All**
Forward Plan ref:	**Not Applicable** ***Key decision:*** **No**
Purpose:	**To provide the fourth quarterly update and outturn report on the Treasury Management Strategy 2013-14 approved by Council in February 2013.**
Recommendation:	**The General Purposes Committee is recommended to note the Treasury Management Report Outturn Report 2013-14 and recommend it to full Council for approval.**

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1. BACKGROUND

1.1 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.

1.2 The Code was adopted via the Treasury Management Strategy Statement (TMSS), which was approved by Council in February 2013. It requires the Council to produce an annual treasury report and a half yearly report. Alongside these Cabinet and now the General Purposes Committee will be provided with quarterly updates on progress against the strategy.

1.3 This report has been developed in consultation with the Council's external investment managers and treasury advisers, Capita Asset Services (CAS).

1.4 The report is based on forecasts and estimates and may change from the actual outturn once the accounts are closed.

2. SUMMARY OF KEY HEADLINES

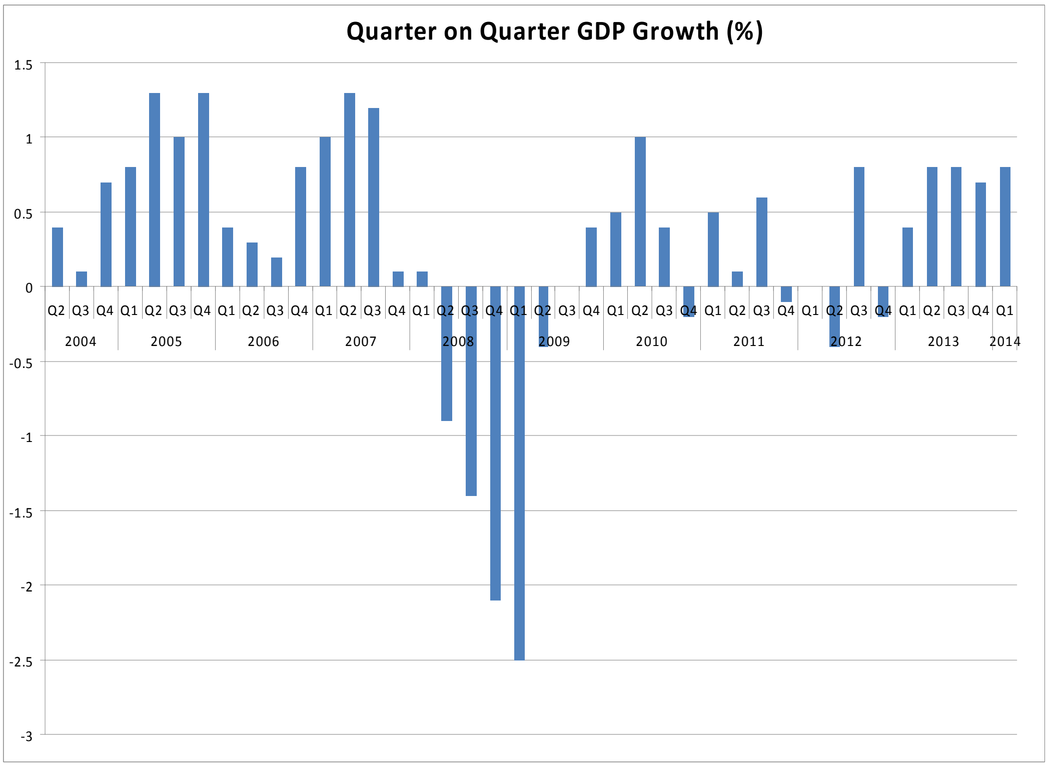
2.1 The main highlights for the quarter are:

- In house investment returns received on cash balances compares favourably to the benchmarks. A return of 0.6% was achieved compared to the 3 month London Interbank Bid Rate (LIBID) benchmark of 0.4% (see section 6.8).

- A favourable outturn variance of £2.440m is reported against the Capital Financing and Interest budget for 2013-14 (see section 4.3).

3. THE ECONOMIC ENVIRONMENT

3.1 After healthy growth of 0.7% in the quarter to December, the preliminary estimate for UK Gross Domestic Product (GDP) growth in the quarter to March shows stronger growth of 0.8%. The chart on page 3 shows the GDP history over the last ten years.



3.2 The run of good news on the labour market continued, with the unemployment rate falling to 6.9% in February compared with 7.1% in the three months to November. Employment rose by 239,000 in the three months to February and up 691,000 from a year earlier. Unemployment was 77,000 lower in February compared to the three months to November and 320,000 lower than a year earlier. As a result the unemployment rate fell to below the threshold as set out by the Monetary Policy Committee (MPC) original forward guidance.

3.3 However the MPC decided to tweak its forward guidance in February as follows:

- The MPC sets policy to achieve the 2% inflation target, and, subject to that, to support the Government's economic policies, including those for growth and employment
- Despite the sharp fall in unemployment, there remains scope to absorb spare capacity further before raising the Bank Rate
- When the Bank Rate does begin to rise, the appropriate path so as to eliminate slack over the next two to three years and keep inflation close to the target is expected to be gradual (i.e. probably 0.25%)
- Even when the economy has returned to normal levels of capacity utilisation and inflation is close to the target, the appropriate level of the Bank Rate is likely to be materially below the 5% level set on average by the Committee prior the financial crisis.
- The MPC will not see any of the holding of the £375bn of gilts before the first rise in Bank Rate.

3.4 The Consumer Prices Index (CPI) fell to 1.6% in the year to March, down from 2.0% in December, the lowest rate since October 2009. Further increases in the value of sterling over the first quarter will exert downward pressure on import prices which combined with past falls in commodity prices should mean that inflation continues to trend downwards. The view of many commentators is that this emphasises the fact that interest rates will be on hold for at least the next 12 months.

3.5 The Chancellor announced a broadly fiscally neutral package of policies in the

March Budget, with measures to help businesses and consumers.

3.6 UK Equity markets performed poorly over the quarter as a whole, with the FTSE falling by 2% to around 6615 compared to a rise of 0.5% in the S&P 500. Emerging markets lost ground because of better growth prospects in western economies. Financial markets were also unsettled by concerns about the fallout from the political troubles surrounding Ukraine and by renewed worries about credit conditions and a slowdown in economic growth in China. These fears have led to a return of volatility and some renewal of safe haven flows from equities to bonds. Developed country bond markets have therefore rallied, with gilt yields and treasury yields both falling since the start of 2014. The ten year gilt yield ended approximately 0.3% lower.

3.7 Activity indicators in the Eurozone continue to suggest that the currency bloc is recovering, albeit very slowly. The economy expanded by 0.3% in the quarter to December following 0.1% expansion in the previous quarter. Survey data suggest that the recovery may not have gathered much pace in the first quarter of 2014.

3.8 The US Federal Reserve made tweaks to its own forward guidance in March, when it dropped its explicit unemployment rate threshold in favour of a more qualitative form of forward guidance. It also decided to continue with its monthly reduction in stimulus tapering.

4. SUMMARY PORTFOLIO POSITION

4.1 A snapshot of the Council's debt and investment position is shown in the table below:

	TMSS Forecast February 2013 (as agreed by Council)		**Actual as at 31 March 2013**		**Actual as at 31 March 2014**	
	£m	Rate %	£m	Rate %	£m	Rate %
<u>Long term borrowing</u> PWLB	382.6		296.6		301.6	
Market	79.5		79.5		79.5	
Total	**462.1**	**4.1**	**376.1**	**4.2**	**381.1**	**4.1**
Short Term Borrowing	-	-	-	-	-	**-**
Total Actual Borrowing	**462.1**	**4.2**	**376.1**	**4.2**	**381.1**	**4.1**
<u>Investments</u> In-house	**57.0**	**0.5**	**35.4**	**1.0**	**47.5**	**0.6**
Total Net Debt / Borrowing	**405.1**		**340.7**		**333.6**	

4.2 The table shows that net borrowing was significantly lower than forecast largely as a result of the Guided Busway receipt and slippage in the capital programme. Further analysis of borrowing and investments is covered in the following two sections.

4.3 A year end forecast under spend of £2.443m is currently reported, and is broken down in the table below.

	Budget £000	Estimated Outturn £000	Variance £000
MRP (net)	17,475	16,858	-617
Interest payable	17,640	15,834	-1,806
Interest receivable	-312	-400	-88
Internal interest payable	382	332	-50
Internal interest receivable	-246	-95	151
Loan premium	165	165	0
Debt management expenses	100	67	-33
Total	**35,204**	**32,761**	**-2,443**

4.4 The Guided Busway receipt of £33m, which was forecast for 2014/15, was received on 30th January 2014. In addition, the projected Capital Financing Requirement (CFR) as at 31st March 2014 has fallen since the budget was set in February 2013, due to slippage in the capital programme. As a result of this, and the outlook for long term interest rates remaining steady, the decision to raise long term borrowing was deferred until 2014/15 and following the refresh of the Business Plan. This together with other small variances in the Debt Charges budget, including the Minimum Revenue Provision, generated savings of £2.443m.

4.5 There may be a small movement on the Debt Charges budget between now and the year end once all technical year end adjustments have been made. The risk is to the upside, so the forecast underspend may increase marginally.

5. LONG TERM BORROWING

5.1 The Council can take out loans in order to fund spending for its Capital Programme for the benefit of Cambridgeshire. The amount of new borrowing needed each year is determined by capital expenditure plans and projections of the Capital Financing Requirement, forecast reserves and current and projected economic conditions.

5.2 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. Cambridgeshire County Council

has been successful in qualifying for these favourable interest rates on any new loans raised.

  - It was announced in the Autumn Statement that a further discounted rate (0.4%), known as the Project Rate, would be available for one strategic priority identified in each Local Enterprise Partnership (LEP) areas.

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

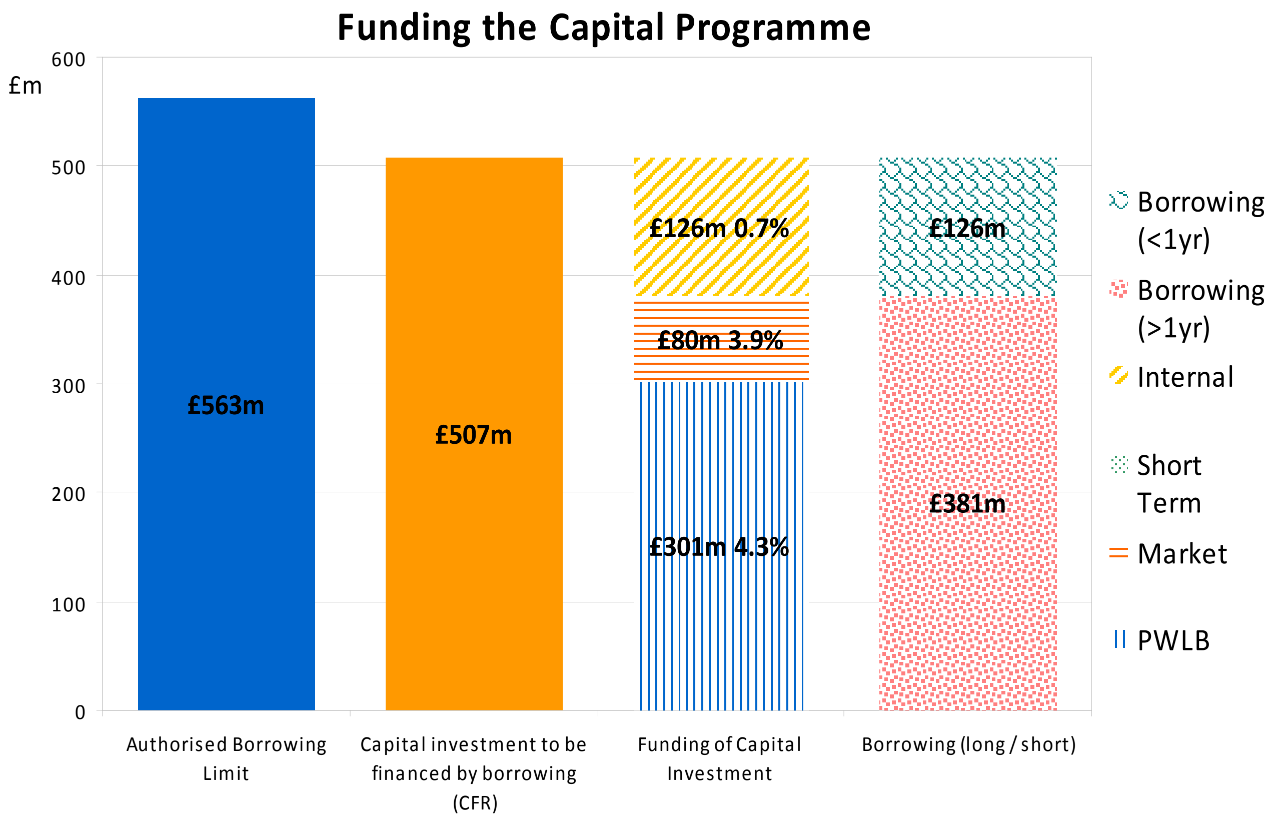
5.3 When market conditions are favourable long term loans can be restructured to:

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

5.4 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, but it is unlikely that opportunities will present themselves during this year. The position will be kept under review, and when opportunities for savings do arise, debt rescheduling will be undertaken to meet business needs.

5.5 The Treasury Management Strategy Statement (TMSS), approved in February 2013, 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 2013-14 TMSS was set, it was anticipated that the Capital Financing Requirement (CFR), the Council's liability for financing the agreed Capital Programme, would be £532.6m. This figure is naturally subject to change as a result of changes to the approved capital programme.

5.6 The graph on page 7 compares the maximum the Council can borrow in 2013-14 with the forecast CFR at 31st March 2014 and the actual position of how this is being financed at 31st March 2014. The final column shows the split between short (internal and external borrowing with duration of less than one year) and long term borrowing.



5.7 The graph shows the Council's current capital investment that is to be funded via borrowing is £56m below the Authorised Borrowing Limit set for the Council at the start of the year.

5.8 In addition, the graph shows how the Council is currently funding its borrowing requirement. As at 31st March the Council was using £126m 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. INVESTMENTS

6.1 The Investment Strategy approved by Council in February 2013, sets out, in order of priority, the investment priorities as being:

- the security of capital,
- liquidity, and
- yield.

6.2 The Council will therefore aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity.

6.3 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 Capita Assets Services. However, the Council does not solely rely on this advice or information from the credit rating agencies, and will seek other advice as well as using its own judgement based on the full range of information available. For example, the Spanish controlled Santander group have been excluded from the Council's counterparty list as a result of credit concerns within this area. The

Council only invests in the strongest countries in the Eurozone and these include Germany, Finland and the Netherlands.

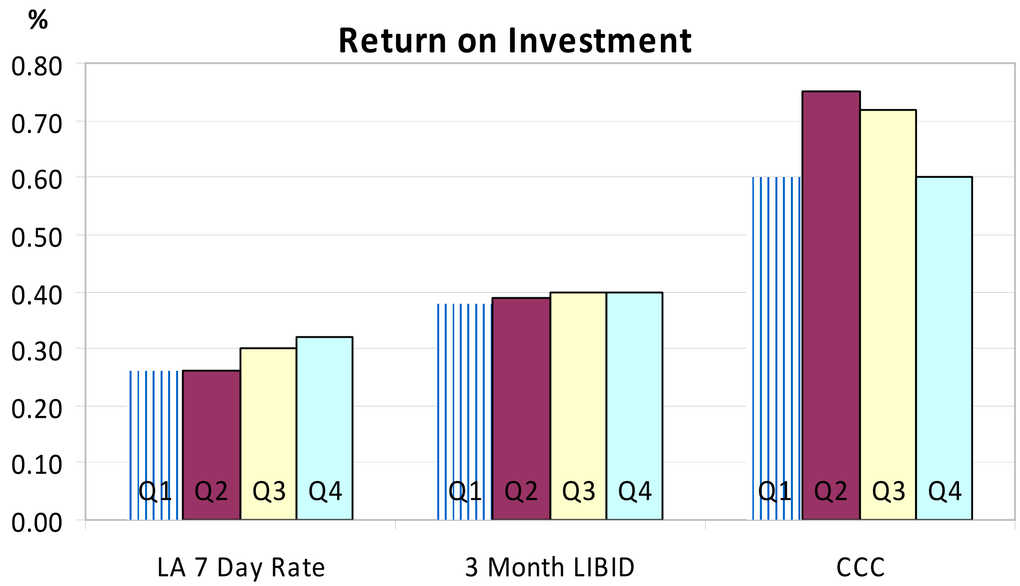
6.4 The Council has also taken action to limit its investment exposure to the financial markets by internal borrowing.

6.5 The Council has exposure to AAA rated Money Market Funds 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 requirements.

6.6 The Council has a facility with 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.

6.7 As at 31st March 2014 the level of investment totalled £47.5m.

6.8 The graph below compares the returns on investments, on a quarterly basis, with the relevant benchmarks this year.



6.9 In house funds returned 0.6% during the quarter which compares favourably with both the both the 7 day (0.3%) and 3 month LIBID (0.4%) benchmarks.

7. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

7.1 With effect from 1st April 2004 The Prudential Code became statute as part of the Local Government Act 2003 and was revised in 2011.

7.2 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.

7.3 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**.

8. ALIGNMENT WITH CORPORATE PRIORITIES

8.1 Developing the local economy for the benefit of all

There are no significant implications for this priority.

8.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

8.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

9. SIGNIFICANT IMPLICATIONS

9.1 Resource 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.

9.2 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**.

9.3 Equality and Diversity Implications

There are no significant implications within this category.

9.4 Engagement and Consultation Implications

There are no significant implications within this category.

9.5 Localism and Local Member Involvement

There are no significant implications within this category.

9.6 Public Health Implications

There are no significant implications within this category.

Source Documents	Location
None	N/A

Appendix 1

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

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 2013-14 which was approved by Council in February 2013.

2. Capital Financing Requirement (estimated borrowing liability excluding Private Finance Initiative (PFI)).

Original 2013-14 Capital Financing Requirement (CFR) £m	2013-14 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
532.6	507.0	381.1	151.5	125.9

3. Ratio of financing costs to net revenue stream

2013-14 Original Estimate %	2013-14 Revised Estimate %	Difference %
9.6	8.9	-0.7

4. Authorised limit for external debt

2013-14 Authorised Limit £m	Actual Borrowing £m	Headroom £m
562.6	381.1	181.5

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

2013-14 Operational Boundary £m	Actual Borrowing £m	Headroom £m
532.6	381.1	151.5

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 2013	**As at 31st March 2014**
Fixed rate	130% to 70%	105%
Variable rate	30% to -30%	-5%
Total		100%

The Interest rate exposure is calculated as a percentage of net debt. Due to the mathematical calculation exposures could be greater than 100% or negative depending on the component parts of the formula. The formula is shown below:

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

Fixed Rate calculation:

$$\frac{\text{(Fixed rate borrowing £350.6m* - Fixed rate investments £0m*)}}{\text{Total borrowing £381.1m - Total investments £47.5m}} = 105.1\%$$

*Defined as greater than 1 year to run

Variable Rate calculation:

$$\frac{\text{(Variable rate borrowing £30.5m** - Variable rate investments £47.5m**)}}{\text{Total borrowing £381.1m - Total investments £47.5m}} = -0.05\%$$

** Defined as less than 1 year to run or in the case of LOBO borrowing the call date falling within the next 12 months.

7. Limits for maturity structure of borrowing

	Upper Limit	**Current**
under 12 months	80%	8%
12 months and within 24 months	50%	6%
24 months and within 5 years	50%	7%
5 years and within 10 years	50%	16%
10 years and above	100%	63%

The maturity structure of borrowing is determined by reference to the earliest date on which lender can require payment and in the case of a LOBO loan this is deemed to be the next call date.

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

Yes. In February 2013 the Council approved the Treasury Management Strategy which allows the Council to invest for longer than 364 days. The council does not currently have any investments that mature in greater than 364 days.

Appendix 2

New Long Term Borrowing taken between 01/04/13 and 30/03/14:

Lender	Date	£m	Interest Rate %	Duration (yrs)	Risk
PWLB	03-Apr-13	5	3.55	18.5	Low

The Risk column for borrowing assesses the risk to the Council of premature repayment request by the counterparty.