TREASURY MANAGEMENT QUARTER ONE REPORT

To:	**General Purposes Committee**
Meeting Date:	**9th September 2014**
From:	**Chief Finance Officer**
Electoral division(s):	**All**
Forward Plan ref:	**Not applicable** ***Key decision:*** **No**
Purpose:	**To provide the first quarterly update on the Treasury Management Strategy 2014-15, approved by Council in February 2014.**
Recommendation:	**The General Purposes Committee is recommended to note the Treasury Management Quarter One Report 2014-15.**

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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 2014. It requires the Council to produce an annual treasury report and a half yearly report. Alongside these Cabinet are also 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) and provides an update for the first quarter to 30th June 2014.

2. SUMMARY OF KEY HEADLINES

2.1 The main highlights for the quarter are:

- Investment returns received on cash balances compares favourably to the benchmarks. A return of 0.5% was achieved compared to the 3 month London Interbank Bid Rate (LIBID) benchmark of 0.41% (see section 6).
- A nil variance is currently reported for the debt charges budget (see section 8).

3. THE ECONOMIC ENVIRONMENT

3.1 A detailed economic commentary is provided in **Appendix 1**. This information has been provided by Capita Asset Services – Treasury Solutions (CAS Treasury Solutions), the Council's treasury management advisors.

3.2 During the quarter ended 30th June 2014, the significant UK headlines of this analysis were:

- Indicators suggested that economic recovery accelerated;
- Household spending rose again;
- Inflation fell to its lowest level since September 2009;
- The International Labour Organisation (ILO) measure of unemployment fell further to 6.6%;
- The Monetary Policy Committee (MPC) suggested that the economy might warrant higher interest rates before the end of the year, however the current forecast for interest rates shows the first rate rise in the first quarter of 2015;
- Low tax receipts put the fiscal tightening slightly off track; and
- The European Central Bank (ECB) made announcements designed to boost bank lending and counter the risk of deflation.

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 2014 (as agreed by Council)		Actual as at 31 March 2014		Actual as at 30 June 2014		Revised Forecast to March 2015	
	£m	Rate %	£m	Rate %	£m	Rate %	£m	Rate %
Long term borrowing								
PWLB	360.3		301.6		301.6		340.5	
Market	79.5		79.5		79.5		79.5	
Total long term	**439.8**	**4.4**	**381.1**	**4.1**	**381.1**	**4.1**	**420.0**	**4.1**
Short term borrowing	-	-	-	-	-	-	-	-
Total borrowing	**439.8**	**4.4**	**381.1**	**4.1**	**381.1**	**4.1**	**420.0**	**4.1**
Investments	**34.3**	**0.8**	**47.5**	**0.6**	**75.2**	**0.5**	**41.2**	**0.6**
Total Net Debt / Borrowing	**405.5**	**-**	**333.6**	**-**	**305.9**	**-**	**379.8**	

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

5. BORROWING

5.1 The Council can take out loans in order to fund spending for its Capital Programme. 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.

New loans and repayment of loans:

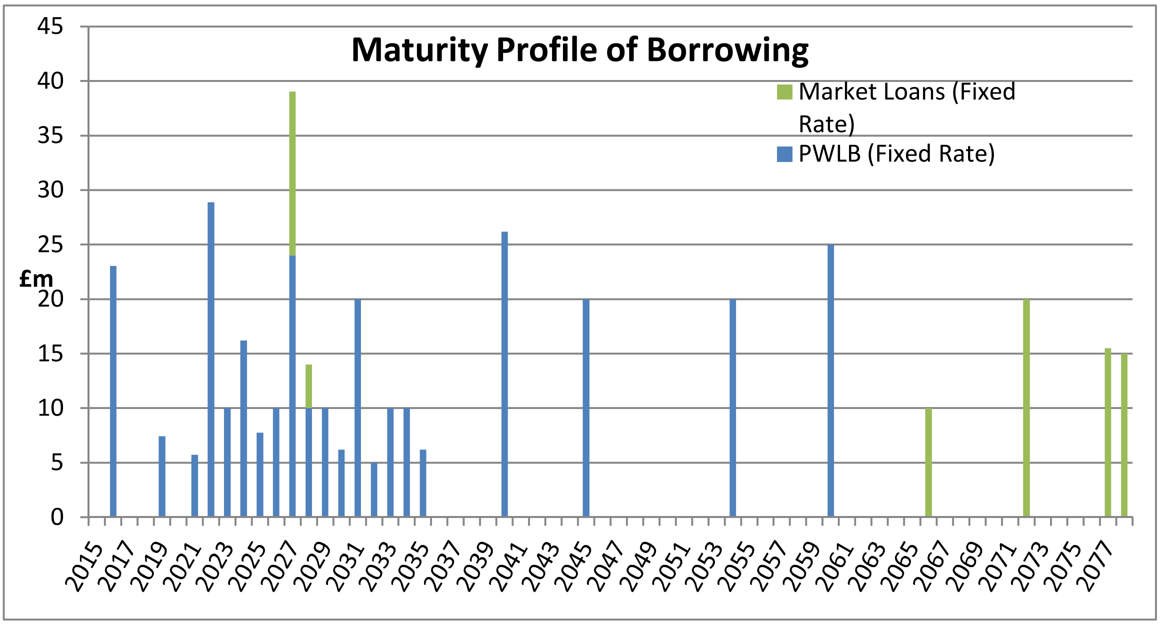
5.2 The table below shows the details new loans raised and loans repaid during the period. No loans were repaid or raised during quarter.

Lender	Raised / Repaid	Start Date	Maturity Date	£m	Interest Rate %	Duration (yrs)
None	-	-	-	-	-	-

Maturity profile of borrowing:

5.3 The following graph shows the maturity profile of the Council's loans. The majority of loans have a fixed interest rate and are long term which limits the Council's exposure to interest rate fluctuations. The weighted average years to maturity of the portfolio is 24.5 years.

5.4 The presentation differs from that in **Appendix 2** paragraph 4, where LOBO loans are included at their final maturity rather than their next call date. In the current low interest rate environment the likelihood of the interest rates on these loans being raised and the loans requiring repayment at the break period is extremely low.



Loan restructuring:

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

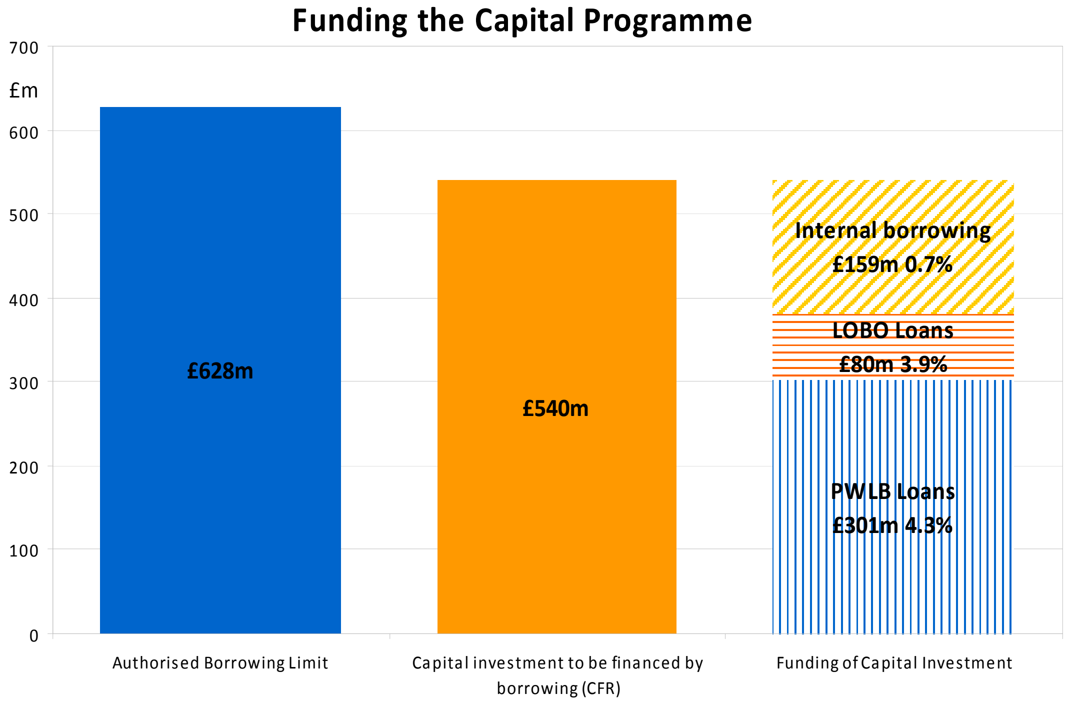
- to generate cash savings
- to reduce the average interest rate
- to enhance the balance of the portfolio by amending the maturity profile and/or the level of volatility. (Volatility is determined by the fixed/variable interest rate mix.)

5.6 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.

Funding the Capital Programme:

5.7 The Treasury Management Strategy Statement (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 2014-15 TMSS was set, it was anticipated that the Capital Financing Requirement (CFR), the Council's liability for financing the agreed Capital Programme, would be £567.5m. This figure is naturally subject to change as a result of changes to the approved capital programme.

5.8 The graph below compares the maximum the Council could borrow in 2014-15 with the forecast CFR at 31st March 2015 and the actual position of how this is being financed at 30th June 2014.



5.9 The graph shows the Council's current capital investment that is to be funded via borrowing is £87.5m below the Authorised Borrowing Limit set for the Council at the start of the year.

5.10 In addition, the graph shows how the Council is currently funding its borrowing requirement. As at 30th June the Council was forecast to be using £159m of internal borrowing by the end of the year, 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

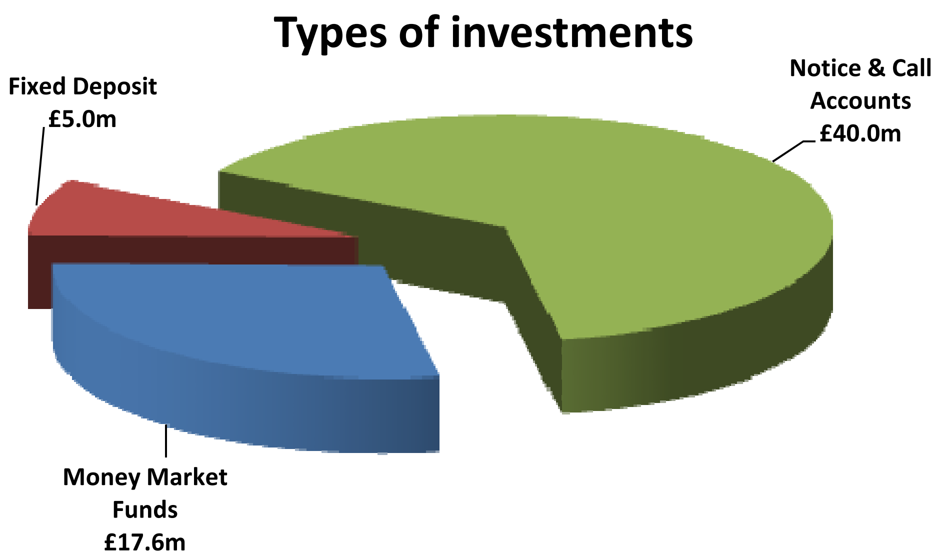
6.1 Investment activity is carried out within the Council's counterparty policies and criteria, and with a clear strategy of risk management in line with the Council's treasury strategy for 2014-15. This ensures that the principle of considering security, liquidity and yield, in that order (SLY), is consistently applied. The Council will therefore aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity. Any variations to agreed policies and practices are reported to Cabinet and Council.

6.2 As described in paragraph 5.10, the strategy currently employed by the Council of internal borrowing also has the affect of limiting the Council's investment exposure to the financial markets, thereby reducing credit risk.

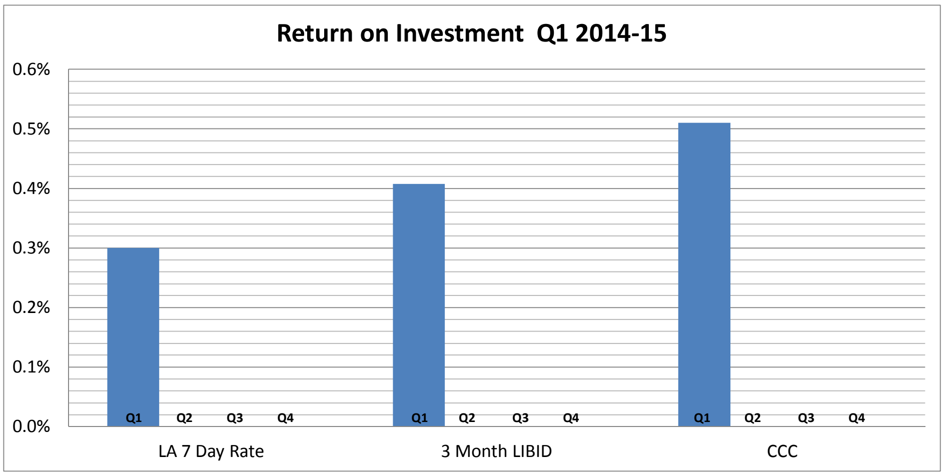
6.3 The Council invests in AAA rated constant net asset value Money Market Funds to diversify the investment portfolio and manage investment risk whilst providing daily liquidity. These are pooled funds which invest in a range of high credit quality institutions, not always accessible by individual investors. Money Market Funds are highly regulated and must comply with specific credit quality criteria and meet certain liquidity requirements.

6.4 As at 30th June the level of investment totalled £75.2m. The level of cash available for investment is as a result of reserves, balances and working capital the Council holds. These funds can be invested in money market deposits, placed in funds or used to reduce external borrowings. A balance sheet review is carried out in October once the Council's accounts have been signed off to reconcile investments.

6.5 A breakdown of investments by type are shown in the graph below. The majority of investments are in notice and call accounts with banks to meet the liquidity demands for the Council. Investments are made within the boundaries of the Investment Strategy and credit worthiness criteria.



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



6.7 From the graph, it can be seen that investments returned 0.51% during the quarter significantly more than the both the 7 day (0.30%), 3 month The London Interbank Bid Rate (LIBID) (0.41%) benchmarks.

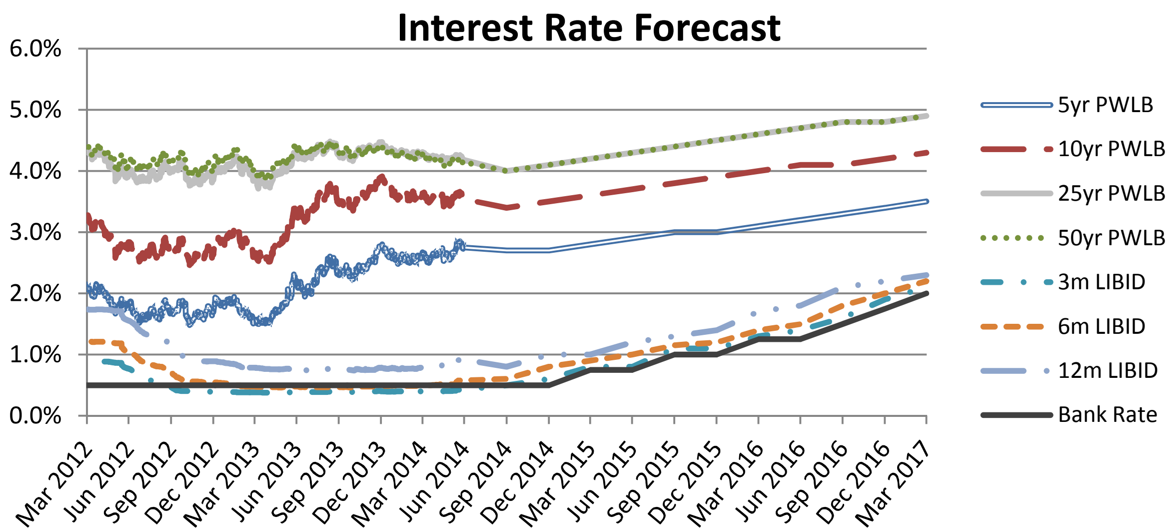
6.8 Where appropriate investments have been locked out for periods of up to one year with nationalised banks (UK Government backed) at higher rates of interest. In a rising interest rate environment it is appropriate to keep investments fairly short in duration so as to take advantage of interest rate rises as soon as they occur.

6.9 Leaving market conditions to one side, the Council's return on investment is influenced by a number of factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument. Credit risk is a measure of the likelihood of default and is controlled through the creditworthiness policy approved by Council. The duration of a investment introduces liquidity risk, the risk that funds can't be access funds when required, and interest rate risk, the risk that arises from fluctuating market interest rates. These factors and associated risks are actively managed by the LGSS Treasury team together with the Council's Treasury Advisors and further information on the Council's risk and return profile will provided in the next quarterly update.

7. OUTLOOK

7.1 The current interest rate forecast is shown in the graph below. The first increase in Bank Rate is forecast for the first quarter of 2015. However there are downside risks to this central forecast, i.e. the first rise could be delayed further if inflation comes in lower than the Bank's forecast, growth in labour productivity disappoints and wage inflation fails to rise as fast as the Bank's new lowered forecast of 1.25%.

7.2 Recent demands for the safe haven of gilts have depressed gilts yields and Public Works Loan Board (PWLB) rates recently. Geopolitical events make forecasting PWLB rates highly unpredictable in the shorter term. It is assumed that these fears will subside and that safe haven flows will unwind and rates will rise back again over the next few quarters.



7.3 As confidence is clearly emerging in the economy it is expected that we will see an upward trend in medium and long term gilt yields over the coming years, although not without volatility.

7.4 From a strategic perspective, the Council is currently reviewing options as to the timing of any potential borrowing and also the alternative approaches around further utilising cash balances and undertaking shorter term borrowing which could potentially generate savings subject to an assessment of the interest rate risks involved.

8. DEBT FINANCING BUDGET

8.1 There is currently a nil outturn variance forecast for Debt Charges. This budget was reduced by £1m when the Business Plan was approved in February in expectation of slippage in the capital programme, and this is expected to be met. The capital programme continues to be monitored closely alongside forecasts for cash balances and interest rates and a pragmatic approach to borrowing is adopted.

8.2 Although there is link between the capital programme, net borrowing and the revenue budget, the Debt Charges budget is impacted by the timing of long term borrowing decisions. These decisions are made in the context of other factors including, interest rate forecasts, forecast levels of cash reserves and the borrowing requirement for the Council over the life of the Business Plan and beyond.

8.3 It is anticipated that a mix of short term loans and long term loans will be raised in the second half of this year. Short term loans will be raised to take advantage of the low interest rate environment and long term loans will be raised to provide some certainty in interest costs over the medium and long term, locking in at rates which are currently viewed to be favourable.

	Budget	**Estimated Outturn**	**Variance**
	£m	**£m**	**£m**
Interest payable	16.147	16.147	0.000
Interest receivable	-0.349	-0.349	0.000
Other	0.296	0.296	0.000
Technical	-0.085	-0.085	0.000
MRP	18.133	18.133	0.000
Total	**34.142**	**34.142**	**0.000**

9. MUNICIPAL BONDS AGENCY

9.1 In July, GPC and Council approved a total investment of £400k (£50k for the mobilisation phase and £350k for the launch phase), to support the formation of a Municipal Bonds Agency, lead by the Local Government Association (LGA).

9.2 The LGA achieved the required match funding sought from local authorities in July of £400k, so together with an investment of £500k from the LGA the mobilisation phase for the Agency was approved. In total Local Authorities and the LGA have pledged £4.1m to date, which is half of the amount prescribed in the business plan required to launch the Agency. The second phase of fund raising will be open to local authorities up until the end of this year. It is still anticipated that the first bond will be issued by the Agency in the spring.

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 2011.

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 2.

11. ALIGNMENT WITH CORPORATE PRIORITIES

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.

12. SIGNIFICANT IMPLICATIONS

12.1 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.

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 within this category.

12.4 Engagement and Consultation Implications

There are no significant implications within this category.

12.5 Localism and Local Member Involvement

There are no significant implications within this category.

12.6 **Public Health Implications**

There are no significant implications within this category.

List of Appendices

Appendix 1: Economic Update (provided by Capita Asset Services Treasury Solutions)
Appendix 2: Capital and Treasury Prudential Indicators
Appendix 3: Investment Portfolio

Source Documents	**Location**
None	Box No: RES1211 Room No:301 Shire Hall Castle Hill Cambridge CB3 0AP

Appendix 1

Economic Update (provided by CAS Treasury Solutions)
Quarter ending 30th June 2014

1. After a healthy quarterly expansion in UK GDP of 0.8% in Q1, some of the early indicators point to growth accelerating in the second quarter. On the basis of past form, the CIPS/Markit business activity surveys point to quarterly GDP growth of around 1.5% in Q2. Admittedly, the composite PMI has tended to overstate the pace of the recovery over the past year. However, survey data was also encouraging on the strength of the recovery in Q2. All of the headline figures in April's industrial production release were encouraging. Indeed, even if production only manages to hold steady in the remaining two months of the quarter, it would still be 0.7% higher in Q2 overall than in Q1. That said, the £2.5bn trade deficit in April, compared to £1.7bn last year, highlights that the recovery is still struggling to rebalance towards exports.

2. Meanwhile, household spending looks to have supported further GDP growth in Q2. While retail sales volumes fell by 0.5% on the previous month in May, following strong growth in April, the underlying trend remains strong as a combination of rapid jobs growth and falling prices continues to fuel a recovery in consumer spending. In addition, the more forward-looking survey balances of expected sales also point to solid growth in consumer spending in the near-term. Furthermore, non-high street spending remained robust too. Annual growth in new car registrations averaged around 5% in April and May and the Bank of England's Agents' Survey recorded the measure of consumer services turnover at its joint highest level in May since 1998. So it still seems likely that overall household spending strengthened in the second quarter.

3. The labour market has continued its strong recovery. Employment rose by a huge 345,000 in the three months to April, by far the biggest increase since records began in 1971. Despite an increase in the workforce, employment growth was enough to bring the headline (three-month average) unemployment rate down to 6.6% in April. In addition, the timelier claimant count measure of unemployment fell by 27,400 in May, potentially pointing to further falls in the broader ILO measure of unemployment. Nonetheless, pay growth has remained subdued, with headline annual growth (three month average) in average earnings (including bonuses) falling to 0.7% in April, well below inflation of 1.8%. Since real earnings have yet to rise, some consumers may be overstretching their finances in order to spend more.

4. Meanwhile, after sending dovish messages through the May Inflation Report, the MPC's communications have now gone full circle, from trying to prevent interest rate expectations from rising too quickly via the introduction of forward guidance last summer, to trying to *raise* them now. A number of Committee members, including Governor Mark Carney, have warned of not-too-distant policy tightening.

5. Indeed, the main factor that could dissuade the MPC from starting on an earlier path for increasing Bank Rate is inflation. CPI inflation fell to 1.5% in May, the lowest rate since late 2009. Recent developments, including sterling's further appreciation, falls in producer price inflation and very weak wages growth, suggest that CPI inflation could fall to as low as 1% later this year.

6. Meanwhile, May's public borrowing figures contained tentative signs that the coalition is struggling to bring down the deficit in line with fiscal plans this year. The underlying measure of borrowing (PSNB ex. excluding APF and Royal Mail pension fund transfers) was £13.3bn in May, exceeding the consensus forecast of £12.2bn. The increase was largely driven by a drop in tax receipts, rather than strong increases in spending. Spending in April and May is around 9% higher than it was in the same period last year. However, it is still too early in the fiscal year to draw conclusions from these figures.

7. One risk which continues to linger is an overheating housing market. Fears that a nationwide bubble is building will not have been assuaged by the Financial Policy Committee's (FPC) relatively timid action announced alongside June's Financial Stability Report. Indeed, the 15% limit on the proportion of the volume of new mortgages that can be advanced at a multiple of 4.5 times income or more is unlikely to prevent a further rise in high loan-to-income ratio lending, given that the limit is a fair way above the actual current proportion of 10%. Furthermore, the tweaks to the existing stress tests used to assess mortgage applicants seem unlikely to make a material difference either. Admittedly, the housing market has already shown some signs of slowing of its own accord. Indeed, approvals for new mortgages fell to an eleven-month low in May, and the new buyer enquiries balance of the RICS Housing Market Survey has continued to moderate. However, with supply remaining tight, further strong increases in house prices in the near-term look likely. Although the FPC could announce further measures at a later date, the timidity of its actions so far may have slightly increased the chances that the MPC could raise Bank Rate in the not too distant future.

8. Internationally, the robust 217,000 increase in US non-farm payrolls in May is another encouraging sign that the economy is getting back on the right track after the weather-related weakness during the winter. The 0.6% m/m rise in US industrial production in May also suggests that activity is bouncing back. Meanwhile, the US Federal Reserve continued tapering its asset purchases by a further $10bn in June's policy meeting and highlighted that the benign outlook for inflation means monetary policy will remain loose for some time. The Fed lowered its forecasts for GDP growth and unemployment, but the FOMC's policy statement made no reference to the recent build up of price pressures.

9. Activity indicators for the Eurozone suggest that the recovery only gained a little momentum in Q2. Moreover, the spectre of deflation continues to hang over the region. HICP inflation fell from 0.7% to 0.5% in May, the joint weakest rate since 2009 and far beneath the ECB's 2% price stability ceiling. Furthermore, unit labour costs have risen by just 0.1% in the past year. As developments in wages tend to affect wider measures of inflation after a short lag, the latest data suggests that consumer price inflation could fall even further. Accordingly, the ECB made a number of announcements in June designed to boost bank lending and counter deflationary risks, including rate cuts and potential asset purchases. However, the policies involved are not as bold as they might seem. The interest rate cuts were very small and the decision not to sterilise bond purchases made under the Securities Markets Programme amounts to just 1.7% of GDP.

Appendix 2

Prudential and Treasury Indicators at 30th June 2014

Monitoring of Prudential and Treasury Indicators: approved by Council in February 2014.

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

The Council has adopted CIPFA's Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes. This is a key element of the Treasury Strategy 2014-15 which was approved by Council in February 2014.

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

	Limits	Actual
Fixed rate	150%	115%
Variable rate	65%	-15%
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 the component parts of the formula. The formula is shown below:

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

Fixed Rate calculation:

$$\frac{\textit{(Fixed rate borrowing £350.6m* - Fixed rate investments £0m*)}}{\textit{Total borrowing £381.1m - Total investments £75.2m}} = 115\%$$

*Defined as greater than 1 year to run

Variable Rate calculation:

$$\frac{\textit{(Variable rate borrowing £30.5m** - Variable rate investments £75.2m**)}}{\textit{Total borrowing £381.1m - Total investments £75.2 m}} = -0.15\%$$

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

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

	2014-15 Limit £m	**Actual £m**
Investment longer than 364 days to run	34.0	0.0

Notes: This indicator is calculated by adding together all investments that have greater than 364 days to run to maturity at this point in time.

4. Limits for maturity structure of borrowing

	Upper Limit	**Actual**
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%	21%
10 years and above	100%	58%

Note: The guidance for this indicator requires that LOBO loans are shown as maturing at the next possible call date rather than at final maturity.

Affordability

5. Ratio of financing costs to net revenue stream

2014-15 Original Estimate %	**2014-15 Revised Estimate %**	**Difference %**
9.65	9.35	-0.3

6. Estimated incremental impact of capital investment decisions on band D council tax

2014-15 Original Estimate £	**2014-15 Revised Estimate £**	**Difference £**
+9.78	+4.51	-5.27

Prudence

7. Gross borrowing and the Capital Financing Requirement (estimated borrowing liability excluding PFI)

Original 2014-15 Capital Financing Requirement (CFR) £m	2014-15 CFR (based on latest capital information) £m	Actual Gross Borrowing £m	Difference between actual borrowing and original CFR £m	Difference between actual borrowing and latest CFR £m
567.5	540.0	381.1	186.4	158.9

Capital Expenditure

8. Estimates of capital expenditure

For details of capital expenditure and funding please refer to the monthly capital report.

External Debt

9. Authorised limit for external debt

2014-15 Authorised Limit £m	Actual Borrowing £m	Headroom £m
627.5	381.1	246.4

The Authorised limit is the statutory limit on the Council's level of debt and must not be breached. This is the absolute maximum amount of debt the Council may have in the year.

10. Operational boundary for external debt

2014-15 Operational Boundary £m	Actual Borrowing £m	Headroom £m
597.5	381.1	216.4

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

Appendix 3

Investment Portfolio as at 30th June 2014

Class	Type	Start Date	Maturity Date	Counterparty	Rate	Principal O/S (£)
Deposit	Fixed	19/06/13	19/06/14	Bank of Scotland plc	1.0500%	5,000,000.00
	Fixed Total					**5,000,000.00**
Deposit	Call	31/03/14	-	National Westminster Bank plc	0.5000%	20,000,000.00
Deposit	Call	31/03/14	-	Barclays Bank plc	0.6500%	20,000,000.00
	Call Total					**40,000,000.00**
Deposit	MMF	31/03/14	-	Ignis Sterling Liquidity 2 GBP	0.4335%	17,564,000.00
	MMF Total					**17,564,000.00**
Deposit Total						**62,564,000.00**