Agenda Item No. 6

TREASURY MANAGEMENT QUARTER TWO REPORT

To:	**Council**
Date:	**11th December 2013**
From:	**Section 151 Officer**
Purpose:	**To provide the second quarterly update on the Treasury Management Strategy 2013-14, approved by Council in February 2013.**
Recommendation:	**Council is recommended to note the Treasury Management Report, Quarter Two 2013-14.**

	Officer contact:		***Member contact:***
Name:	Chris Malyon	Name:	Councillor Steve Count
Post:	Chief Finance Officer and Section 151 Officer	Portfolio:	Resources and Performance
Email:	chris.malyon@cambridgeshire.gov.uk	Email:	Steve.Count@cambridgeshire.gov.uk
Tel:	01223 699796	Tel:	01223 699173

1. PURPOSE OF REPORT

1.1 This report provides the second quarterly update on the Treasury Management Strategy 2013-14, approved by Council in February 2013.

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 2013. 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 September 2013.

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

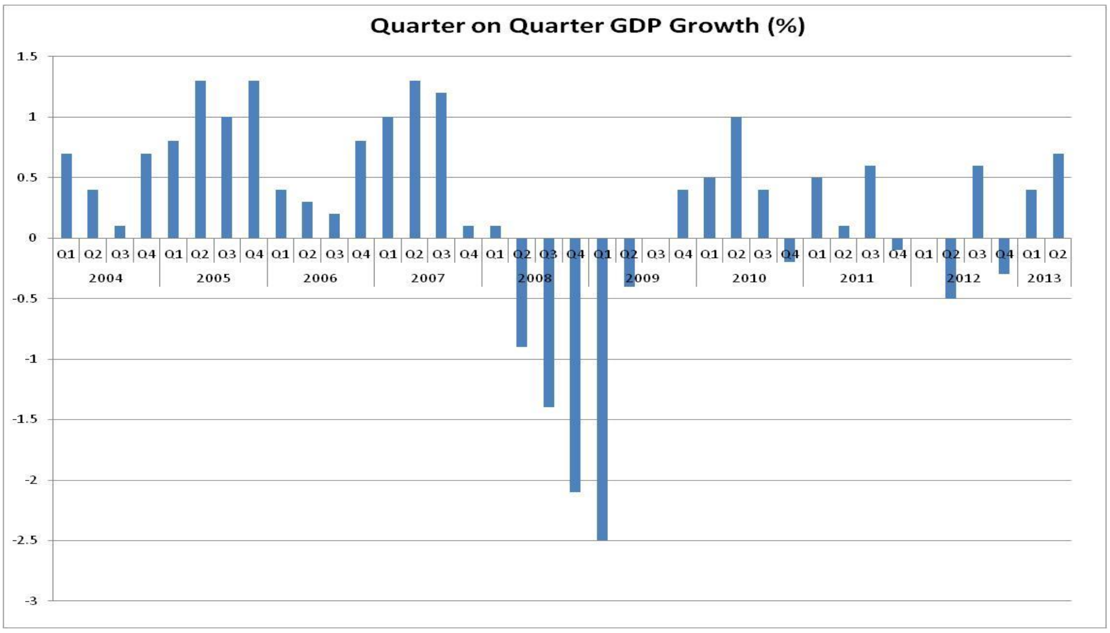
3. SUMMARY OF KEY HEADLINES

3.1 The main highlights for the quarter are:

- In house investment returns received on cash balances compares favourably to the benchmarks. A return of 0.75% was achieved compared to the 3 month London Interbank Bid Rate (LIBID) benchmark of 0.39% (see section 7.8).
- A favourable outturn variance of £2.0m is reported against the Capital Financing and Interest budget for 2013-14 (see section 5.3).

4. THE ECONOMIC ENVIRONMENT

4.1 After strong growth of 0.7% in the quarter to June, UK GDP grew at an even faster pace in the quarter to September, with the recent data release showing that GDP increased by 0.8% during this period. The chart overleaf shows the GDP history over the last ten years.



4.2 All four main industrial groupings within the economy (agriculture, productions, construction and services) increased when compared with the previous quarter. Output from services is now slightly above its previous peak in Q1 2008, prior to the economic downturn.

4.3 Consumer spending also continued to rise, with retail sales during the quarter ending September increasing by 1.5%. This is the largest quarter-on-quarter rise since March 2008 when again, the economy as a whole was at its peak and before the economic downturn.

4.4 The run of good news on the labour market continued, with the unemployment rate falling to 7.7% in August from 7.8% in June. Employment rose by 155,000 in the three months to August and up 279,000 from a year earlier.

4.5 The Consumer Prices Index (CPI) fell to 2.7% in the year to September, down from 2.9% in June. The largest fall in contribution to the change in the rate came from motoring costs. The Retail Prices Index (RPI) fell to 3.2% in the same period, down from 3.3% in June.

4.6 The new Governor of the Bank of England, Mark Carney, took office in July. Alongside the Quarterly Inflation Report, the bank introduced its new policy of forward guidance in which the Monetary Policy Committee (MPC) pledged not to raise official interest rates or reduce the size of the asset purchase facility, until the unemployment rate falls to 7%. At this point, the MPC would discuss whether or not to alter official policy. The guidance was subject to judgement around inflation expectations in the short and medium term and other potential threats to financial stability. On the MPC’s current forecasts, the unemployment rate is most likely to reach 7% in late 2016.

4.7 Equity markets stayed relatively flat over the quarter. While the FTSE rose from 6,470 to 6,620 over the first few weeks of June, the index closed the quarter at 6,462. Over the quarter bond markets sold off and gilt yields tracked the US Treasury yields up, with ten year gilts rising by around 0.6% to reach 3% in early September. After the Federal Reserve’s decision not to taper, gilt yields fell back, although not enough to offset the previous rise.

4.8 In the US the Federal Reserve unexpectedly decided not to taper its asset purchases in September. In announcing its decision to maintain monthly purchases at $85bn, the Fed explained that it wanted to await more evidence that the economic recovery will be sustained before adjusting the pace of its purchases. This came despite previous hints of tapering from the Fed and the fall in the unemployment rate in both July and August which currently stand at 7.3%.

4.9 In the Eurozone business surveys suggested that the economy continued to expand in Quarter 3, albeit at a moderate pace. There was a general election in which the incumbent Chancellor, Angela Merkel, performed better than expected by winning 41.5% of the vote. She is now likely to form a coalition, but it remains to be seen what form this will take.

5. SUMMARY PORTFOLIO POSITION

5.1 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 30 September 2013**		**Revised Forecast to March 2014**	
	£m	Rate %	£m	Rate %	£m	Rate %	£m	Rate %
Long term borrowing PWLB (Public Works Loans Board). Market.	382.6 79.5		296.6 79.5		301.6 79.5		307.6 79.5	
Total	**462.1**	**4.1**	**376.1**	**4.2**	**381.1**	**4.1**	**387.1**	**4.1**
Short Term Borrowing	-	-	-	-	20.0	**0.3**	-	**-**
Total Actual Borrowing	**462.1**	**4.2**	**376.1**	**4.2**	**401.1**	**3.9**	**387.1**	**4.1**
Investments **In-house.**	**57.0**	**0.5**	**35.4**	**1.0**	**41.4**	**0.8**	**55.4**	**0.5**
Total Net Debt / Borrowing	**405.1**		**340.7**		**359.7**		**331.7**	

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

5.3 A year end forecast under spend of £2m is currently reported, and is broken down in the table below.

	Budget £000	Estimated Outturn £000	Variance £000
MRP	17,475	17,157	-318
Interest payable	17,640	15,828	-1,828
Interest receivable	-312	-312	0
Internal interest payable	382	382	0
Internal interest receivable	-246	-104	142
Loan premium	165	165	0
Debt management expenses	100	100	0
Total	**35,204**	**33,216**	**-1,988**

5.4 The Guided Busway receipt of £30m (excludes £3m contribution towards legal fees), which was forecast to come in 2014/15, is now reflected in 2013/14. The projection of the Capital Financing Requirement (CFR) as at 31st March 2014 has fallen by £30m since the budget was set in February, due to capital programme slippage. This has reduced the Council's need to borrow by approximately £60m, which was budgeted at a rate of 4.2% (long term borrowing rate).

5.5 Due to the long term nature of borrowing decisions and the budgetary impact of servicing debt in future years, other factors including interest rate projections, capital expenditure plans and projections of the Capital Financing Requirement are taken into consideration when deciding when and how much to borrow.

6. LONG TERM BORROWING

6.1 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.

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. 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.

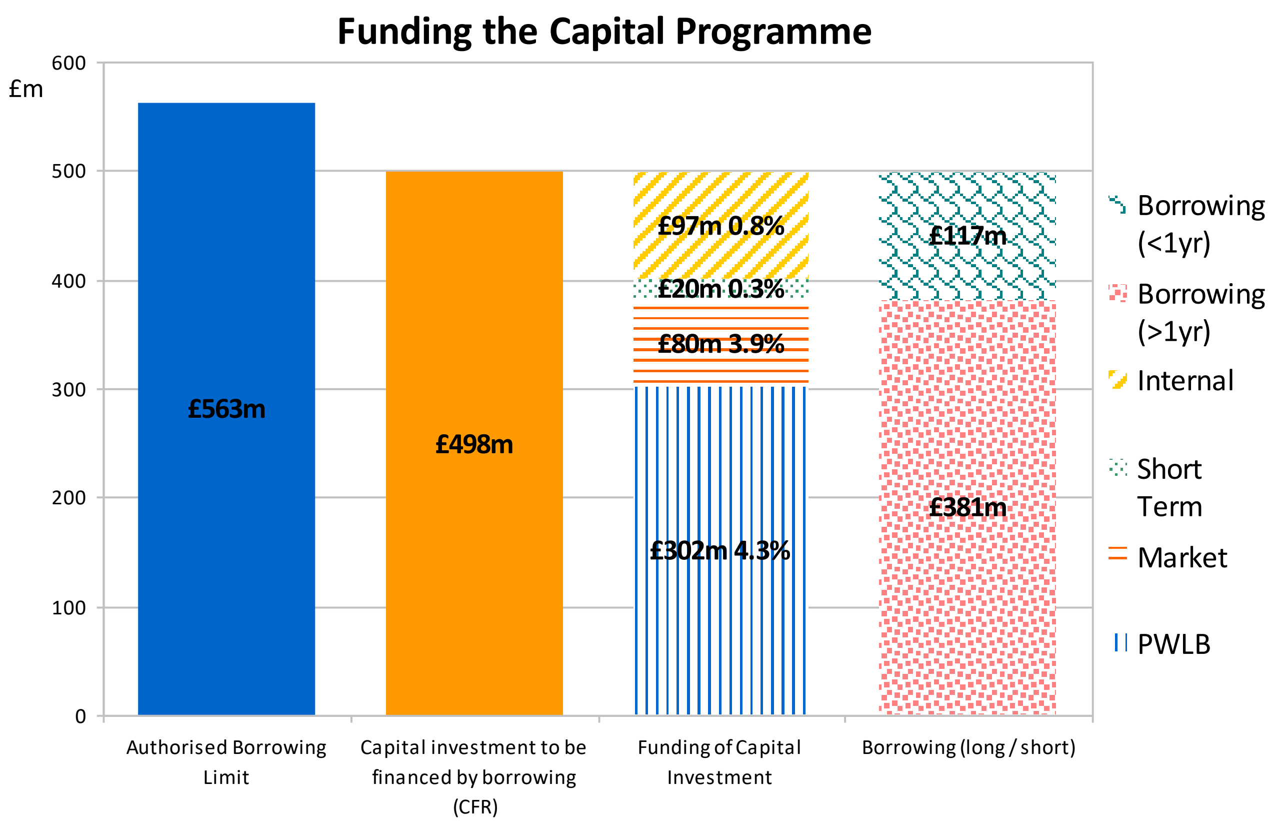
6.3 When market conditions are favourable long term loans can be restructured to:

- 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.)

6.4 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.

6.5 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.

6.6 The graph below 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 30th September 2013. The final column shows the split between short (internal and external borrowing with duration of less than one year) and long term borrowing.



6.7 The graph shows the Council's current capital investment that is to be funded via borrowing is £65m below the Authorised Borrowing Limit set for the Council at the start of the year.

6.8 In addition, the graph shows how the Council is currently funding its borrowing requirement. As at 30th September the Council was using £97m 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.

6.9 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 and as confidence is returning in the economy, gilt yields are starting to move upwards and this trend is expected to continue in the coming years. As a result the Council will start to look for opportunities to close a proportion of the internal borrowing gap later this year, to minimise the budgetary impact in 2013-14, if market conditions are suitable.

7. INVESTMENTS

7.1 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.

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

7.3 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 Sector. 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.

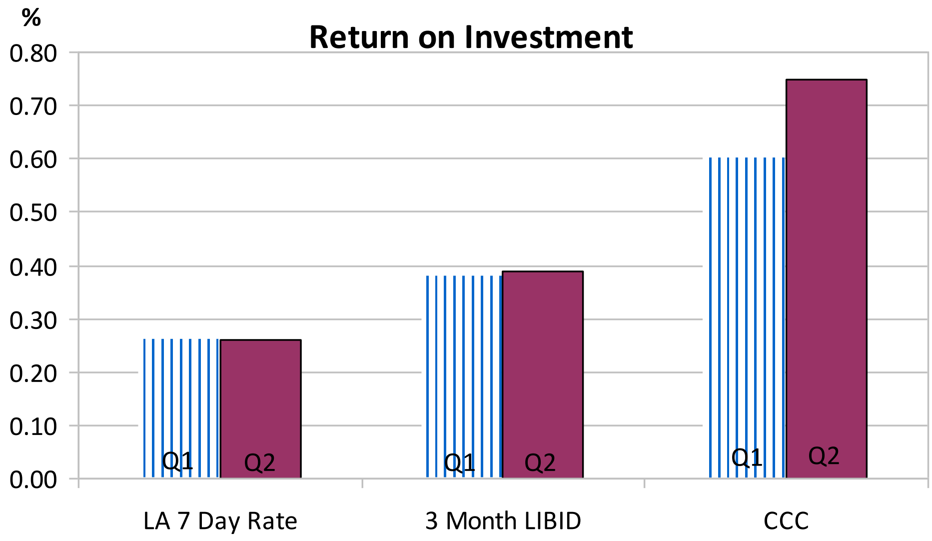
7.4 The Council has also taken action to limit its investment exposure to the financial markets by internal borrowing.

7.5 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 requirements.

7.6 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.

7.7 As at 30th September 2013 the level of investment totalled £41.4m.

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



7.9 In house funds returned 0.75% during the quarter which compares favourably with both the both the 7 day (0.26%) and 3 month LIBID (0.39%) 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 2011.

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**.

9. ALIGNMENT WITH PRIORITIES AND WAYS OF WORKING

9.1 Developing the local economy for the benefit of all

There are no significant implications for this priority.

9.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

9.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

9.4 Ways of working

There are no significant implications for this priority.

10. SIGNIFICANT IMPLICATIONS

10.1 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.

10.2 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.

10.3 Equality and Diversity Implications

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

10.4 Engagement and Consultation Implications

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

10.5 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 2013) to indicators approved by Council in February 2013

Appendix 2: New long term borrowing 2013-14.

Source Documents	Location
The Treasury Management Strategy Statement The Capital Management Report Advice from Capita Asset Services	Room No:301 Shire Hall Castle Hill Cambridge CB3 0AP

Treasury related Prudential Indicators: comparison of 30 September 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 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	498.2	401.1	131.5	97.1

3. Ratio of financing costs to net revenue stream

2013-14 Original Estimate %	2013-14 Revised Estimate %	Difference %
9.6	9.0	-0.6

4. Authorised limit for external debt

2013-14 Authorised Limit £m	Actual Borrowing £m	Headroom £m
562.6	401.1	161.5

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	401.1	131.5

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 30th September 2013**
Fixed rate	130% to 70%	98%
Variable rate	30% to -30%	2%
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:

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

Fixed Rate calculation:

$$\frac{\text{(Fixed rate borrowing £350.6m* - Fixed rate investments £0m*)}}{\text{Total borrowing £401.1m - Total investments £41.4m}} = 97.5\%$$

*Defined as greater than 1 year to run

Variable Rate calculation:

$$\frac{\text{(Variable rate borrowing £50.5m** - Variable rate investments £41.4m**)}}{\text{Total borrowing £401.1m - Total investments £41.4m}} = 2.5\%$$

** 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%	13%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	6%
5 years and within 10 years	50%	15%
10 years and above	100%	66%

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.

Appendix 2

New Long Term Borrowing taken between 01/04/13 and 30/09/13:

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.